

Contempory Development Models

DCDM – 1003

The free Market (forces of Demand & supply)

Economic System

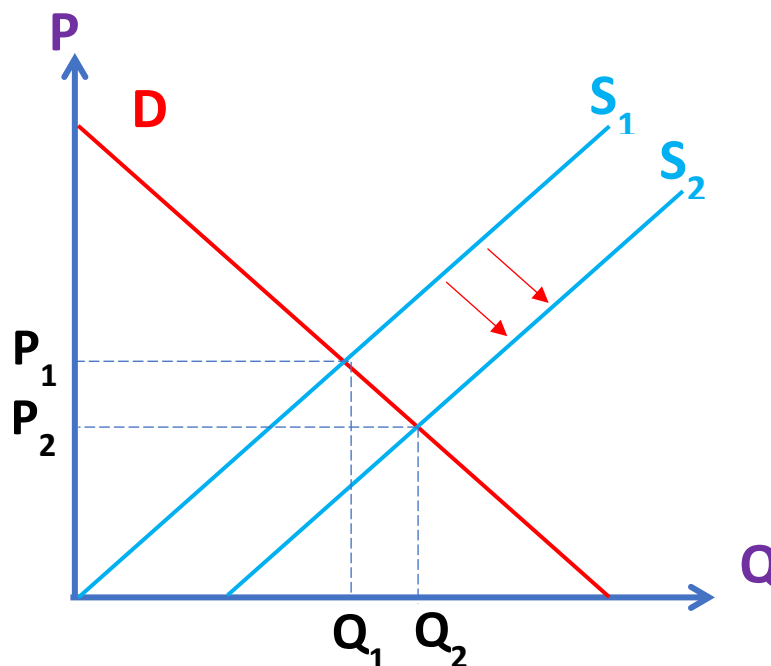
- An economic system is a network of the organization used to resolve the problems of what to produce, how much to produce, how to produce it and for whom to supply the goods and services

IF YOU DESTROY A FREE MARKET, YOU CREATE A BLECK MARKET

- WINSTON CHURCHILL
-

Free Market Ideology

- A free-market (Laissez-Faire) economy is one in which the process of goods and services are determined by the market forces of demand and supply, the decisions about the allocation of those resources are made by individuals with no government intervention



Characteristics of free market



The profit Motive

Companies are free to decide which resources they wish to employ



Government Minimal Intervention

Government has little or no role in the functioning of the economy



Competition

People are free to start their own business as they desire



Adaptability

Individuals have the freedom to dedicate their time to the career of their choice

Benefits of Free Market



Greater Innovation due to competition

Spurs companies to develop better products at lower costs, offer consumers more choices.



Greater Economic Growth

Economics of scale and free trade has boosted production and increased employment



Greater Economic Freedom

Incentivize stakeholders such entrepreneurs' investors and financiers to take an active part in the business and help the economy grow

Eg: - Us exports support over 12 million jobs in America

Issues of Free Market

- Market can fail (monopoly, Oligopoly).
- Inequity give inequality.
- Excessive profiteering.
- Creative Destruction.
- Price Volatility.

Demand And Supply

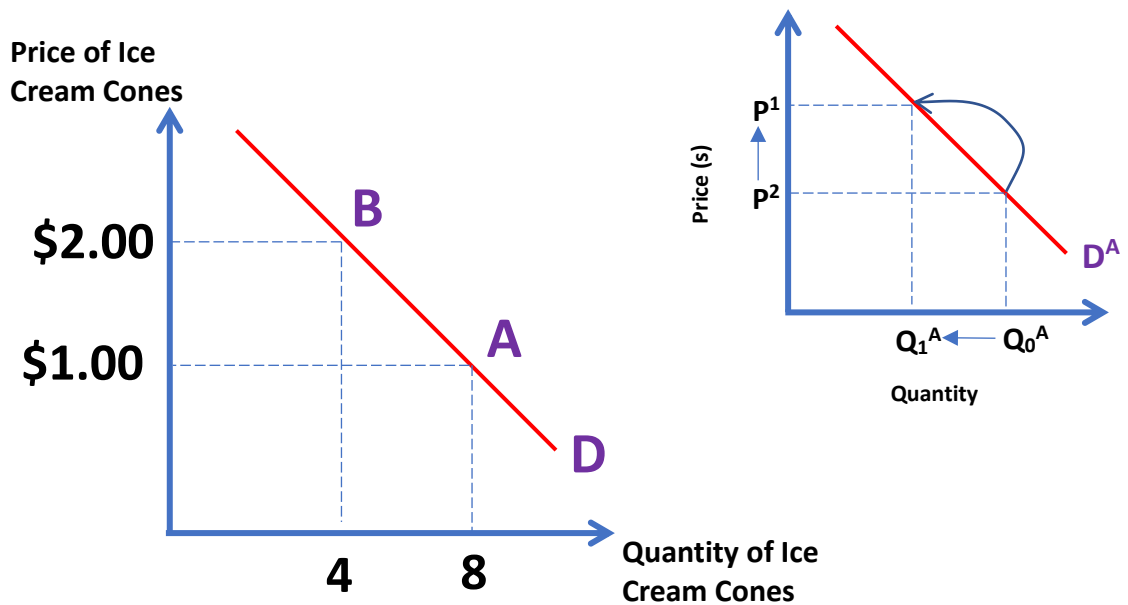
Demand is the amount of a good, service or resource that people are willing and able to buy during a specified period at a specified price.	The law of demand state that other things equal, the quantity demanded of a good fall when the price of the good rises.
Demand and Supply	
Supply is the amount of a good service or resource that people and willing and able to sell during a specified period at a specified price.	<p>The law of supply states that other things the same,</p> <ul style="list-style-type: none">• If the price of a good rises, the quantity supplied of those good increases.• If the price of a good falls, the quality supplied of those good decreases.

Ceteris Paribus

- Ceteris Paribus is a Latin phrase that means all variables other than the ones being studied are assumed to be constant (the things being equal)
- Example: - The demand curve slopes is downward because Ceteris Paribus lower prices imply a greater quantity demanded.

Demand Curve

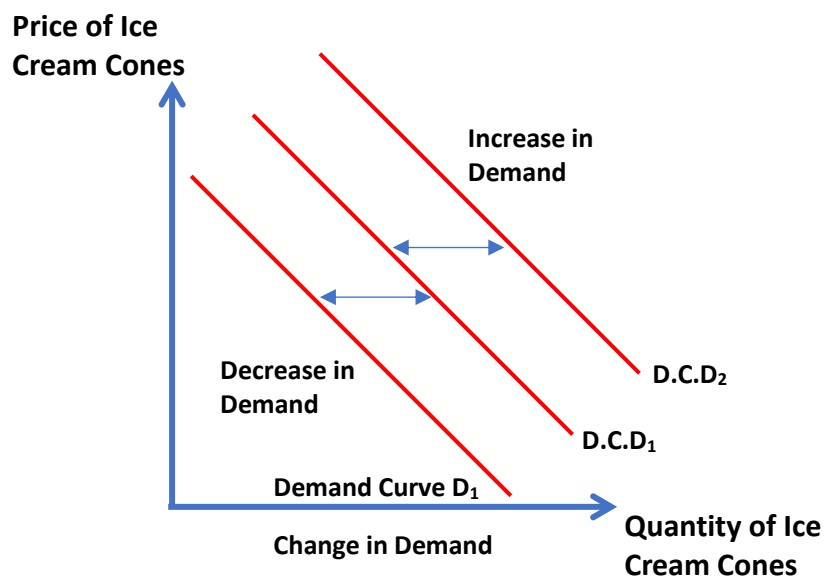
The demand curve is a graph of the relationship between the price of a good and the quantity demanded.



Factors Determining the Quantity Demanded

- Consumer income
- Prices of related goods
- Tastes
- Expectation (Number of buyers)

Shift is Demand Curve



Types of Elasticity

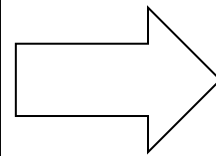
- An elastic demand is one in which the change in quantity demanded in due to change in price is large. An inelastic demand is one which the change in quantity demanded is due to a change in price is small.

Inelastic Demand:

- Percentage change in price is greater that percentage change in quantity demand.
- Price elasticity of demand is less than one.

Elastic Demand:

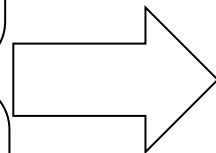
- Percentage change in quantity demand is greater that percentage change in price.
- Price elasticity of demand is greater than one.



**Price
Elasticity**

Inferior Goods:

- An increase in income leads to decrease the demand for inferior goods



**Income
Elasticity**

Normal Goods:

- An increase in income leads to increase the quantity

Complementary Goods:

- Increase in the types of petroleum will decrease the demand of cars.

Substitute Goods:

- Increase in the price of Coca-Cola will increase the quantity demanded of Pepsi.

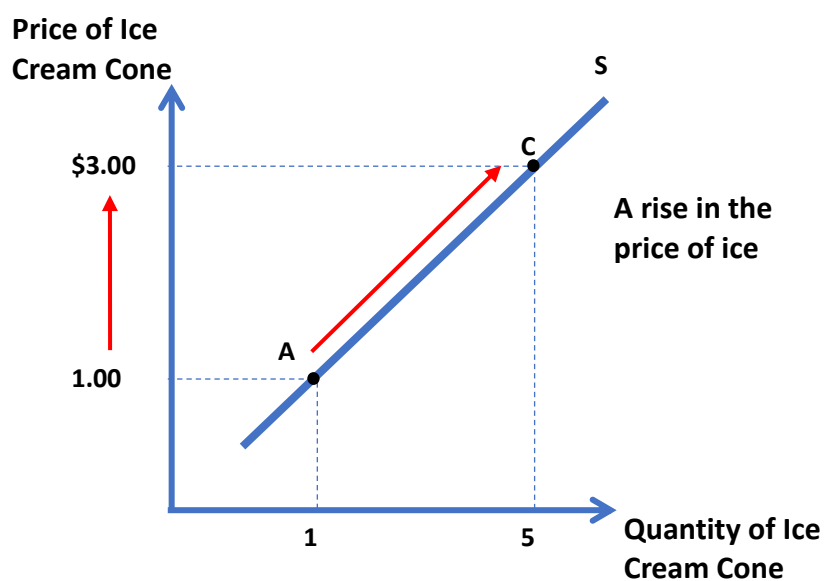
**Cross
Elasticity**

Market Supply

- The sum of the supplies of all sellers in a market.
- The market supply curve is the sum of the supply curves of all the seller in the market.

Supply curve

Change in supply: Change in price of a good or services leads to change in quantity supplied.

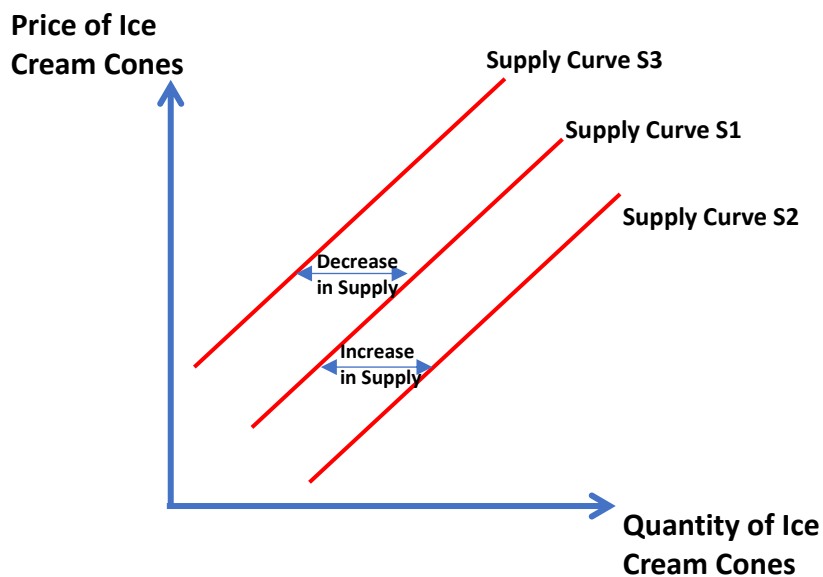


Factors Determining change in Quantity of supply

- Availability of factors of production (Technology)
- Price of commodity (Goods and services)
- Price of required input on goods (Labor, Capital and land)
- Number of suppliers.
- Unforeseen event (weather, war)

Shift in Demand Curve

- Change in quantity supplied: Change in Costs, input prices, technology, or prices of related goods and services leads to change in supply.



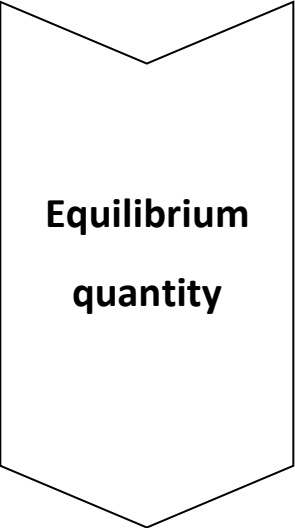
Market Equilibrium

- An equilibrium is the condition that exists when quantity supplied and quantity demanded, are equal only in equilibrium is quantity supplied equal to quantity demanded.



Equilibrium Price

- The price that balances quantity supplied and quantity demanded.
- On a graph it is a price at which the supply and demand curves intersect



Equilibrium quantity

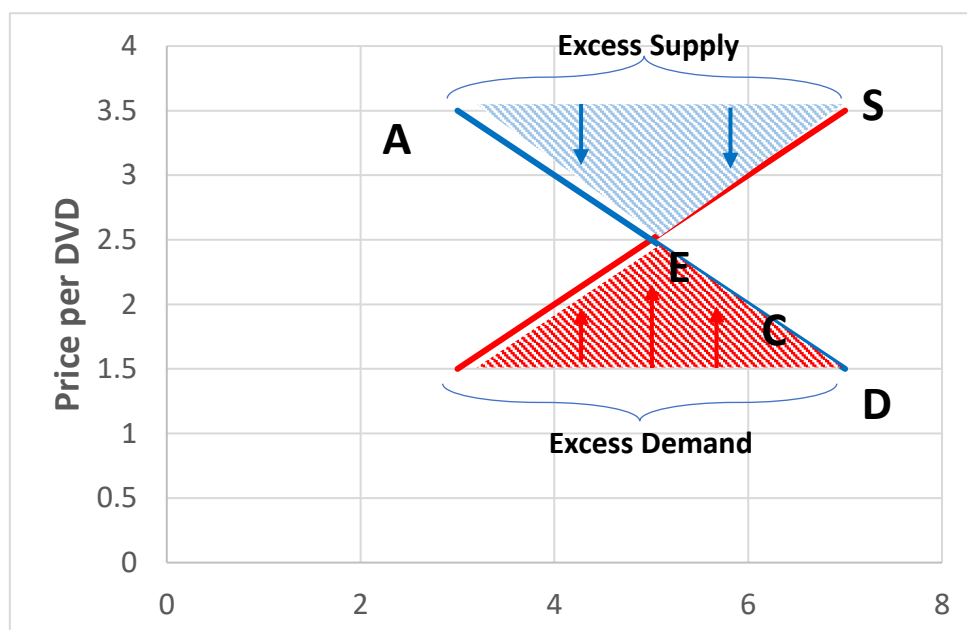
The quantity supplied and the quantity demanded at the equilibrium price. On a graph it is the quantity at which the supply and demand curves intersect.

Excess Demand, or shortage of supply is the condition that exists when quantity demanded exceeds quantity supplied at the current price.

Excess Supply, or shortage of demand, is the condition that exists when quantity supplied exceeds quantity demanded at the current price.

Equilibrium Point

Where the quantity supplied are willing and able to offer for sale is the same as the quantity that buyers are willing and able to purchase. Here equilibrium occurs at the price of \$3 per DVD and the quantity of 66 DVDs. It is shown as point E at the intersection of the demand and supply curves prices above \$3, the quantity supplied is greater than the quantity demanded, and the result is surplus. At the price below \$3, the quantity supplied is less than quantity demanded, and the result is shortage.



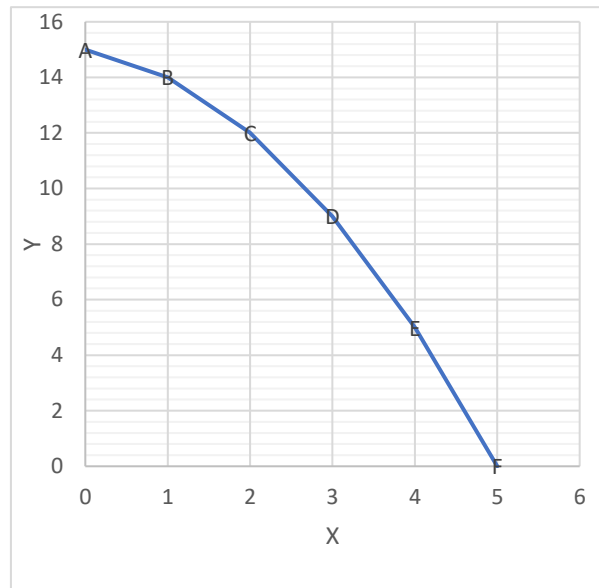
Production Possibility Frontier (PPF) / Production Possibility Curve (PPC)

Production Possibility Frontier (PPF)

- A static model is assumed where:
 - A country's resources consist of only labor and capital
 - Availability of labor and capital is given
 - A country produces only two goods
 - Production technology for the goods is given
- A **Production Possibility Frontier (PPF)** refers to the alternative combinations of goods and services that a society is capable of producing with its given resources and state of technology
- A **Production Possibility Frontier (PPF)** measures the maximum combination of outputs that can be achieved from a fixed amount of input.
- A production possibility frontier is used to illustrate **opportunity cost**.
- It also can be used to **measure opportunity cost**.
- **Efficiencies and inefficiencies in resource utilization** also can be explained using PPF.

OPPORTUNITY COST & PPF

Points	X In units	Y In units
A	0	15
B	1	14
C	2	12
D	3	9
E	4	5
F	5	0



OPPORTUNITY COST

- Is the value of the next best alternative forgone when you are faced with a selection decision.
- Eg: Producing at point A on PPC

Point	Production
A	15 units of Y is produced while none of X units are produced
B	Production of X starts and 1 unit of X is produced. Production of Y is reduced to 14 units (given up/sacrificed 01 unit)
C	Production of X increased to 2 units (increment of 1 unit) Production of Y reduced to 12 units (sacrificed 02 units)
D	Production of X increased to 3 units (increment of 1 unit) Production of Y reduced to 9 units (sacrificed 03 units)
E	Production of X increased to 4 units (increment of 1 unit) Production of Y reduced to 5 units (sacrificed 04 units)
F	Production of X increased to 5 units (increment of 1 unit) Production of Y reduced to 0 units (sacrificed 05 units)