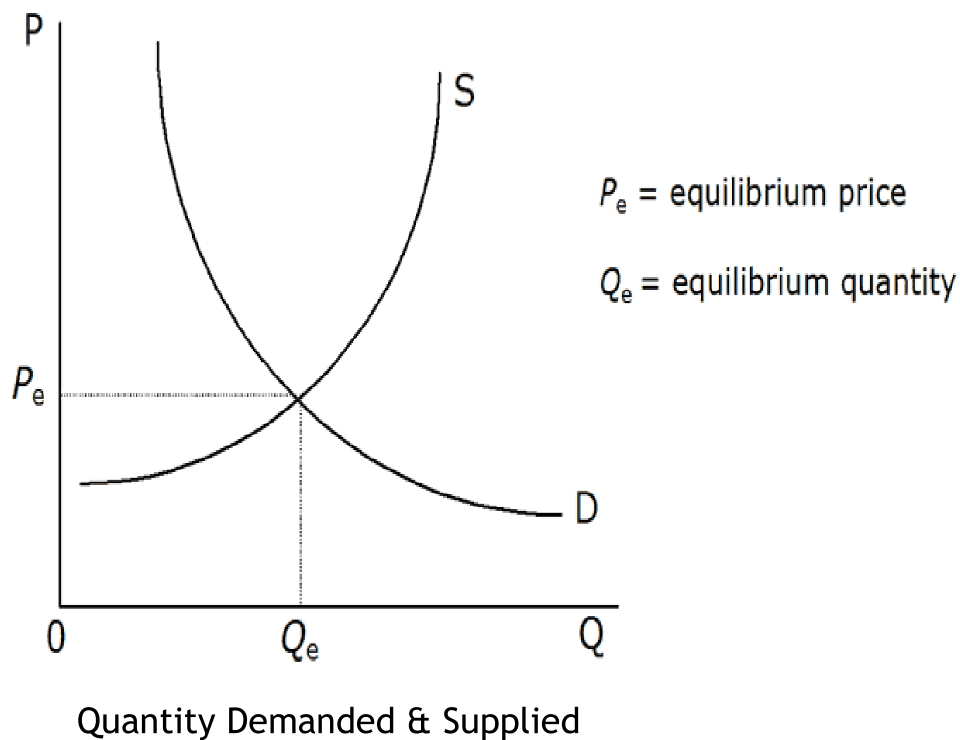
Market Equilibrium

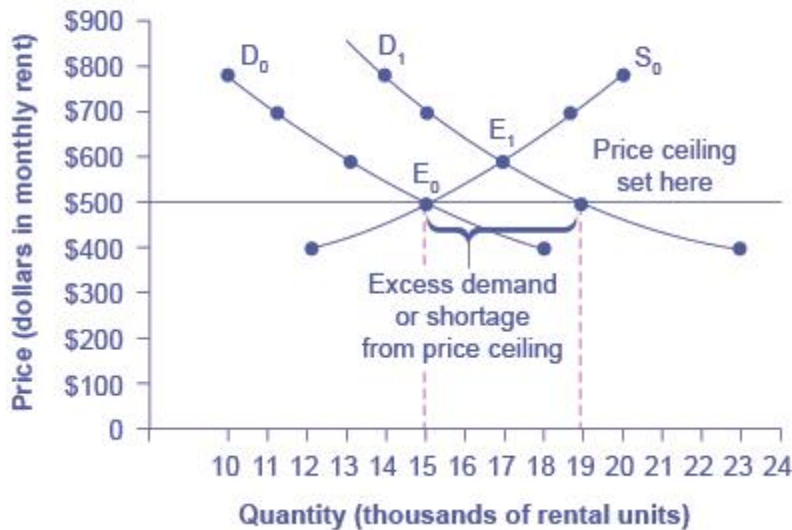
Supply and Demand Together

The **intersection** of the supply and demand curves determines the **market equilibrium** . At the equilibrium price, the quantity demanded equals the quantity supplied. Because the graphs for demand and supply curves both have price on the vertical axis and quantity on the horizontal axis, the demand curve and supply curve for a particular good or service can appear on the same graph. Together, demand and supply determine the price and the quantity that will be bought and sold in a market.



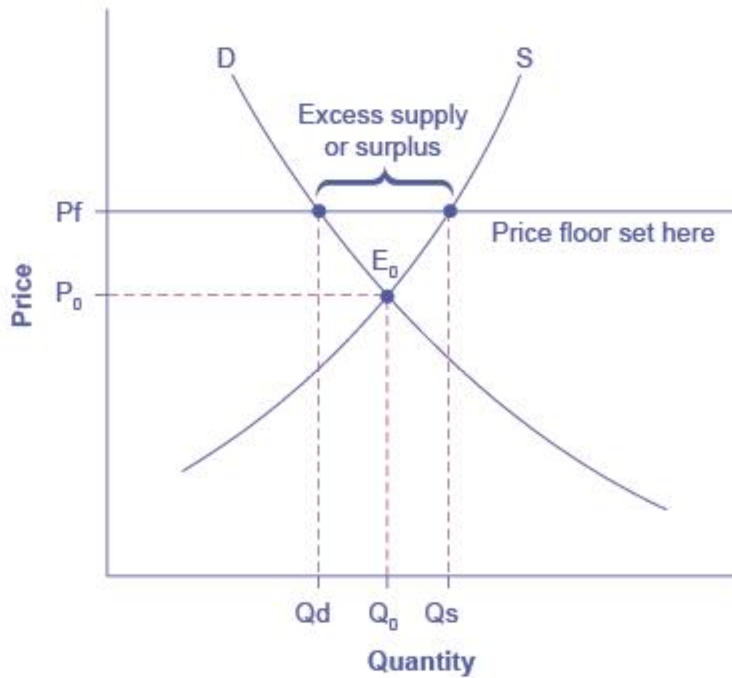
Government regulations will create surpluses and shortages in the market. When a price ceiling is set, there will be a shortage. When there is a price floor, there will be a surplus.

Price Ceiling:
Price Ceiling is legally imposed maximum price on the market. Transactions above this price is prohibited. Policy makers set ceiling price below the market equilibrium price which they believed is too high. Intention of price ceiling is keeping stuff affordable for poor people. Price ceiling generates shortages on the market. Example: Rent control.



A Price Ceiling Example—Rent Control The original intersection of demand and supply occurs at E0. If demand shifts from D0 to D1, the new equilibrium would be at E1—unless a price ceiling prevents the price from rising. If the price is not permitted to rise, the quantity supplied remains at 15,000. However, after the change in demand, the quantity demanded rises to 19,000, resulting in a shortage.

Price Floor:
Price floor is legally imposed minimum price on the market. Transactions below this price is prohibited.Policy makers set floor price above the market equilibrium price which they believed is too low.Price floors are most often placed on markets for goods that are an important source of income for the sellers, such as labor market. Price floor generate surpluses on the market. Example: minimum wage.



Wheat Prices: A Price Floor Example The intersection of demand (D) and supply (S) would be at the equilibrium point E0. However, a price floor set at Pf holds the price above E0 and prevents it from falling. The result of the price floor is that the quantity supplied Qs exceeds the quantity demanded Qd. There is excess supply, also called a surplus.

Difference between Price Ceiling & Price Flooring:

Price Ceiling	Price Floor
Definition	
It is a mechanism of price control where the price for a good is prevented from rising above a certain level	It is a method of price control where the price of a good is prevented from falling below a certain level
When it becomes effective	
Price ceiling becomes effective when it is set below the equilibrium price	Price floor becomes effective when it is set at above the equilibrium price
Impact on market	
It causes shortage of goods in the market	It causes an excess or surplus of goods in the market
Example	
Rent control is one of the most prominent examples of price ceiling	Minimum wages is regarded as one of the commonly used examples of price floor.

References:

- *Dwivedi D N, Managerial Economics, Vikas Publishing House Pvt. Ltd, 2006*
- *Samuelson, Paul A; Nordhaus, William D. (2014). Economics. Boston, Mass: Irwin McGraw-Hill*