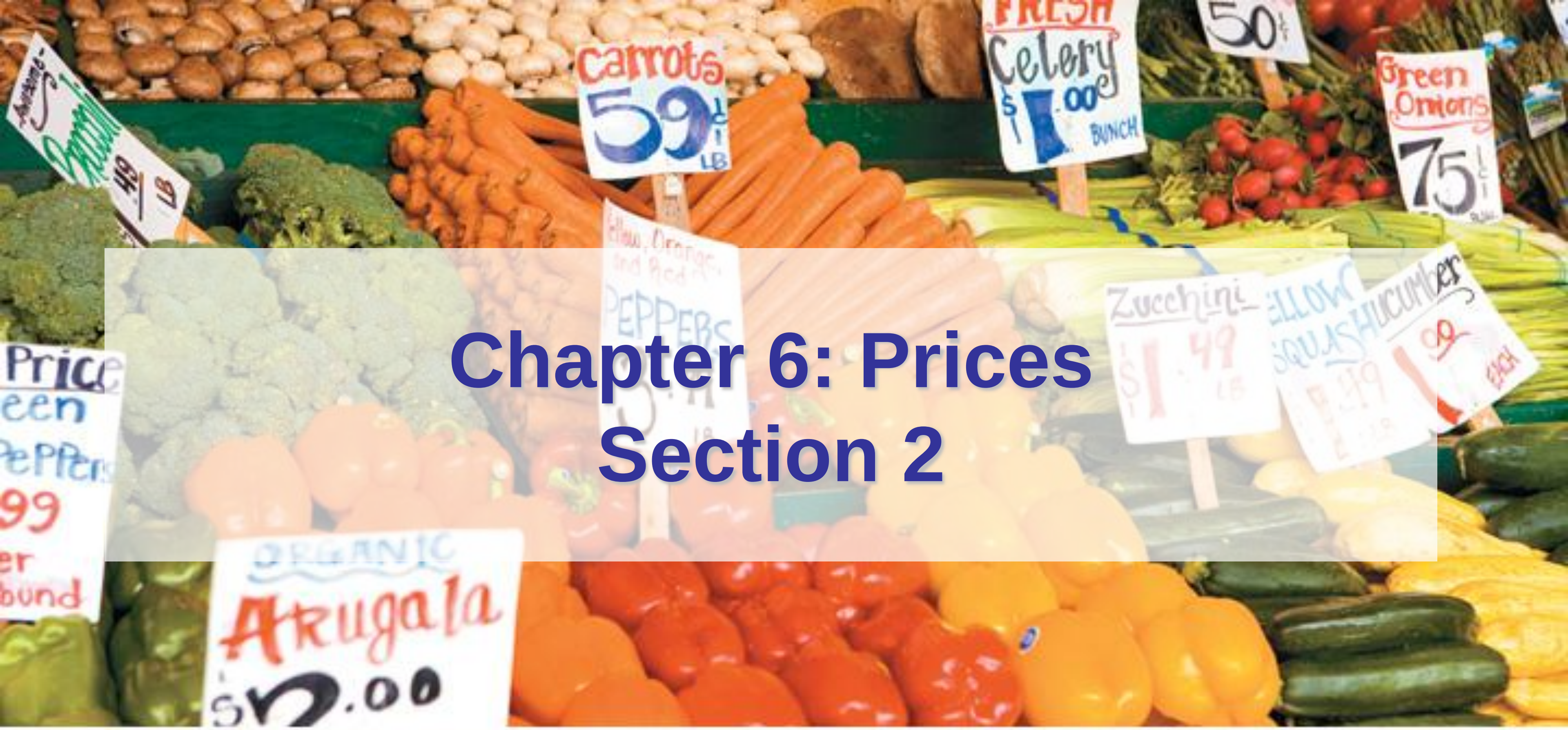

Chapter 6: Prices
Section 2

Prentice Hall
ECONOMICS

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Objectives

1. **Explain** why a free market naturally tends to move toward equilibrium.
2. **Analyze** how a market reacts to an increase or decrease in supply.
3. **Analyze** how a market reacts to an increase or decrease in demand.

Key Terms

ECONOMICS

- **inventory**: the quantity of goods that a firm has on hand
- **fad**: a product that is popular for a short period of time
- **search costs**: the financial and opportunity costs that consumers pay when searching for a good or service

Introduction

- How do changes in supply and demand affect equilibrium?
  - Changes in supply and demand cause prices to go up and down, which disrupts the equilibrium for a particular good or service.
  - In a free market, price and quantity will tend to move toward equilibrium whenever they find themselves in disequilibrium.

Equilibrium

- When a market is in disequilibrium, it experiences either shortages or surpluses, both of which will eventually lead the market back toward equilibrium.
  - Shortages cause a firm to raise its prices. Higher prices cause the quantity supplied to rise and the quantity demanded to fall until the two values are equal again.
  - The same holds true for a surplus, only in reverse: Surpluses cause a firm to drop its prices. Lower prices cause the quantity supplied to fall and the quantity demanded to rise until equilibrium is restored.

Increase in Supply

- A shift in the supply curve will change the equilibrium price and quantity.
- As supply increases, it will cause the market to move toward a new equilibrium price.
- An example of a product that saw a radical market change in recent years is the digital camera.

Falling Prices and the Supply Curve

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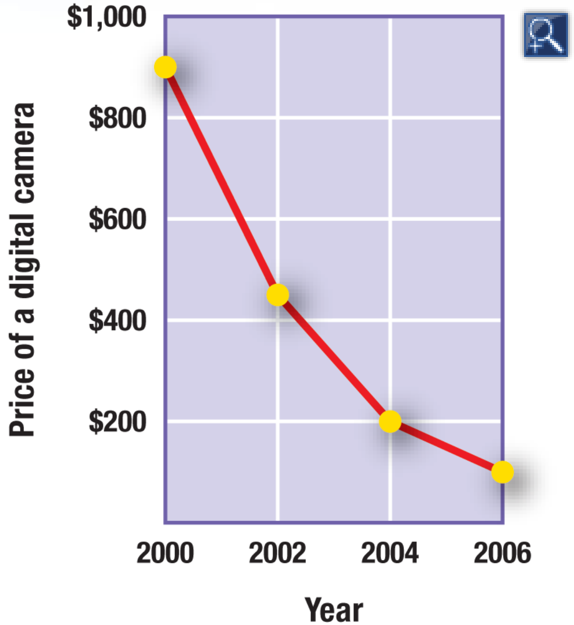
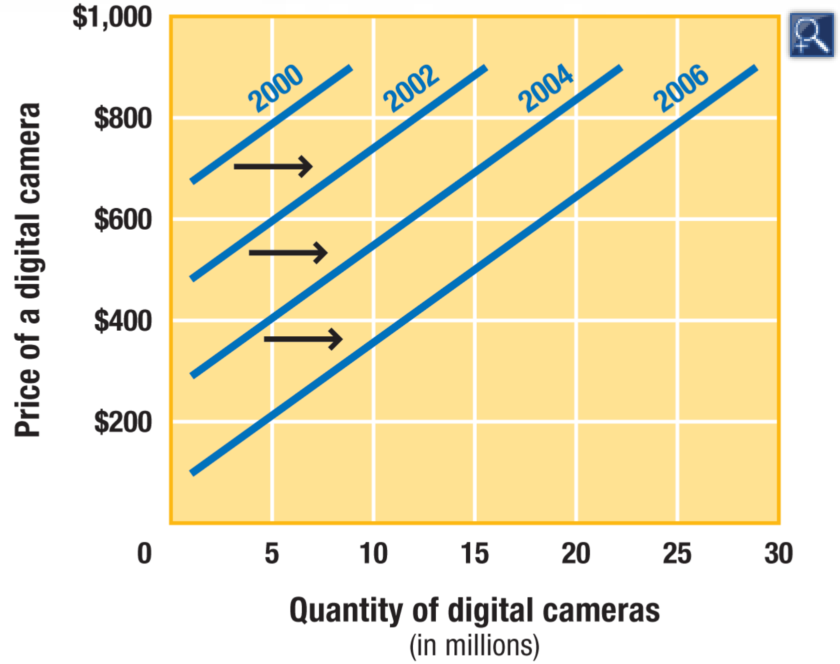
Falling Prices*



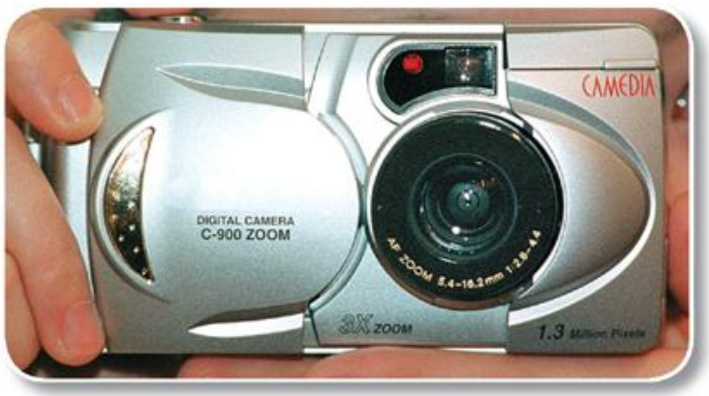
Shifting Supply Curve*



Action Graph online

*Estimated data for a mid-priced digital camera

A 1.3 megapixel digital camera sold for $650 in 1998.



Changes in Supply

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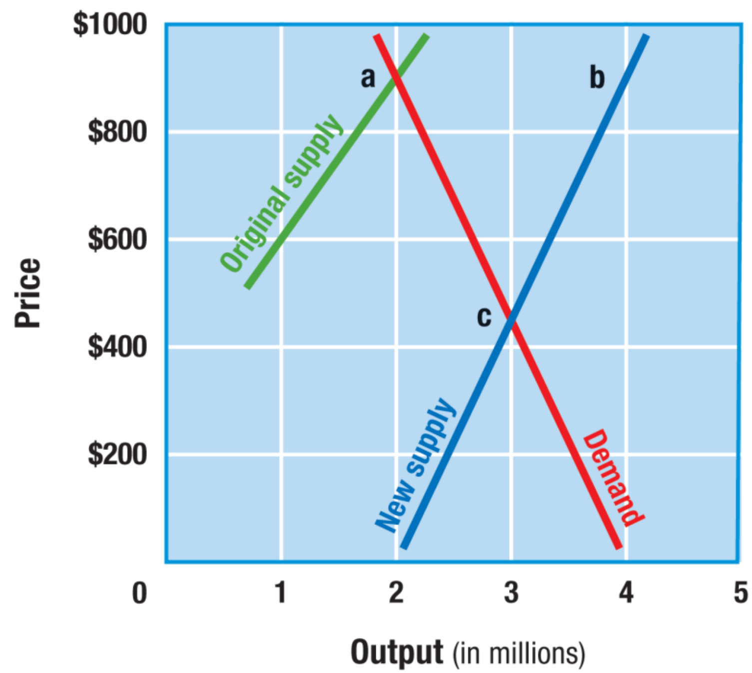
- Checkpoint: What happens to the equilibrium price when the supply curve shifts to the right?
  - An increase in supply shifts the supply curve to the right.
  - This shift throws the market into disequilibrium.
  - Something will have to change in order to bring the market back to equilibrium.



Action Graph online

A “Moving Target”

- Equilibrium for most products is in constant motion.

- Think of equilibrium as a “moving target” that changes as market conditions change. As supply or demand increases or decreases, a new equilibrium is created for that product.

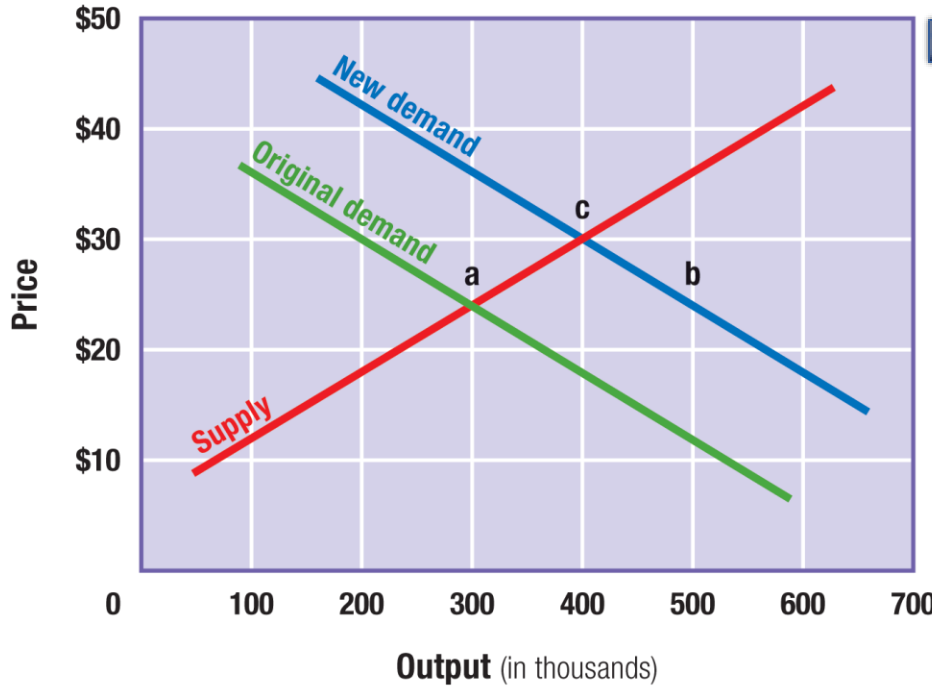
Decrease in Supply

- Some factors lead to a decrease in supply, which shifts the supply curve to the left and results in a higher market price and a decrease in quantity sold.

- These factors include:
  - An increase in the costs of resources to produce a good
  - An increase in labor costs
  - An increase in government regulations

A Change in Demand: Fads

- Fads often lead to an increase in demand for a particular good.
- The sudden increase in market demand cause the demand curve to shift to the right.
  - What impact did the change in demand shown in the graph have on the equilibrium price?



Fads and Shortages

- As a result of fads, shortages appear to customers in different forms:
  - Empty shelves at the stores
  - Long lines to buy a product in short supply
  - Search costs, such as driving to multiple stores to find a product.

Reaching a New Equilibrium

- Checkpoint: How is equilibrium reached after a shortage?
  - Eventually, the increase in demand for a particular good will push the product to a new equilibrium price and quantity.
  - Once a fad reaches its peak, though, prices will drop as quickly as they rose:
    - A shortage becomes a surplus, causing the demand curve to shift to the left and restoring the original price and quantity supplied.
    - New technology can also lead to a decrease in consumer demand for one product as a more high-tech substitute becomes available.

Review

- Now that you have learned how changes in supply and demand affect equilibrium, go back and answer the Chapter Essential Question.
  - What is the right price?