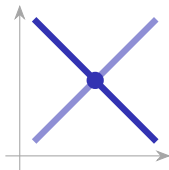


The Allocation of Resources

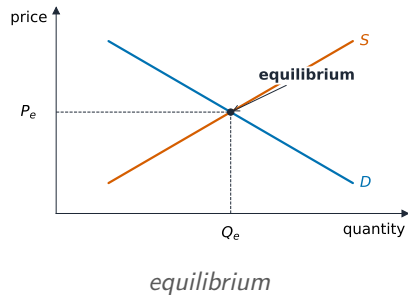
IGCSE Economics ■ Topic 2

IGCSE Economics



What we will cover

- 1 The price mechanism
- 2 Demand & supply
- 3 Equilibrium
- 4 Price elasticity
- 5 Price controls
- 6 Market failure



The price mechanism

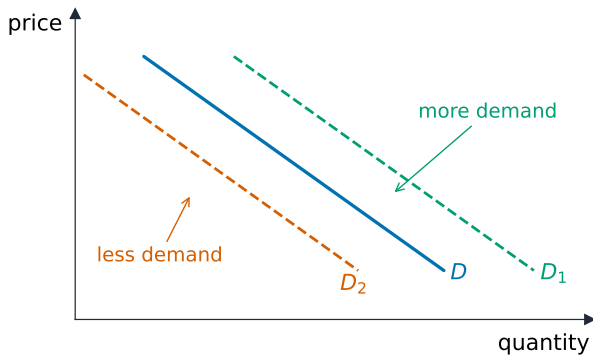
In a free **market** 市场, the **price mechanism** 价格机制 **allocates** 配置 resources – deciding what is made, how, & for whom.

- **signalling** – tells what to make
- **incentive** – a reason to supply
- **rationing** – shares out scarce goods



Prices guide who buys and what is made

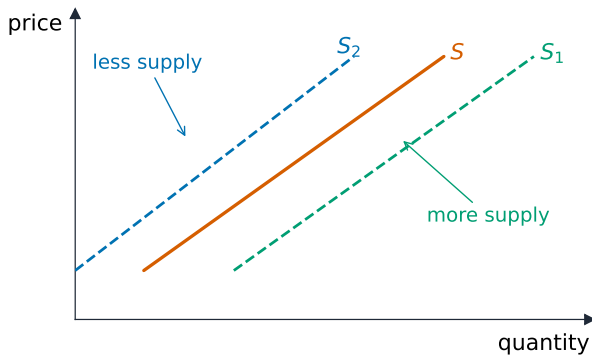
Demand



Demand 需求 slopes **down**: a higher price, less bought (**law of demand** 需求定律).

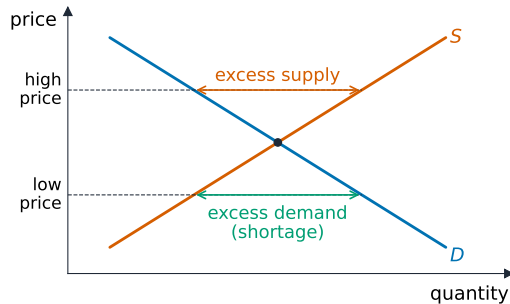
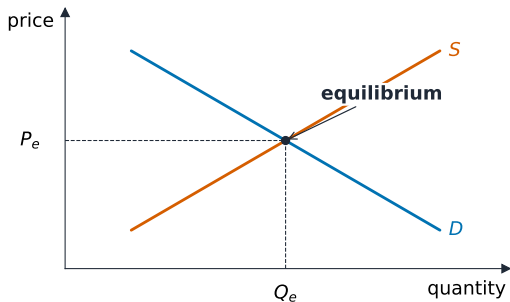
Own price → a **movement along**; income, tastes & related prices **shift** the curve.

Supply



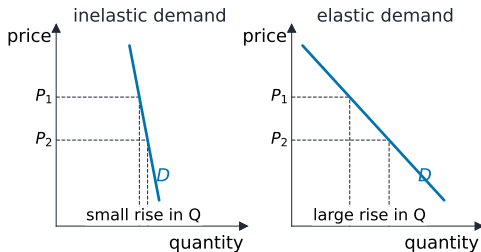
Supply 供给 slopes **up**: a higher price, more supplied (**law of supply** 供给定律). Costs, technology & taxes **shift** the supply curve.

Equilibrium



Equilibrium 均衡 price is where demand meets supply. Above it: **excess supply** 供给过剩; below it: **excess demand** 需求过剩 – price moves back.

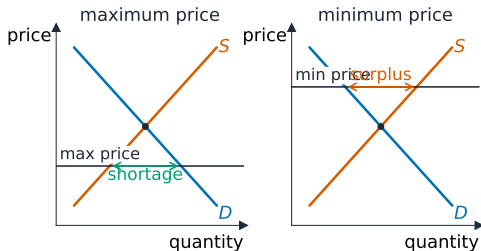
Price elasticity of demand



Price elasticity of demand 需求价格弹性 measures how much quantity responds to price.

- **inelastic** 缺乏弹性 – little response
- **elastic** 富有弹性 – big response

Price controls



- a **maximum price** 最高限价 (below equilibrium) causes a **shortage**
- a **minimum price** 最低限价 (above) causes a **surplus**

Externalities

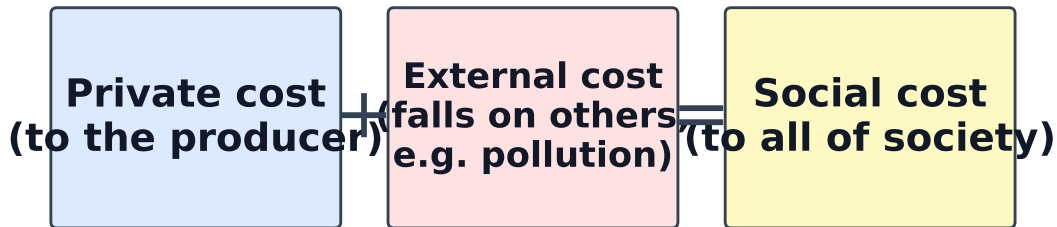
An **externality** 外部性 falls on third parties.

An **external cost** 外部成本 (pollution) is over-produced by the market – a **market failure** 市场失灵.



External costs spill onto third parties

Externalities – diagram



Public, merit and demerit goods

Private good

rival + excludable
firms supply it for profit
(e.g. an apple, a phone)

Public good

non-rival + non-excludable
free-rider problem, so the
government must supply
(e.g. street lighting)

Merit good

better for you than you
realise → under-consumed
(e.g. education, healthcare)

Demerit good

worse for you than you
realise → over-consumed
(e.g. cigarettes, alcohol)

A **public good** 公共物品 (street lights) is not provided by the market. **Merit goods** 有益品 are under-consumed; **demerit goods** 有害品 over-consumed.

Worked example – price elasticity of demand

Price rises 20% and quantity demanded falls 10%. Find the PED and say what it means.

- $\text{PED} = \frac{\% \Delta Q_d}{\% \Delta P} = \frac{-10}{20} = -0.5$
- Ignoring the sign, $0.5 < 1 \Rightarrow$ demand is **price inelastic**.
- Quantity changed **proportionally less** than price.
- So raising the price **raises total revenue** – which is why petrol is taxed so heavily.

PED is normally **negative** (price up, demand down) – compare its **size** with 1. Inelastic $\Rightarrow$ raise price for more revenue; elastic $\Rightarrow$ cut it.

Topic 2 – key takeaways

1

Demand & supply

demand down, supply up

2

Equilibrium

where demand meets supply

3

Elasticity

how quantity responds to price

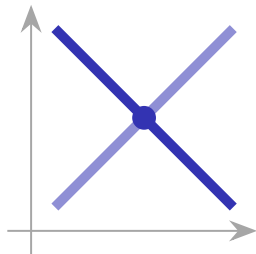
4

Market failure

externalities, public & merit goods

Check yourself

- 1 Which way does a demand curve slope?
- 2 What is the equilibrium price?
- 3 What does a maximum price cause?
- 4 Give one example of an external cost.



Answers 1. downwards 2. where demand = supply 3. a shortage 4. e.g. pollution