What is a market?

- A market definition specifies the competing products (close demand or supply substitutes) & geographic area in which competition occurs that determines the price for a given product.

- A space where buyers and sellers meet to determine the quantities & prices at which goods or services exchange.
Why market exchange?

Because it facilitates change – markets do not require every buyer communicating exact specifications to every possible seller – it is more efficient.
What are the alternatives?

- Exchange in a command or directed economy
  - Requires the central authority to have information on buyers’ preferences, suppliers’ inputs & production facilities and a matching of those
  - Informational requirements huge
Then why do firms exist?

- Firms represent a type of command economy – conscious coordination of production decisions
  - Type/characteristics of product, method of production, quantities, price
- If this is inefficient, then why do firms exist?
  - Because of transaction costs
What are the elements of a market?

Two sides to a market

- Buyers: they have a demand for a particular good or service
- Sellers: they provide the supply of a particular good or service

The two sides interact to determine the prices & quantities exchanged
Price-taking behaviour

- As a consumer, do I have any say over the price I pay??
  - In most cases, no
    - I accept price as given by the seller
  - In some cases, I can obtain reductions in price
- Why?
Price-taking behaviour

As a seller, do I have any influence over price??

Most would say “Yes, I set the price.”

However, your ability to do this is limited by:
  – how much consumers are willing to pay
  – what other producers are charging
Price-takers

- Price takers do not have influence over price - they take it as given by the market place

- Whether or not firms or buyers are price takers depends on the number of other buyers & sellers
How are prices determined in the market?

- The process of markets moving toward equilibrium prices & quantities occurs as buyers accept or reject the quantities on offer at the prices put forward by the sellers.

- When a particular price clears the market, we have a market equilibrium.
What is the equilibrium mechanism?

- If demand is insufficient at existing prices, producers will lower the price to encourage greater demand.
- If demand is too great at existing prices, producers will raise prices as a way to ration the existing output.
What is behind the change in prices?

A basic property of demand: when prices rise, other things being equal, the total quantity demanded falls.

Why?
- If the price falls, the opportunity cost of obtaining the good falls, so consumers are willing to buy more.
An example

<table>
<thead>
<tr>
<th>Price</th>
<th>Quantity</th>
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<tbody>
<tr>
<td>$1.00</td>
<td>2</td>
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<td>12</td>
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<td>14</td>
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An alternative representation

Price

$1.10
$1.00
$0.90
$0.80
$0.70
$0.60
$0.50
$0.40
$0.30
$0.00

Quantity

2 4 6 8 10 12 14 16 18
Movement along the demand curve

If price changes we move along the demand curve.
Shifts in demand

If a factor other than price changes, this represents a shift in the demand curve.
What causes shifts in demand?

- Income
- Change in tastes, preferences
  - As a result of advertising/marketing?
- Changes in the price of complements
- Changes in the price of substitutes
- Changes in expectations
If we add up each individual’s demand at a particular price, we obtain the total market demand at that price.

If we do this for every possible price, then we derive the market demand curve.
Add up individual demand at each price to obtain the market demand curve:
At $0.70, market demand equals $4 + 9 = 13$
As prices rise, a greater quantity of goods is supplied, everything else equal.

Why?
- Because suppliers find it more profitable to sell more output when the price is higher, all else equal.
Determinants of supply

- Input prices: when input prices rise, firms will produce the same quantity only if prices rise.
- Technology: determines the cost of producing goods & services.
- Expectations: if prices are expected to rise, firms may hold off on putting goods on the market.
## A supply schedule

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Movements along the supply curve

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Going from individual supply to market supply

- Under certain conditions, if we add up each individual firm’s supply at a particular price, we obtain the total market supply at that price.

- If we do this for every possible price, then we derive the market supply curve.
Market supply

Add up individual supply at each price to obtain the market supply curve:
At $2.00, market supply equals 1 + 3 = 4
Shifts in the supply curve

If a factor other than price changes, this represents a shift in the supply curve.
What causes the supply curve to shift?

- Input prices: an increase in input prices causes the supply curve to shift up
  - Taxes: an increase in taxes causes supply curve to shift up
- Technology: a new technology may lower the cost of production, shifting the supply curve down
- Expectations: if prices are expected to rise, costs may go up today
- Number of sellers: more sellers shifts curve to right
Market equilibrium

The equilibrium price is determined by the intersection of market demand & supply.
Excess supply occurs when the price is too high: supply is greater than demand.
Excess demand occurs when the price is too low: demand is greater than supply.