**Question 22**

**The terrorist attack on New York 11 September 2001 caused a worldwide recession and an increased fear of flying, both severely affected the demand for travel by air. This led to the closure of some of the major airlines in the world.**

**a) With the aid of diagrams, explain how the recession and the closure of some of the major airlines of the world affected the market for air travel. (10)**

(decrease in income / change in taste and preference / reduction in number of supplier)

**a) Introduction**

1) States that the market for air travel is determined by the demand and supply of air travel as the price level and quantity of air travel will be set. (derive the market equilibrium – determine the price and output level)

2) The market will be affected by the closure of airlines and the incident of September 11. The price and quantity will change.

**Main Body**

1. Explain how the market equilibrium is attained and the price and quantity of air travel is determined

- State that the market demand for air travel is downward sloping from left to right.

- State that the market Ss of air travel is upward sloping from left to right

- State that the intersection of Dd and Ss will mean that the market is in equilibrium and price and quantity level will be set.

**2. Explain how incident of September 11 will cause a fall in dd for air travel**

decrease in income – decrease in demand for air travel – air travel is a normal good (large proportion of income spent on it for average consumers) –

fear of flying – affecting the preference for air travel – reduce demand as individuals switch to other modes of transport – (suitability of substitutes)

- both situation will lead to fall in demand

**3. Explain how closure of the airlines will cause a decrease in ss of the air travel**

closure of firms – lesser no of suppliers – reduce the supply of air travel – decrease in supply

( the extent of impact of rise in price of oil on the airline industry)

**4. Explain that the quantity for air travel will reduce but the price level is uncertain**

If decrease in dd > decrease in ss, price will fall, output will fall

If decrease in dd < decrease in ss, price will rise but output will fall

**5. predict the result and draw and describe the graph – decrease in dd > decrease in ss**

the reduction in dd is from the whole industry / but price of oil is only a variable cost, airline will not close down just because of the increase in variable cost, the largest cost of variable is the plane.

**Draw diagram and describe the diagram**

**Conclusion**

**Question 2**

**The terrorist attack on New York 11 September 2001 caused a worldwide recession and an increased fear of flying, both severely affected the demand for travel by air. This led to the closure of some of the major airlines in the world.**

**a) With the aid of diagrams, explain how the recession and the closure of some of the major airlines of the world affected the market for air travel. (10)**

**Introduction**

The understanding of the above-mentioned pricing condition for the air-travel industry can be explained with the understanding on how market equilibrium is derived. Market equilibrium is attained at the level when the market demand intersects with the market supply, and the price level and quantity is determined for the air-travel market. From the pre-amble,

**Main Body**

**a) Explain how the price level of the air-travel is determined.**

 Based on the economic analysis of demand and supply, the price level and quantity for the air-travel market is determined through negotiation of the consumers’ demand preference and purchasing power and producers’ profit motive and production capacity, as reflected by the market demand and supply curve respectively. As seen from diagram 1-a, the demand curve is downward sloping from left to right, implying that more quantity of air-travel will be demanded when there is fall in price and vice-versa. As for the supply curve, more quantity of air-travel will be supplied when there is increase in price and vice-versa. At the point intersection, the market equilibrium is set at Eo where the price level and quantity are at Po and Qo. However, the market equilibrium will change when there is a change in the market and supply condition due to changes identified in the pre-amble.

 As stated in the pre-amble, the September 11 terrorist attack has struck fear in the global air-travelers, undermining their preference for air-travel. Consequently, there will be a fall in demand for air-travel as the fear of flying will deter many consumers from flying and resort to other modes of transport or simply cancel their needs to travel. At the same time, this unfortunate incident has also contributed to the world recession and this will reduce the disposable income of global consumers. The fall in income will induce a fall in demand for air-travel as it is a normal good which occupies a large portion of income spent on the consumption of air-travel. Consequently, there will be a reduction in demand in the air-travel industry.

 From the supply perspective, the tragic incident has affected the demand for the air-travel industry so extensively that there will be a fall in revenue which will cause a few firms to incur loss or sub-normal profit, given that there is no change in cost condition, The closure of these few firms will mean a reduction in supply of air-travel which will affect the market equilibrium.

 When we analyze both effects together, it can be observed that there will be a definite fall in quantity of air-travel but the impact on the price level of air-travel is uncertain. If the fall in demand is lesser than the fall in supply, the price level will rise as there will be a shortage and if the fall in demand is greater than the fall in supply, there will be a fall in price as there will be a surplus.

 Given the conditional factors in the pre-amble, there will be a surplus as the fall in demand for air-travel is greater than fall in supply of air-travel. The sense of flying and global recession will affect the whole global consumer market, creating an extensive fall in demand. On the other hand, the fall in supply is limited to a few firms as the airlines have extensive fixed cost and will not close immediately due to temporary unfavourable business environment. Consequently, it can be observed that there will a fall in price and quantity in the air-travel market.

 As seen from diagram 1-b, the fall in demand from Do to D1 is greater than the fall in supply from S0 to S1 and this will create a surplus condition. Consequently, there will be a fall in price from Po to P1 and a fall in quantity from Qo to Q1.

 In retrospect, the demand and supply analysis will be able to assess the impact of the incident on the market for air-travel as the event will affect the determinants of demand and supply, The extent of the impact must consider the extent of change in demand and supply and the price-elasticity of demand and supply as it will affect the direction and extent of change in price and output.