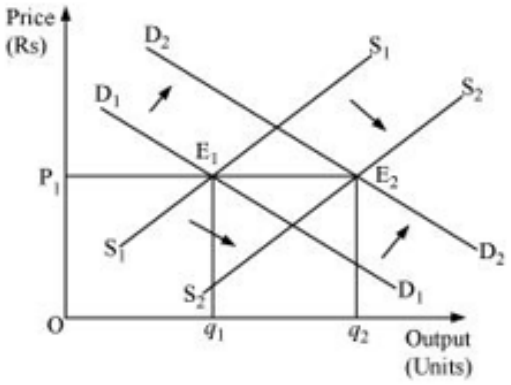
Q15. Explain through a diagram the effect of a rightward shift of both the demand and supply curves on equilibrium price and quantity.
Ans:
(a) When demand and supply increase in the same proportion:

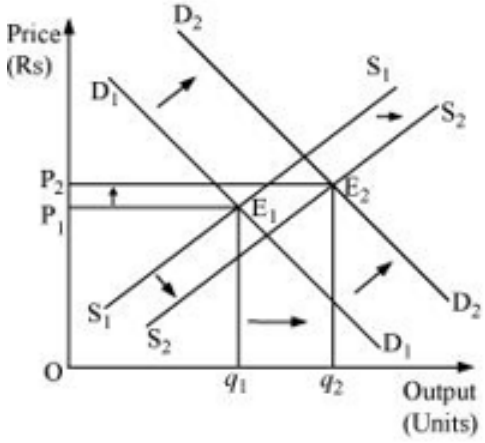


E_1 is the initial equilibrium with equilibrium price P_1 and equilibrium output q_1.

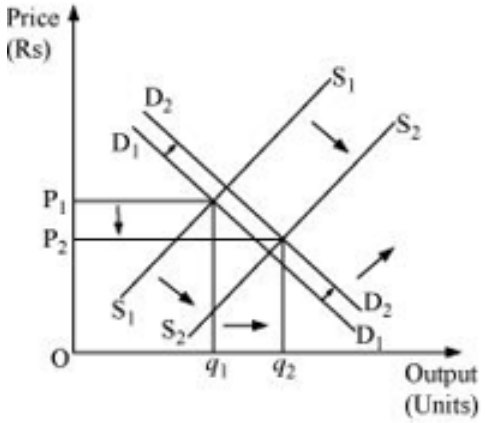
Now, let us suppose that the demand increases to D_2D_2 and the supply increase to S_2S_2 by the same proportion. The new demand and new supply curve intersect at E_2, which is the new equilibrium, with a new equilibrium output q2, but the same equilibrium price P_1. Thus, an increase in the demand and the supply by the same proportion leaves the equilibrium price unchanged.

(b) When demand increases more than the increase in supply: The original demand and supply curves intersect each other at E_1 with initial equilibrium price P_1 and initial equilibrium output q_1.

Now, let us suppose that the demand increases and thereby the demand curve shifts to D_2D_2; the supply curve also shifts rightwards to S_2S_2. However, the increase in supply is less than the increase in demand. The new supply curve and the new demand curve intersect each other at point E_2 with higher equilibrium price P_2 and higher equilibrium output q_2.



(c) When the increase in demand is less than the increase in supply: Let the initial equilibrium be at E_1 with the equilibrium price P_1 and equilibrium output q_1. Now, let us suppose that the demand increases to D_2D_2 and the supply increases to S_2S_2; where the increase in supply is more than that of demand. The new demand curve D_2D_2 and the new supply curve S_2S_2 intersect at E_2. Thus, the greater increase in supply curve as compared to the demand curve will lead the equilibrium price to fall and equilibrium output to rise.



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