

1.1 Choice, models and market adjustment

Name: _____ Class: _____ Date: _____

Total: 6 marks

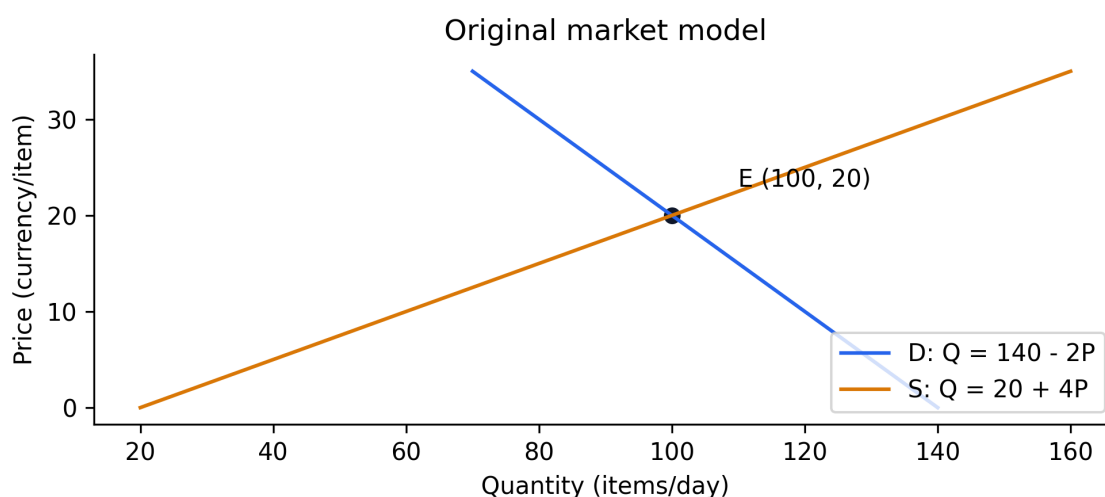
KEY WORDS scarcity • opportunity cost • equilibrium
• excess demand

Objective

Apply the supported native methods to original data and justify a qualified transfer conclusion.

1 Key knowledge and worked examples

A model specifies variables and holds other relevant influences constant. Scarcity requires choice; opportunity cost is the benefit of the next-best alternative. Marginal choice compares additional benefit and cost. A positive statement can in principle be tested; a normative statement adds a value judgement. Consumer and firm objectives are model assumptions, not a claim that everyone calculates perfectly.



In an original market model, $Q_d = 140 - 2P$ and $Q_s = 20 + 4P$, where P is currency units per item and Q is items per day. Explain equilibrium and a price of 15.

Equilibrium requires $Q_d = Q_s$. Thus $140 - 2P = 20 + 4P$; $120 = 6P$; $P = 20$ currency units/item. $Q_d = 140 - 2(20) = 100$ items/day and $Q_s = 20 + 4(20) = 100$ items/day. At $P = 15$, $Q_d = 110$ and $Q_s = 80$ items/day, giving excess demand $= 110 - 80 = 30$ items/day.

In the simple adjustment story, buyers bid up price or suppliers change prices; quantities then move along unchanged curves. A demand shift requires a different determinant, such as income or preferences. Shortages do not prove instantaneous adjustment or unrestricted competition.

2 Practice

2.1 For the worked case, state the method, show its application and give a limitation. [3]

3 Exam-style questions

3.1 A publicity campaign raises demand while a supplier's input costs increase. Explain why equilibrium quantity cannot be predicted from these directions alone and describe the diagram. [3]

Solutions

2.1 Equilibrium requires $Q_d = Q_s$. Thus $140 - 2P = 20 + 4P$; $120 = 6P$; $P = 20$ currency units/item. $Q_d = 140 - 2(20) = 100$ items/day and $Q_s = 20 + 4(20) = 100$ items/day. At $P = 15$, $Q_d = 110$ and $Q_s = 80$ items/day, giving excess demand $= 110 - 80 = 30$ items/day. In the simple adjustment story, buyers bid up price or suppliers change prices; quantities then move along unchanged curves. A demand shift requires a different determinant, such as income or preferences. Shortages do not prove instantaneous adjustment or unrestricted competition. Authored points for method, application and relevant qualification.

3.1 Demand shifts right and supply shifts left on axes of price and quantity. Both changes tend to raise equilibrium price, but their quantity effects oppose one another. Draw both new curves and compare relative shifts before judging quantity. Identify the unchanged determinants and time horizon. A large demand increase can outweigh the supply contraction; a large contraction can reverse that result. Do not confuse a movement caused by the new equilibrium price with a second demand shift. Authored points for judgement, case-linked reasoning and justified qualification. Accept supported alternatives.