

Competitive Market Equilibrium

2.3



Definition

Equilibrium

- Equilibrium is a state of balance, where two opposing forces are equally matched.
- The market equilibrium occurs at the point where the supply curve of a good or service crosses the demand curve.
- The equilibrium price, also called the market-clearing price, is the price at which the quantity demanded of a good is equal to the quantity supplied

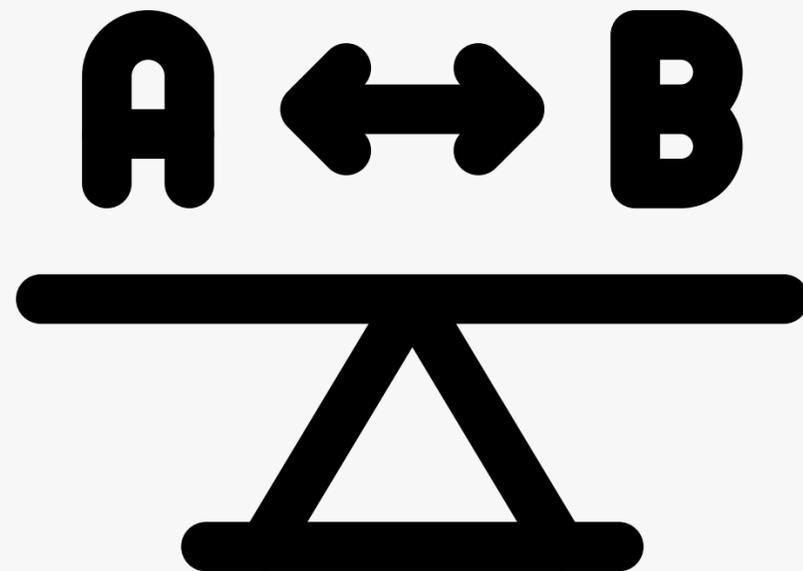


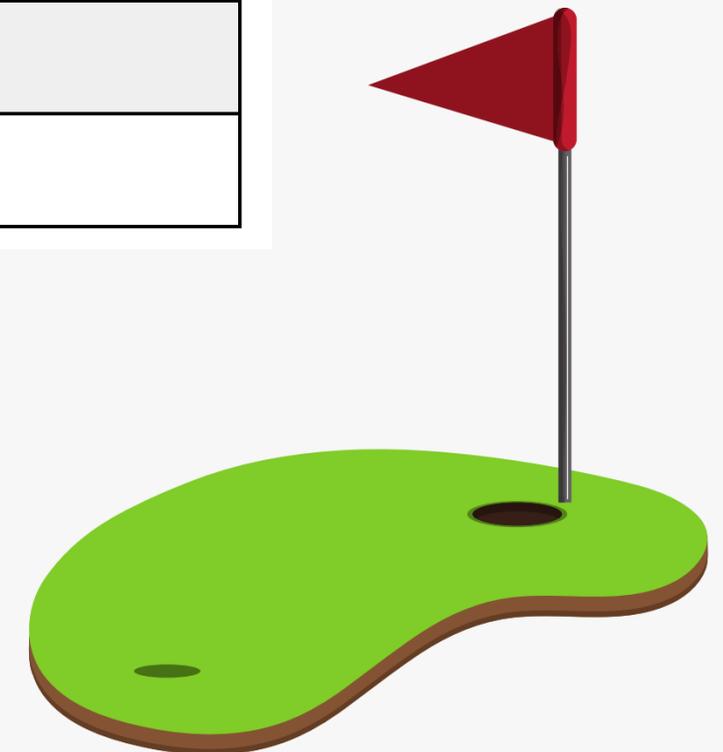
Figure 1. Balance between supply and demand.

Credit: siraanamwong Getty Images

Equilibrium

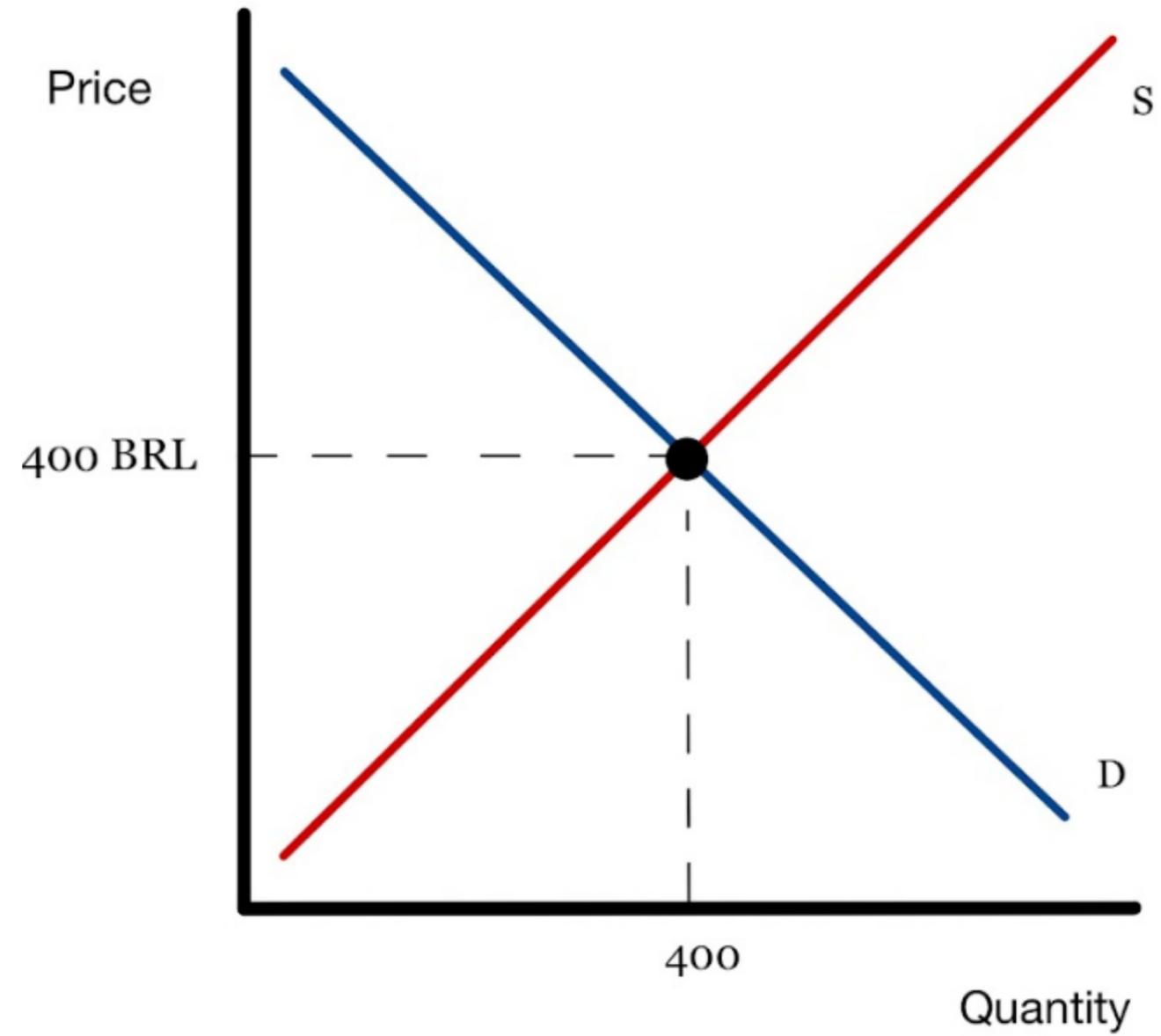
What is the Equilibrium Price and Quantity in this example of golf lessons in Brazil?

Price (BRL) of Golf Lessons	Quantity of Individual golf lessons demanded(Q_d)	Quantity of Individual golf lessons supplied(Q_s)
220	200	600
200	300	500
180	400	400
160	500	300
140	600	200



Equilibrium

Golf Lesson Market in Brazil



Attention



Now, from this point on, you should only be drawing complete Supply and Demand graphs with both curves present.

Disequilibrium

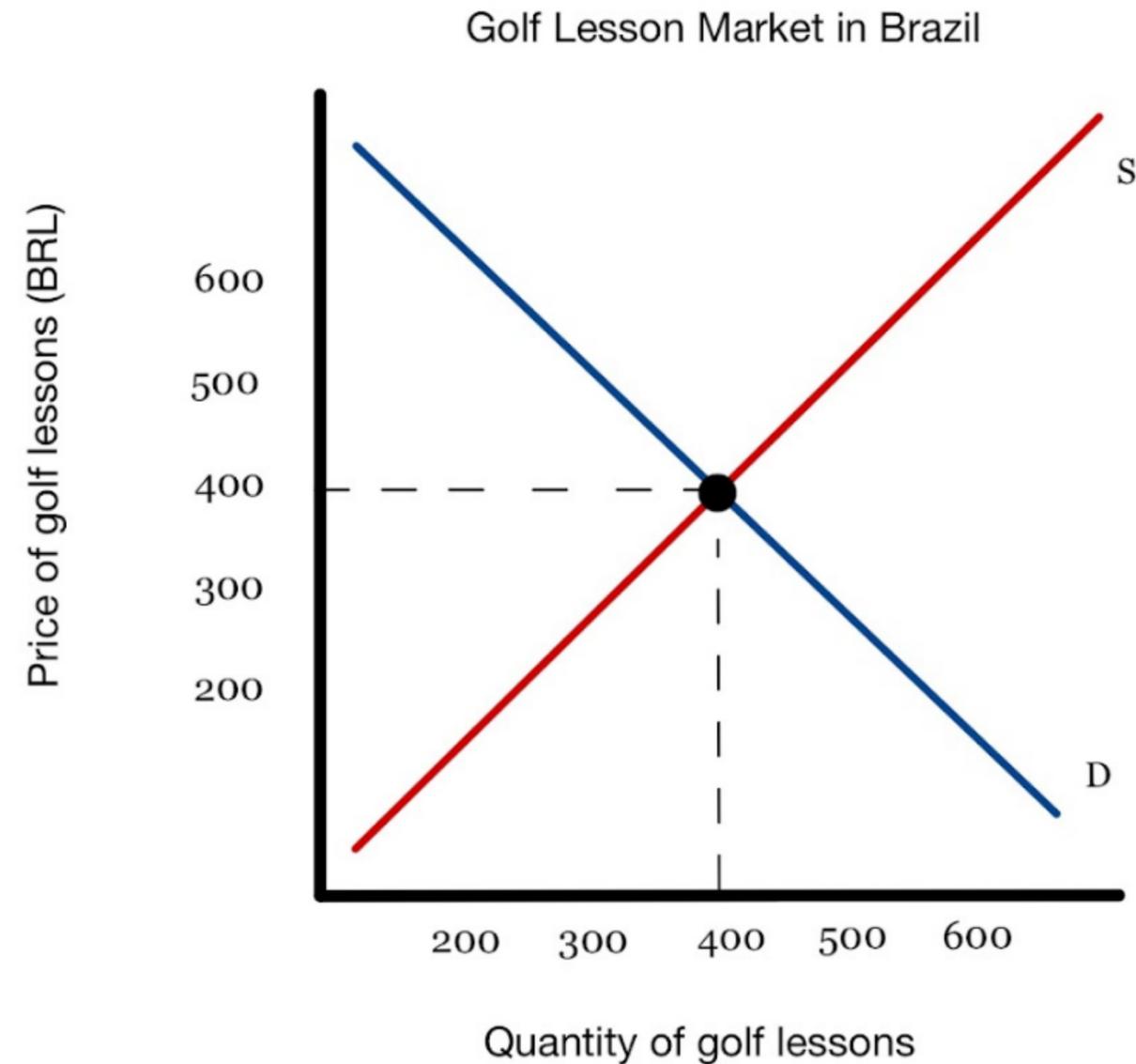
- As markets move with Supply and Demand shifting, the market typically finds itself in disequilibrium where Q_d does not equal Q_s .
- These issues are theoretically seen as temporary, and the market should adjust to equilibrium.



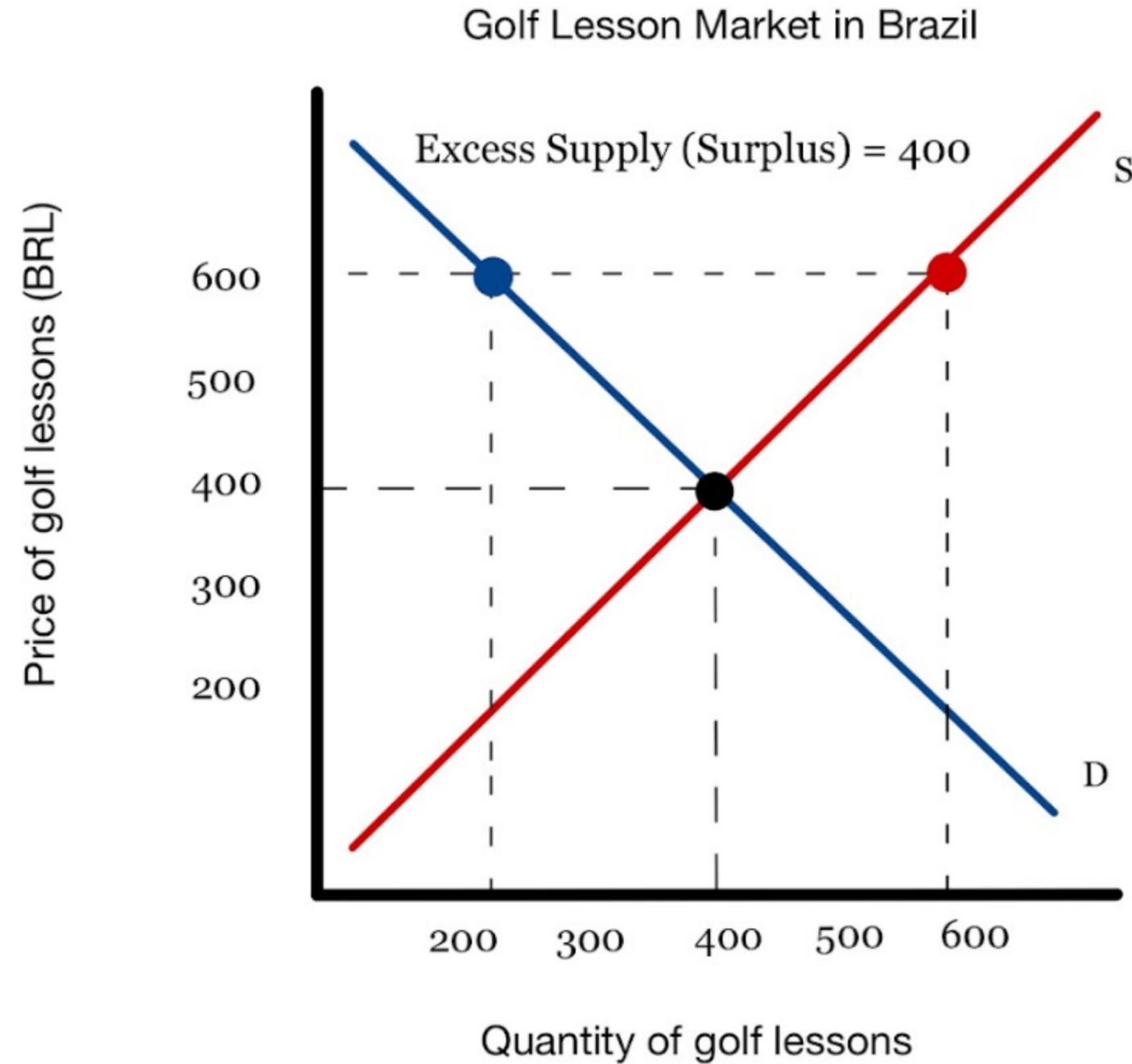
Excess Supply (Surplus)

- Quantity Supplied > Quantity Demanded

What will happen if the price of golfing lessons rises to BRL 500? Use specific numbers

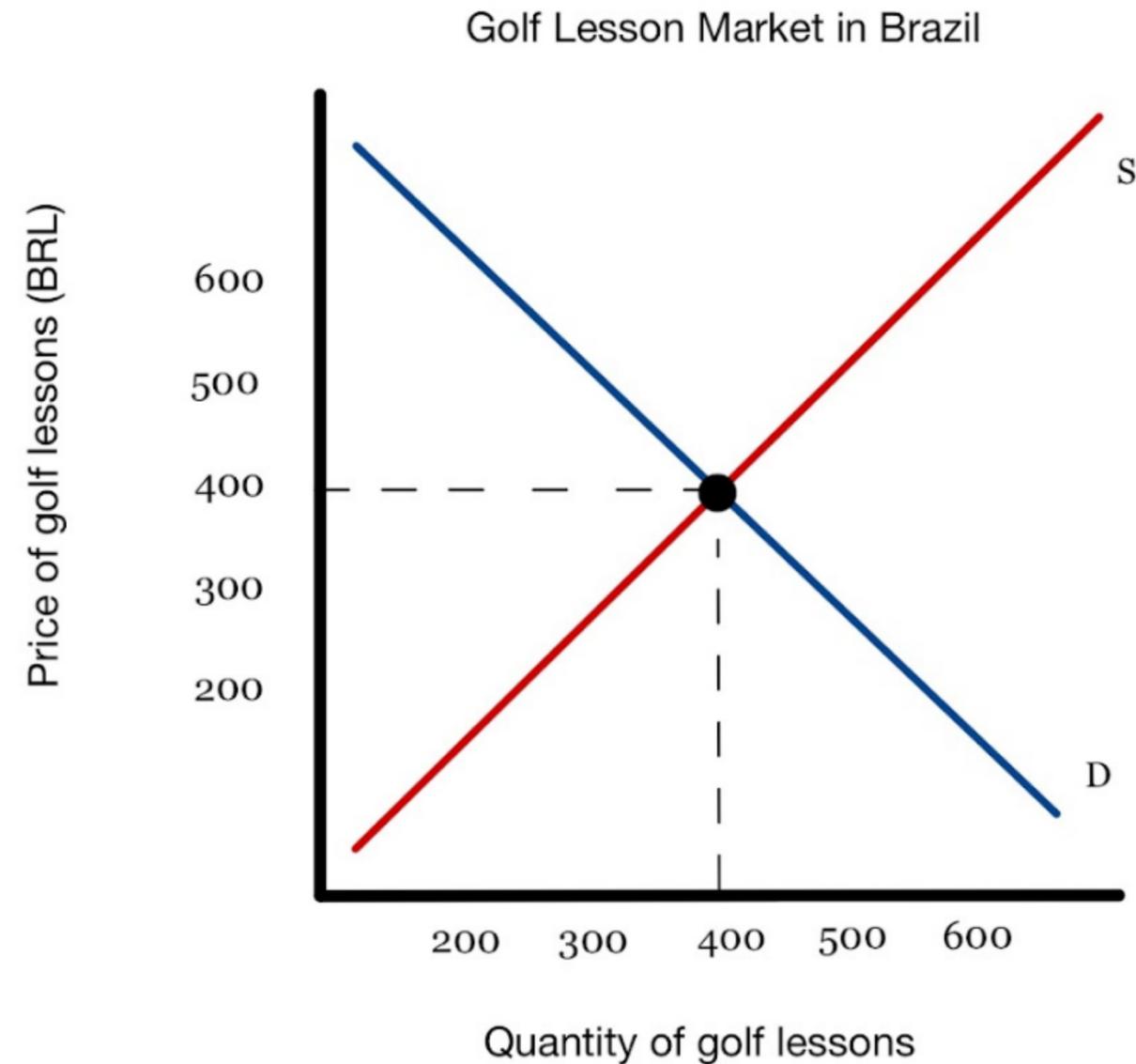


Excess Supply (Surplus)

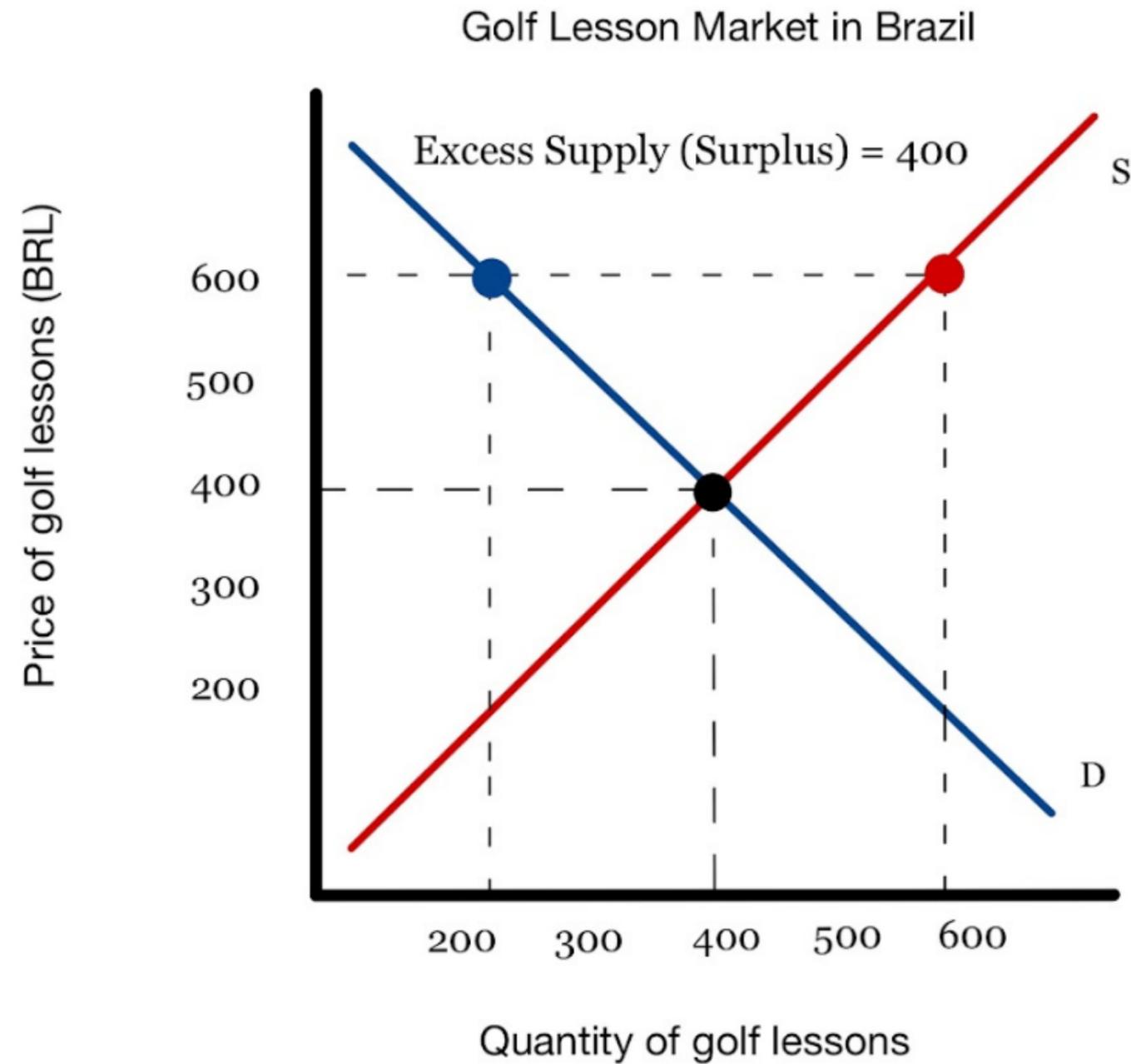


Excess Supply (Surplus)

What will happen if the price of golfing lessons rises further to BRL 600? Use specific numbers



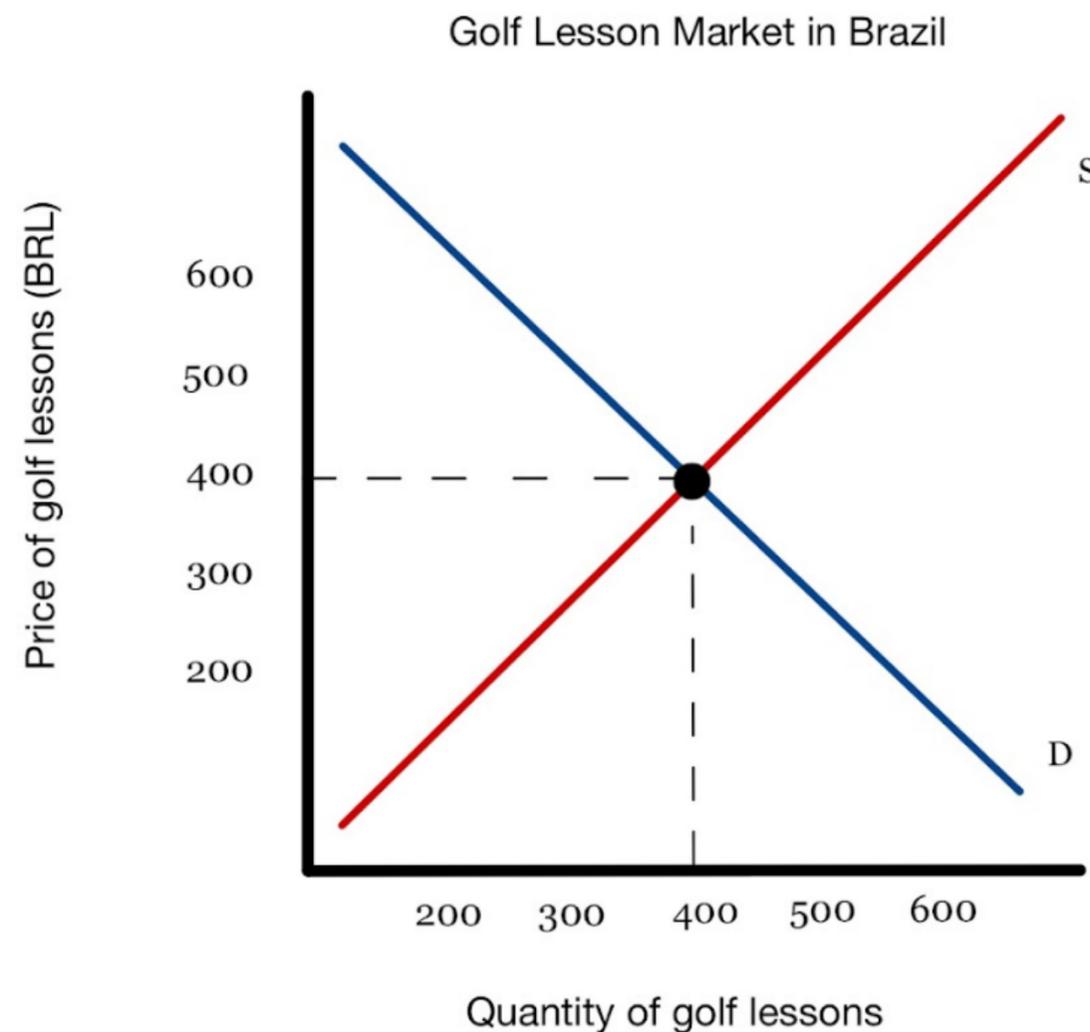
Excess Supply (Surplus)



Excess Demand (Shortage)

- Quantity Demanded > Quantity Supply

What will happen if the price of golfing lessons drops to BRL 300? Use specific numbers



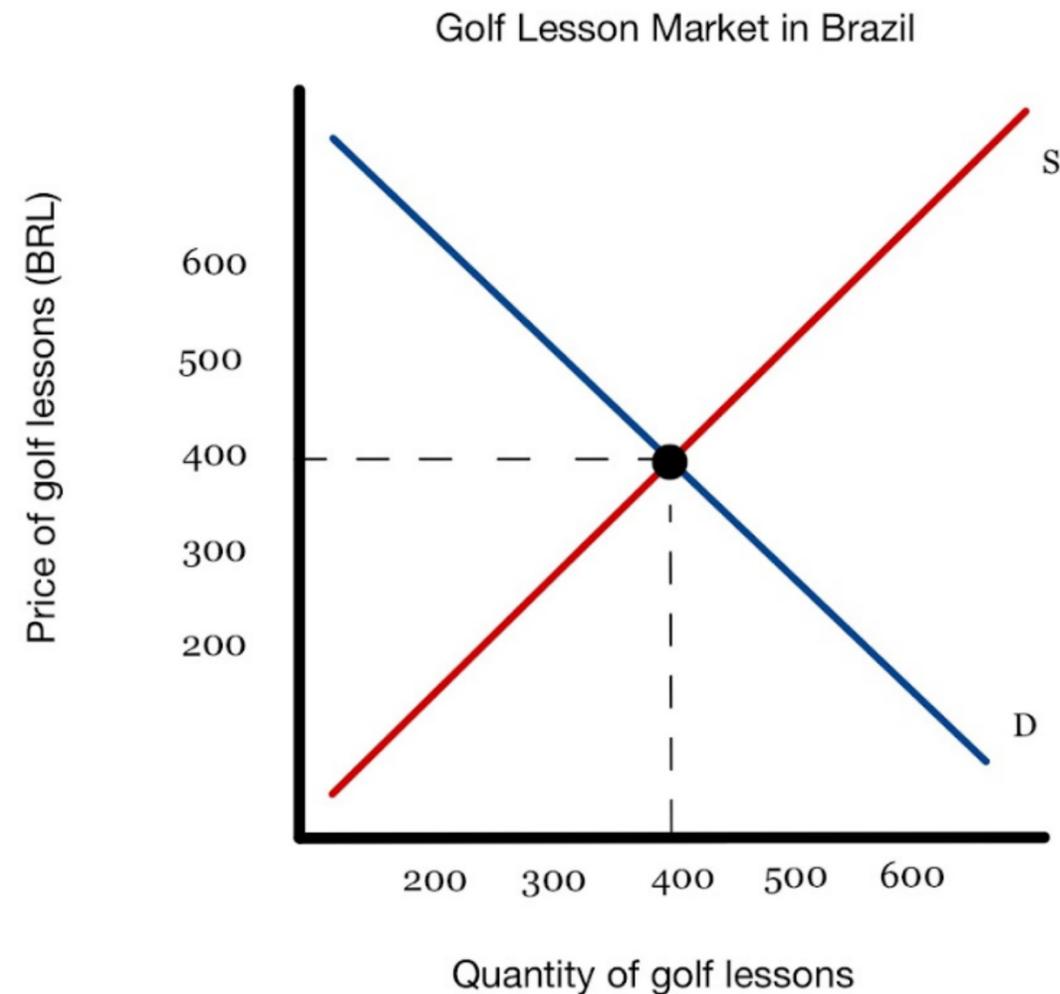
Excess Demand (Shortage)



Excess Demand (Shortage)

- Quantity Demanded > Quantity Supply

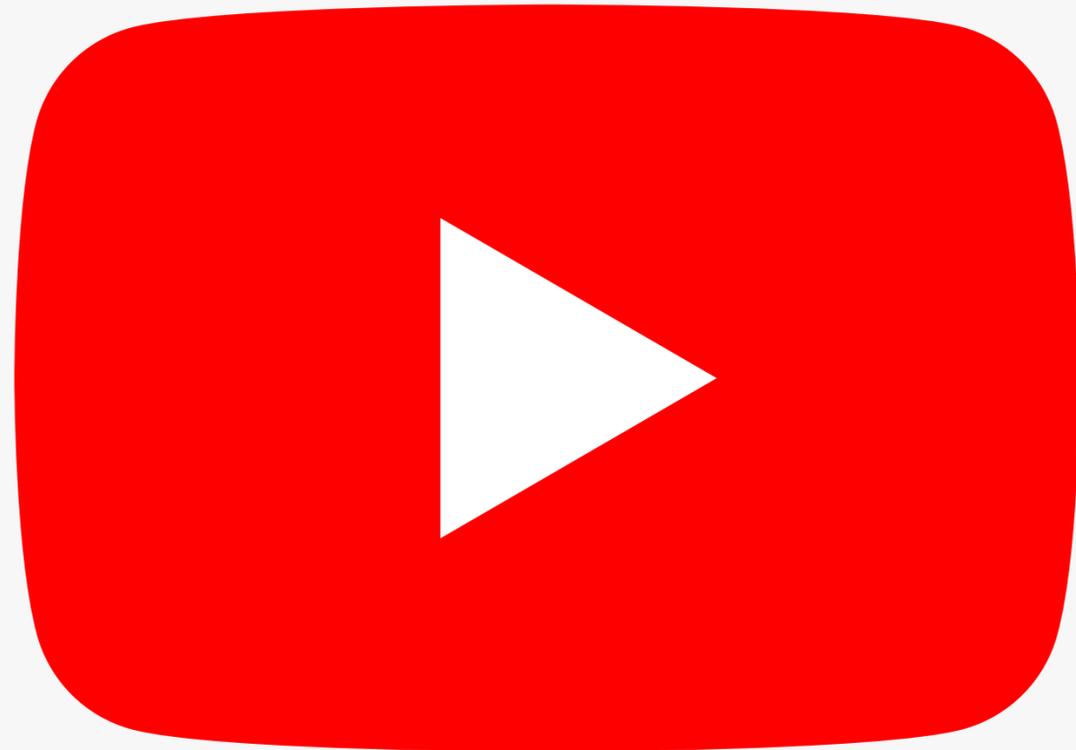
What will happen if the price of golfing lessons drops further to BRL 200? Use specific numbers



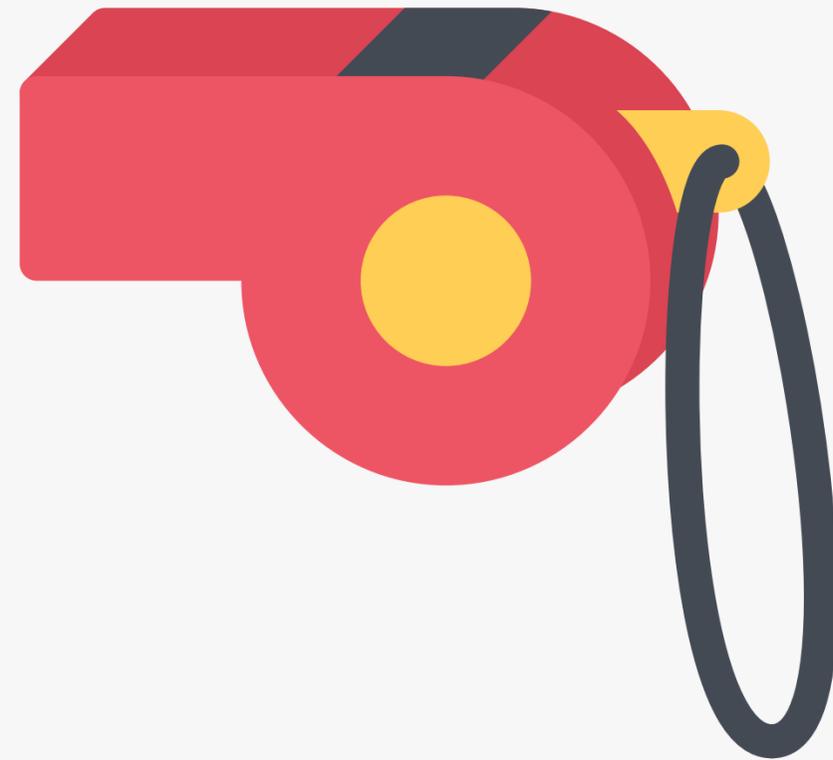
Excess Demand (Shortage)



Video



Practice



Supply & Demand Analysis

Follow Step 1,2, and 3.

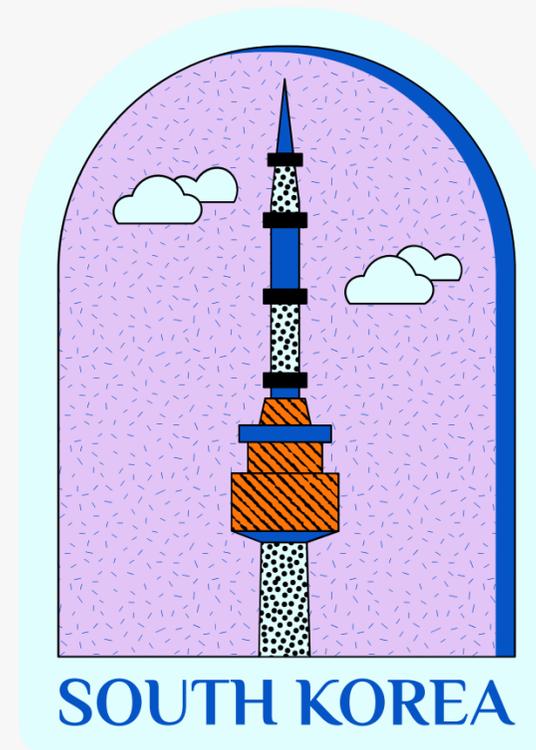
1. Draw supply and demand. Label Equilibrium Price and Quantity
2. Draw the change
 - a. Does it affect Supply or Demand FIRST?
 - b. What is the shifter? Increase or Decrease
3. After change
 - a. Label new Equilibrium. What happened to P? What happened to Q?

Analyze Pizza

- 1. New Pizza oven technology makes production more efficient.**
- 2. Price of calzones decrease**
- 3. Price of Pizza rises from \$2 to \$4**
- 4. Price of wheat doubles**
- 5. Human Hair consistently found in pizza slices**
- 6. A large conference takes place near our pizza restaurant**

Practice

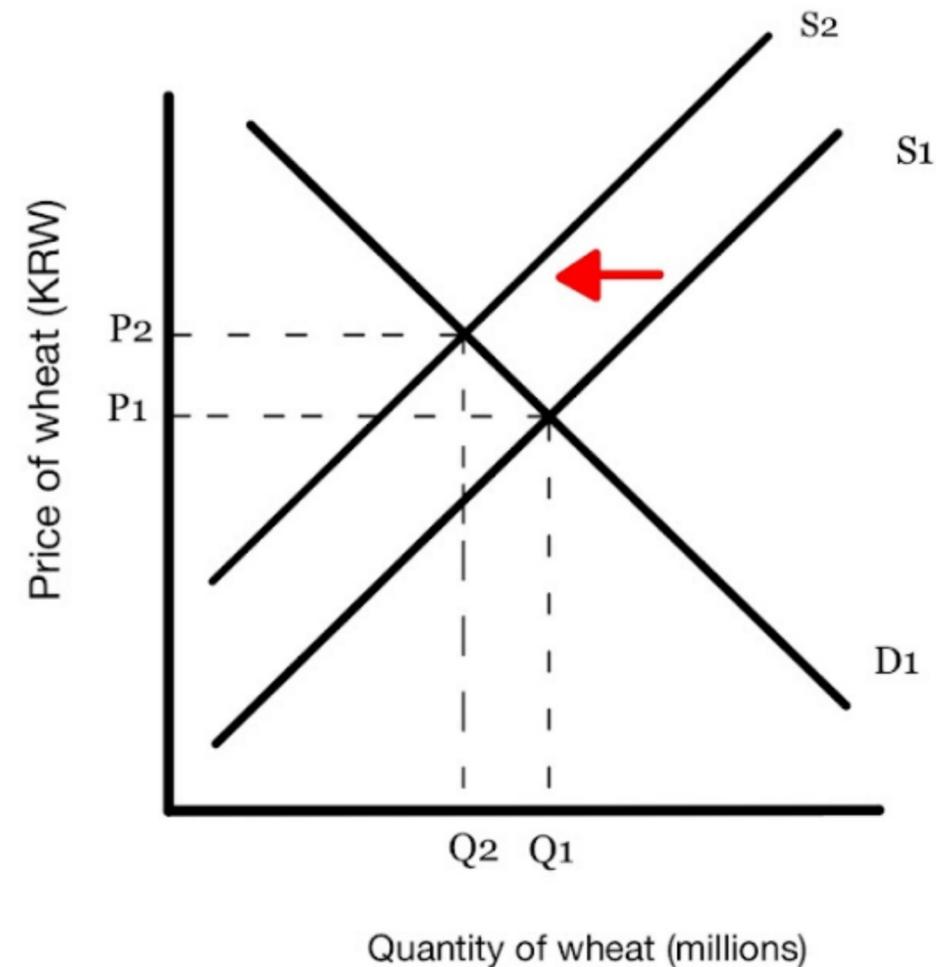
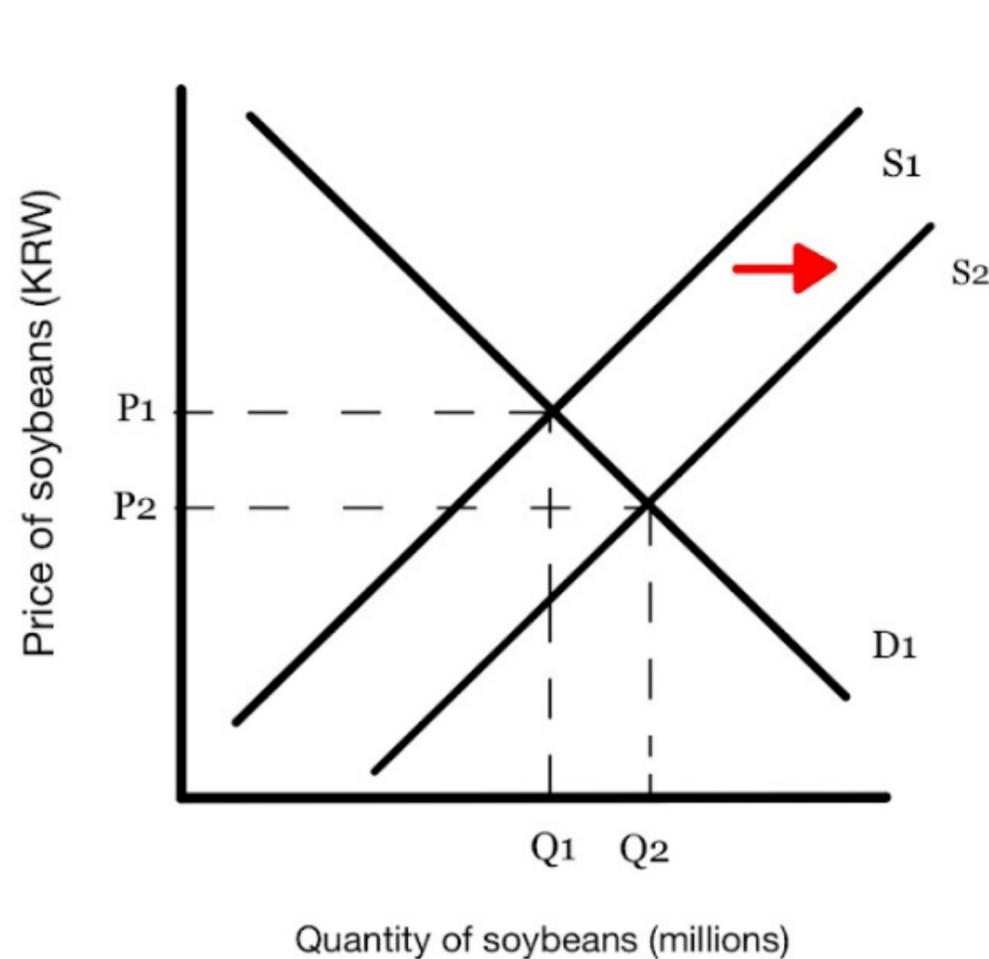
IN 2018, THE KOREAN GOVERNMENT INCREASED SUBSIDIES FOR SOYBEANS AND REDUCED SUBSIDIES FOR WHEAT. USE APPROPRIATE DIAGRAMS TO EXPLAIN THE IMPACT ON THE SOYBEAN AND WHEAT MARKETS OF THESE CHANGES TO SUBSIDIES.



Answer

A subsidy is a government payment to a producer with the aim of increasing supply or lowering prices in the market. An increase in subsidies for Korean soybean farmers should increase the supply of soybeans. A decrease in subsidies for Korean wheat farmers should decrease the supply of wheat. The impact is shown in Figure 5 and Figure 6. The supply of soybeans increases from S_1 to S_2 . The price of soybeans decreases from P_1 to P_2 and the quantity demanded and supplied of soybeans increases from Q_1 to Q_2 , ceteris paribus. The supply of wheat decreases from S_1 to S_2 . The price of wheat increases from P_1 to P_2 and the quantity demanded and supplied of wheat decreases from Q_1 to Q_2 , ceteris paribus.

The change in subsidy policy by the Korean government should result in a greater supply of soybeans and a reduced supply of wheat.



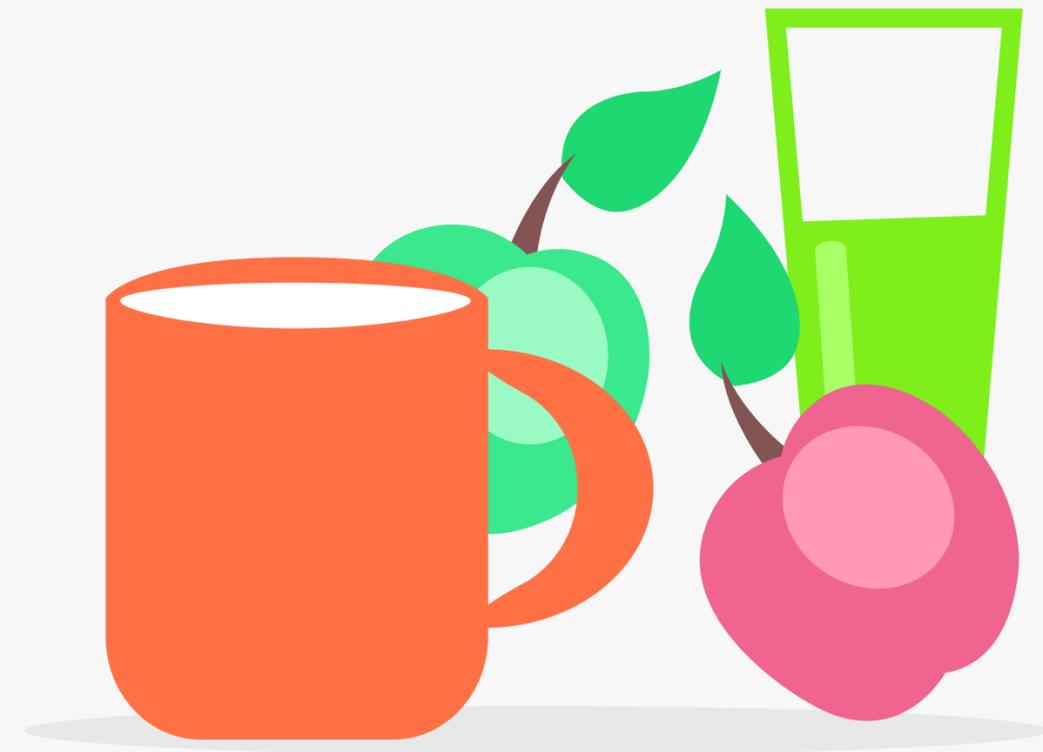
Price Mechanisms

- Changes in price, or the price mechanism determine how scarce resources are allocated in an economy.
- As price changes, the free market corrects itself using a system of negative feedback consisting of **signals** and **incentives**.
- Signalling function of prices
 - Introduces negative feedback into the market system by communicating **WHAT** consumers and producers should do. The feedback causes stakeholders to respond in a way that brings the market back into equilibrium, stabilising the system.
- The incentive function of prices
 - introduces negative feedback into the market system by providing financial **MOTIVATION** to consumers and producers to react in a way that brings the market back into equilibrium, stabilising the system.



Rationing

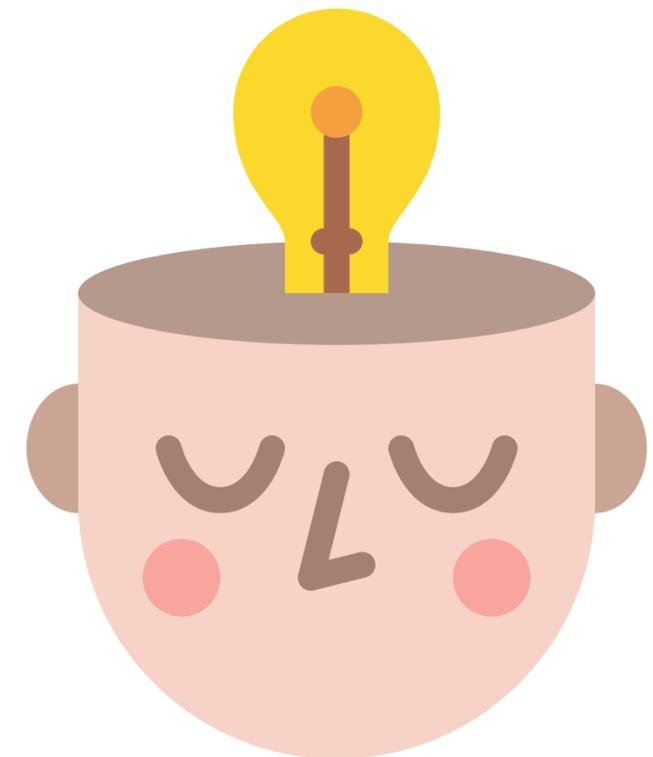
- Rationing refers to the controlled distribution of resources. Rationing is necessary at any time when goods and resources are scarce.
- Price is typically the best rationing function
- However, during times of severe scarcity where individuals are WILLING but NOT ABLE to purchase basic necessities due to dramatic shortages, the government may step in. In World War II for example, government rationing of many goods in the UK.



Recap and Review



- 1. Identify the 5 shifters of demand.**
- 2. Identify the 6 shifters of supply .**
- 3. Define Subsidy.**
- 4. Explain why price DOESN'T shift the curve.**
- 5. Define Equilibrium.**
- 6. Define Shortage.**
- 7. Define Surplus.**



Practice Question



Paper 1 Part A

N18/3/ECONO/HP1/ENG/TZ0/XX

- (a) Explain how the price mechanism reallocates resources when there is an increase in demand for a good or service. [10]



Check Answers

Explain how the price mechanism reallocates resources when there is an increase in demand for a good or service.

Answers may include:

- definitions of resources, demand
- diagram to show how an increase in demand leads to a reallocation of resources
- explanation of how the signalling and incentive functions of price lead to a reallocation of resources when demand increases for a good or service
- examples of goods and services where the price mechanism has reallocated resources because of an increase in demand.

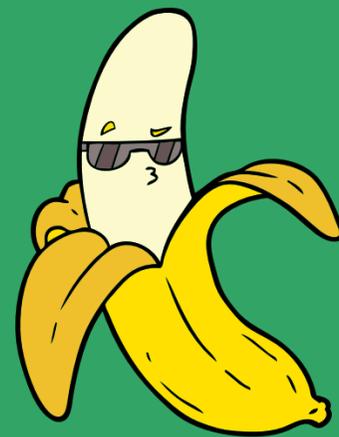
Paper 1 (SL/HL)

Part (a) 10-mark question

Marks	Level descriptor
0-10	
0	The work does not reach a standard described by the descriptors below.
1-2	<ul style="list-style-type: none">• The response indicates little understanding of the specific demands of the question.• Economic theory is stated but it is not relevant.• Economic terms are stated but they are not relevant.
3-4	<ul style="list-style-type: none">• The response indicates some understanding of the specific demands of the question.• Relevant economic theory is described.• Some relevant economic terms are included.
5-6	<ul style="list-style-type: none">• The response indicates understanding of the specific demands of the question, but these demands are only partially addressed.• Relevant economic theory is partly explained.• Some relevant economic terms are used appropriately.• Where appropriate, relevant diagram(s) are included.
7-8	<ul style="list-style-type: none">• The specific demands of the question are understood and addressed.• Relevant economic theory is explained.• Relevant economic terms are used mostly appropriately.• Where appropriate, relevant diagram(s) are included and explained.
9-10	<ul style="list-style-type: none">• The specific demands of the question are understood and addressed• Relevant economic theory is fully explained.• Relevant economic terms are used appropriately throughout the response.• Where appropriate, relevant diagram(s) are included and fully explained

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