Prices

Chapter 6

Combining Supply and Demand

Section 1

1. What is unique about an equilibrium price?

- The equilibrium price is unique because it is the point where price and amount supplied are equal to the price and amount demanded

2. What situation can lead to excess demand?

- Excess demand occurs when the quantity demanded is more that the quantity supplied. This can occur when the actual price in a market is lower than the equilibrium price.

3. How is a price floor different than a price ceiling?

- A price floor is a government set minimum price for certain goods or services.
  - minimum wage
- A price ceiling is a government set maximum price that can be charged for a good or service
  - Rent control

4. How does rent control work?

- Rent control is a price ceiling placed on rent that is often motivated by a desire to help poor households by cutting their housing costs

5. According to the databank on pg. 536, suppose the government raised the minimum wage to $600 week. (a) What category of jobs is affected least? (b)What categories are most affected? (c) What are the likely consequences for workers?

a. Managerial and professional
b. Farming, forestry, and fishing service
c. Wages will probably increase but some may lose their jobs as companies cut back to save money

6. What are the benefits and drawbacks of a price ceiling?

Price ceilings benefit lower-income people by keeping prices from rising beyond their means.

Drawbacks include possible shortages, such as waiting lists for apartments

Changes in Market Equilibrium

Section 2

1. What conditions lead to a surplus?

- Surpluses are caused by shifts in the supply curve, which cause the quantity supplied to exceed quantity demanded. Surpluses can also occur if consumers demand far less of a good that they did previously.

2. What is an example of a search cost?

- An example of a search cost is the time and gas money spent looking for a hard to find item

3. Explain how the equilibrium price and the quantity sold of eggs will change in the following cases. (a) Food poisoning traced to eggs (b)New chicken can lay twice as many eggs (c) Popular host starts eating eggs

a. Quantity sold decreases: equilibrium price decreases (I question this…it assumes the decrease in demand will be greater the decrease in supply
b. Quantity sold may increase; equilibrium price decreases
c. Quantity sold increases; equilibrium price increases

4. What will happen to suppliers in a market if there is a surplus of the good they sell, but no supplier can afford to lower prices?

- Suppliers will be at the mercy of the product's elasticity of demand.
  - If demand is inelastic, they should be able to sell the product at the price they have been asking and will need to adjust production to make sure they do not produce more of it until the surplus is gone
  - If demand is elastic, they may be stuck with the surplus unless some other market factor increases sales

5.

a. Increased, the curve has shifted to the right
b. Original equilibrium price is $20; original quantity sold is 150
c. New equilibrium price is $25; new quantity sold is 180
d. The supply curve will shift to the left

The Role of Prices

Section 3

1. How does a supply shock affect equilibrium price and quantity?

- Supply shock will cause the market to move into a brief disequilibrium and will usually cause an increase in the price of the good thus decreasing the quantity demanded

2. How is rationing different from a price based market system?

- Rationing distributes scarce goods and services according to criteria other than price, so it is the exact opposite of a price based economy

3. List three reasons why a price based system works more efficiently than central planning.

1. Price based systems allow for flexibility in the marketplace between consumers and suppliers
2. Price based systems allow for a larger selection of goods and services
3. Command economies are very inefficient at delivering consumer goods to the marketplace despite their lower prices

4. Give two examples of situations in which prices gave you an incentive to purchase or not purchase a good or service.

- Me personally:
  - Bought first flat-screen plasma TV due to Black Friday sale
  - Prices play a vital role in my 1.25 liter sodas…99cents is cheaper than $1.69 for a one liter

6. What do you think Adam Smith would think of rationing?

- Adam Smith would be against any form of rationing because it goes against his theory of the "invisible hand" guiding the market