1.3 Price determination in a competitive market: 30-minute Pack

AQA 7136 · Calculator allowed · about 30 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

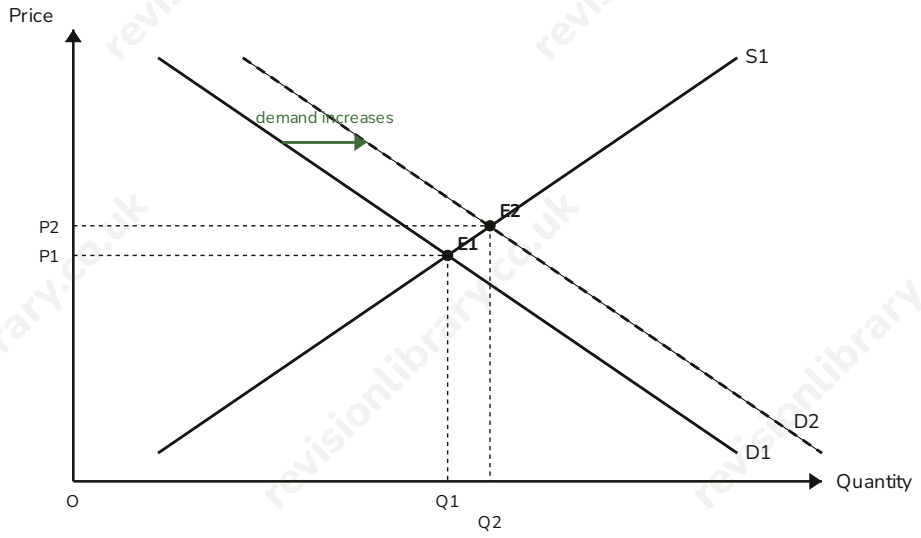
Answer ALL questions. Show all your working.

1 Analyse how the price mechanism performs the rationing and signalling functions in a competitive market, using an example of a sudden increase in demand for a good.

(Total for Question 1 is 12 marks)

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2 The diagram shows the market for a good, initially in equilibrium at E1. Demand then rises, shown by a rightward shift of the demand curve from D1 to D2, with the supply curve S1 unchanged. A new equilibrium is reached at E2.



(a) State the change in equilibrium price and quantity shown by the shift from D1 to D2. **(2)**

(b) Using the diagram, and an example, explain ONE non-price factor that could cause the rightward shift shown from D1 to D2. **(4)**

(c) Explain why the market mechanism (the price mechanism) restores equilibrium at the new price P2 without the need for government intervention. **(4)**

(Total for Question 2 is 10 marks)

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Mark scheme · 1.3 Price determination in a competitive market: 30-minute Pack

Question 1

Level 3 Thorough, well-linked analysis of both the rationing and signalling functions, applied clearly to a chosen example, using correct terminology throughout. **9-12**

Level 2 Some accurate analysis of at least one function, with partial application to an example. **5-8**

Level 1 Basic or generic statements about the price mechanism with little application to an example. **1-4**

Level 0 No relevant content. **0**

Indicative content:

- The signalling function: a rise in demand causes excess demand at the original price, which signals to producers (via rising prices) that consumers want more of the good.
- The rationing function: as price rises, the good is rationed (allocated) towards those consumers most willing and able to pay, while some consumers are priced out of the market.
- Higher prices act as an incentive for existing firms to expand output, and for new firms to enter the market, drawing resources into producing the good in higher demand.
- Example application: a sudden rise in demand for umbrellas during an unusually wet month; price rises, rationing available umbrellas to those willing to pay most, while signalling to producers/retailers to order and supply more umbrellas.
- The two functions work together: price changes both allocate the existing quantity (rationing) and direct resources towards or away from a market (signalling), reallocating resources without central planning.
- Evaluative extension: the price mechanism works most effectively where markets are competitive and information is good; time lags in production mean the rationing function may operate faster than the signalling function's effect on output.

Question 2

(a) price rises, from P1 to P2 **B1**

(a) quantity rises, from Q1 to Q2 **B1**

(a) Answer: Price rises (P1 to P2); quantity rises (Q1 to Q2).

(b) identifies a valid non-price determinant of demand, e.g. a rise in consumer income for a normal good, a successful advertising campaign, a rise in the price of a substitute, or a favourable change in tastes **M1**

(b) explains the mechanism: at every price, consumers now wish to buy more of the good than before **M1**

(b) links this explicitly to a rightward shift of the whole demand curve (not a movement along it) **A1**

(b) correctly identifies that this produces the higher equilibrium price and quantity shown at E2 (ft candidate's own example) **A1**

(b) Answer: Example: a rise in consumer income raises demand for a normal good at every price, shifting D1 to D2 and raising both price and quantity.

(c) at the original price P1, the increase in demand creates excess demand (a shortage) at that price, since quantity demanded on D2 now exceeds quantity supplied on S1 **M1**

(c) firms respond to the shortage (e.g. falling stock, queues) by raising price **M1**

(c) as price rises, quantity supplied extends along S1 (a movement along the supply curve) while quantity demanded contracts along D2, closing the gap between the two **A1**

(c) price continues to adjust until quantity demanded again equals quantity supplied, at the new equilibrium (P2, Q2), where there is no further tendency for price to change **A1**

(c) Answer: Excess demand at P1 bids the price up until Qd (on D2) again equals Qs (on S1) at P2, Q2.

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