Revision Notes

Class - 12 Micro Economics

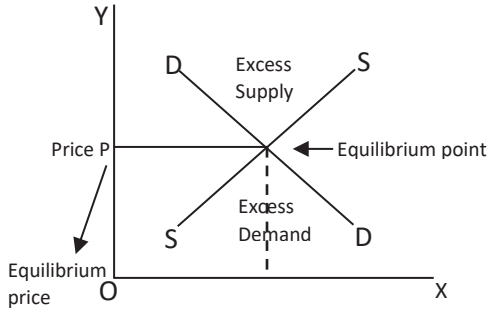
Chapter 5 – Market Equilibrium

Market: It is a mechanism or arrangement that brings buyers and sellers of a commodity or service together and allows them to complete the act of selling and buying the commodity or service at mutually agreed prices.

Market Equilibrium: It is a condition in which supply equals demand for a specific good. There is no tendency for prices to move while the market is in equilibrium. A competitive market is in balance at the market cost if the amount provided, i.e., the quantity supplied rises to the amount requested, i.e., the quantity demanded.
So, Equilibrium = uniformity of the amount supplied and the amount demanded.

Equilibrium Price: The equilibrium price is the price at which the amount demanded and supplied are equal. A condition of no change is termed equilibrium. So unmistakably, at the equilibrium price, both purchaser and vendor are in the situation of no change. Hypothetically, at this price, the amount of products demanded by purchasers is equivalent to the sum provided by the vendors. As a result, supply and demand are in sync with the equilibrium price. So, this can be considered as an example of equilibrium price.

Equilibrium Quantity: The term equilibrium quantity alludes to the number of goods provided in the marketplace when the amount provided by vendors precisely coordinates with the amount demanded by purchasers. It is an idea inside the branch of knowledge of market equilibrium or market balance and is identified with the idea of equilibrium price. In other terms, the equilibrium quantity is the quantity demanded and supplied at an equilibrium price.



Excess Demand: When the amount wanted exceeds the quantity supplied at the current price level, the market is said to be in excess demand. Excess demand arises at a lower price than equilibrium. Because prices would fall, it would operate as a lure for purchasers to come to markets, resulting in competition among them.

$Y^d > Y^s$

Here, Y^d = Market Demand and Y^s = Market Supply.

Excess Supply: Excess supply is a market condition in which the quantity supplied for a commodity is greater than the demand at the current market price. It happens at a higher price than the equilibrium price. Since the price will be higher than the equilibrium price, sellers will see this as an opportunity to increase their profits and will increase supply.

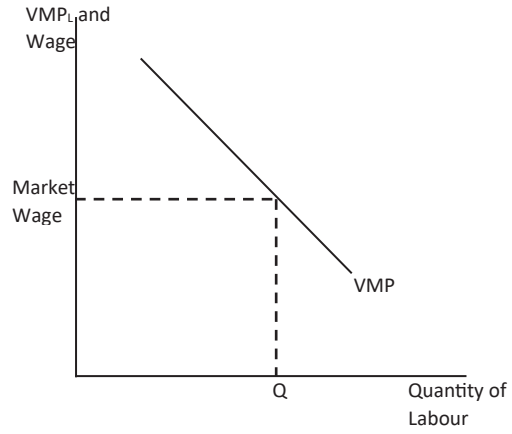
$Y^s > Y^d$

Here, Y^s = Market Supply and Y^d = Market Demand.

Marginal Revenue Product of Labour (MRP_L): It is the extra revenue a company can create by hiring one more employee. It is calculated by multiplying the labour marginal product by the output price. Until the MRPL equals the wage rate, firms will seek labour.

$MRP_L = MR \times MP_L$

Value of Marginal Product of Labour: The term "value of the marginal product of labour" has three potential interpretations. One is the "magnitude" of marginal product, which refers to the increase in physical output that comes with adding a new employee. In competitive output marketplaces, the more typical definition is the price of output times that size, which indicates the monetary worth of another worker to be contrasted against the marginal monetary cost of that person. In the third situation, the firm has some market power, therefore the physical marginal product is multiplied by marginal revenue. In every scenario, marginal benefits must be weighed against marginal costs.



Demand Shift: A shift in demand indicates that the quantity demanded will be different at any and all prices than it was previously.

Supply Shift: A shift in the supply curve caused by a change in supply generates a market imbalance that is addressed by altering pricing and demand. The supply curve shifts to the right as the change in supply increases, whereas the supply curve shifts to the left as the change in supply decreases.

Simultaneous Shifts of Demand and Supply:
Four potential ways in which the simultaneous shifts can happen:
a. The supply and demand curves both shift to the right.
b. The supply and demand curves both shift to the left.
c. The supply curve shifts to the left, while the demand curve shifts to the right.
d. The supply curve shifts to the right, whereas the demand curve shifts to the left.

Viable Industry: These industries are known as viable industries since their equilibrium can be identified. Manufacturing is one example of a viable industry.

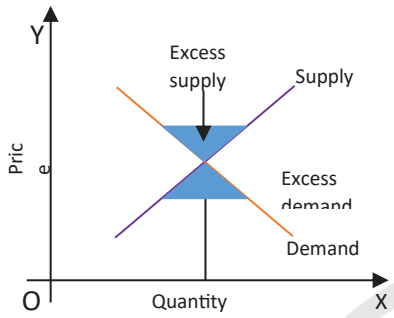
Non-viable Industry: The demand and supply curves of a non-viable industry do not intersect at any positive quantity. It's an industry where the costs are too high to achieve any beneficial results.

Price Ceiling: The practise of fixing the price of particular required products at a lower level so that they might be made available to the poor is known as setting a price ceiling. The Indian government sets a price ceiling on basic necessities that should be available to the poor. Rice, wheat, sugar, kerosene, and lentils are just a few examples.

The effects of imposing a price ceiling:
a) Imposing a price ceiling causes an uncontrollable increase in demand. People are more inclined to raise their demand for such things if the price is lower.
b) Poor consumers do not have unlimited access to products. For certain commodities, a quota has been set.
The goods given under the price ceiling scheme are typically of lower quality.

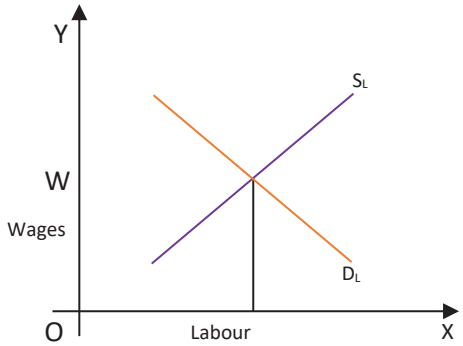
Price Floor: At the point when the price charged is more prominent than or less than the equilibrium value set by market influences of interest and supply, it is alluded to as a price floor. Lower price floors have been demonstrated to be unsuccessful through observation. The importance of a price floor in the labour market has been discovered.

Price Determination in Perfect Market Competition: Price is determined by market demand and supply in a perfectly competitive market. The aggregate of all individual market requests is known as market demand. The aggregate of all individual supply schedules in the market is also known as market supply. The cost in a totally competitive market is controlled by the crossing point of market supply and market demand.
Graphical representation of price determination in perfect competitive market:



The price is decided at the point where the market demand curve intersects the market supply curve, as shown in the diagram above. As seen in the diagram, every position above the equilibrium price provides excess supply, whereas any point below the equilibrium price creates excess demand.

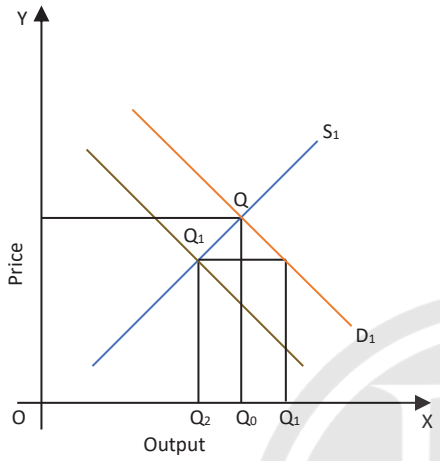
Wage Determination in Perfect Competitive Labour Market: The wage rate is determined by the equilibrium of labour demand and supply. The marginal product of labour is a key factor in determining labour demand. The wage rate is equal to the marginal revenue product of labour, which is determined by the demand for and supply of labour. As a result, in a perfect labour market, a firm will employ the amount of labour at which the wage rate equals the MRP of labour.
A graphical representation of Wage Determination in Perfect Competitive Labour Market:



Effects of Income on Price and Quantity Equilibrium:

a. If the number of businesses in the market remains constant, an increase in consumer income leads to an increase in the equilibrium price. With an increase in their income, consumers are more inclined to raise their demand. When demand rises, the equilibrium price rises as well.

A graphical representation of the effects of rising income levels on equilibrium price and quantity:



b. If the number of consumers remains constant, a fall in consumer income results in a decrease in the equilibrium price. In the market, firms are constant. As a result of their lower income, consumers are more inclined to reduce their demand. Due to the availability of extra supply in the market, a drop in demand induces a drop in the equilibrium price.

A graphical representation of the effects of declining income levels on equilibrium price and quantity: