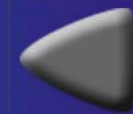


# Combining Supply and Demand

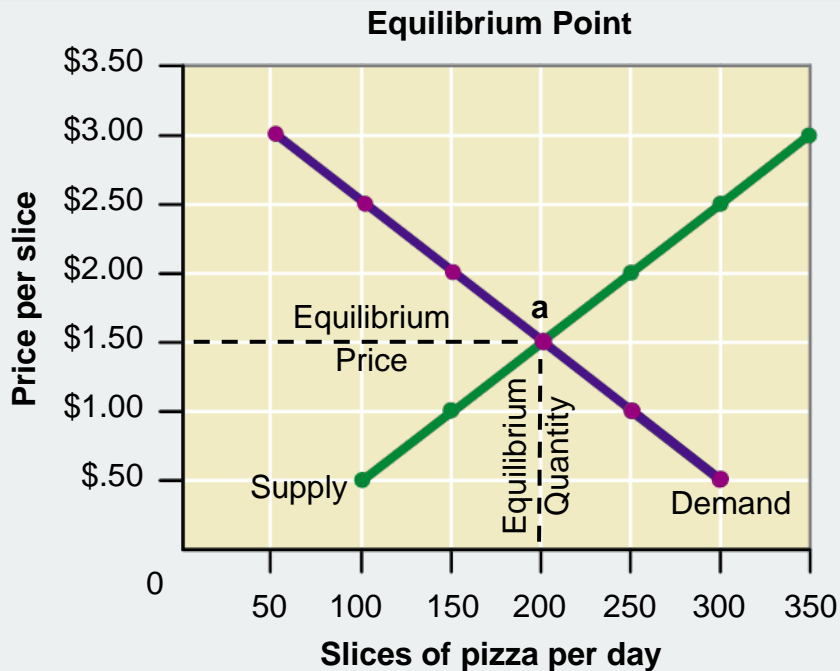
- **How do supply and demand create balance in the marketplace?**
- **What are differences between a market in equilibrium and a market in disequilibrium?**
- **What are the effects of price ceilings and price floors?**



# Balancing the Market

The point at which quantity demanded and quantity supplied come together is known as **equilibrium**.

## Finding Equilibrium



**Combined Supply and Demand Schedule**

Price of a slice of pizza	Quantity demanded	Quantity supplied	Result
\$ .50	300	100	Shortage from excess demand
\$1.00	250	150	
\$1.50	200	200	Equilibrium
\$2.00	150	250	Surplus from excess supply
\$2.50	100	300	
\$3.00	50	350	



# Market Disequilibrium

If the market price or quantity supplied is anywhere but at the equilibrium price, the market is in a state called **disequilibrium**. There are two causes for **disequilibrium**:

## Excess Demand

- Excess demand occurs when quantity demanded is more than quantity supplied.

## Excess Supply

- Excess supply occurs when quantity supplied exceeds quantity demanded.

Interactions between buyers and sellers will always push the market back towards equilibrium.



# Price Ceilings

In some cases the government steps in to control prices. These interventions appear as price ceilings and price floors.

- A **price ceiling** is a maximum price that can be legally charged for a good.
- An example of a price ceiling is rent control, a situation where a government sets a maximum amount that can be charged for rent in an area.



# Price Floors

- A **price floor** is a minimum price, set by the government, that must be paid for a good or service.
- One well-known price floor is the **minimum wage**, which sets a minimum price that an employer can pay a worker for an hour of labor.



# Section 1 Assessment

1. Equilibrium in a market means which of the following?
  - (a) the point at which quantity supplied and quantity demanded are the same
  - (b) the point at which unsold goods begin to pile up
  - (c) the point at which suppliers begin to reduce prices
  - (d) the point at which prices fall below the cost of production
2. The government's price floor on low wages is called the
  - (a) market equilibrium
  - (b) base wage rate
  - (c) minimum wage
  - (d) employment guarantee

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# Changes in Market Equilibrium

- **How do shifts in supply affect market equilibrium?**
- **How do shifts in demand affect market equilibrium?**
- **How can we use supply and demand curves to analyze changes in market equilibrium?**



# Shifts in Supply

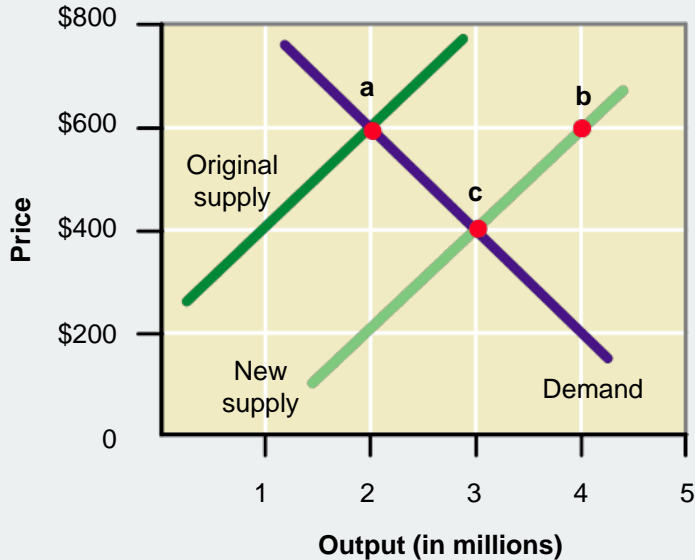
- **Understanding a Shift**
  - **Since markets tend toward equilibrium, a change in supply will set market forces in motion that lead the market to a new equilibrium price and quantity sold.**
- **Excess Supply**
  - **A surplus is a situation in which quantity supplied is greater than quantity demanded. If a surplus occurs, producers reduce prices to sell their products. This creates a new market equilibrium.**
- **A Fall in Supply**
  - **The exact opposite will occur when supply is decreased. As supply decreases, producers will raise prices and demand will decrease.**

# Shifts in Demand

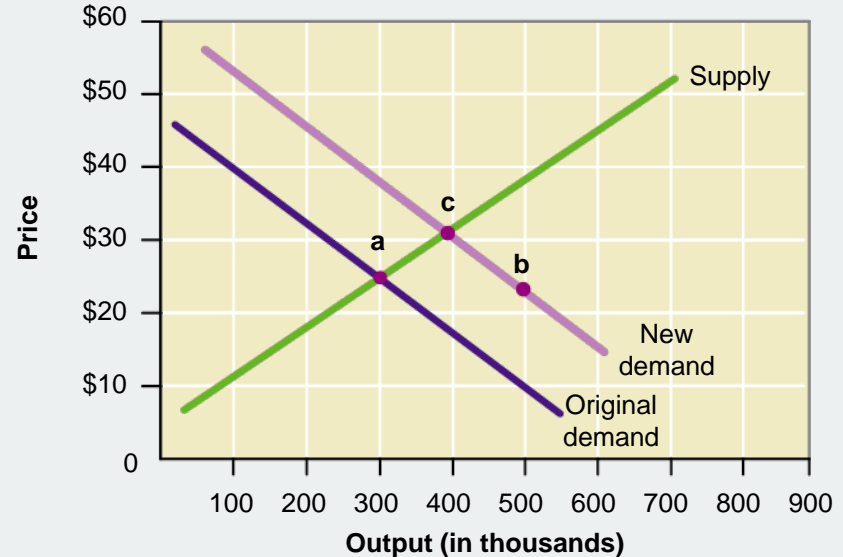
- **Excess Demand**
  - A shortage is a situation in which quantity demanded is greater than quantity supplied.
- **Search Costs**
  - Search costs are the financial and opportunity costs consumers pay when searching for a good or service.
- **A Fall in Demand**
  - When demand falls, suppliers respond by cutting prices, and a new market equilibrium is found.

# Analyzing Shifts in Supply and Demand

Graph A: A Change in Supply



Graph B: A Change in Demand



- Graph A shows how the market finds a new equilibrium when there is an increase in supply.
- Graph B shows how the market finds a new equilibrium when there is an increase in demand.

# Section 2 Assessment

1. When a new equilibrium is reached after a fall in demand, the new equilibrium has a
  - (a) lower market price and a higher quantity sold.
  - (b) higher market price and a higher quantity sold.
  - (c) lower market price and a lower quantity sold.
  - (d) higher market price and a lower quantity sold.
2. What happens when any market is in disequilibrium and prices are flexible?
  - (a) market forces push toward equilibrium
  - (b) sellers waste their resources
  - (c) excess demand is created
  - (d) unsold perishable goods are thrown out

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# The Role of Prices

- **What role do prices play in a free market system?**
- **What advantages do prices offer?**
- **How do prices allow for efficient resource allocation?**



# The Role of Prices in a Free Market

- **Prices serve a vital role in a free market economy.**
- **Prices help move land, labor, and capital into the hands of producers, and finished goods in to the hands of buyers.**
- **Prices create efficient resource allocation for producers and a language that both consumers and producers can use.**



# Advantages of Prices

## Prices provide a language for buyers and sellers.

### 1. Prices as an Incentive

Prices communicate to both buyers and sellers whether goods or services are scarce or easily available. Prices can encourage or discourage production.

### 2. Signals

Think of prices as a traffic light. A relatively high price is a green light telling producers to make more. A relatively low price is a red light telling producers to make less.

### 3. Flexibility

In many markets, prices are much more flexible than production levels. They can be easily increased or decreased to solve problems of excess supply or excess demand.

### 4. Price System is "Free"

Unlike central planning, a distribution system based on prices costs nothing to administer.



# Efficient Resource Allocation

- **Resource Allocation**
  - A market system, with its fully changing prices, ensures that resources go to the uses that consumers value most highly.
- **Market Problems**
  - Imperfect competition between firms in a market can affect prices and consumer decisions.
  - **Spillover costs**, or externalities, are costs of production, such as air and water pollution, that “spill over” onto people who have no control over how much of a good is produced.
  - If buyers and sellers have imperfect information on a product, they may not make the best purchasing or selling decision.



# Section 3 Assessment

1. What prompts efficient resource allocation in a well-functioning market system?
  - (a) businesses working to earn a profit
  - (b) government regulation
  - (c) the need for fair allocation of resources
  - (d) the need to buy goods regardless of price
2. How do price changes affect equilibrium?
  - (a) Price changes assist the centrally planned economy.
  - (b) Price changes serve as a tool for distributing goods and services.
  - (c) Price changes limit all markets to people who have the most money.
  - (d) Price changes prevent inflation or deflation from affecting the supply of goods.

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