Supply and Demand

SAFA Financial Literacy Lesson

What is a free market?

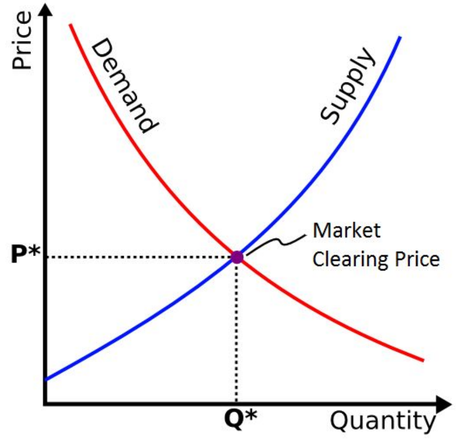
A free market is a market that allows for the free exchange of goods between numerous sellers and consumers. Free market economies are based on supply and demand.

Supply and Demand

Supply is the quantity of a particular resource that is sold on the market, and demand is the desire of the consumer to buy that particular resource.

Supply Curve and Demand Curve

The Supply curve depicts the available quantity of a resource sold at a particular price. The Demand curve depicts the quantity of the product that the consumers desire. The intersection between the two curves is the price at which the resource is sold at the market. This is known as Market Equilibrium. This is because the quantity of the resource that the seller has and the quantity of the resource that the consumer wants is the same, and ideally this is the price at which the product is sold at in the market.

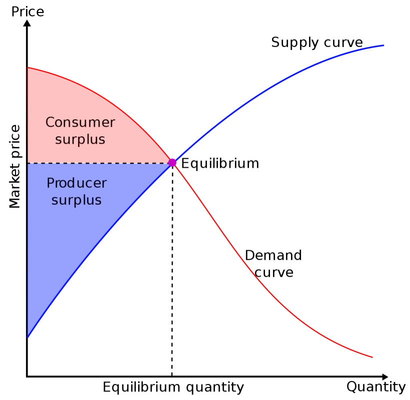


The Consumer and the Seller

The seller has a minimum selling price for their product, which is known as the Marginal Cost of Production, which is determined by the cost needed for the seller to produce the product. Below this price, the seller would just keep the product. The consumer has a maximum selling price for their product, which is known as the Marginal Utility of Consumption. Above that price, the consumer will not buy the product unless it is of absolute necessity.

What is surplus?

Surplus is the extra monetary value that a party receives from a transaction. Consumer surplus is the value that the consumer gains from the transaction(how much lower the price is from their maximum buying price), and producer surplus is the value that the seller gains from the transaction(how much higher the price is from their minimum selling price). The greatest total economic surplus is achieved at market equilibrium(most benefit for both parties).



What is the Invisible Hand?

The term Invisible Hand simply refers to the fact that when the sellers and consumers simply act in their own interest as described before, the optimal price that benefits both parties is automatically achieved, which helps society.

Price Controls

Price controls are regulations imposed by the government on the market which limit the Invisible Hand by either setting a price ceiling(maximum price) or a price floor(minimum price). Some examples of price controls are minimum wage, which is a price floor for an employee's salary, and limits on rent(price ceiling on the rent a property owner can charge).