

Functions of the price mechanism

Functions of price in a market economy

- Price allocates resources in an economy e.g. price of mask rises to reduce shortage

- **3 Functions of price**

1. Rationing: where a producer limits the supply of products in the market to ensure the products remain exclusive. When demand exceeds supply, it makes its price higher.

2. Signaling : Where decisions taken by buyers or sellers are determined by price

When price rises \Rightarrow It gives information that there is shortage \Rightarrow firms should increase production

When price falls \Rightarrow It gives information that there is surplus \Rightarrow firms should reduce production

3. Incentive: where low or high prices influence consumption and production by encouraging buyers to consume and sellers to produce.

e. g. When price rises \Rightarrow It makes incentive to sell more products.

When price falls \Rightarrow It makes incentive to buy more products.