

MARKET EQUILIBRIUM



Multiple choice

- 1 B
- 2 C
- 3 C
- 4 B
- 5 A

Matching terms

External costs and benefits that private agents in a market do not consider in their decision making process.	externalities
The situation where, at a certain price, the quantity supplied and the quantity demanded are equal.	market equilibrium
Intervention by the government in a market to set a maximum price.	price ceiling
Intervention by the government in a market to set a minimum price.	price floor
Goods that have benefits to the community that go beyond the individual who enjoys them directly.	merit goods
A market structure where a few large firms dominate the industry.	oligopoly
A market structure where there are many buyers and sellers selling homogenous products.	perfect competition
A market structure where there are many small firms, all with some degree of market power.	monopolistic competition

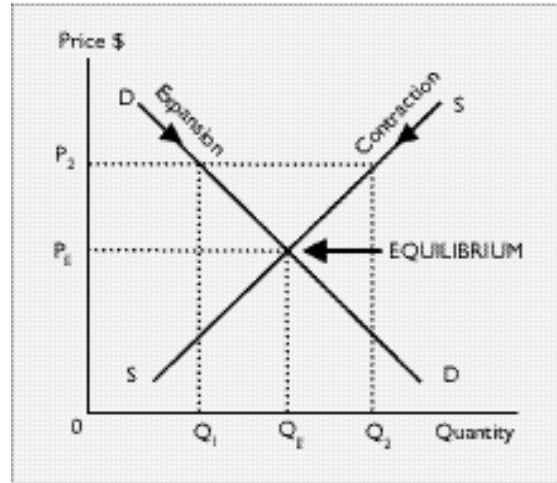
True or false

Select the alternative true or false that best answers the question. Place a tick in the space provided.

	True ✓	False ✓
1 The price mechanism determines equilibrium in a market economy.	✓	
2 If excess demand for a product exists, price will fall.		✓
3 The onset of winter will lead to an increase in price of woollen jumpers and a decrease in quantity sold.		✓
4 A price ceiling protects the consumer at the expense of the producer.	✓	
5 An example of a merit good is a nuclear weapon.		✓
6 A firm in a monopoly situation faces a perfectly inelastic demand curve.		✓
7 A firm that has high advertising expenses would be likely to be in monopolistic competition.	✓	
8 At equilibrium there is no problem of shortages and surpluses.	✓	
9 An increase in the price of butter will increase the price of margarine.	✓	
10 The government can always determine the most appropriate price in a market economy.		✓

Short answers

Question 1

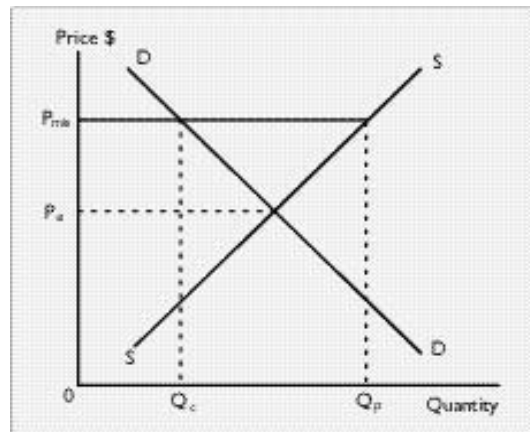


Because the price is above equilibrium, there is excess supply - goods that are not sold. To clear the surplus, sellers will gradually reduce the price. As it falls, consumers will increase their demand until the surplus has been all sold. This is equilibrium.

Question 2

- i) An increase in demand will **increase** the equilibrium price and **decrease** the equilibrium quantity in the market.
- ii) A decrease in demand will **decrease** the equilibrium price and **decrease** the equilibrium quantity in the market.
- iii) An increase in supply will **decrease** the equilibrium price and **increase** the equilibrium quantity in the market.
- ii) A decrease in supply will **increase** the equilibrium price and **decrease** the equilibrium quantity in the market.

Question 3



The government will impose a price floor if they believe that the equilibrium price for a product is too low. This is usually done in resource markets.

A price floor will result in an increase in price (above equilibrium), a contraction in demand for the product and an expansion of supply.

Question 4

Highlight which boxes in the table are incorrect.

Market structure	Number / size of firms	Product characteristics	Barriers to entry	Examples
Perfect competition	numerous small firms	homogeneous product	no barriers to entry	Telstra and Optus
Monopoly	a few large firms	Only one firm in a monopoly	extremely high barriers to entry	real estate agents
Monopolistic competition	Products are differentiated, all slightly different	homogeneous product	high barriers to entry	Some barriers, but not high or prohibitive
Oligopoly	one large firm	Small number of large firms in this market	relatively easy entry	Significant barriers to entry, such as large sunk costs

Additional annotations:

- Callout for Perfect competition: Telstra and Optus are large firms dominating a market. Perfect competition characterised by many firms in an undominated market e.g. fish markets
- Callout for Monopoly: Wide ranging competition in a real estate market. Better example would be water supply.

Question 5

An externality is an unintended consequence of the production process or the provision of goods and services. Examples may include pollution of local waterways from a steel mill, or noise pollution from a nightclub. These are not the aim of the business, but a consequence of their operations.