MICROECONOMICS

2. 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

1. The Market and its Importance

- **The emergence of the market?**
  - **The problem of limited resources (VF) and unlimited economic needs.**
  - **The need to allocate and use resources efficiently. → There are many ways to allocate and use resources efficiently;**
  - **The emergence of fundamental economic issues (questions) regarding production:**
    - **What?**
    - **How?**
    - **For whom?**

1. The Market and its Importance

- **The emergence of the market:**
  - **in a market economy, the market answers these questions;**
  - **through the market, sellers and buyers clash (to determine the price and quantity of goods);**
  - **the market emerged gradually, unconsciously and spontaneously as a „side effect" of human activity;**
  - **the essential impulse for the formation of the market was the division of labour;**
  - **given the sophistication of human society, the market is necessary (the most sophisticated mechanism yet known that can regulate and stimulate economic and social development).**

1. The Market and its Importance

- **Division of labour:**
  - **gradual natural shift towards the formation of market principles and relations – a natural consequence of the historical development of the production process – everyone gradually specialised according to their own:**
    - **genetic predispositions;**
    - **historical heritage;**
    - **preferences;**
  - **division of the production process into stages, work activities or work operations.**

1. The Market and its Importance

- **Division of labour:**
  - **the division of labour represents the specialization of different people in the production of different goods;**
  - **by each producer specialising in accordance with his individual abilities, the efficiency of production (output) increases;**
  - **specialisation in production and the creation of production surpluses thus necessarily led to the need for barter (exchange) → market emergence.**

1. The Market and its Importance

- **Division of labour:**
  - **the importance of the division of labour:**
    - **specialisation of the participants in production (production);**
    - **more efficient use of resources (VF) → saving of resources;**
    - **increase in labour efficiency → increase in efficiency of production (output):**
      - **better personal assumptions for the activity;**
      - **easier transfer of experience (reducing the so-called learning costs);**
      - **economies of scale by producing more.;**

1. The Market and its Importance

- **Division of labour:**
  - **Adam Smith considered the division of labour and specialisation as the main source of economic growth (growth of wealth).**
  - **But beware!!! Extreme specialization requiring too one-sided and monotonous activity of a person → reduces work motivation and increases psychological and physical deformation.**
  - **With the division of labour (specialisation), the problem of exchange (barter) of goods and services between producers increasingly emerged.**

1. The Market and its Importance

- **Market:**
  - **Many definitions;**
    - **a space of conflict (clash) between supply and demand;**
    - **mechanism for organising market activities;**
    - **the process of exchange.**
  - **Market actors:**
    - **offerers and buyers (market participants - households, firms and the state);**
    - **market participants enter the market with different objectives and act on both the supply and demand side.**

1. The Market and its Importance

- **Basic market elements:**
  - **The key market elements are supply and demand.**
  - **These two elements have conflicting interests, i.e., the bidders want to sell as much as possible at the highest price and the buyers want to buy as many goods as possible as cheaply as possible.**

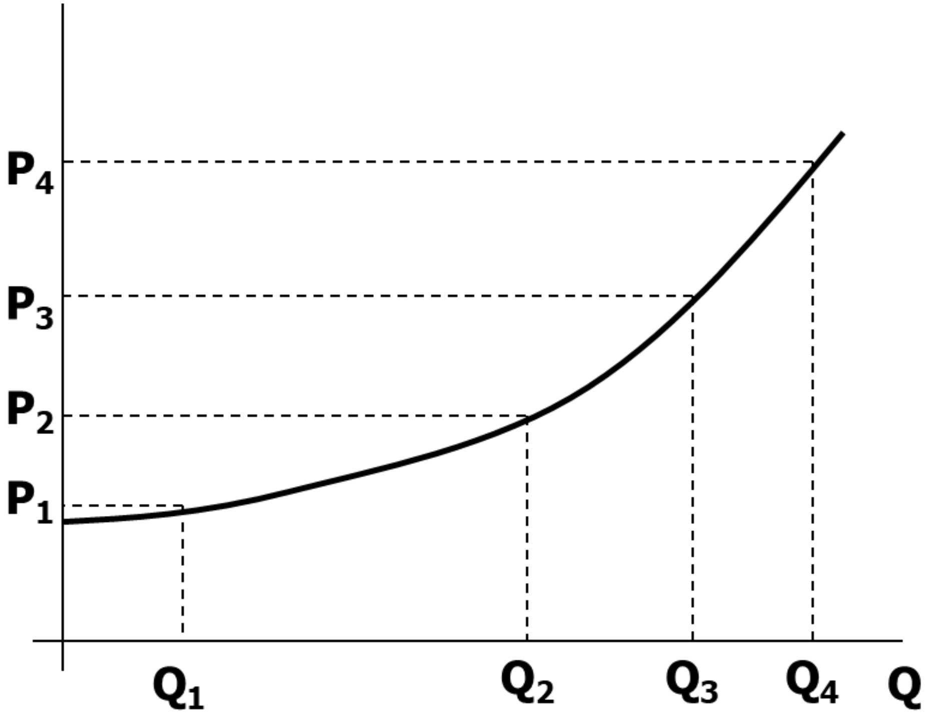
  - **Another important element commonly encountered in the market is competition.**

2. Supply

- We mark S.
- The higher the price of the product offered, the more tempting it is for the bidder (firm) to increase the quantity of the product offered.

- Expresses the direct relationship between price and quantity of a good → increasing function.
- The sum of all intended sales with which economic agents enter the market.
- Three types:
  - individual;
  - market;
  - aggregate.

2. Supply



- The Supply quantity (quantity offered) (Q) depends on the price (P).
- Price = independent variable.
- Supply quantity = dependent variable.
- The relationship between these two variables is expressed by the supply curve.

2. Supply

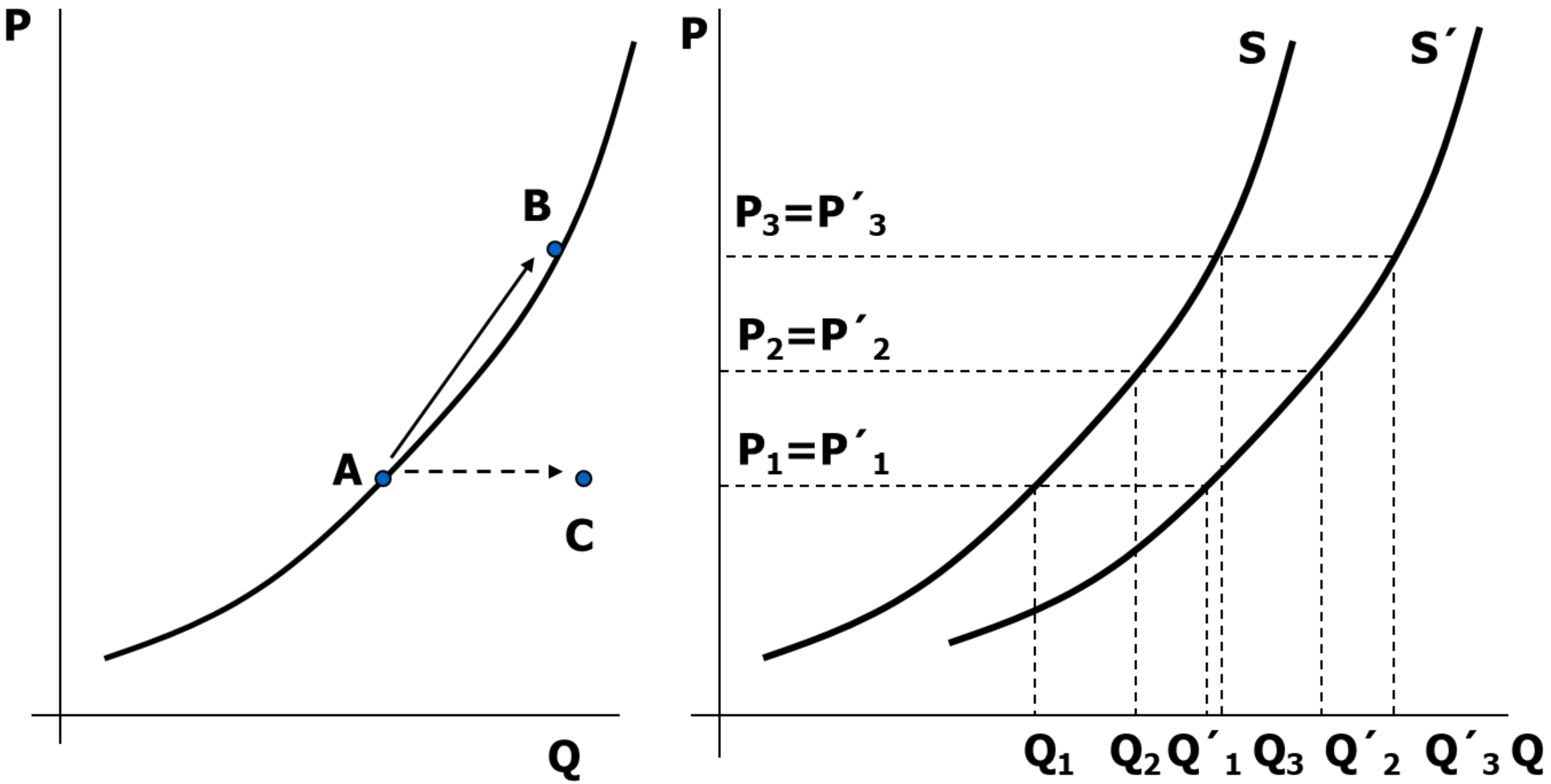
- **Supply versus quantity supplied:**
  - **supply:**
    - **given by the relationship between price and quantity;**
    - **graphically represents the entire curve;**
  - **quantity supplied:**
    - **the part of supply that determines its size at a particular price;**
    - **graphically represents a point on a curve.**

2. Supply

- **Supply versus quantity supplied:**
  - **Supply change: influences other than price cause shifts in total supply, shifts in the curve to the left or to the right (production costs, prices of substitutes, natural effects, market changes (change in preferences due to other trends) or other conditions).**
  - **Change in the quantity offered: price is the factor which, in graphical terms, causes shifts along the curve (shifts from one point on the supply curve to another).**

2. Supply

- **Supply versus quantity supplied:**



2. Supply

- The law of increasing supply applies, which states that an increase in price causes an increase in the quantity offered, and vice versa, a decrease in price means a decrease in the quantity offered, because:
    - a rise in price will induce an increased interest in production, attract more producers, induce an interest in production growth in those who previously produced less than they could, i.e. did not use their production capacity to the full (but not indefinitely, see the incentive function of price);
    - price rise = higher prices = higher incomes = ability to buy more additional factors of production = expansion of production.

2. Supply

- **Types of supply:**

  1. **Individual supply - the supply of one producer, determined by the quantity of production of this producer and the intended prices of his products.**

  2. **Market supply (S - we have discussed this so far) - the supply of a single product from different producers, the sum of the offers on the market for one product.**

  3. **Aggregate supply (AS) - the sum of all intended sales with which producers come to the market (determined by the quantity of production of all producers and the prices at which they want to sell their products).**

Thank You for Your Attention