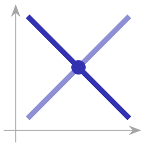
The Allocation of Resources

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

1 The market

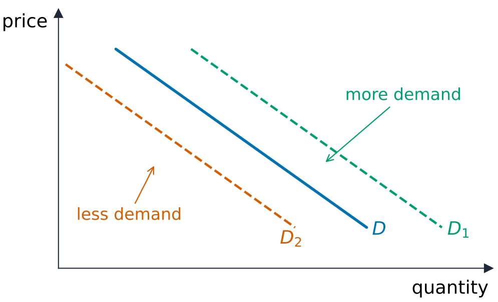
The price mechanism

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

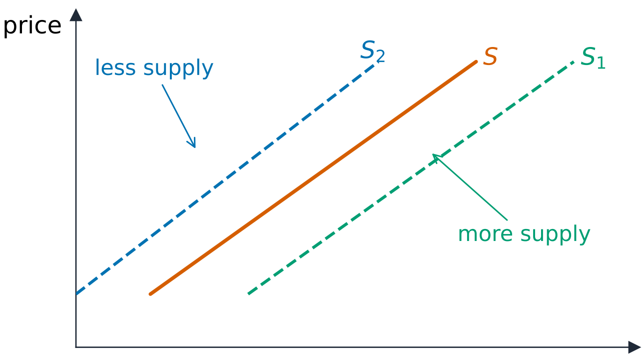


Demand 需求 slopes down: a higher price, less bought (**law of demand** 需求定律).

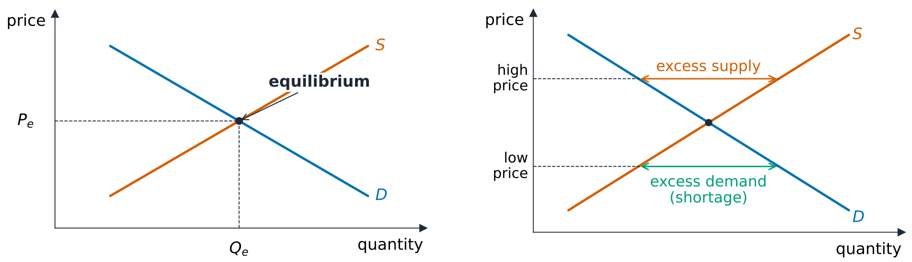
> Own price → a movement along; income, tastes & related prices shift the curve.

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.



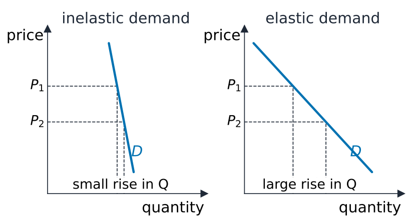
Equilibrium



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.

2 Elasticity and failure

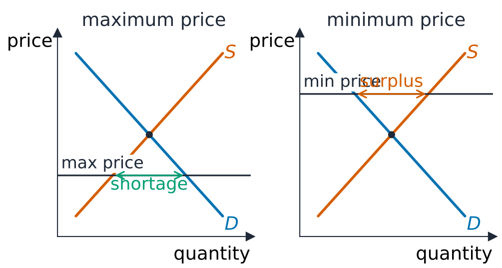
Price elasticity of demand



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

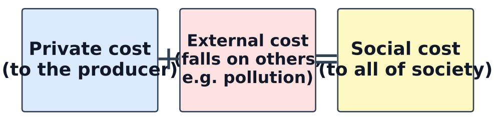
Externalities

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



- **merit goods** 有益物品 are better for you than you realise, so the market makes too few (education, healthcare).
- **demerit goods** 有害物品 are worse for you than you realise, so the market makes too many (cigarettes, alcohol).
- **public goods** 公共物品 are things everyone can use and no one can be stopped from using, like street lights or national defence. The market...

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.

3 Recap

Worked example – price elasticity of demand

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

- PED $= \dfrac{\%\Delta Q_d}{\%\Delta P} = \dfrac{-10}{20} = -0.5$
- 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

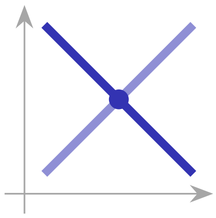
4 **Market failure**

externalities, public & merit goods

The Allocation of Resources
└Recap

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