- Bharathi

What is a Market?

- A market is an institution through which buyers and sellers interact and engage in exchange.
- If buyers want to buy more of a good, prices rise and sellers respond by supplying more to the marketplace.
- If buyers want to buy less of a good, prices fall and sellers respond by supplying less to the marketplace.
- The market mechanism allows an economy to solve the three economic problems of what, how, and for whom.

The Economic Problem

- Unlimited Wants
- ☐ Limited Resources
- ☐ Many Uses of Resources
- ☐ Problem of Choice

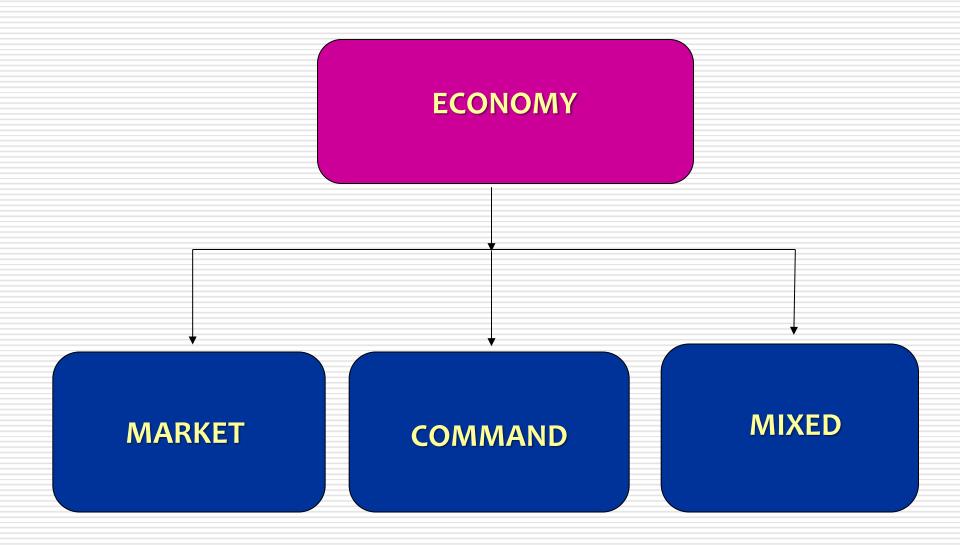


The Economic Problem

- What goods and services should an economy produce?
 - should the emphasis be on agriculture, manufacturing or services, should it be on sport and leisure or housing?
- How should goods and services be produced?
 labour intensive, capital intensive?
- Who should get the goods and services produced?
 - Even distribution? More for the rich? For those who work hard?

Economic Problem

- ☐ The economic problem: Given scarce resources, how, exactly, do large, complex societies go about answering the three basic economic questions?
- To answer the three basic questions we need to look into the economic systems.
- Economic systems are the basic arrangements made by societies to solve the economic problem.



WHAT TO PRODUCE Determined by consumer's preferences

Market economy

HOW TO PRODUCE Determined by producers seeking profits

FOR WHOM TO PRODUCE

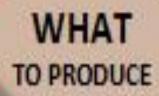
Determined by purchasing power WHAT TO PRODUCE Determined by government preferences

Command economy

HOW TO PRODUCE Determined by government and their employees

FOR WHOM TO PRODUCE

Determined by government preferences



Determined partly by consumer preferences and partly by government

Mixed economy

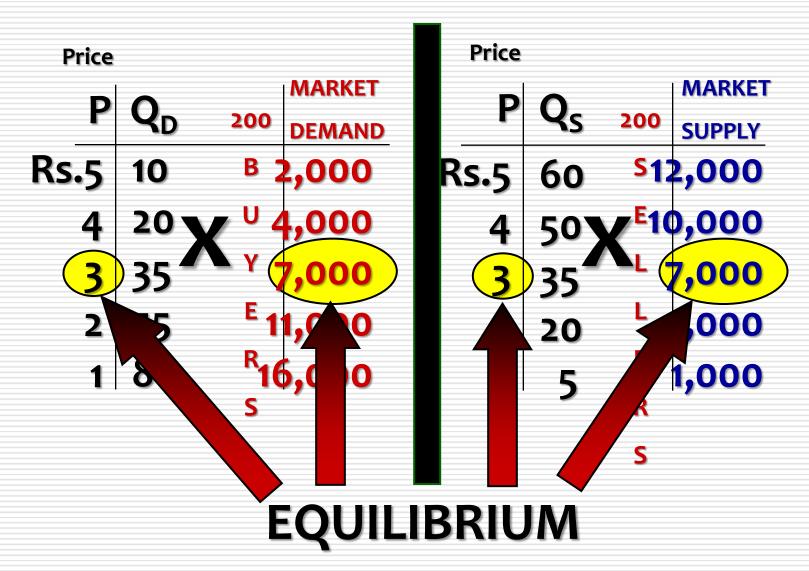
HOW TO PRODUCE Determined partly by producers seeking profits and partly by government

FOR WHOM TO PRODUCE

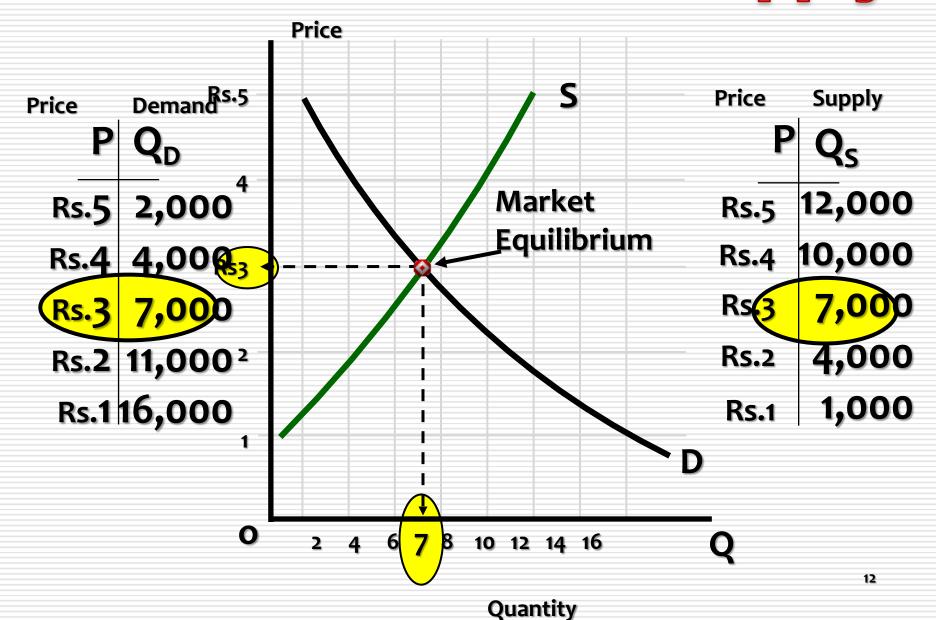
Determined partly by purchasing power and partly by government preference

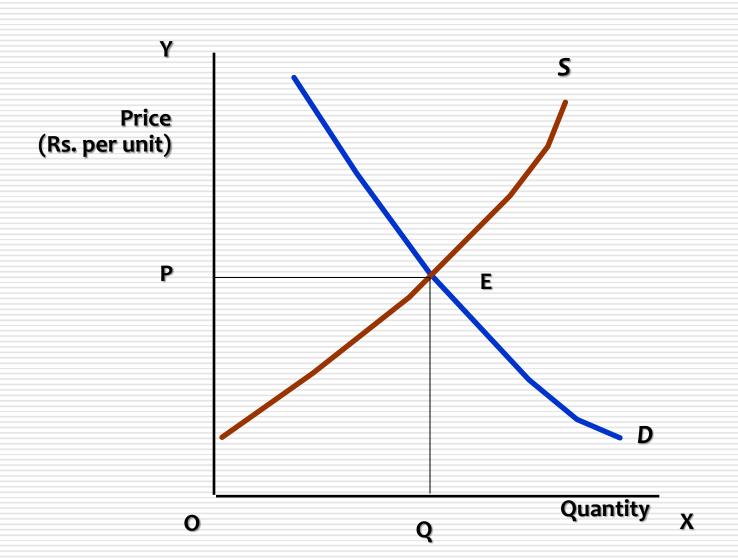
- Market Mechanism Summary
 - 1) Supply and demand interact to determine the equilibrium price.
 - 2) When not in equilibrium, the market will adjust to a shortage or surplus and return to the equilibrium.
 - 3) Markets must be competitive for the mechanism to be efficient.

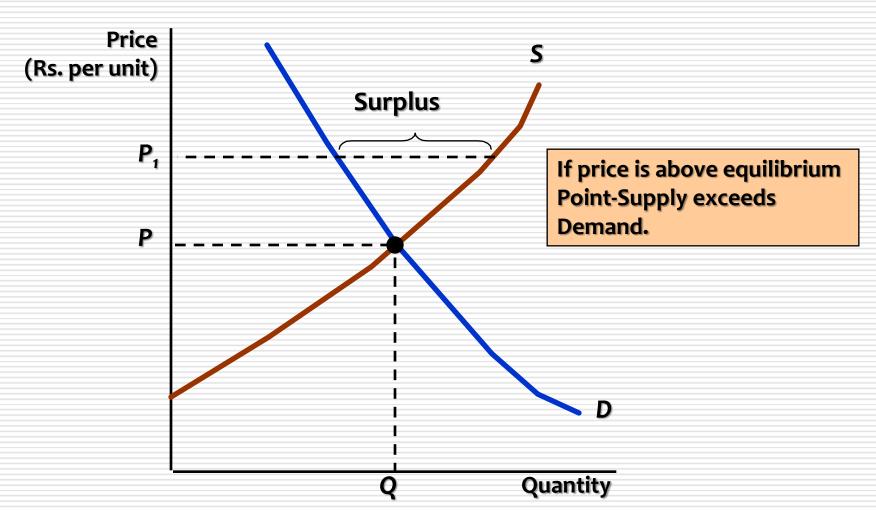
Market Demand & Supply

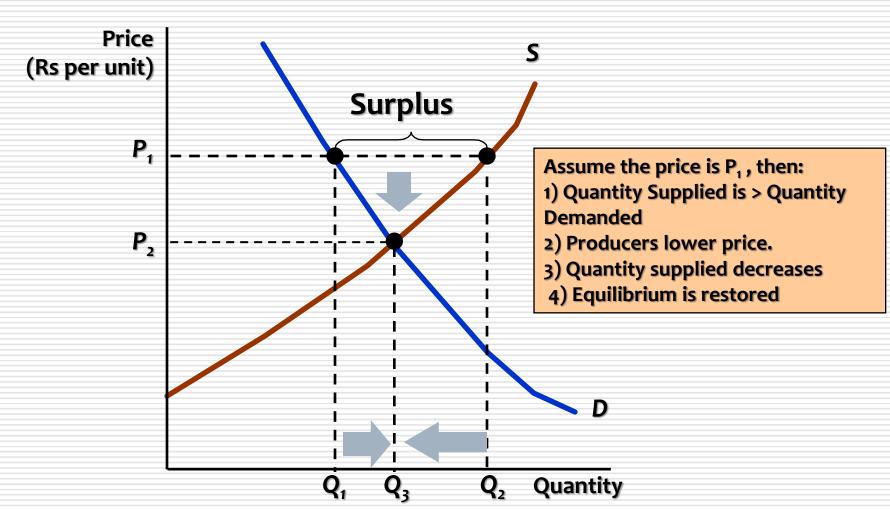


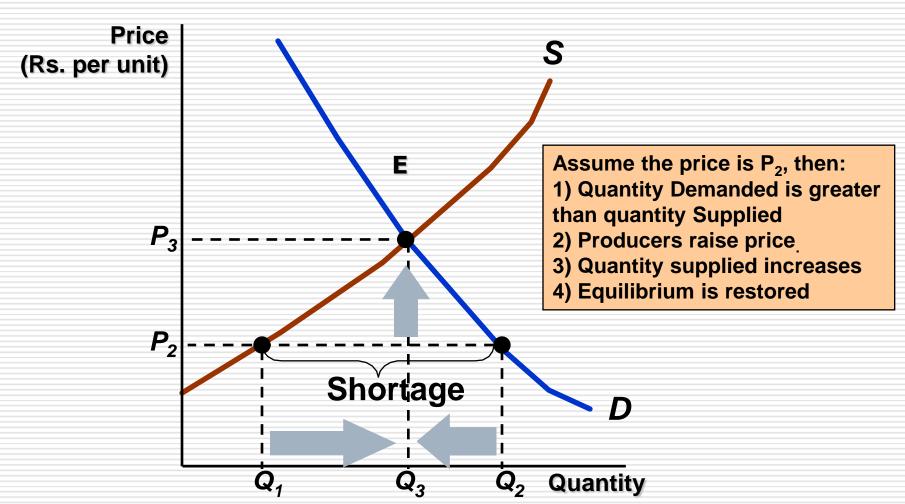
Market Demand & Supply



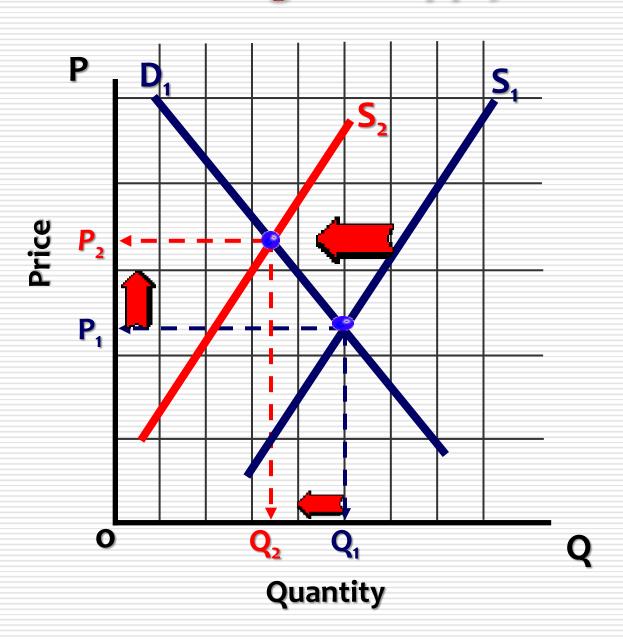




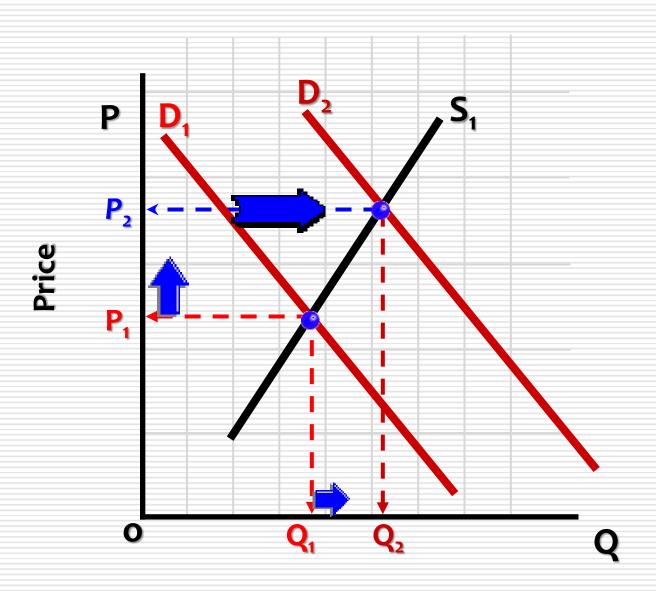


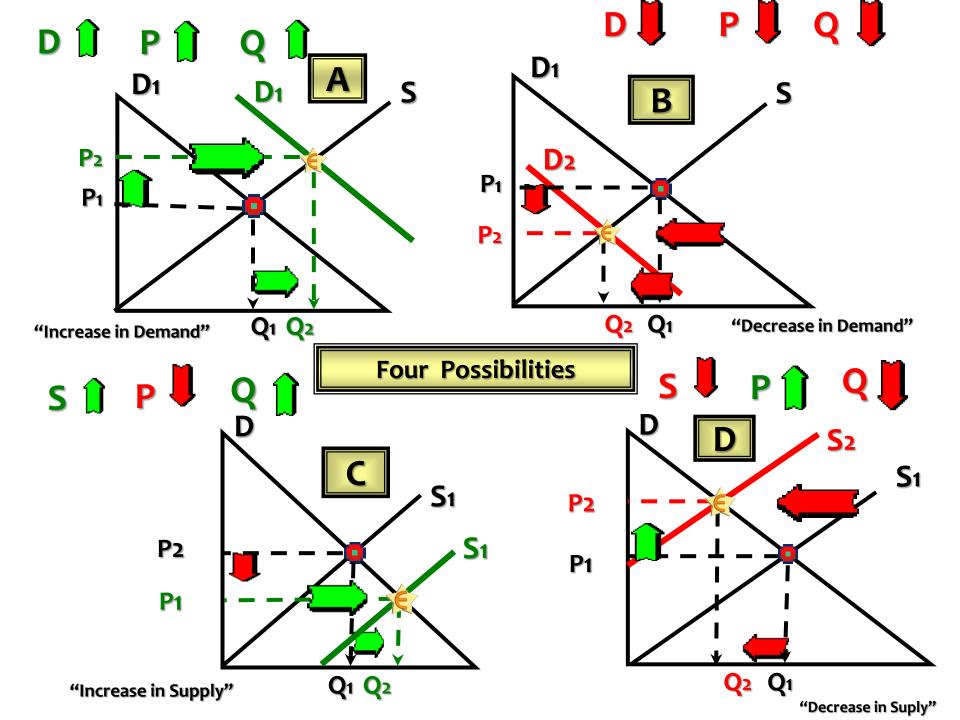


Change in Supply

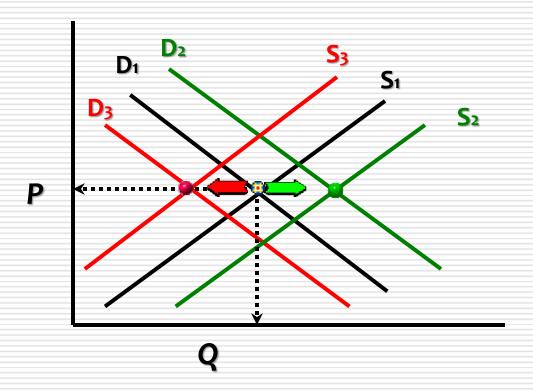


Change in Demand



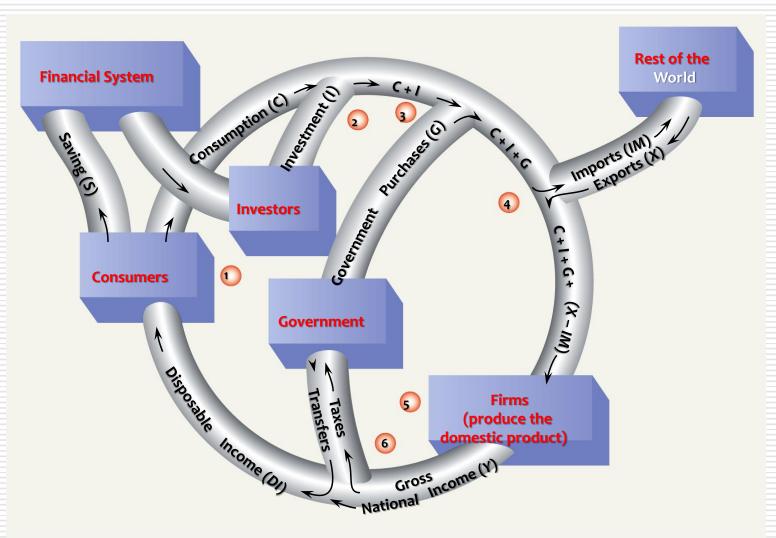


Change in Supply = Change in Demand

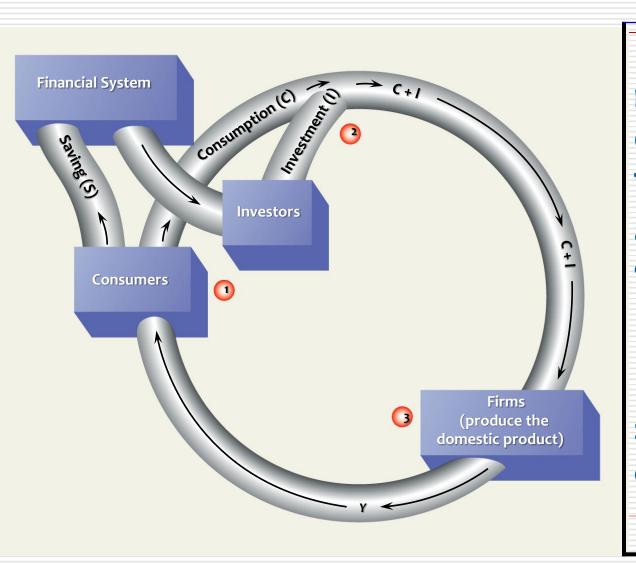


The Circular Flow of Income

The Circular Flow



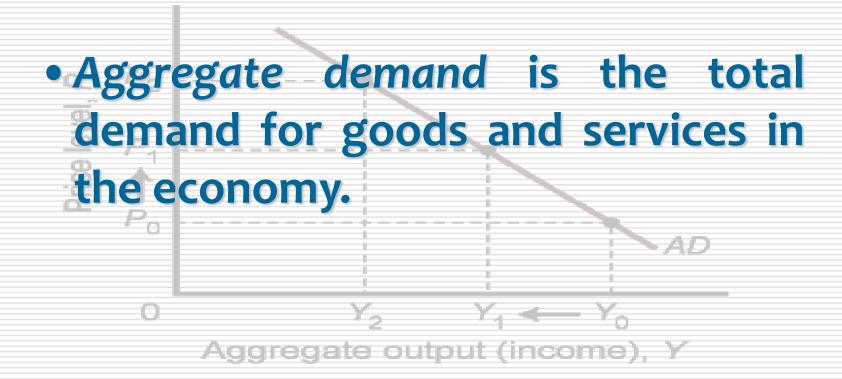
A simplified Circular Flow



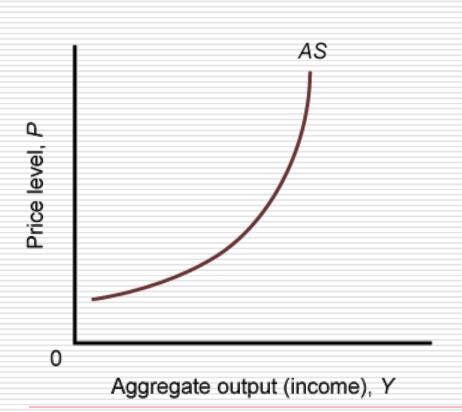
Even in a simple model with out Government or Trade in order to be at full employment 'S' must be equal 'I'

Do we need someone to coordinate them?

The Aggregate Demand

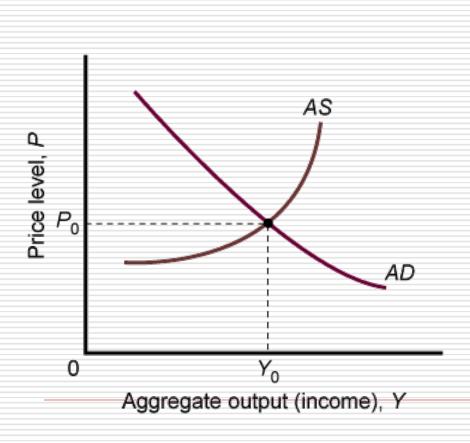


The Aggregate Supply



☐ In the short run, the aggregate supply curve has a positive slope.

The Equilibrium Price Level



☐ The equilibrium price level is the point at which the aggregate demand and aggregate supply curves intersect.

Effects of Government Intervention Price Controls

If the Government decides that the equilibrium price is too high, they may establish a maximum allowable ceiling price.

TAX SHIFTING AND THE ELASTICITIES OF DEMAND AND SUPPLY

- When a product is taxed, who ultimately shoulders the tax burden depends upon the elasticity of demand and supply of the product taxed.
- Usually the tax burden is shared between producers and consumers.
- Consumers pay more of the tax, if demand is relatively less elastic than supply
- Producers pay more of the tax if demand is relatively more elastic than supply.

Price Ceilings and Price Floors

□ Price Ceiling

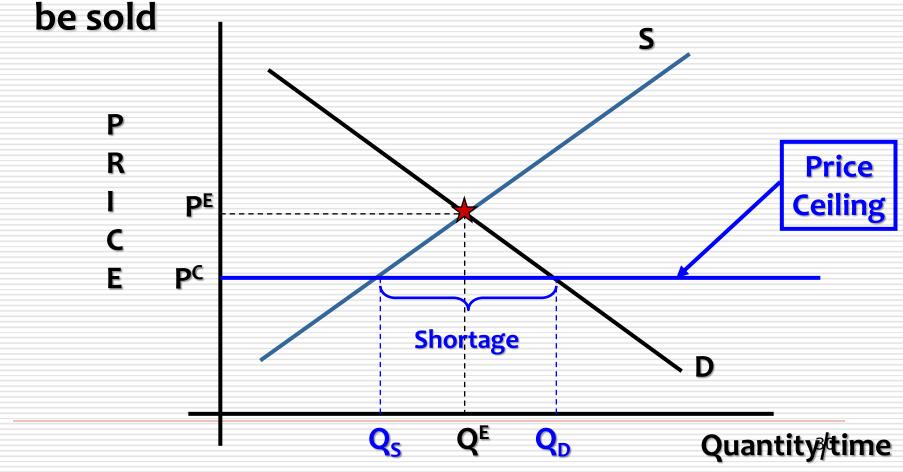
is a legally established maximum price which a seller can charge or a buyer must pay.

☐ Price Floor

is a legally established minimum price which a seller can charge or a buyer must pay.

Price Ceilings

☐ The Government imposes a price ceiling i.e., a legal maximum price at which a good can

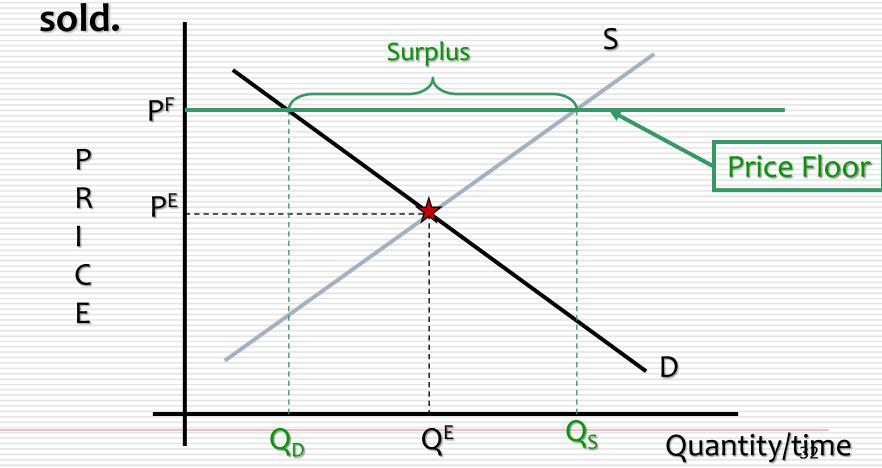


Market Impacts of a Price Ceiling

- A Binding Price Ceiling creates...
 - Shortages (QD > QS)
 - Shortages create:
 - Queuing
 - Discrimination criteria set by sellers
 - Bundled pricing with other goods
 - □ Bribery/corruption

Price Floors

☐ The Government imposes a price floor i.e., a legal minimum price at which a good can be



Market Impacts of a Price Floor

- ☐ A Price Floor creates. . .
 - Surpluses (QS > QD)
 - Surpluses create:
 - ☐ Discrimination criteria set by buyers
 - Examples:
 - Agricultural Price Supports

