

UNIT 3 How the market works

Recommended Prior Knowledge This Unit can be studied without any prior knowledge but it does build on one area covered in Unit 1. The price mechanism is a key element in a market economy and this Unit looks at how an equilibrium price is established in a market. Students will hopefully already have some basic idea of the possible influences on and effects of price changes. They should certainly have an awareness of the importance of advertising in an economy and they might have some broad idea of the potential problems when a business organisation is in a monopoly position in an economy.

Context As already indicated, the Unit builds on the importance of the price mechanism which was covered in the section on market economies in Unit 1. It will also provide a link with some of the ideas covered in later Units, such as the usefulness of the concept of price elasticity of demand in relation to the impact and incidence of taxation which is covered in Unit 6

Outline The Unit starts by examining the concepts of demand and supply and how they interact to establish an equilibrium price in a market. It then goes on to consider the price elasticity of demand and supply and to demonstrate the usefulness of elasticity in particular situations. It then deals with the purposes and methods of advertising and concludes with a discussion of the pricing and output policies in perfect competition and monopoly. It should be pointed out that these are the only two markets covered in the O Level syllabus and it is therefore not necessary to bring in either monopolistic competition or oligopoly.

	Learning Outcomes	Suggested Teaching Activities	Online Resources	Other Resources
3 a	Students should be able to demonstrate the principle of equilibrium price (analyse simple market situations with changes in demand and supply).	A good place to start would be to get the students thinking and talking about prices in an economy and, in particular, why some goods are priced higher than others. They are likely to have an idea that a shortage of something will probably make it more expensive and an excess of something is likely to make it cheaper. They could think of examples which support this, such as the vast amounts of money that can be paid for certain paintings. A useful exercise would be to get students to draw up a demand schedule showing their demand for a particular product at different prices and then to plot this in a demand curve. All of the resources cover this topic very thoroughly. The study points and check points in Anderton (pages 28-35) are very helpful and he has some useful data	URL – http://www.bized.ac.uk/virtual/via/theories/mkt_equilibrium.htm URL – http://www.s-cool.co.uk/quicklearn Supply and Demand: The equilibrium price URL – http://www.s-cool.co.uk/quicklearn Supply and Demand: real world applications – the market for coffee URL – http://www.s-cool.co.uk/quicklearn Supply and Demand: real	Anderton, Units 10-13, pages 28-37 Harrison and Nutter, Chapter 7, pages 61-71 and 74-77 Moynihan and Titley, Chapter 8, pages 151-170 Paisley and Quillfeldt, Part 1, Unit 1.2, pages 10-16

		<p>response questions on the topic (pages 36-37). Harrison and Nutter are very thorough (pages 61-71) and Paisley and Quillfeldt have some relevant questions which will help improve the level of understanding (pages 10-16). The s-cool website is particularly good on this topic and has three real world applications covering the market for coffee, the housing market and the market for health care.</p>	<p>world applications – the housing market</p> <p>URL – http://www.s-cool.co.uk/quicklearn Supply and Demand: real world applications – the market for health care</p> <p>URL – http://www.tutor2u.net/economics/content/topics/demandsupply/market_equilibrium.htm</p>	
b	<p>Students should be able to describe the causes of changes in demand and supply conditions and analyse such changes to show the effects on price.</p>	<p>In the first section of this Unit, students should have understood the principle of ‘ceteris paribus’, i.e. the idea that demand and supply are determined by changes in price with every other possible variable held constant. In this section, they need to consider what these other variables might be. The crucial idea that they need to understand is the distinction between an extension/contraction along a demand or supply curve and an increase/decrease of demand or supply as there is a shift of the demand or supply curve.</p> <p>A useful starting point would be to get the students to work in groups and discuss the various factors that could influence demand apart from the price of a good, then present their findings to the rest of the class. It is probably easier to start with demand; once they have covered that, they can then consider the factors that might influence supply, apart from the price of the good. Moynihan and Titley (pages 157-158) have a number of relevant articles which help to explain what might cause a change in the</p>	<p>URL – http://www.bized.ac.uk/virtual/via/theories/demand_curve_movements.htm</p> <p>URL – http://www.bized.ac.uk/virtual/via/theories/supply_curve_movements.htm</p> <p>URL – http://www.tutor2u.net/economics/content/topics/demandsupply/market_demand.htm</p> <p>URL – http://www.tutor2u.net/economics/content/topics/demandsupply/supply.htm</p> <p>URL – http://www.s-cool.co.uk/quicklearn Supply and Demand: The demand curve</p>	As above

		conditions of demand. Harrison and Nutter have some useful checkpoints on changes in the conditions of both demand and supply (pages 30-33).	URL – http://www.s-cool.co.uk/quicklearn Supply and Demand: The supply curve	
c	Students should be able to define price elasticity of demand and supply and perform simple calculations.	<p>The O Level syllabus focuses only on price elasticity and so there is no need to consider cross elasticity or income elasticity.</p> <p>Students often find elasticity a difficult concept to understand; it is necessary for them to appreciate not only that demand and supply respond to changes in price but that it is important to know the degree to which they respond. A good starting point would be to focus on demand and to get the students to consider how responsive their demand would be to changes in the price of a number of products or services; hopefully they will understand that demand for matches or newspapers is likely to be less responsive to changes in price than the demand for cars or holidays.</p> <p>The syllabus requires that students are capable of performing simple calculations in relation to elasticity and there are various figures given in the resources that will enable them to do this. Moynihan and Titley (pages 171-173 and 178-181), Anderton (pages 38-41), Harrison and Nutter (pages 71-77) and Paisley and Quillfeldt (pages 17-20) all have examples of the calculations and questions for students to complete.</p> <p>It is also necessary for students to understand the factors that can influence the price elasticity of demand and supply; groups of students could be given different examples of particular goods or services</p>	<p>URL – http://www.bized.ac.uk/virtualdc/trade/theory/th17.htm</p> <p>URL – http://www.bized.ac.uk/virtual/via/theories/ped.htm</p> <p>URL – http://www.bized.ac.uk/virtual/via/theories/determinants_ped.htm</p> <p>URL – http://www.bized.ac.uk/virtual/via/theories/interpreting_ped.htm</p> <p>URL – http://www.tutor2u.net/economics/content/topics/elasticity/elastic.htm</p> <p>URL – http://www.tutor2u.net/economics/content/topics//elasticity//elasticity_of_supply.htm</p> <p>URL – http://www.s-cool.co.uk/quicklearn Elasticities: Price elasticity of demand formulae</p> <p>URL – http://www.s-cool.co.uk/quicklearn</p>	<p>Anderton, Units 14-15, pages 38-43</p> <p>Harrison and Nutter, Chapter 7, pages 71-77</p> <p>Moynihan and Titley, Chapter 8, pages 170-182</p> <p>Paisley and Quillfeldt, Part 1, Unit 1.2, pages 17-20</p>

		and asked to consider the factors that might make the demand for or the supply of these goods or services more or less responsive to a price change.	cool.co.uk/quicklearn Elasticities: Price elasticity of demand URL – http://www.s-cool.co.uk/quicklearn Elasticities: Price elasticity of supply formulae URL – http://www.s-cool.co.uk/quicklearn Elasticities: Price elasticity of supply	
d	Students should be able to demonstrate the usefulness of elasticity in particular situations e.g. tax yields, turnover.	<p>Whereas the previous section was concerned with the definitions of price elasticity and the way in which it can be calculated, this section is an applied one. Students need to consider its usefulness and one important example would be in relation to tax yields. They could work in groups and suggest examples of goods which had a relatively inelastic price elasticity of demand; they could then consider why these goods, such as alcohol, cigarettes and petrol, would be more likely to be taxed by a government.</p> <p>Another example would be in relation to the revenue of a firm. Students could compare the likely effects of a change in price of a good with an elastic demand with one with an inelastic demand. They need to realise that if a good has an inelastic demand, it would be better to increase price in order to increase revenue; if it has an elastic demand, it would be better to decrease price in order to increase revenue. If the price elasticity of demand is unitary, the revenue will stay the same whether price is</p>	URL – http://www.bized.ac.uk/virtual/economy/policy/tools/vat/vatth3.htm URL – http://www.s-cool.co.uk/quicklearn Elasticities: Price elasticity – the significance of revenue	As above

		increased or decreased. Paisley and Quillfeldt (pages 17-18), Harrison and Nutter (page 43) and Moynihan and Titley (pages 173-174) are all good on this topic. The bized website is good in relation to VAT and the s-cool site is helpful on the link between elasticity and revenue.		
e	Students should be able to describe the purposes and methods of advertising.	<p>Most students should enjoy doing some work on advertising. They could work in groups and come up with a list of the most important purposes of advertising, taking into account some of the ethical and legal issues involved. They should then consider the variety of methods which could be used, considering the advantages and disadvantages of each. They could then give a presentation to the class on their findings.</p> <p>They could also select a number of adverts on television/radio and in newspapers/magazines and suggest why some might be considered more appealing than others.</p> <p>Another interesting activity would be to give each group a particular good or service for which they would have to devise an appropriate advertising strategy. The website of the Advertising Standards Authority would be worth looking at in relation to this activity.</p> <p>Exercise 5 in Moynihan and Titley (pages 215-216) would be worth doing. Paisley and Quillfeldt are particularly good on this topic and the data response question (page 186) is helpful. The tutor2u website is also very useful.</p>	<p>URL – http://www.tutor2u.net/business/marketing/promotion_advertising.asp</p> <p>URL – http://www.tutor2u.net/business/marketing/promotion_advertising_effectiveness.asp</p> <p>URL – http://www.tutor2u.net/business/marketing/promotion_advertising_whywhat.asp</p> <p>URL – http://www.tutor2u.net/business/marketing/promotion_advertising_media.asp</p> <p>URL – http://www.asa.org.uk/index.asp</p>	<p>Anderton, Unit 11, pages 30-31</p> <p>Anderton, Unit 18, pages 48-49</p> <p>Anderton, Unit 35, pages 90-91</p> <p>Anderton, Unit 37, pages 96-97</p> <p>Moynihan and Titley, Chapter 10, pages 214-217</p> <p>Paisley and Quillfeldt, Part 6, Unit 6.7, pages 181-186</p>
f	Students should be able to describe pricing and output policies in perfect competition	Students need to consider the likely benefits of a market situation in which there	URL – http://www.bized.ac.uk/virtual	Anderton, Units 35-36, pages 90-95

	and monopoly.	<p>are a large number of firms competing against each other. They then need to contrast this with a monopoly situation where one firm controls a market and consider the likely advantages and disadvantages of this situation. Teachers could give groups of students examples from their own countries of markets with a high level of competition and those where one firm controls the market or is in a very dominant position and get them to compare the two situations.</p> <p>Teachers need to remember that the syllabus only covers perfect competition and monopoly; there is no need to bring in monopolistic competition or oligopoly. All of the resources cover this topic. Moynihan and Titley are very thorough (pages 201-211) and Harrison and Nutter (pages 90-95) have some useful checkpoints and two helpful data response questions.</p>	<p>/dc/farming/theory/th12.htm</p> <p>URL – http://tutor2u.net/economics/content/topics/competition/competition_importance.htm</p> <p>URL – http://tutor2u.net/economics/content/topics/competition/competition.htm</p> <p>URL – http://www.tutor2u.net/economics/content/topics/monopoly/barriers_to_entry.htm</p> <p>URL – http://www.tutor2u.net/economics/content/topics/monopoly/price_discrimination.htm</p> <p>URL – http://www.tutor2u.net/economics/content/topics/monopoly/benefits_of_monopoly.htm</p> <p>URL – http://www.tutor2u.net/economics/content/topics/monopoly/monopoly_profits.htm</p> <p>URL – http://www.s-cool.co.uk/quicklearn Market Structure 1: Perfect competition</p>	<p>Harrison and Nutter, Chapter 12, pages 124-129 Moynihan and Titley, Chapter 10, pages 201-211</p> <p>Paisley and Quillfeldt, Part 6, Unit 6.5, page 171</p>
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