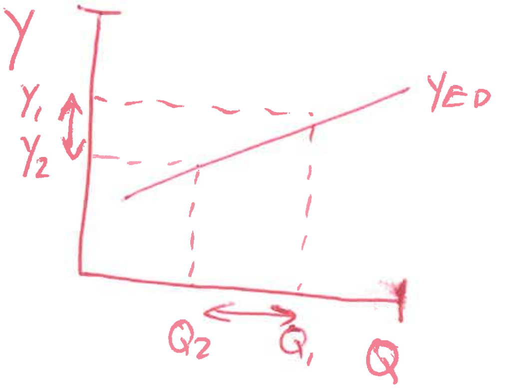
Discuss ~~[illegible]~~

YED of cars question

Question Number	Answer	Mark
10(c)	Explanation KAA up to ~~4 marks~~: 6 marks • Definition or formula of income elasticity of demand (responsiveness of demand for a good due to a change in income). (1) • Demand for new cars appear income elastic since proportionate change in demand is greater than the proportionate change in income / OR YED is greater than 1 / OR use of figures (1) • Reference to the data: 1% fall in income has lead to a 21.8% fall in demand (1). • Calculation of income elasticity of demand is $\boxed{21.8}$ (1). $\left(\frac{21.8}{1}\right)$ NB Do not award if answer states $\boxed{21.8\%}$ • Cars are a normal good (accept luxury) / they have a positive income elasticity of demand (1). • Diagram depicting income elastic demand for new cars (1) Evaluation ~~(2)~~ 4 marks • Depends on type of car e.g. luxury cars may have a different income elasticity of demand than smaller cars. • Discussion of second hand cars which may be less income elastic in demand. They may even be inferior goods. • YED for cars may change over time. • People unlikely to purchase new car if uncertainty over future employment prospects and lack of consumer confidence (income elastic). • Other factors e.g. the availability of finance might also be significant in determining changes in demand.	~~20~~ (6) (10)

+21.8
∴ Normal (+)
Luxury (>1)



$Y_1 - Y_2$ 1% ↓

$Q_1 - Q_2$ 21.8% ↓

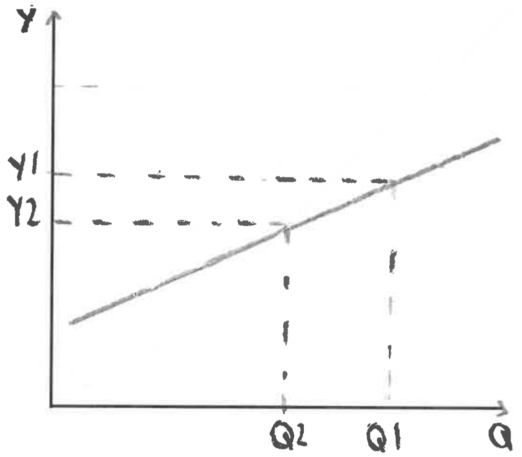
Normal good (+)

Luxury good (>1)

* Must integrate into text using labels - or lose KAA marks

The Impact of the Economic Downturn on the UK Car Market

Diagram- Income elasticity of new cars



The income elasticity of demand is the percentage change in the quantity demanded of a product divided by the percentage change in income. The demand for cars is income elastic because, as stated in Extract 1, a decrease in income of 1% (Y_1 to Y_2) in the first three months of 2009 resulted in a proportionately bigger fall of 21.8% in the quantity demanded of new cars (Q_1 to Q_2). The diagram shows this because Q_1 to Q_2 > Y_1 to Y_2 (21.8 > 1). A possible explanation is that cars are a luxury good because extract 1 states that 'the purchase of a car is the second largest expenditure for consumers'. When the income of a consumer falls, they will buy less of a luxury good because they believe they can do without it. They will switch to substitutes that are inferior goods or necessities. These will be offered at a lower price therefore rather than continuing to buy the expensive product, they will switch to the cheaper alternative. In terms of cars, consumers may switch to taking the bus or train instead of investing in a new car. Buses and trains are inferior goods, so as the income of consumers reduces, demand for buses and trains will increase. Bus and train fares will take up a smaller proportion of their income, which has reduced due to the economic downturn, making it more desirable among consumers in comparison to cars. Therefore, with a small reduction in income, many consumers will stop buying cars because they can switch to a cheaper mode of transport. This makes cars income elastic.

Link to YED figure (+ and >1)

However, the breadth of definition of 'cars' is very wide. There are many brands that sell cars at various different prices. Some consumers who have faced a reduction in income, may not be able to afford the more expensive brands of cars, however because there are a range of prices, cheaper cars may still be affordable for them to buy. Therefore, those who are planning on buying a car, may decide to buy a cheaper car as a result of the downturn rather than not buying a car at all. In this case, a cheaper brands act as a substitute for luxury brands such as Mercedes Benz. Therefore, as the real income of consumers fall the quantity demanded of

good

luxury brands of cars may fall whilst the quantity demanded of cheaper brands may not see much difference. This means that luxury cars are more income elastic than cheaper cars. An example of this can be seen in extract 1. Extract 1 tells us that 'Honda has reduced wage rates by 10%' whilst BMW has 'closed their motor vehicle factories temporarily' as a result of the economic downturn. The impact that the economic downturn has had on BMW is more severe than on Honda because BMW have had to take more drastic actions in order to reduce loses. BMW have predicted a large number of consumers will stop buying their cars due to the reduction in income so have ceased production in order to reduce 'stockpiles of cars'. This suggests that BMW is more income elastic than Honda. BMW is considered to be more of a luxury brand than Honda. Therefore the economic downturn has had more of an impact on luxury brands than cheaper brands.

V. good

To conclude, cars are elastic because they are a luxury good. Therefore, consumers will switch to alternative mode of transport rather than buy a car. However, this may not always be true. Cars are increasingly becoming necessary for everyday life and many people may find that public transport is unreliable and inefficient therefore will not switch to alternative modes of transport. They will instead opt for a cheaper brand of car. Therefore, demand for all cars is not income elastic. Cheaper cars are less likely to be income elastic as nowadays they are sometimes considered to be a necessity rather than a luxury.

KAA 6/6

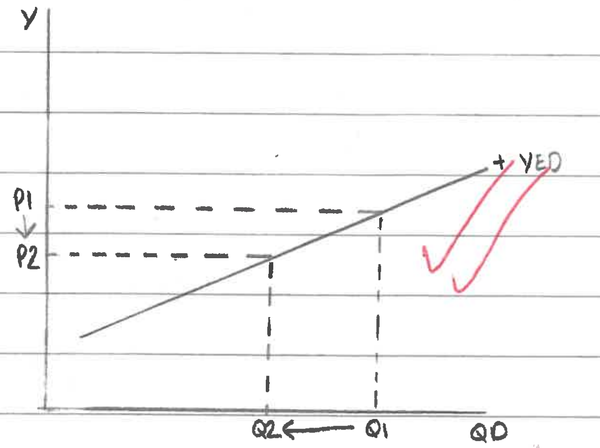
Ev 4/4

Your evaluation brilliant – strong use of the info provided to form a point.

10/10.

Impact of the economic downturn on the UK car market - 10 marks.

Income elasticity of demand measures how a change in income can affect a change in quantity demanded for a given product or service in a market. The diagram shows that as income decreases from P_1 to P_2, quantity demanded also decreases from Q_1 to Q_2. This means that the income elasticity of demand for cars is positive, this is because cars are a normal good, demand increases when incomes rise, and in this case demand decreases as incomes fall. The graph also



indicates that the YED for cars is elastic because the percentage change in income, a decrease of 1%, was much smaller than the percentage change in quantity demanded, a decrease of 21.8%. This makes YED greater than one, and therefore elastic. This is because cars are seen as luxury goods, if incomes fall, for example Honda has reduced wages by 10%, the expenditure someone has to pay for a car becomes a much larger proportion of their income. Therefore because having a car becomes more expensive and there are cheaper alternatives such as buses and trains some consumers will not buy a car despite planning to buy one before their income fell. This reduces the quantity demanded for cars, thus making the demand income elastic.

what is the YED??

good EV technique – groups of consumers

However, the demand for cars will not be that elastic, because everyone is in different income brackets. For those on higher incomes a 1% decrease in their income will not have a large impact on them and so therefore they will continue to demand a new car because they can still afford it. Whereas ~~too~~ for those on lower incomes 1% will be a larger proportion of their income and so they may not be able to afford a car but use cheaper substitutes such as buses and trains. Therefore, for high income earners the demand for cars is likely to be income inelastic but for low income earners demand is likely to be income elastic. However, it could be argued that those on higher incomes already have cars thus making the demand ~~price ed~~ income elastic as only low income earners will be looking to buy cars.

In conclusion, in the short run the demand for cars is income elastic because cars are a ~~normal~~ ~~good~~ luxury and so if incomes ~~fall~~ so will the demand for cars and vice versa, however, in the long run demand for cars will be more income inelastic. This is because as incomes rise and cars become a big part of everyday life where it is inconvinient not to have a car, people will save up to buy cars, thus meaning that the demand for cars won't respond that dramatically to a change in income.

10/10.

KAA 6/6 EV 4/4

Nicely written.

Well done, Lottie.