**Economics Essays – Chapter 2 – The Allocation of Resources – Demand and Supply**

**Essay Question 1**

The costs of production in the motorcycle industry have risen significantly in recent years.

1. Using a demand and supply diagram, analyse the effect of an increase in production costs in the motorcycle industry on the equilibrium price and the equilibrium quantity of new motorcycles. [6]
2. Explain the concept of price elasticity of supply. [4]
3. Discuss to what extent time is the main influence on the price elasticity of supply.

**Essay Question 2**

1. Explain what is meant by price elasticity of supply. [5]
2. Explain what influences the price elasticity of demand of a product. [7]
3. Discuss how knowledge of price elasticity of supply and of price elasticity of demand could be of use to a business. [8]

**Essay Question 1**

**The costs of production in the motorcycle industry have risen significantly in recent years.**

1. **Using a demand and supply diagram, analyse the effect of an increase in production costs in the motorcycle industry on the equilibrium price and the equilibrium quantity of new motorcycles. [6]**

Draw Diagram

* correctly labelled axes
* shift of the supply curve to the left
* increase in equilibrium price
* decrease in equilibrium quantity

Description of Diagram

* to cover higher production costs, firms will require higher prices
* effect of shift of supply curve to the left on equilibrium price
* effect of shift of supply curve to the left on equilibrium quantity

1. **Explain the concept of price elasticity of supply. [4]**

Define PES

* the responsiveness of supply to a change in price/the percentage change in quantity supplied of a product divided by the percentage change in price
* how price affects supply/change in supply divided by change in price

Explanation of Concept

* elastic supply has value greater than 1
* inelastic supply has a value less than 1
* PES varies from perfectly elastic to perfectly inelastic
* PES varies along the length of the supply curve and always positive

**(c) Discuss to what extent time is the main influence on the price elasticity of supply.**

Explain why time is the main influence

* At a particular moment in time, it may be very difficult (or impossible) to increase supply
* supply may be relatively inelastic
* the longer the period of time, the more responsive supply is likely to be to a price change relatively elastic

Explain other factors

* the ease with which a product can be stored the easier it is to store the product, the more elastic the supply will be
* the availability of factors of production, e.g. supply may be inelastic in periods of full employment
* the cost of adjusting supply , e.g. it is cheaper to adjust the supply of pens than the
* supply of ships

**Essay Question 2**

**(a) Explain what is meant by price elasticity of supply. [5]**

Definition of PES

* A measure of the responsiveness supply to a change in price of a product
* Formula: the percentage change in quantity supplied of a product/the percentage change in price of a product

Elaboration of PES

* Explanation of the range of values from perfectly inelastic to perfectly elastic
* Reference to appropriate examples.

**(b) Explain what influences the price elasticity of demand of a product. [7]**

Definition of PED

* a measure of the responsiveness demand to a change in price of a product
* the percentage change in quantity demanded of a product/the percentage change in price of a product.

Explain factors affecting PED

* the availability of substitutes
* the proportion of income spent on a product
* whether the product is a necessity or a luxury
* whether the product is addictive or not
* whether its purchase can be postponed
* how the market is defined
* the time period.

**(c) Discuss how knowledge of price elasticity of supply and of price elasticity of demand could be of use to a business. [8]**

Definition of PES

* Supply of a product will be price elastic if the change in supply is measured over a long period of time during which producers can increase or decrease production easily;
* Resources are readily available to expand supply in response to an increase in price
* Supply of a product will be price inelastic if the time period is too short for producers to make significant changes in production; there is a shortage of resources available to expand supply in response to an increase in price.

Explanation of PES

* Idea that if PED for a product is elastic, the business should reduce the price to increase revenue
* Idea that if PED for a product is inelastic, the business should raise the price to increase revenue.

**Case Study Q1**

**The struggles of the Ivory Coast’s cocoa farmers**

Cocoa prices have hit a 30-year high due to demand exceeding supply.

Production of cocoa in the Ivory Coast, which provides about a third of the world’s cocoa beans, has fallen as a result of poor weather and under-investment in the industry. The 2009 harvest was badly affected by dry weather, pests and disease.

A spokesperson at the International Cocoa Organisation commented, “We have now had three consecutive years of supply declining. With current production methods, the Ivory Coast has reached maximum output. Farmers don’t use many chemicals and pesticides. They need to invest more in chemicals and other farming techniques to increase their yields.”

The demand for cocoa has continued to grow. The fashion for more expensive, high-quality chocolate has helped to increase demand as it typically has a higher cocoa content.

A spokesperson from the Fair Trade Association commented, “The large, unpredictable fluctuations in the cocoa market make life extremely difficult for farmers.”

The Government of the Ivory Coast is planning to create greater stability in the cocoa market by regulating the industry. It is thinking of selling the cocoa itself and also fixing the price. If the government fixed the price for cocoa, the farmers would be less vulnerable to fluctuations in prices due to changes in demand and supply factors.

1. (i) State one reason for the increase in demand for cocoa. [1]

(ii) State two reasons for the decrease in supply of cocoa. [2]

1. Explain, using a demand and supply diagram, how the changes in the demand for and the supply of cocoa have affected the equilibrium price and equilibrium quantity in the cocoa market. [6]
2. Explain why the large, unpredictable fluctuations in the cocoa market make life difficult for cocoa farmers. [3]
3. Discuss whether an economy would benefit from its government intervening to regulate an industry. [8]