Exercise walk-through

The role of markets in allocating resources ▪ 2.1

eXercise

You must be able to

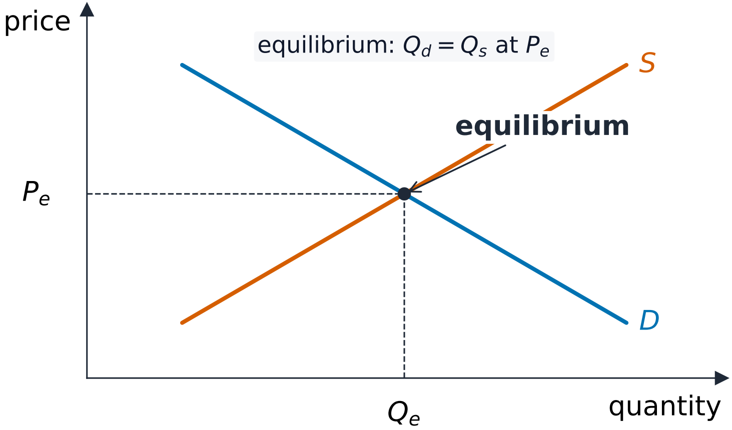
- distinguish micro from macroeconomics
- explain what a market is
- explain the three functions of the price mechanism

Method — How a market allocates resources

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

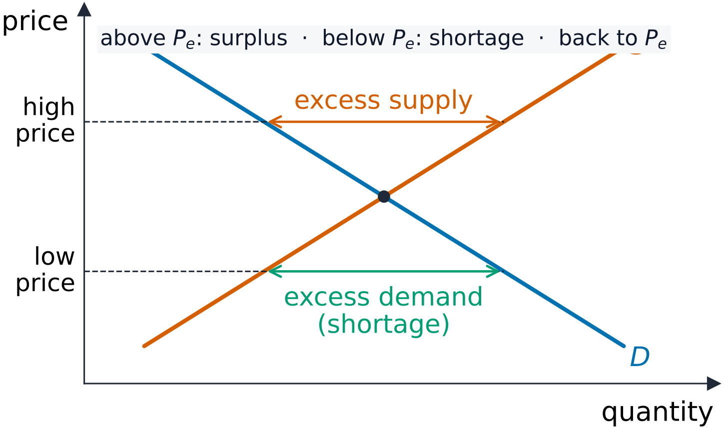
Answer shapes: K + App + An + Ev (a justified judgement, for discuss questions).

Method — How a market allocates resources



The price settles where demand and supply cross

Method — How a market allocates resources



Above equilibrium there is excess supply; below it there is excess demand

Practice 2.1 ▪ 2 marks

Define the term *market*.

Solution 2.1

Worked steps

any place or system where buyers and sellers meet to trade (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ▪ 3 marks

State the three functions of the price mechanism.

Solution 2.2

Method: How a market allocates resources

Worked steps

signalling; incentive; rationing $(1 + 1 + 1)$.

Practice 2.3 ▪ 2 marks

State the difference between microeconomics and macroeconomics.

Solution 2.3

Method: How a market allocates resources

Worked steps

microeconomics studies single parts of the economy (one market/firm); macroeconomics studies the whole economy (total jobs, prices, growth) (2 for a clear difference; 1 for a partial idea).

Exam-style 3.1 ▪ 1 mark

A rising price acts as an **incentive** because it:

A signals what to produce

B gives firms a reason to produce more

C rations a scarce good

D reduces consumer demand

Solution 3.1

Method: How a market allocates resources

A signals what to produce

B gives firms a reason to produce more ✓

C rations a scarce good

D reduces consumer demand

Worked steps

B. An incentive gives firms a reason to produce more.

Exam-style 3.2 ▪ 4 marks

Explain how the price mechanism allocates resources in a free market.

Solution 3.2

Method: How a market allocates resources

Worked steps

[4] K 1 + An up to 3 — a price change *signals* what buyers want and gives firms an *incentive* to supply more of wanted goods, while *rationing* scarce goods to those willing to pay → resources move to where they are most valued, with no planner.

Exam-style 3.3 ▪ 6 marks

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

Solution 3.3

Method: How a market allocates resources

Worked steps

[6] K/App/An — a rise in demand means buyers want more at the current price $\rightarrow$ this creates a shortage (excess demand) $\rightarrow$ buyers compete and bid the price up $\rightarrow$ the higher price gives firms an incentive to supply more $\rightarrow$ the market moves to a new, higher equilibrium price and quantity.