

Demand, supply and policy

IB DP Economics SL Unit 2 sections 2.1-2.7 full package

1. Unit 2 at a glance

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IB Economics SL Unit 2.1-2.7: demand, supply, competitive market equilibrium with welfare, the critique of maximizing behaviour, elasticity of demand and supply, and the role of government - on the shared diagram with equilibrium (20, 100). Values are read from the diagram; solving the functions is HL Paper 3.

Must-know: excess demand 48 at price 12; PED -0.4 with TR 2000 to 2112 (inelastic); PES +0.8; CS 2500 and PS 1000; tax of 6 gives price 24, quantity 92, revenue 552, incidence 4:2; subsidy of 6 gives price 16, quantity 108; maximum price 16 shorts 24; minimum price 24 surpluses 24.

2. Demand and supply

Demand and supply

Demand slopes downward by diminishing marginal utility; own price moves **ALONG**, other determinants **SHIFT** (income, substitutes, complements, tastes, expectations, numbers). Supply slopes upward; costs, technology, taxes, subsidies and seller numbers shift it.

The 2.4 critique: consumers do not always maximise utility (bounded rationality, herding, framing, imperfect information) and producers do not always maximise profit (satisficing, CSR, stakeholder aims) - behavioural economics supplies the evidence.

3. Competitive market equilibrium

Competitive market equilibrium

Equilibrium is where the curves cross, at (20, 100). At 12 the shortage is 48 - price bid up; at 25 the surplus is 30 - price pushed down: the invisible hand of price signals, rationing and incentives.

Welfare: consumer surplus 2500 below demand above price; producer surplus 1000 above supply below price. Allocative efficiency where $P = MC$ - the competitive equilibrium without externalities - maximises social surplus; any price away from equilibrium creates deadweight loss.

4. Elasticity

Elasticity

$PED = \frac{\% \text{change in quantity}}{\% \text{change in price}}$: 20 to 22 gives -0.4, confirmed by the TR test (2000 rises to 2112 - inelastic). Along a straight-line demand curve PED is elastic on the high-price stretch and inelastic on the low-price stretch, so the TR test changes its answer.

$PES = \frac{\% \text{change in quantity supplied}}{\% \text{change in price}}$: +0.8 here, driven by spare capacity, stocks, mobility and time. Commodities with inelastic supply AND demand see wild price swings from small shifts. YED: positive normal, negative inferior, above 1 luxury - the primary sector shrinks relative to services as incomes grow.

5. Role of government

Role of government

Indirect taxes: a specific 6 shifts supply up by 6 - on the diagram price 24, quantity 92, producers keep 18, revenue 552, incidence 4:2 towards the less elastic consumers. Subsidies reverse it: price 16, quantity 108, cost 648.

Maximum price 16 creates a 24 shortage (queues, black markets); minimum price 24 a 24 surplus (government buys). Quotas restrict quantity directly. Weigh every correction against unintended consequences - the key concepts intervention, efficiency, equity frame the answer.

Check yourself

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Demand and supply laws with shift lists; the 2.4 behavioural critique.

Equilibrium with both excesses; the surplus triangles; allocative efficiency.

PED, PES and YED with the TR test and the elastic/inelastic stretches of a straight line.

Tax, subsidy, price-control and quota diagrams with incidence by elasticity and an evaluation.