Economics
Econ

Chapter – [1]

Key Learning Outcomes

- Understanding what is meant by a 'Market' in economics
- Ability to define the concept of 'Demand' [outlining the implications and features of demand]
- Identifying 'Law of Demand' and being able to explain the principal reasons for the law of demand
- The ability to construct (derive) and interpret the demand curve and equation.
- The ability to technically analyze and represent Changes in demand and change in quantity demanded
- Identifying the situations converse to the law of demand

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Dashboard: Market Economics (Price Theory)

Unit (Competency) - **(2)**

Microeconomics

Conceptualized by: Imran Hasheem

Market Economic System

Competitive Market

- **Demand [D]**
- **Market 'Price' Determination**
- **Supply [S]**

[1] Demand & [2] Supply Analysis

- ❑ **Definition (Concept)**
- ❑ **Determinants**
- ❑ **Governing Laws**
  - ❑ L.O.D.
  - ❑ L.O.S.
- ❑ **Change events**
  - ❑ ΔQd Vs. ΔD
  - ❑ ΔQs Vs. ΔS

[3] Elasticity (E)

- ❑ ED [PED,YED,XED]
- ❑ ES

[4] Market Equilibrium Analysis

- ❑ **Concept & Conditions**
- ❑ **Representation**
- ❑ **Change events**

[5] Economic Surplus

- ❑ Consumer Surplus
- ❑ Producer Surplus

Unit Introduction

In Unit 1, a market economy was defined as an economic system in which the '**price mechanism**' allocates scarce resources amongst alternative uses, through **decentralized** decision making to optimize each decision maker's **self-interest**. In this unit, the **functioning** of the **price mechanism** in a **single market** [1] (market for one product) operating within a **market economy** [2] is studied.

There are two very important phenomenon or concepts which will be explored in-depth in Chapter IV of this unit, namely 'equilibrium' and 'disequilibrium', when there is disequilibrium in a market, shown by excess demand or excess supply, **price adjusts** to **restore** or **bring back market equilibrium**. We will also learn the different dimensions of **elasticity** with regards to demand and supply for a given product, while attempting to understand the way in which **equilibrium** may be **disturbed** by a **shift** of a **supply** or **demand** curve.

Background

A key question to be asked in the very beginning of learning market economics is, what is microeconomics?

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Microeconomics is different from macroeconomics which focuses on problems in the **broader economy** like inflation, unemployment, and the rate of economic growth.

Adam Smith is usually considered the **intellectual forefather** of **microeconomics**. In his classic book, The Wealth of Nations, published in 1776. Smith considered how individual product prices are set, study the determination of prices for land, labor, and capital and examined the strengths and weaknesses of the free market mechanism. Most importantly he identified the **remarkable efficiency properties** of **perfectly competitive markets**. Using his now famous **invisible hand** analogy, Smith argued that the **self-interested actions of individuals guide market outcomes to yield** great economic benefits for the **broader society**.

[**1**] This is a **microeconomic** area or analysis

[**2**] How **price is decided** in individual **markets,** within a **market economic system.**

Learning Key [1]

[1.1] Liberal Market Economic System:

- Private ownership of production resources [Private Property ownership and rights].
- Free entrepreneurship and freedom of choice [decentralized or Liberal system].
- High degree of Competition in markets (for profit maximizing)
- Use of Price Mechanism in resource allocation.
- Limited / no Government role within markets [Pure market Economy: 'Laissez-faire' Government]

[1.2] Markets [What is a Market]:

▼ Key **Definition**

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It's not essentially a specific place or location, rather any mechanism which creates a Link between demanders and suppliers [Physical or virtual].

Alternatively:
A market is a group of buyers and sellers of a particular good or service

Main elements or dimensions of a market:

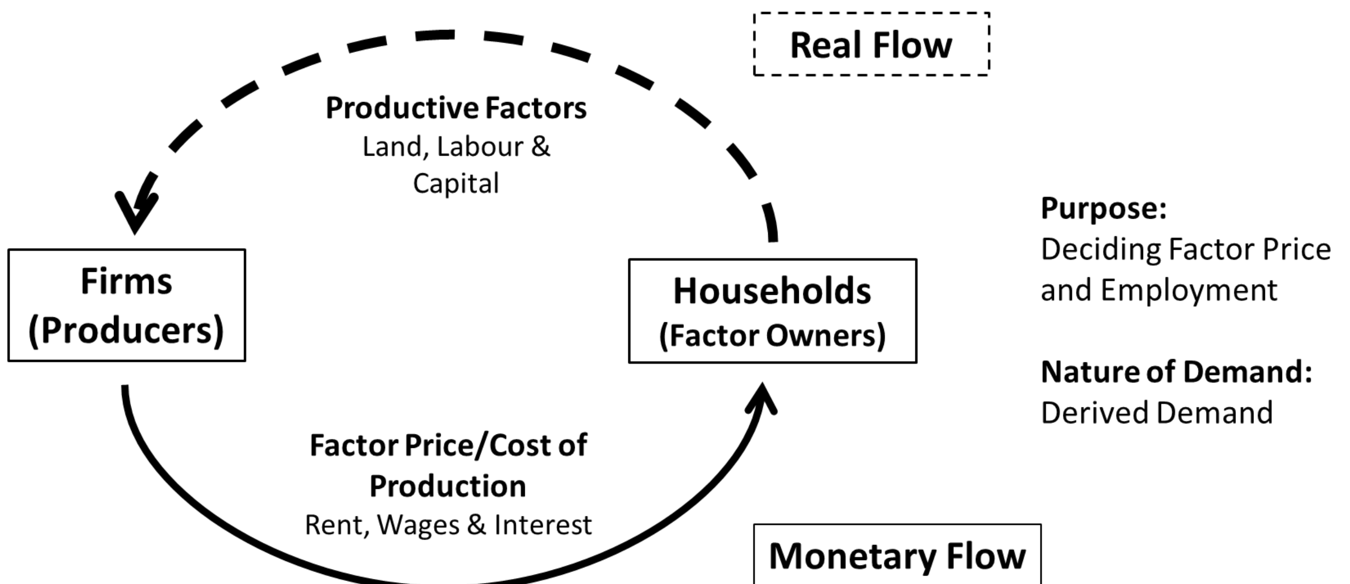
- Buyer and Seller
- A good, service or production factor [Item of value]
- Institutional Mechanism to link buyers and sellers
- Mutual agreement on a common Price and Quantity

[1.3] Types of Markets: Factor Vs. Product

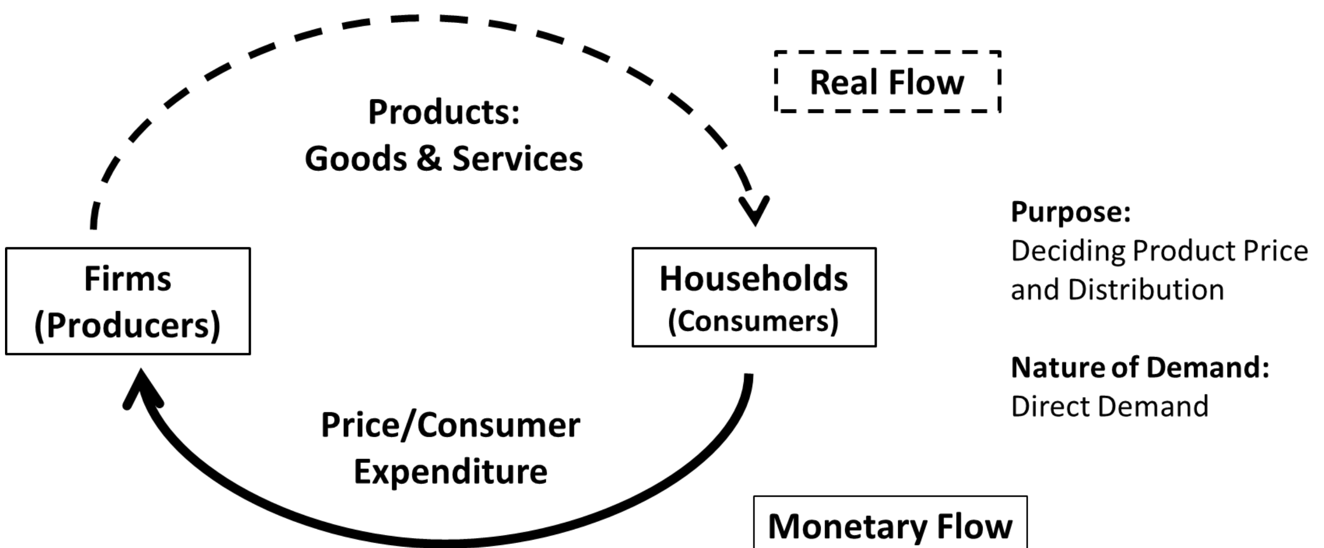
[A] **Factor market**: a market in which the price and employment of production factors are decided (or determined) by the derived demand made by firms and supply made by households acting as factor owners.

[B] **Product Market:** a market in which the price and distribution of products: goods (tangible) and services (intangible) is determined by the direct demand made by households acting as consumers and supply made by firms (production units).

Factor Market Flows:



Product Market Flows:



Summary of Key Features:

Feature	Product Mkt.	Factor Mkt.
Item	**Goods** and Non-factor based **Services**	Factors of Production
Function	Determine: price & distribution	Determine: wages, rent, interest rates and employment
Buyer (Demanders)	**HH as Consumers**	Production firms
Sellers (Suppliers)	Production firms and service providers	**HH as Factor Owners**
Nature of Demand	Direct Demand [purchase for own use]	Derived Demand [Purchased to produce other goods]
Examples	Food, medicine, transport	Labour, land, capital

[1.4] **Competition** [What is a Competitive Market]:

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Different levels of competition will be faced by buyers and sellers within different market situations. Several market structures or situations (such as perfect competition, monopoly, monopolistic competition, and oligopoly) can be identified, essentially depending on the level of competition within each structure.

TYPES OF MARKETS STRUCTURES

- PERFECT COMPETITION
- MONOPOLY MARKETS
- MONOPOLISTIC COMPETITION
- OLIGOPOLY

(Monopolistic Competition and Oligopoly: **Imperfect Competition**)

Level of Competition

High ←——————————————→ **Low**

Perfect Competition | **Monopolistic Competition** | **Oligopoly** | **Duopoly** | **Monopoly**