Why the lower quantity rules ...

Note Title 6/4/2005

Dr. Myers,

After taking the Module 3 quiz the second time, I was wrong only on one question which was Equlibrium-Question 129:

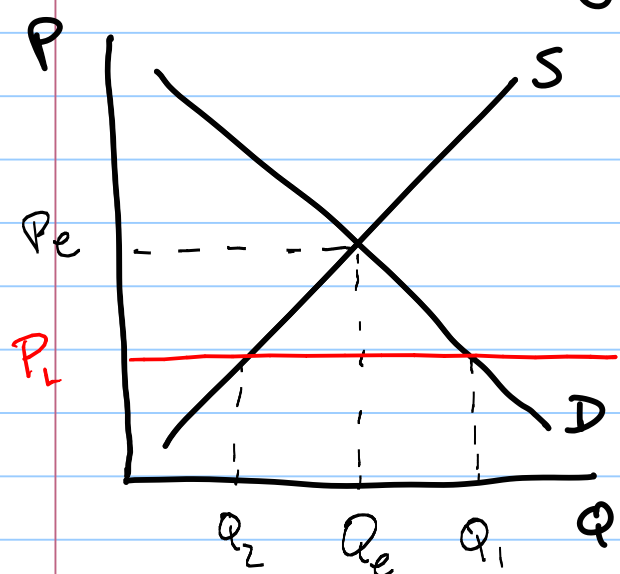
When there is a shortage in the market, the quantity sold is ______

I chose: a. greater than the quantity supplied

The correct answer was: b. equal to the quantity supplied

This confused me, because I understood that if the quantity suppled equaled the quantity sold then that is the equilibrium point. Could you check this question over for me?

I can see your confusion, but consider the following graph where there is a shortage...

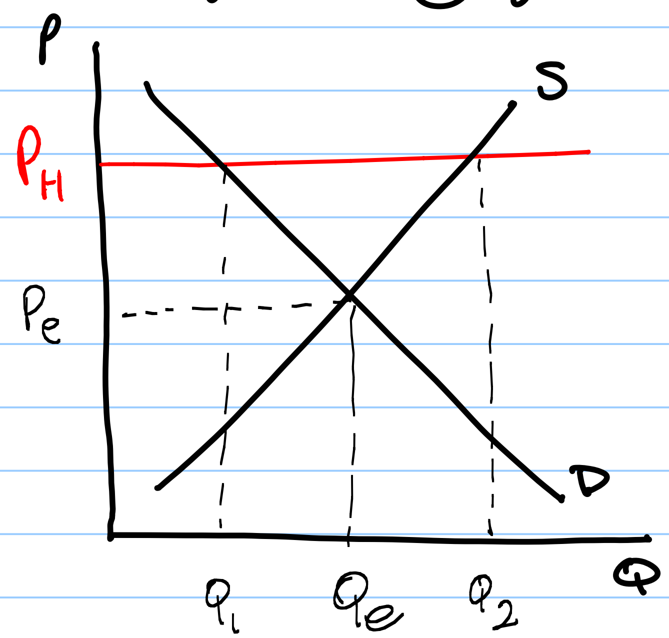


let price be "low" at P_L, then a shortage exists since at P_L quantity supplied is Q_2.

That is all there is. The shortage exists because demanders want Q_1 at P_L, but can't have that.

So the lower amount Q_2 "rules" over Q_1.

Now consider a surplus as shown in the following graph...



If price is "too high" at P_H then demanders will only want to buy Q_1 while suppliers will want to put Q_2 out for sale.

The surplus at P_H is $Q_2 - Q_1$.

Since buyers will not buy more than Q_1 at P_H, the excess supply goes unsold as long as price "sticks" at P_H.

In this case as well as on the last page the lower amount "rules."

Please note two very important concepts here.

(1) Surplus & shortage only exist when the price is higher or lower than equilibrium price respectively.

(2) The natural tendency of all markets is for price to move to equilibrium. This is consistent with a "mathematically" stable system.