

3. MARKET EQUILIBRIUM AND EFFICIENCY

3.1 Equilibrium

We can combine demand and supply to analyze markets more completely.

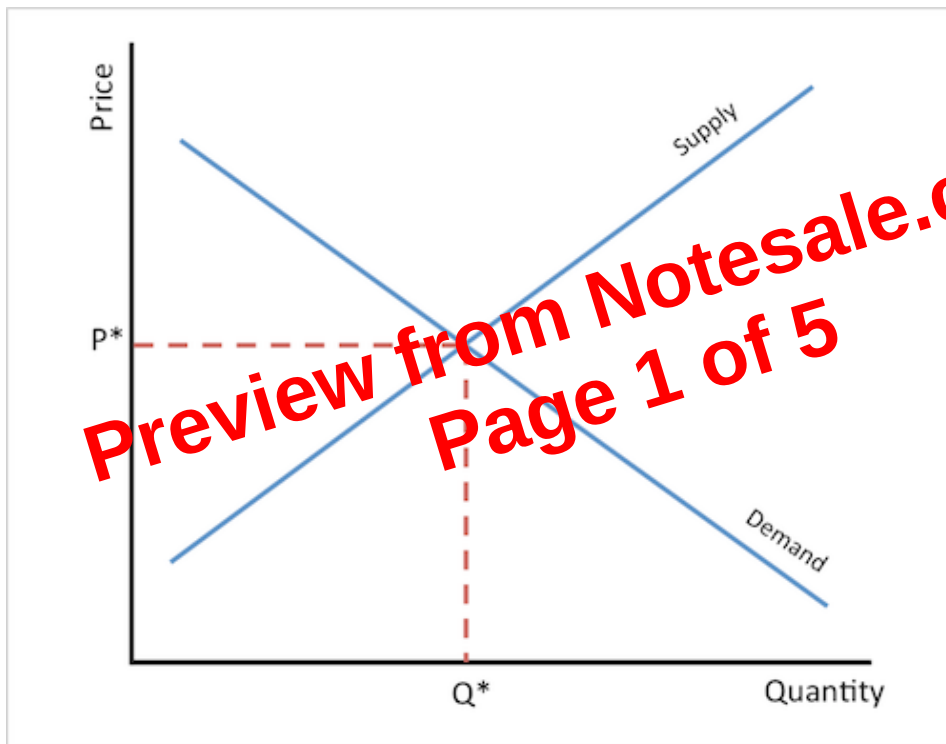
--> tendency for the market to reach an equilibrium state

Market equilibrium: the state in which the quantity supplied is equal to the quantity demanded

- The price at this point is called equilibrium price

The amount purchased is exactly equal to the amount sold. There is no surplus product nor are there shortage of supply at that price. --> Also called the "market-clearing price" because market clears all output at that price

Prices above or below the market price --> market disequilibrium --> excess demand/supply



Market Disequilibrium

- Any price at which the demand and supply quantities are not equal

Excess supply

As price increases, the quantity demanded decreases or moves upwards and left along the demand curve

the quantity supplied increases

What happens to this surplus? Producers lower price to sell the extra goods. As they do, more quantity is demanded and producers reduce the production.