

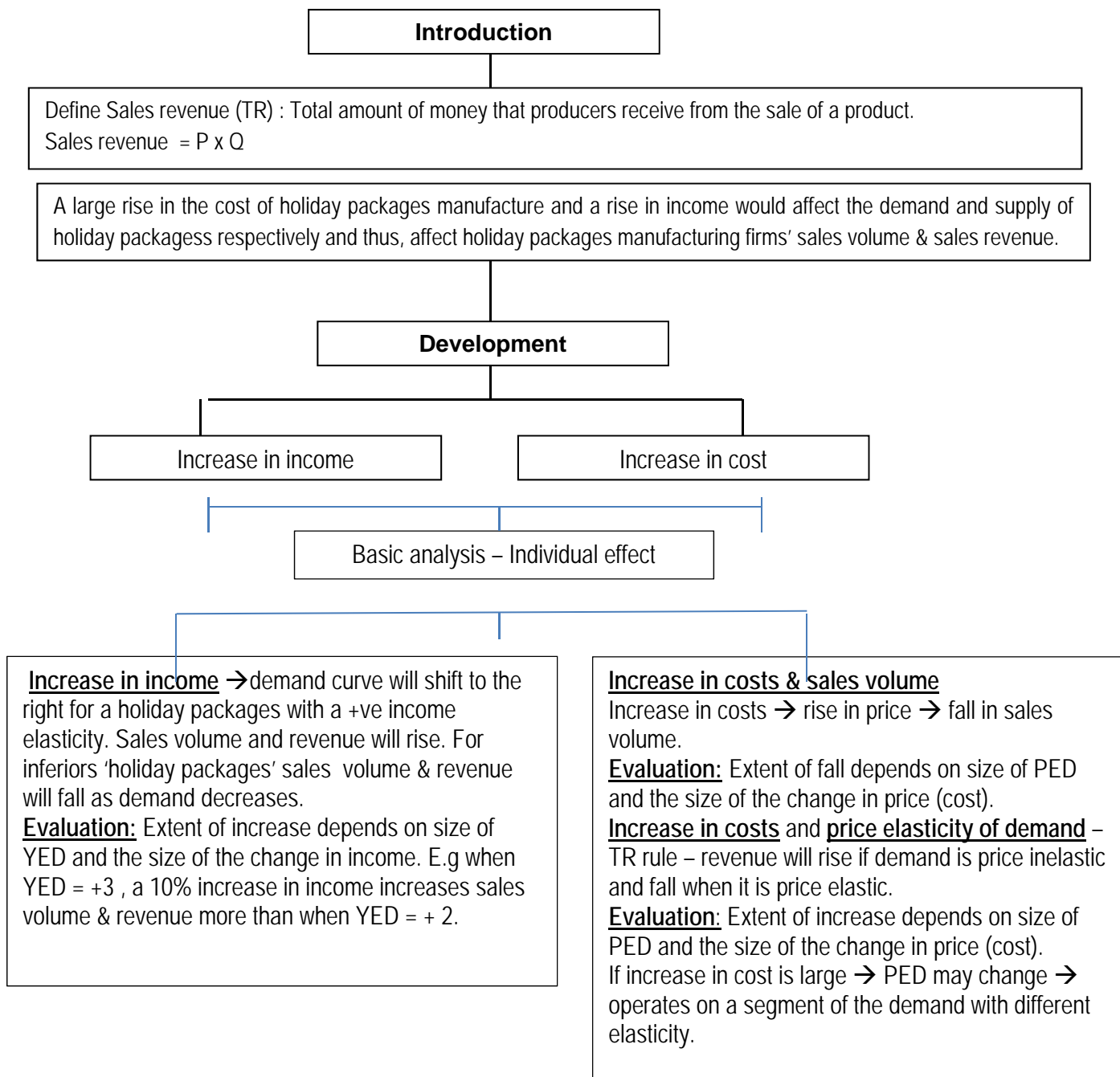
Question 1

Many different types of holiday packages ranging from budget to high-end luxury packages are available in Singapore. A large fall in the cost of producing holiday packages in the midst of a global slowdown are likely to affect the sales of different categories of holiday packages in Singapore

Critically examine the likely impact of a large fall in cost of production of holiday packages in Singapore and a global slowdown on the sales volume and revenue earned from the sales of different categories of holiday packages. [25]

Suggested Answer Model a

Explain how elasticities of demand can assist in understanding the effect of each of these changes on the sales volume of different categories of holidays.



Extended analysis – Combined effect

4 possible combinations

Case 1

Volume:

Rise in Y: +ve YED \rightarrow Q rises

Rise in cost: PED $< 1 \rightarrow$ Q fall

The impact on Q of a rise in income and that of a rise in cost contradict each other.

Total impact on total Q depends on extent of shift of DD compared to that of SS

\rightarrow Rise in DD $>$ Fall in SS \rightarrow Increase in Q

Total revenue:

Rise in Y : +ve YED \rightarrow TR rises,

Rise in costs : PED $< 1 \rightarrow$ TR rises

Total revenue rises since the impact on TR of a rise in income and that of a rise in cost reinforce each other.

Case 2

Volume:

Rise in Y: +ve YED \rightarrow Q rises

Rise in cost: PED $> 1 \rightarrow$ Q fall

The impact on Q of a rise in income and that of a rise in cost contradict each other.

Total impact on total Q depends on extent of shift of DD compared to that of SS

Rise in DD $>$ Fall in SS \rightarrow Increase in Q

Total revenue:

Rise in Y : +ve YED \rightarrow TR rises

Rise in costs : PED $> 1 \rightarrow$ TR falls:

Total impact on total revenue is indeterminate since the impact on TR of a rise in income and that of a rise in cost contradict each other.

Case 3

Volume:

Rise in Y: -ve YED \rightarrow Q fall

Rise in cost: PED $< 1 \rightarrow$ Q fall

Total Q falls since the impact on Q of a rise in income and that of a rise in cost reinforce each other.

Total revenue

Rise in Y : -ve YED - TR falls

Rise in costs : PED < 1 - TR rises:

Total effect on total revenue is indeterminate since the impact on TR of a rise in income and that of a rise in cost contradict each other.

Case 4

Volume:

Rise in Y: -ve YED \rightarrow Q fall

Rise in cost: PED $> 1 \rightarrow$ Q fall

Total Q falls since the impact on Q of a rise in income and that of a rise in cost reinforce each other.

Total revenue

Rise in Y: -ve YED - TR falls

Rise in costs: PED > 1 - TR falls:

Total revenue falls since the impact on TR of a rise in income and that of a rise in cost reinforce each other.

Evaluation

A comment comparing either different income or price
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E.g. Impact also depends on the size of the change in income, size of the change in price, magnitude of the YED and PED

- E.g. In case 3 ($YED = -ve$, $PED < 1$), if the change in income is very large while the increase in price (due to increase in cost) is very small then the fall in the total revenue due to the rise in income is likely to be greater than rise in total revenue of a rise in price (due to the rise in cost). Hence overall, total revenue falls.
- If the YED value is very positive while the PED is close to one, the effect on the total revenue of the rise in income is likely to be greater than that of a rise in price (due to the rise in cost). Hence, overall total revenue falls.
- If the increase in price is very large, the PED of a good may change. If the increase in income, is very great the YED of a good may change.

Synthesis / Conclusion

Finally, as a country becomes more affluent, even the more luxurious holiday packages may be perceived increasingly as necessities.

- The above analysis suggests that overall sales revenue from (i) luxury holiday packages with $PED > 1$ is indeterminate, (ii) budget holiday packages (normal goods) with $PED < 1$ will increase and (iii) budget holiday packages (inferior goods) with $PED < 1$ will indeterminate.
- However, the ceteris paribus assumption is unlikely to hold as factors other than cost of holiday packages manufacture and income may change in reality. Changes in other factors such as prices of related goods, competitive strategies undertaken by firms, government policies and taste and preferences may also impact sales volume and revenue. Hence, the impact on sales volume and revenue for different holiday packages models may be different from the above analysis.

Level	Knowledge, Application, Understanding and Analysis	Marks
L3	For an answer using analysis to support the conclusion on whether expenditure rises or falls. Expect 3-4 possible combined effect cases analysed to gain L3 marks (7-9) <u>4 possible cases:</u> (1) rise in Y : +ve YED – Q rises ; TR rises / rise in costs : $PED < 1$ – Q falls; Q indeterminate; TR rises : they reinforce each other. (2) rise in Y : +ve YED – Q rises; TR rises / rise in costs : $PED > 1$ – Q falls; TR falls: Q indeterminate ; TR indeterminate impact. (3) rise in Y : -ve YED – Q falls; TR falls / rise in costs : $PED < 1$ – Q falls; TR rises: indeterminate effect. (4) rise in Y : -ve YED – Q falls; TR falls / rise in costs: $PED > 1$ – Q falls; TR falls: reinforce each other.	15 – 21 (18)
L2	For an answer that gives <u>descriptive</u> explanation of the impact of an income and cost	9 – 14

	<p>change on total revenue for two of the four possible combined effect cases or an <u>analytic</u> answer for one of the four possible combined effect cases. [[Max 6 marks if only one combined effect analysed]. Expect 2-3 combinations to gain L2 marks</p> <p><u>4 possible cases:</u></p> <p>(1) rise in Y : +ve Y ed – Q rise ; TR rises / rise in costs : $P_{ed} < 1$ – Q falls; Q indeterminate; TR rises : they reinforce each other.</p> <p>(2) rise in Y : +ve Y ed - Q rises; TR rises / rise in costs : $P_{ed} > 1$ – Q falls; TR falls: Q indeterminate ; TR indeterminate impact.</p> <p>(3) rise in Y : -ve Y ed – Q falls; TR falls / rise in costs : $P_{ed} < 1$ – Q falls; TR rises: indeterminate effect.</p> <p>(4) rise in Y : -ve Y ed - Q falls; TR falls / rise in costs: $P_{ed} > 1$ - Q falls; TR falls: reinforce each other.</p>	(11.5)
L1	For an answer that shows descriptive knowledge of effect of an income and cost change on volume and total revenue. For an answer that shows some basic but largely unexplained knowledge of S + D curves plus the factors that might causes them to shift.	1 – 8 (4.5)
	Allow up to 4 additional marks for Evaluation	
E2	For an evaluative assessment based on economic analysis e.g. one that uses elasticities or relative shifts in curves to come to a well-argued conclusion. A brief <u>comment</u> comparing either different income or price effects.	3-4
E1	For unexplained assessment e.g. a basic statement that the effect depends on the relative shifts in both the supply and demand. Or an unexplained evaluation statement - revenue from low end model cars will fall whilst that for other models will rise.	1-2