

2.1 The role of markets in allocating resources

Name: _____ Class: _____ Date: _____

Total: 18 marks

KEY WORDS resources • market • allocate • incentive
• price mechanism

Objective

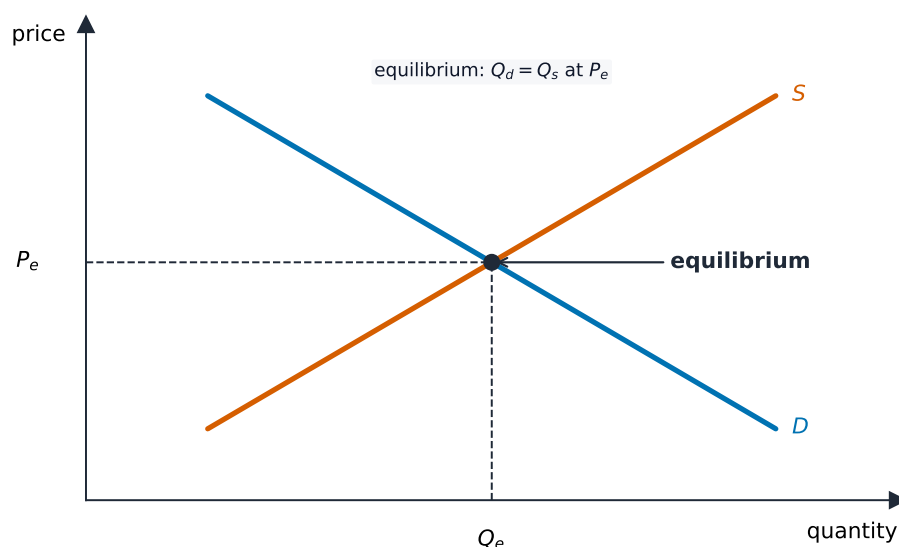
Build the skills to answer exam questions on **the role of markets in allocating resources** – what a **market** is, micro and macroeconomics, and the **price mechanism**.

You must be able to:

- distinguish micro from macroeconomics
- explain what a market is
- explain the three functions of the price mechanism

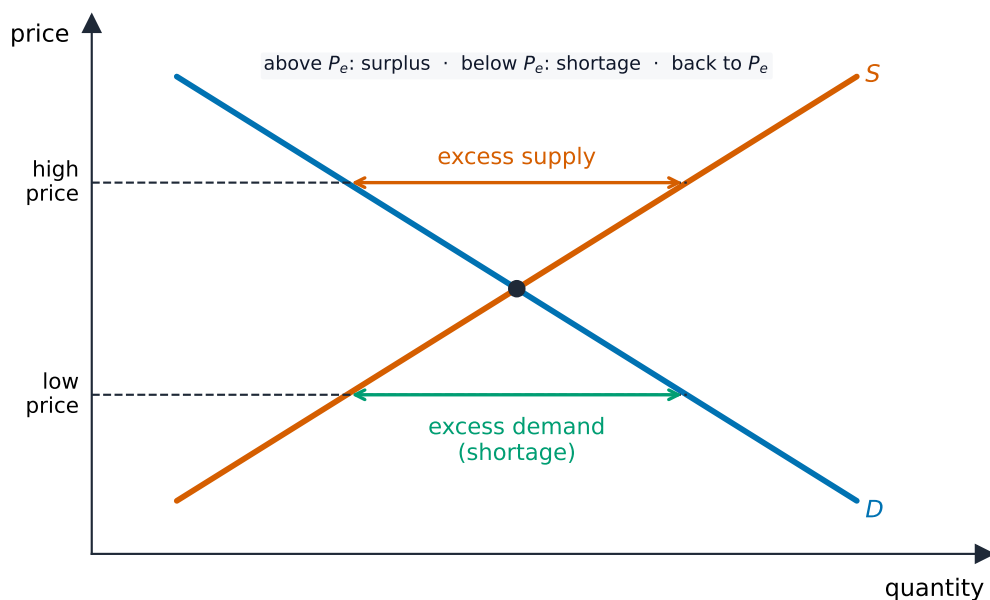
1 Key knowledge and worked examples

■ How a market allocates resources



In a free market, prices – not planners – decide what is made

- **Microeconomics** : single markets/products. **Macroeconomics** : the whole economy.
- **Market** : where buyers and sellers trade (a place, online, or by phone).
- **Price mechanism** does three jobs: **signalling** (shows what to make), **incentive** (rewards more output), **rationing** (shares out a scarce good).



Price does the rationing: a shortage pushes price up, a surplus pushes it down, until the market clears

Answer shapes: K + App + An + Ev (a justified judgement, for discuss questions).

2 Practice

2.1 Define the term *market*.

[2]

2.2 State the three functions of the price mechanism.

[3]

2.3 State the difference between microeconomics and macroeconomics. [2]

3 Exam-style questions

3.1 A rising price acts as an **incentive** because it: [1]

- ☐ **A** signals what to produce
B gives firms a reason to produce more
C rations a scarce good
D reduces consumer demand

3.2 Explain how the price mechanism allocates resources in a free market. [4]

3.3 Analyse how the price of a good responds to a sudden rise in demand for it. [6]

Solutions

IGCSE Economics answers are marked by **level of response**: award **K** knowledge, **App** application, **An** analysis and **Ev** a justified judgement.

Each answer shows the steps, then the **result**.

2.1

- a **market** is any place or system where **buyers and sellers** meet to trade (K)

2.2

- the three functions of the price mechanism
- **signalling**, **incentive**, **rationing** (K each)

2.3

- **microeconomics** studies one market or firm (K)
- **macroeconomics** studies the **whole economy** (jobs, prices, growth) (K)

3.1 B

- an **incentive** gives firms a **reason to produce more** (K)
- A is signalling; C is rationing; D is a demand effect, not an incentive

3.2

- a price change **signals** what buyers want (K)
- it gives firms an **incentive** to supply more of wanted goods (An)
- it **ration**s scarce goods to those willing to pay – resources move to where they are most valued (An)

3.3

- a rise in demand means buyers want more at the current price (K)
- this creates a **shortage** (excess demand) (An)
- buyers bid the price up; firms supply more → a **new, higher equilibrium** price and quantity (An)