SUPPLY, DEMAND AND MARKET PRICES

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Market economies are directed by prices. Prices ration scarce recources, and they motivate production. As a general rule, the more scarce something is, the higher its price will be, and the fewer people will want to buy it. Economists describe this as the rationing effect of prices.

Prices encourage producers to increase or decrease their level of output. Economists refer to this as the production - motivating function of prices. Prices send out «signals» to buyers and sellers, keeping the economy responsive to the forces of supply and demand.

In a free market economy prices are determined by the interaction of the forces of supply and demand. Perfectly competitive markets are those in which many buyers and sellers, with full knowledge of market conditions, buy and sell products that are identical to one another.

Demand is a consumer's willingness and ability to buy a product or a service at a particular time and place. If you would like to own a new pair of athletic shoes but can't afford them, economists would describe that your feeling is desire, not demand. If, however, you had the money and were ready to spend it on shoes, you would be included in their demand calculations.

The law of demand describes the relationship between prices and the quantity of goods and services that would be purchased at each price. It says that all else being equal, more items will be sold at a lower price than at a higher price.

The degree to which price changes affect demand will depend upon the elasticity of demand for a particular item.

If total revenue increased following a price decrease, demand would be elastic. If the price decrease lėd to a decrease in total revenue, the demand for the item would be described as inelastic.

The demand for some goods and services will be inelastic for one or more of the following reasons:

- They are necessities.
- It is difficult to find substitutes.
- They are relatively inexpensive.
- It is difficult to delay a purchase.

Sometimes things happen that change the demand for an item at each and every price. When this occurs, we have an increase or a decrease in demand.

Supply, which is the quantity of goods or services that sellers offer for sale at all possible prices at a particular time and place, varies directly with a price. In other words, at a higher price, more goods and services will be offered for sale than at a lower one, and vice versa.

The price at which goods and services actually change hands is known as the equilibrium, or market price. It is the point at which the quantity demanded exactly equals the quantity supplied. Market price can be represented graphically as the point of intersection of the supply and demand curves.

Shifts in demand or supply will affect market price. When everything else is held constant, an increase in demand will result in an increase in market price, and vice versa. Similarly, an increase in supply will result in a decrease in price, and vice versa.

The market price is the only price that can exist for any length of time under perfect competition conditions. Perfect competition exists when the following conditions prevail:

- Buyers and sellers have full knowledge of the prices quoted in the market.
- There are many buyers and sellers so that no individual or group can control

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