Warm up

- What are advantages of having supply and demand determine prices in a market economy rather than a government (command) do it for you, or determine them on the spot (traditional)?
  - Come up with a list of 5 advantages with your partner
  - Also try to come up with 2 disadvantages

Introduction to Prices

Principles of Microeconomics

The Advantages of Prices

- 1. Don't have to barter
    - -Don't have to trade good for a good
    - -Bartering makes it hard for supplier to produce enough goods

How Much????

How do prices help a supplier?

Price help the supplier know how much demand there is.

The Advantages of Prices

2. Efficient Resource Allocation

- Price systems make sure land, labor, and capital are used efficiently
- Producers want to get the highest price so they are going to use their resources in a way that gets them the highest prices (meeting the demand)

The Advantages of Prices

3. Prices act as signals for producers and consumers to help them make economic decisions

Supplier

Low Price - Overproducing

High Price – Good is in demand, make more

Consumer

High price – think before I buy the good

Low Price – Buy more

The Advantages of Prices

4. Price system is “Free” Kinda

- Central Government – have to hire people to distribute goods in Command system
- Free Market – don’t have to hire people to make prices
    - Producers and Consumers do this

The Advantages of Prices

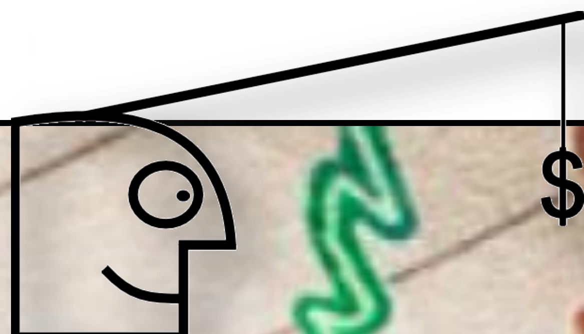
5. Prices help suppliers produce a wider variety of Goods

- Prices help people choose what they are going to buy.
- Prices help suppliers choose who they are going to market to

6. Prices as Incentives

6. Prices act as an Incentive to produce more to make more money so they can consume more

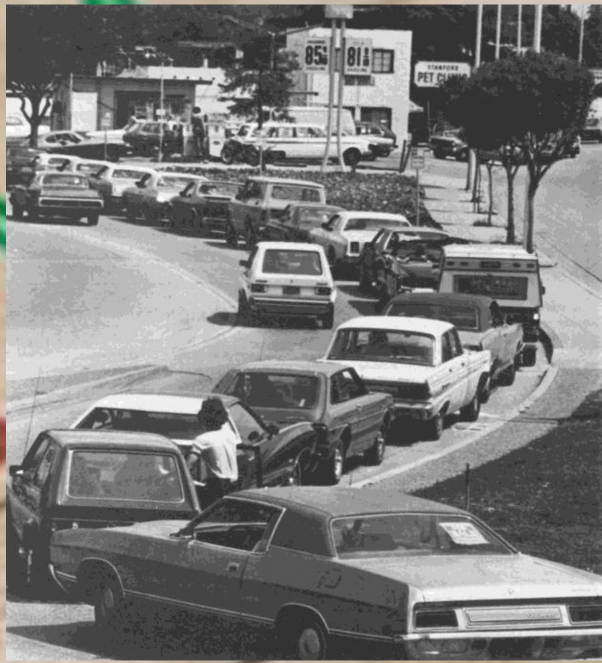
- Prices let people know if there will be a shortage or surplus
  - Result: Supplier and consumer can adjust



The Advantages of Prices

7. Prices can be flexible

- It is much easier to change the price than the supply

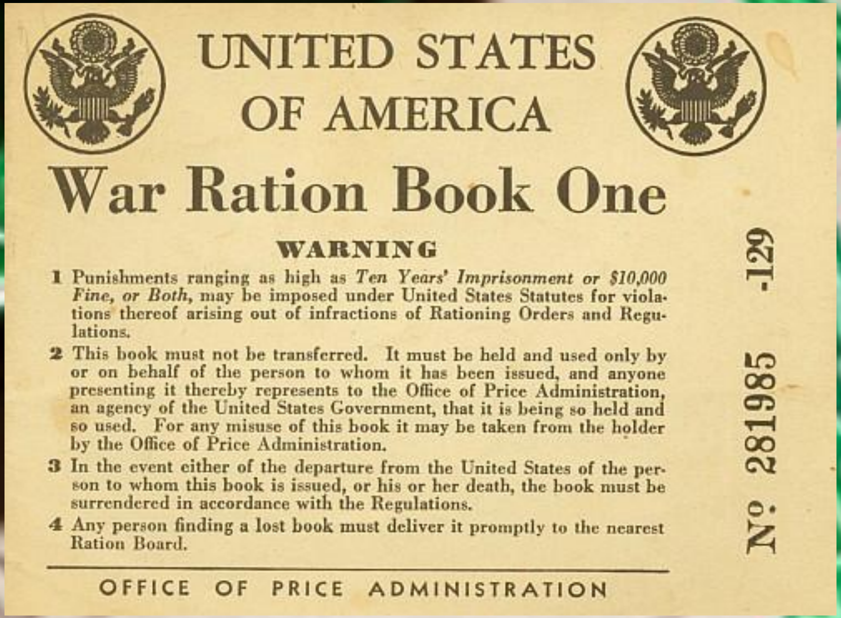


Disadvantages of Prices

- Supply Shock – an immediate shortage of a good (or excess demand)
  - Solutions to supply shock:
    - Increase supply – can't do this right away. It takes time to make more goods)
    - Rationing – Divide the goods equally among people
    - Raise prices – This will create a new equilibrium (Best Solution?)

Dealing with Supply Shock

- Rationing – Government Intervention to equally divide goods
- Rapid Price Increase – Companies raise prices to the point where limited people will be able to afford good



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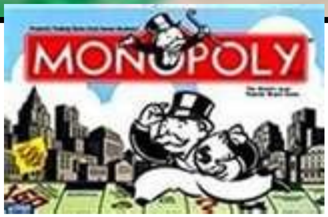
Black Market

- During Rationing – It was too hard to police suppliers
  - o People would give extra money under the table

Market Problems



- Three Problems:

1. Imperfect Competition

   -This will cause price to be higher than it should be

2. Spillover Costs

   - The supply curve will be too far to the right

3. Imperfect Information

   - The Demand curve will be too far to the right