An Introduction to Microeconomics
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Lecture- 22
Implications of Market Equilibrium

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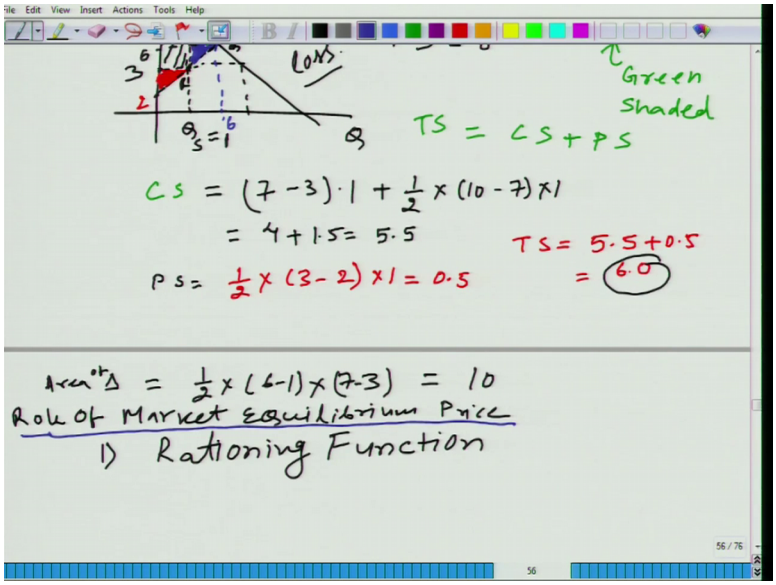

One property I can say of this market equilibrium it maximises the gain to the society. Mind you one thing you should always keep in mind that this scenario is valid only when you have large number of buyers and large number of sellers. Later on we will learn this thing in a more technical way in more concrete manner; we will learn that this is a property of com perfectly competitive equilibrium.

So, keep this remember this term yes we will come back to this term what is perfectly competitive market and what is perfectly competitive equilibrium. But one thing that we could see that equilibrium maximises the gain to the society. So, we can say this is the one role that the equilibrium price the equilibrium is playing in the market.

Now, let us look at the some other role that this equilibrium price plays in the market and let me name them what we have is something called rationing function. Let me write it here role of market equilibrium rationing function. What is rationing function? See what is happening in this case now let us forget about that we do not have any intervention from government or anybody outside the market.

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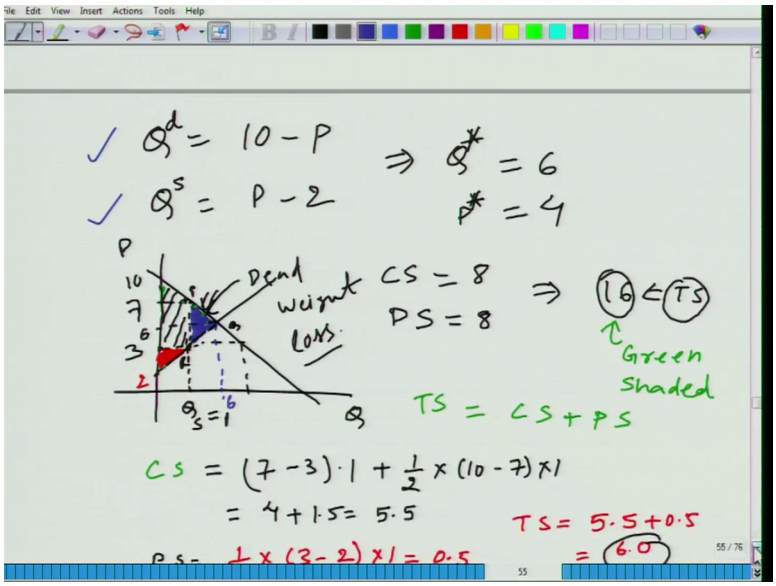

So, what is happening with this demand function and with this supply function, what we are getting is that |P star is equal to 4; that means, goods will be bought this particular kind of good will be bought and sold at 4 unit price.

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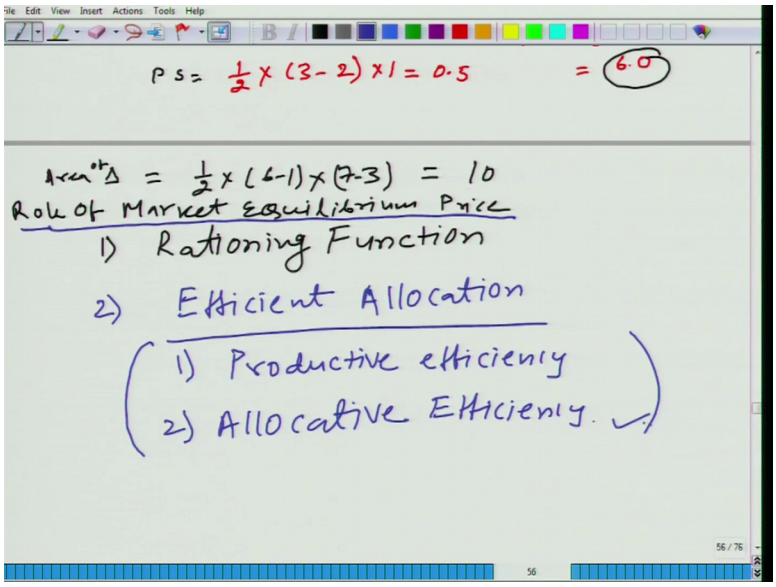

So, it means people whoever values this product at level lower than 4. Let us say for an example for one unit of this good will give me marginal value of 3 unit will I buy this product in the market? The price is 4 unit the gain to me is if marginal value is 3 unit. So, if I get this product my gain would be 3 units. So, price is 4 units gain is 3 units if in case

I go for this unit, then will I buy this product? No because by buying I will be incurring a loss of.

Student: 1.

One unit that is why I will not buy. So, see the price is automatically rationing, its pro excluding the people who value this product at a price lower than the market price. People who value this product their valuation is lower than the market price, they would not be able to buy. So, its a rationing what is rationing? Basically you control the buying behaviour of the people. So, its controlling in a way that you do not value the product good high enough you should not buy this product. So, that is the rationing role that it is playing fine any question about it ok.

Now, the second that I want to talk about is efficient allocation; and in efficient allocation I will talk about efficiency first something called productive efficiency and then allocative efficiency. So, because we know we are talking about large number of buyers and large number of sellers. So, sellers are competing against each other to sell their own product. So, now, consider two scenarios, where a seller a has marginal cost of 4 rupees and seller b has marginal cost of 3 rupees.

So, if just consider this scenario; if pro seller b says I will sell my product at 3 rupees 99 paisa what will happen? He will be able to sell the product and make a profit of 99 paisa, but what about the seller a? Seller a cannot bring down his price to 3 rupees 99 paisa. The reason being is that he will incur a loss. So, what it is doing, it is in a way its forcing the producer to use the least costly technology and the combination of input that reduces the price of the output. So, no one is telling him to do this, but he finds it to do it in his own benefit. So, this is basically productive efficiency.

And we will come to all these when we start talking about welfare economics towards the end in much more technical manner, in much more detailed manner. But right now I just want you to understand the basic these basic concepts that how the market equilibrium is leading to the productive efficiency. Fine is it clear how it is leading to productive efficiency ok?

Now, allocative efficiency; now imagine a scenario when you have only two kinds of input and combining this two inputs in various different ways, you can get various

different kind of output fine. So, now, you can combine it in different ways and you get different kind of outputs using different technology or whatever you have. For example, let us say one input is time and let us say you are living on a island, and you can participate into two activities either you can gather coconut or you can catch fish. So, input is just here all even I am using only one kind of input. So, what I said even if you have two kinds of inputs, you can combine it differently or use different technology and you get different output.

And then what happens in society people consume different types of outputs, but society needs a particular mix of goods and services. So, in a way I will tell you how, but in a way this market equilibrium is forcing producer to produce and the optimal the optimal mix of those goods and services why? Because they want to make maximum amount of money. So, they would let us say if the demand goes up too high what will happen to the market equilibrium price.

Student: (Refer Time: 08:14) demand goes up it will rise.

It will rise and what happens if let us say if you are supplying too many of a particular kind of a good?

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It will come down. So, automatically no one is telling you to adjust your production, but you will do it in order to maximise your profit. So, society would end up producing that optimal mix of goods and services. So, it will also lead to allocative efficiency, fine by the way I will come back to these two topics later on also.