# MICROECONOMICS

## 2.B MARKET MECHANISM

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# Objectives of the Presentation:

- define the market as the basic mechanism of a market economy arising from the division of labour;
- define the basic elements of the market;
- describe the types of markets.

# Presentation Outline

1. The market and its importance
2. Supply
3. Demand
4. Market equilibrium
5. Exchange and the price function
6. Competition
7. Types of markets

# 3. Demand

- **We mark D.**

- **The lower the price of the product (good), the more attractive the product is to the buyer/consumer/customer (with minor exceptions).**

- **Expresses the inverse relationship between price and quantity of the good decreasing function;**

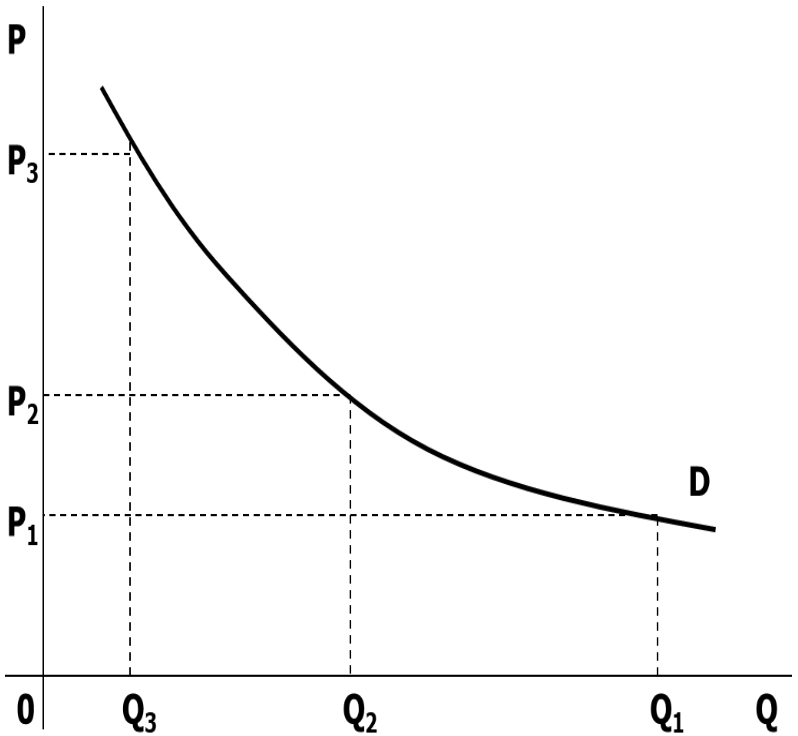
- **Law of decreasing demand: when the price of a product is higher, the quantity demanded decreases.**

# 3. Demand

- **Two effects (two causes) of the law of falling demand:**
  - **The income effect: the consumer buys less as a result of the rise in the price of the product because his real income has fallen;**
  - **The substitution effect: the probability of buying another product to replace the priced product increases.**

# 3. Demand

- **Demand curve:**




- **The demand quantity (quantity demanded) (Q) depends on the price (P).**
- **Price = independent variable.**
- **Demand quantity = dependent variable.**
- **The relationship between these two variables is expressed by the demand curve.**

# 3. Demand

- **Demand versus quantity demanded:**
  - **Change in demand (whole curve): other than price effects, shifts in the whole demand curve to the right or left are caused (e.g. changes in the nominal amount of income, changes in the prices of other goods that are substitutes or complements, taste, fashion, seasonality, etc.).**
  - **Change in the size of the good demanded: changes in price cause shifts along the demand curve (the size of the quantity demanded is determined by the specific price level).**

# 3. Demand

- **Types of demand:**

  1. **Individual demand - demand from one consumer or demand for goods from one producer.**

  2. **Market (partial) demand (D - we have discussed this so far) - demand for a single product from different producers, the aggregate of market demands for a single product.**

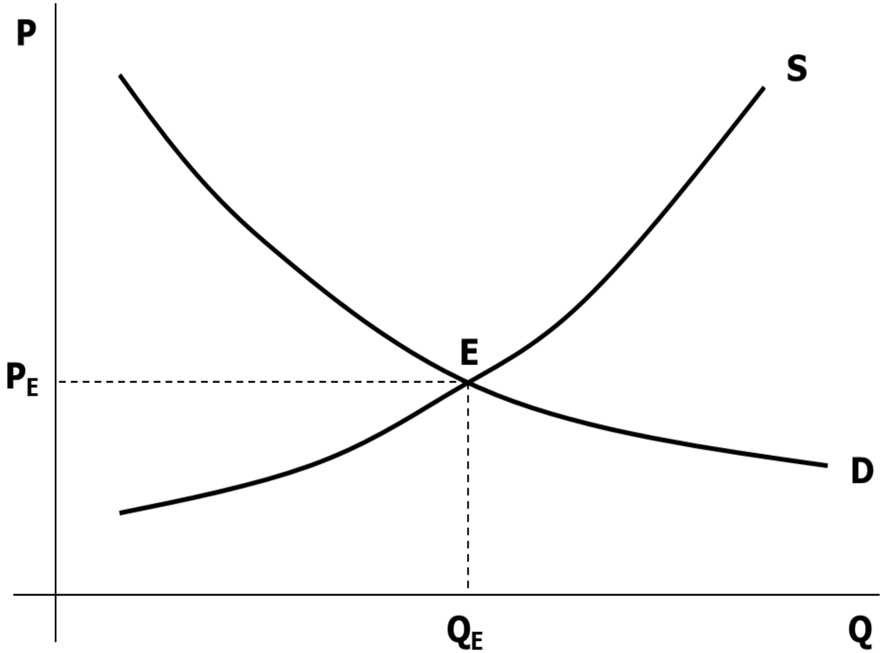
  3. **Aggregate demand (AD) - the sum of all intended purchases made by buyers in the market.**

# 4. Market Equilibrium

- **Market equilibrium = price formation.**
- **Equilibrium between the demanding (buying) and the supplying (selling) side of the market.**
- **Market equilibrium and the functioning of the market mechanism can also be viewed as the ability to solve three basic economic problems (What? How? For whom?) through which a rational allocation of scarce resources occurs.**

# 4. Market Equilibrium

- **Market equilibrium is expressed by the relation: S = D.**




- E: market equilibrium (meets the condition of equality of supply and demand, i.e. equality of the quantity offered and the quantity demanded).
- PE: equilibrium price (the price that corresponds to the market equilibrium).
- QE: equilibrium quantity of a good (the quantity demanded and the quantity supplied are equal).
- PE: equilibrium price, has a "cleansing" function (market-cleansing price) because it cleanses the market of excess supply and demand.

# 5. Exchange and the Price Function

- **With the development of the division of labour and specialisation (see above), the problem of exchange of activities (goods/products) between specialised producers arises.**

- **The division of labour therefore results in exchange.**

- **The economic system becomes more complex, more interdependent and more sensitive to disturbances in the interplay of the various elements of the system.**

# 5. Exchange and the Price Function

- At the same time, the development of exchange retroactively creates new incentives for the further development of the division of labour (as the division of labour and the specialisation of producers deepens, the market mechanism is strengthened again).

- In the old days, products were exchanged without the use of money (in kind ecxchange - the direct, immediate exchange of one product for another, so-called barter) - there had to be a more significant agreement on the needs of the economic agents involved than in the case of barter with money (finding two individuals who want to exchange goods and finding a consensus in the exchange ratio).

# 5. Exchange and the Price Function

**With the increasing amount of goods that need to be exchanged throughout the economy, it becomes much more difficult for any seller to find an exchange partner (who has the good I demand, wants to buy the good I offer at the same time, and is willing to exchange it at a mutually acceptable exchange rate).**

**Switching to exchange by means of payments (money).**

# 5. Exchange and the Price Function

- **Exchange value: the quantitative ratio in which a certain commodity is exchanged in the market with others.**
- **Price: the exchange value expressed in money (a specific form of exchange value).**
- **Price provides real information only when we compare the prices of different goods with each other.**
- **In this context, we speak of relative prices. The term 'relative price' emphasises the fact that a price compares the value of different goods with each other (price is actually a comparator of the values of goods).**

# 5. Exchange and the Price Function

- **Economic theory has not yet been able to resolve the question of what determines the magnitude of exchange value, or the level of price.**

- **However, the mysteriousness of the mechanisms that shape the magnitude of exchange value and the level of price does not prevent the market mechanism from functioning properly and fulfilling its functions.**

- **The price and its level perform a number of functions, e.g.:**
  - **it expresses the value of goods and of productive resources;**
  - **setting the market equilibrium;**
  - **signals which products and factors of production are valued in the market and which are not.**

# 5. Exchange and the Price Function

- **Two basic functions of price:**
  - **informational;**
  - **motivational.**

# 5. Exchange and the Price Function

- **Ad a) Information function of price:**
  - information about the relative advantageousness (availability) of one product in relation to the relative scarcity (disadvantage, unavailability) of another product (the more expensive product) - a function addressing the "price-quality" relationship;
  - coordination of the behaviour and decision-making of economic agents in the market.
- **Ad b) Motivational (allocative) function of price:**
  - motivates producers to increase production of more profitable products at the expense of scarce products.

# 6. Competition

- **Duel, rivalry, clash.**
- **In economic terms, it is a clash of (usually) conflicting interests of different actors in the market.**
- **The area of this conflict = the competitive environment.**
- **Actors (competitors) pursue their own interests and goals without regard to the goals of others (usually even at their expense).**
- **Competitive environment: a necessary condition for the healthy functioning of the market.**

# 6. Competition

- **Three types of competition (competitive environment):**

  1. **supply-side competition;**
  2. **demand-side competition;**
  3. **competition across the market.**

# 6. Competition

- **Ad 1. Supply-side competition:**
  - **A clash of producers → efforts to sell as many goods as possible on the market under the most favourable conditions (the most familiar form of competition).**
  - **Producers' objectives:**
    - **profit maximization (the most common objective);**
    - **achieving a larger market share (weakening the position of their competitors);**
    - **strengthening barriers to market entry etc.**

# 6. Competition

- **Ad 1. Supply-side competition:**
  - **Forms:**
    - **price - lowering the price of goods by the producer in order to destroy competitors (seemingly meaningless step, unsustainable in the long run);**
    - **non-price - various practices, e.g. customer access, quality, advertising, packaging policy, extra services.**
  - **The division between perfect and imperfect competition is also included (special chapter).**

# 6. Competition

- **Ad 2. Demand-side competition:**
  - **A clash of demanders in a market (a lesser-known form of competition).**
  - **Each consumer wants to buy as many goods as possible as cheaply as possible in order to achieve their primary objective, utility maximisation.**
  - **This form of competition occurs mainly when there is a shortage of goods (when there is an excess of demand over supply, i.e. demand is higher than supply).**

# 6. Competition

- **Ad 3. Competition across the market:**
  - **The supply and demand sides clash with their conflicting interests (the least known form of competition).**
  - **It is a logical fact - the consumer wants to buy as much as possible as cheaply as possible, but the producer also wants to sell on the most favourable terms (as much as possible at the highest price).**
  - **The essence: a compromise solution, so that producers do not realise surpluses, they have to reduce the price according to the interest of demand. The demanders do not want a shortage of goods on the market, so they are willing to accept a higher price (we are waiting for a market equilibrium).**

# 7. Types of Market

- **We divide the markets according to the following aspects (criteria):**

  1. **territorial aspect;**
  2. **the number of goods (which are sold on the market);**
  3. **the buying and selling aspect.**

# 7. Types of Market

- **Ad 1. Territorial aspect (corresponds to the real economic life of the society):**
  a) **Local market:**
    - **a less common form of market today;**
    - **municipal markets, fairs or traditional small shops in a small village;**
    - **examples:**
      - **local produce and livestock products (farmers' fruit and vegetables, home-grown eggs, yoghurt, etc.);**
      - **regional dishes (specialities) linked to local tradition or local natural resources (Štramberk ears, Hořice tubes, etc.);**
      - **traditional local crafts (blacksmiths, carvers, etc.).**

# 7. Types of Market

- **Ad 1. Territorial aspect:**

  b) **National Market:**

  - **a market within a national unit;**
  - **created by the merging of local markets (development of division of labour and transport) - previously there were only local markets;**
  - **complete merging (as in the case of local markets) of individual national markets does not occur (autonomy of national markets and protective function of the state in relation to its national producers) - but merging into international groupings represents a partial merging of national markets.**

# 7. Types of Market

- **Ad 1. Territorial aspect:**

  c) **World market:**

  - **represents the fact that the autonomy of national markets is partially limited;**
  - **the development of the division of labour has forced specialisation not only within individual national economies but also internationally ➡ international trade and the world market (if I am the only one specialised in a particular sector, I have to expand and be global).**

# 7. Types of Market

- **Ad 2. The aspect of the number of goods (theoretical abstraction for a better understanding of the economic context):**

a) **Partial market:**

- **supply and demand (sales and purchases) of a single type of product;**
- **using this market division, it is possible to define supply and demand as basic market categories and their linkages.**

b) **Aggregate market:**

- **the market for all goods.**

# 7. Types of Market

- **Ad 3. Aspect of buying and selling (again the theoretical abstraction for a better understanding of the economic context):**

  a) **Product (goods and services) market – final production market.**

  b) **Market of factors of production (human capital market, land market and financial capital market).**

  c) **The money market (very closely related to the capital market - not taken into account by all economists).**

  - **When studying economics, it is necessary to be aware of the market we are in (avoiding mistakes and ambiguities).**

# Thank You for Your Attention