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Here in the United States of America, we have a capitalist economy, otherwise known as a market economy. In our market economy, we have free reign over what we want to buy, at what price, and from whom we wish to purchase our goods. Our market, or group of buyers and sellers of a good or service, is known as a competitive market. This means that each individual buyer or seller has very little to no impact on the market price of a specific product or service. So how are the prices in a competitive market established? The answer is found within one of economics’ most important principles, the laws of supply and demand.

The law of demand states that other things remaining unchanged, there is an inverse relationship between the price of a product and the quantity of that product demanded by consumers. First of all, the quantity demanded of a product is not just about how many people want something, but it is about how many people want and are able to buy a certain product at the current price. For example, everyone wants a Lamborghini, but only very few people are rich enough to afford one, so the quantity demanded for Lamborghini’s is quite low. With that being said, we can express this graphically in what is known as a demand curve. Not all products have the same demand curve. Gas prices and ice cream both have different demand curves. Even gas prices today compared to gas prices from 100 years ago have different demand curves. What are the reasons, or determinants, that demand curves can shift and vary from one another? When consumer’s incomes go down, they can’t afford to buy as much of a certain product as before. For example, a consumer might have to start buying margarine instead of butter because the cost of margarine is much cheaper. The demand curve for butter will shift to the left (decrease) and the demand curve of margarine will shift to the right (increase). In this example, butter is a normal good because its demand curve decreased when income fell. Likewise, margarine would be considered an inferior good because its demand curve increased when income fell. The next determinant is the price of related goods. When the price of ice cream rises, consumers will be less likely to spend money on ice cream when they can get a substitute, frozen yogurt, for much cheaper. On the other hand, when people are buying less ice cream, the demand for sprinkles, a compliment to ice cream, will go down as well. In other words, when the price of a product goes up, people will be more inclined to buy a substitute product at a cheaper price and people will be less likely to buy a compliment to that product, causing their demands to go down. The next determinant is taste. Consumers all want to have their favorite foods and clothes. These items will be demanded in higher quantities than objects that are less popular. The future expectation of the market is also a determinant of the shift of the demand curve. If consumers expect the price of a good to go down, they will hold off buying it until the price really does go down. Likewise, if a product is expected to increase in price, consumers will try to buy the product quickly before the price really does go up. The last determinant of the shifts in the demand curve is the number of buyers. When there are more buyers in the market, the quantity demanded of all goods will increase. The 5 determinates of the demand curve help us to explain several reasons why prices will fall and rise. The one thing that remains constant is that all these changes are because of the buyers, thus showing the different ways that buyers can influence the prices of goods in the marketplace through how much of a product they demand when its price changes.

Demand curves and the law of demand represent how consumers have some control in market prices, but what control do producers have over prices? Their control is found within the law of supply. The law of supply states that the price of a good and the quantity supplied of a good have a direct relationship to one another. We can show this relationship graphically by creating a supply curve between the two variables. Like demand curves, supply curves can shift and take on different forms as well. The first determinant that causes a shift in the supply curve is the cost of inputs. In simple words, when the prices of ingredients or supplies needed to make a product increase or decrease, the price of the good will reflect that. For example, if the price of sugar and milk both dropped, then the price of ice cream will be cheaper as well. The next cause of these shifts is new technology. When new technology comes out, producing a good can be made much cheaper and more efficiently. When televisions first came out, they were very expensive to make, so there were very few of them. Presently, televisions can be made a lot cheaper and at a higher quantity because the technology has gotten so much better in the last century. Now nearly everyone has at least one television in their house because they are so much more affordable. Next, future expectations can cause changes in the supply curve. When a business thinks that the price of their good is going to increase, they will save enough supply so they can maximize their profit when prices do increase. Likewise, when a business thinks that the price of its good is going to decrease, they will try to sell as many products as they can before they do decrease. Lastly, the more sellers there are in a marketplace, the more quantity of a certain product there will be. These determinants all explain how sellers can influence the price of goods in a market based on how much of a quantity they supply when prices change.

When we put the supply curve and the demand curve of a product together, we can see that there is a point of intersection. This point is known as the equilibrium. At this equilibrium price, the quantity of goods buyers are willing and able to buy exactly equals the quantity of goods that sellers are able and willing to sell the product for. This leads us to the law of supply and demand, which is what really establishes the prices of products in a market. The law of supply and demand states that the price of any good adjusts to bring the quantity supplied and the quantity demanded into equilibrium. This means that the market forces are always pushing the price of goods toward the equilibrium price. When the quantity supplied of a good is greater than the quantity demanded, there will be a surplus. To fix this, sellers will have to start selling their products at a cheaper price to sell the rest of their supply. This cheaper price becomes the new equilibrium price. On the other hand, when the quantity demanded of a product is greater than the quantity supplied, there will be a shortage of the product. This means that businesses will increase its prices to maximize their profits. The price will increase until the number of goods they supply exactly equals the number of goods that are demanded, achieving what is known as the equilibrium price. Shifts in either the demand curve, supply curve, or both will change the equilibrium price. There are many different variations of shifts in curves, but a couple basic shifts are that when the supply curve shifts to the right, there will be a greater quantity of goods at a cheaper price, and when a demand curve shifts to the right, there will be a greater quantity of goods at a more expensive price. The equilibrium really puts everything together and helps us explain how all the determinants come together to change the equilibrium price. For example, when the input prices of ice cream go down, the supply curve shifts to the right because ice cream producers can now make more ice cream for the same price that they previously did. This will cause the equilibrium price to decrease and allow a greater number of ice creams to be sold. It also helps show us how supply and demand work in the market. Like when there is excess demand, prices will increase and when there is excess supply, prices will decrease.

As we have seen, the supply and demand of products, represented by the supply and demand curves, are what influences the price of goods in a market economy. When the curves shift, the equilibrium price of the product will change as well. But these prices determine how we allocate our limited number of resources. In our free market economy, we have full control over how we use our resources. For example, everyone wants a fancy sports car, but there is a lot less sports cars than there are regular, everyday cars. Given this, the people who end up buying sports cars are the people who have the necessary amount of money. Similarly, when looking for jobs, there is no law that says that some people must be farmers. But we, as a society, need farmers to produce food to survive. People, therefore, allocate their time to become farmers because it is profitable. Why is it profitable? It is profitable because the law of supply and demand will always push the market price towards equilibrium where the farmers are able to make a profit and buyers are able to buy food at a reasonable cost.

In conclusion, the prices of goods in a market economy are not established solely by buyers, nor solely by sellers. Rather, the prices are established by the market as a whole through the many changes in supply and demand curves and the law of supply and demand, which pushes prices towards the equilibrium price where both buyers and sellers are satisfied.