

**ADVANCED SUBSIDIARY GCE UNIT  
ECONOMICS**

The Market System

**FRIDAY 8 JUNE 2007**

**2881**

Afternoon

Time: 1 hour

Additional materials: Designated Answer Booklet [2881/AB].



**INSTRUCTIONS TO CANDIDATES**

- Write your name, Centre number and candidate number in the spaces provided on the answer booklet.
- Answer **all** the questions.
- Write all your answers on the separate answer booklet provided.

**INFORMATION FOR CANDIDATES**

- The number of marks is given in brackets [ ] at the end of each question or part question.
- The quality of your written communication will be taken into account in marking your answer to the question labelled with an asterisk (\*).

This document consists of **4** printed pages.

Answer **all** parts of this question in the accompanying answer booklet.

### China's booming travel markets

China is one of the world's fastest growing travel markets, with an emerging middle class providing an ever-increasing demand for personal and business travel. The outlook for China's vehicle manufacturers and domestic airlines is very positive and business prospects will continue to expand following China's entry into the World Trade Organisation (WTO).

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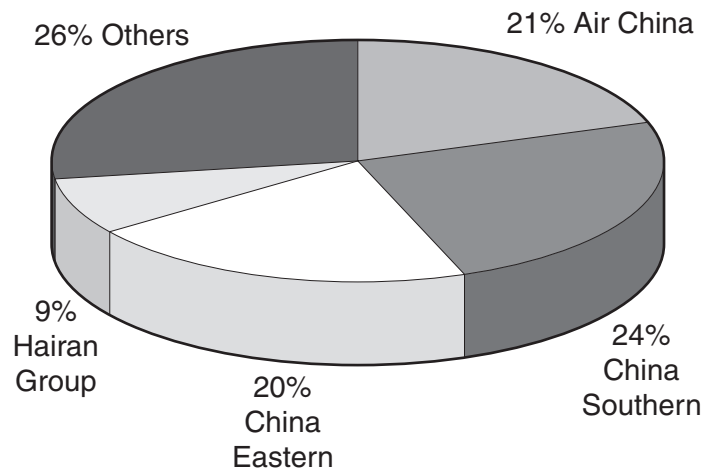
In 2004, there were an estimated 295m private cars in China, which is a small number in relation to the country's large and expanding population. With their new found affluence, one of the first things Chinese families purchase is a car which is seen as a more convenient means of transport compared to buses and trains. Manufacturers such as Nanjing Auto, the owners of MG Rover, are frantically increasing their productive capacity to meet the demand from domestic consumers. They are also moving production away from basic saloon cars to higher performance vehicles.

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At the same time, the Chinese airline market has experienced a tremendous surge in demand. The immense geographical scale of the domestic market, the ever-increasing demand for travel and the removal of a barrier to entry through the adoption of an 'open skies' policy have all contributed to a market that is now dominated by a few large airlines (see below). Nevertheless, other barriers to entry remain and will continue to restrict the entry of new firms.

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Market Share of Air Passengers in China (2004)



- (a) Companies such as Nanjing Auto have to decide how to allocate their productive capacity between basic saloon cars and higher performance vehicles (lines 12 to 13).
- (i) Explain what is meant by opportunity cost. [2]
  - (ii) Draw a production possibility curve to show the choices a company such as Nanjing Auto might face when deciding which type of vehicle to produce. [4]
  - (iii) Explain how opportunity cost can be used to show the effects of Nanjing Auto increasing the production of higher performance vehicles. [2]
- (b) (i) Using the information provided, explain **two** possible determinants of the increased demand for private cars in China. [4]
- (ii) Using the information provided, and with the aid of a diagram, analyse how the changes in demand and supply might affect the market equilibrium for private cars in China. [6]
- (c) A recent report contained the following estimates for income elasticity of demand in China:
- Private car purchases + 1.8  
Domestic air travel + 3.0
- (i) Define income elasticity of demand. [2]
  - (ii) Explain what each of the above estimates means. [4]
  - (iii) Comment on their business significance for private car manufacturers and for domestic airlines in China. [5]
- (d) (i) State and explain **two** characteristics of an oligopoly. [4]
- \*(ii) Discuss the extent to which the domestic airline market in China is oligopolistic. [12]

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