Leo Ste

8. Explain how changes in prices work to reallocate resources in a market.

Plan:

P1. Define 'key terms', price mechanism, resource allocation.

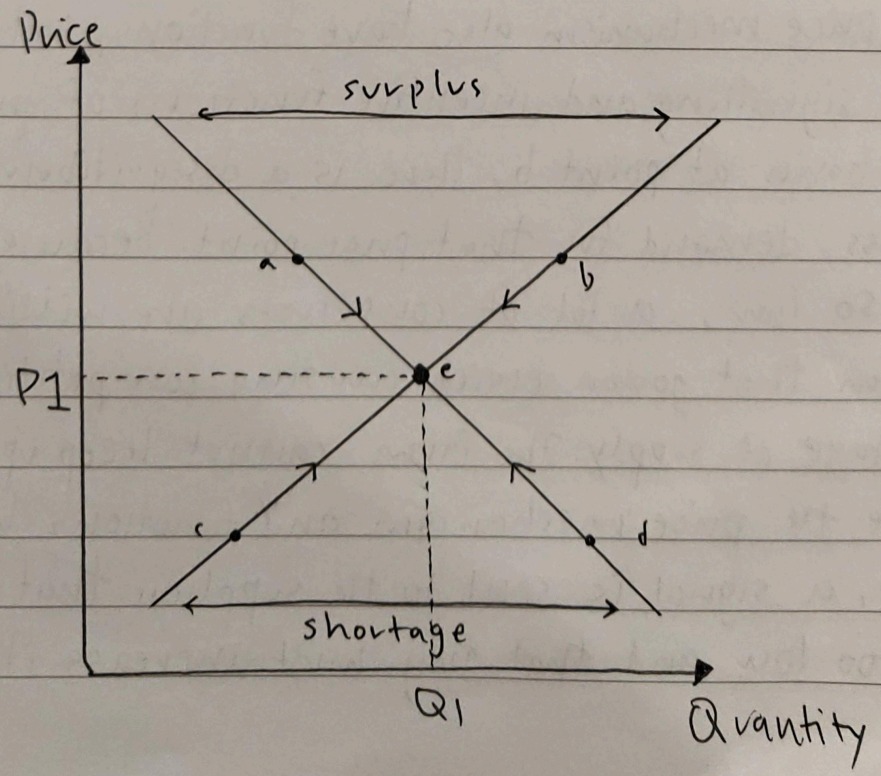
P2. Diagram (s)
- surplus vs shortage
- movement + shift
- example diagram

Answer the question – ie price signals significant

P3 Example (real world) AIRBUS

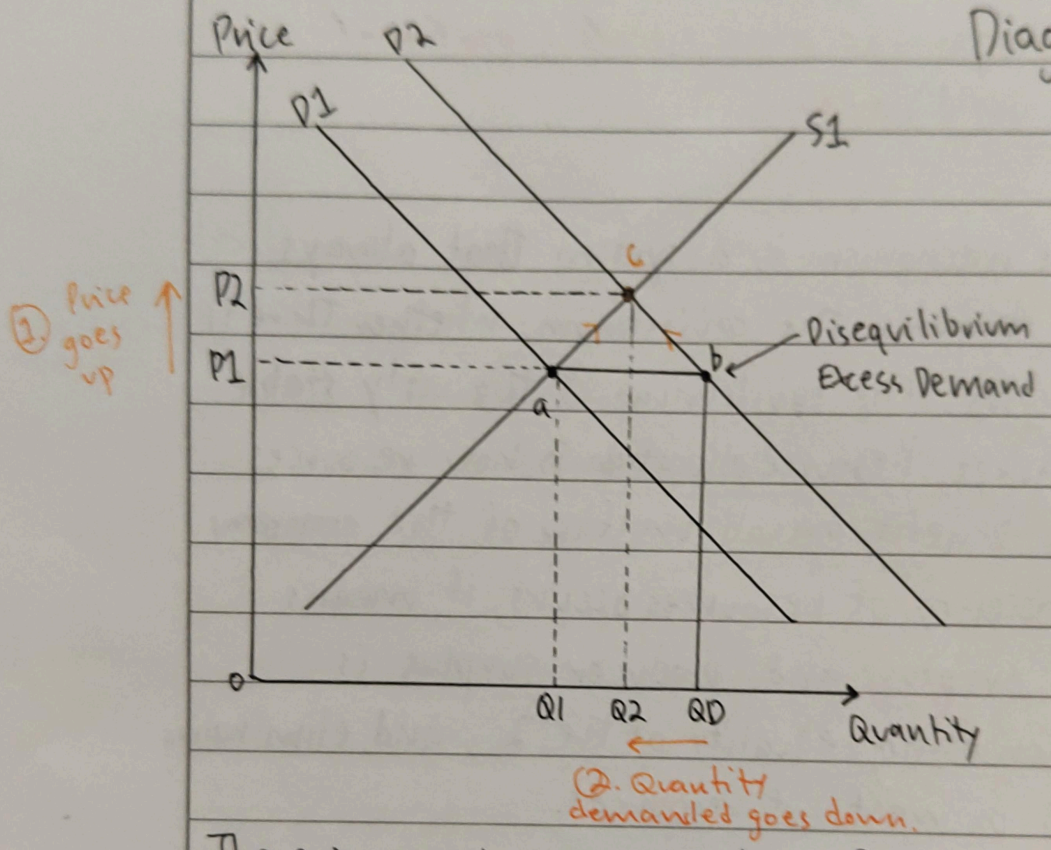
The price mechanism is a system that always pushes the price towards the equilibrium, whether there is shortage or surplus, the equilibrium is the only stable point in the market. Resource allocation is how resources are allocated to benefit overall welfare of the economy. If allocative efficiency of resources occurs, it means that consumer surplus and producer surplus is maximised, promoting equality of the 2, and eliminating deadweight loss or waste of resources.

Diagram 1



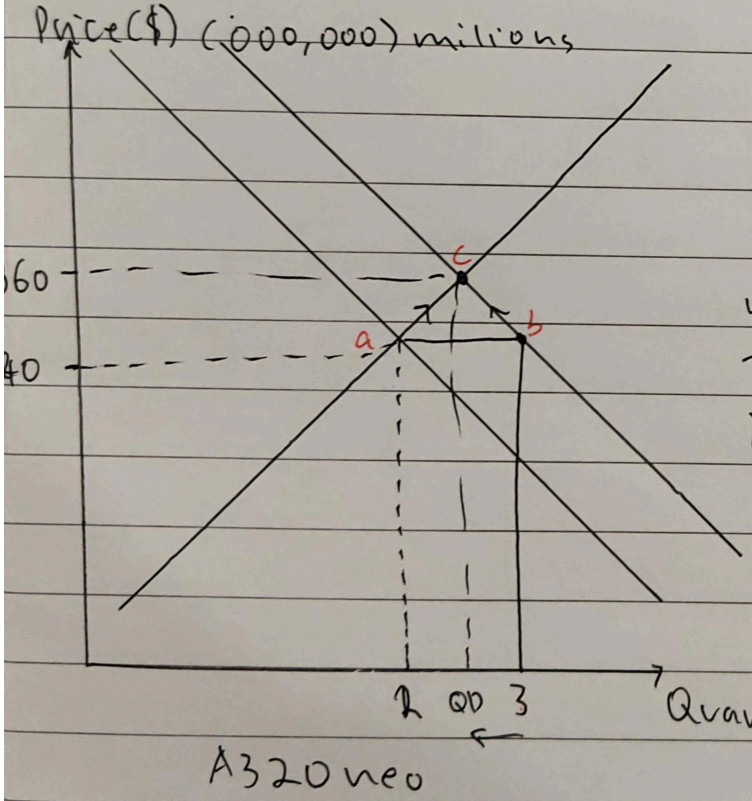
This can be shown on diagram 1, where the price mechanism kicks in a puts the market in to equilibrium. Points a and b, which are surpluses are pushed down towards point e, market equilibrium. Points c and d conversly in shortage are worked by the price mechanism and pushed towards point e.
This in more detail.

Diagram 2



The price mechanism also have functions, such as the signalling and incentive functions of price. As shown at point b, there is a disequilibrium and excess demand for that price point. Because the price is so low, a lot of consumers are willing to claim that good or service causing competition, and shortage of supply. The firm cannot keep up, which is where the price mechanism and functions kick in. First, a signal is sent to the supplier that their price is too low and that they must increase it to keep up

with the market. Then, there is an incentive for the producers to increase the price to ration out the excess demand. Once the excess demand is rationed out the market is again at equilibrium, promoting the efficiency of resource allocation. This can be shown on diagram 2, where when price rises from P1 to P2, less people are now willing to buy the good or service, causing quantity demanded to move from QP to Q2. This creates a new market equilibrium point c, which sums up how the price mechanism works. Now a real world example of this inside the aviation industry.



Airbus a320neo at equilibrium is 2 planes for 240 million dollars. If the quantity demanded increases to 3 units, it signals airbus to increase the price because of excess demand. T

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