

(c) Increase in demand < Decrease in supply

Equilibrium price falls and Equilibrium Quantity rises

(a) Increase in supply when demand remains the same

(b) Increase in demand < Increase in supply

(c) Decrease in demand < Increase in supply

- **Price Ceiling** refers to fixing the maximum price of a commodity at a level lower than the equilibrium price.
- **Price Floor** refers to the minimum price (above the equilibrium price), fixed by the government, which the producers must be paid for their produce.

Synonyms or Similar Terms of this Chapter

Price Ceiling	Maximum Price Ceiling
Price Floor	<ul style="list-style-type: none">• Minimum Price Ceiling• Minimum Support Price (MSP)

GUIDELINES TO NCERT QUESTIONS

1. Explain market equilibrium.

Hint: Market Equilibrium refers to the situation when the quantity demanded of a commodity becomes equal to the quantity supplied.

2. When do we say there is excess demand for a commodity in the market?

Hint: There is excess demand for a commodity in the market when its quantity demanded is more than quantity supplied at the prevailing market price.

3. When do we say there is excess supply for a commodity in the market?

Hint: There is excess supply for a commodity in the market when its quantity supplied is more than quantity demanded at the prevailing market price.

4. What will happen if the price prevailing in the market is:

(i) above the equilibrium price?

(ii) below the equilibrium price?

Hint:

(i) If the market price is above the equilibrium price, then there will be a situation of Excess Supply in the market. Discuss 'Excess Supply'.

(ii) If the market price is below the equilibrium price, then there will be a situation of Excess Demand in the market. Discuss 'Excess Demand'.

5. Explain how price is determined in a perfectly competitive market with fixed number of firms.

Hint: Discuss "Determination of Equilibrium Price under Perfect Competition".

6. Suppose the price at which equilibrium is attained is above the minimum average cost of the firms constituting the market. Now if we allow for free entry and exit of firms, how will the market price adjust to it?

Hint: If the equilibrium price is above the minimum average cost of the firms, it indicates that the existing firms have an opportunity to earn abnormal profits. With freedom of entry and exit of firms, new firms will enter the industry, which will increase the market supply and will shift the supply curve towards right. This rise in supply will lead to fall in equilibrium price till it becomes equal to the minimum average cost.

7. How are equilibrium price and quantity affected when income of the consumers: (a) Increase; (b) Decrease

Hint:

(a) An increase in income of buyers will increase the demand (assuming normal goods) at the given price. It will lead to excess demand. This leads to competition among buyers, which raises the price. Increase in price leads to rise in supply and fall in demand. These changes continue till supply and demand become equal at a new equilibrium price. As there is an increase in demand only, equilibrium price rises.

Refer 'Increase in Demand' given in Section 11.5 for diagrammatic explanation.

(b) A decrease in income will decrease the demand (assuming normal goods) at the given price. It will lead to excess supply. This leads to competition among sellers, which reduces the price. Fall in price leads to decrease in supply and rise in demand. These changes continue till supply and demand become equal at a new equilibrium price. As there is a decrease in demand only, both equilibrium price and equilibrium quantity will fall.

Refer 'Decrease in Demand' given in Section 11.5 for diagrammatic explanation.

8. Using supply and demand curves, show how an increase in the price of shoes affects the price of a pair of socks and the number of pairs of socks bought and sold.

Hint: An increase in the price of shoes (complementary good) will decrease the demand for socks (given commodity) as it becomes relatively expensive to consume the two commodities (socks and shoes) together. It will lead to excess supply. This leads to competition among sellers, which reduces the price. Fall in price leads to decrease in supply and rise in demand. These changes continue till supply and demand become equal at a new equilibrium price. As there is a decrease in demand only, both equilibrium price and equilibrium quantity will fall. Refer 'Decrease in Demand' given in Section 11.5 for diagrammatic explanation.

9. How will a change in price of coffee affect the equilibrium price of tea? Explain the effect on equilibrium quantity also through a diagram.

Hint: A change in price of coffee will directly influence the equilibrium price and quantity of tea as coffee is a substitute of tea.

- An increase in price of coffee will make tea relatively cheaper and demand for tea will rise. It will lead to excess demand. Refer 'Increase in Demand' given in Section 11.5 for a detailed and diagrammatic explanation.
- On the other hand, a decrease in price of coffee will decrease the demand for tea as tea will become relatively costly. It will lead to excess supply. Refer 'Decrease in Demand' given in Section 11.5 for a detailed and diagrammatic explanation.

10. How do the equilibrium price and quantity of a commodity change when price of input used in its production changes?

Hint: A change in price of inputs will directly influence the equilibrium price and quantity of the commodity.

- An increase in price of inputs will raise the production cost and it will lead to decrease in supply of the commodity. It will lead to excess demand. Refer 'Decrease in Supply' given in Section 11.6 for a detailed and diagrammatic explanation.
- On the other hand, a decrease in price of inputs will increase the supply due to fall in cost of production and rise in profit margin. It will lead to excess supply. Refer 'Increase in Supply' given in Section 11.6 for a detailed and diagrammatic explanation.

11. If the price of a substitute (Y) of good X increases, what impact does it have on the equilibrium price and quantity of good X?

Hint: An increase in price of a substitute (Y) of good X will directly affect the equilibrium price and quantity of good X. Rise in price of Y will make X relatively cheaper and demand for X will rise. It will lead to excess demand. It will lead to increase in both equilibrium price and equilibrium quantity. Refer 'Increase in Demand' given in Section 11.5 for a detailed and diagrammatic explanation.

12. Explain through a diagram the effect of a rightward shift of both the demand and supply curves on equilibrium price and quantity.

Hint: Discuss 'Both Demand and Supply Increase' given in Section 11.7.

13. How are the equilibrium price and quantity affected when:

- (a) Both demand and supply curves shift in the same direction.
- (b) Demand and supply curves shift in opposite directions.

Hint:

- (a) Discuss 'Both Demand and Supply decrease' and 'Both Demand and Supply Increase' given in Section 11.7.
- (b) Discuss 'Demand decreases and Supply increases' and 'Demand increases and Supply decreases' given in Section 11.7.

14. Suppose the demand and supply curve of commodity X in a perfectly competitive market are given by:

$$q^D = 700 - p$$

$$q^S = 500 + 3p \text{ for } p \geq 15$$

$$= 0 \text{ for } 0 \leq p < 15$$

Assume that the market consists of identical firms. Identify the reason behind the market supply of commodity X being zero at any price less than ₹ 15. What will be the equilibrium price for this commodity? At equilibrium, what quantity of X will be produced?

Hint: From the given supply curve, it can be concluded that ₹ 15 must be the minimum average variable cost (AVC) of producing commodity X. In a perfectly competitive market, firms do not produce positive level of output for any price less than AVC as they will be at loss if they supply at a price less than AVC. So, firms will not be interested in producing commodity X at any price less than ₹ 15.

Calculation of Equilibrium Price and Equilibrium Quantity

At equilibrium, $q^D = q^S$

It means, $700 - p = 500 + 3p$

$$4p = 200$$

p or Equilibrium Price = ₹ 50.

Putting the value of equilibrium price in the equation of demand curve:

$$q^D \text{ or Equilibrium Quantity} = 700 - 50 = 650 \text{ units.}$$

15. The market demand curve for commodity X is $q^D = 700 - p$. Now, let us allow for free entry and exit of the firms producing commodity X. Also assume the market consists of identical firms producing commodity X. Let the supply curve of a single firm be explained as:

$$q_f^S = 8 + 3p \text{ for } p \geq 20$$

$$= 0 \text{ for } 0 \leq p < 20$$

- (a) What is the significance of $p = 20$?
- (b) Calculate the equilibrium quantity and number of firms at the equilibrium price of ₹ 20.

Hint:

- (a) $p = 20$ indicates that the minimum average cost of the firm is ₹ 20 and the firm will not supply or produce commodity X for any price less than ₹ 20.

- (b) Determination of Equilibrium Quantity: It can be determined by putting the value of equilibrium price of ₹ 20 in the market demand curve.

$$q^D \text{ or Equilibrium Quantity} = 700 - 20 = 680 \text{ units.}$$

Determination of Number of Firms: The number of firms can be determined by dividing the equilibrium quantity by quantity supplied by each firm. Quantity supplied by a single firm can be calculated by putting the value of equilibrium price of ₹ 20 in the supply curve.

$$q_f^S = 8 + 3 \times 20 = 68 \text{ units.}$$

Quantity supplied by each firm will be 68 units as there are identical firms producing commodity X.

$$\text{Number of Firms} = \frac{\text{Equilibrium Quantity}}{\text{Quantity Supplied by Each Firm}} = \frac{680}{68} = 10 \text{ Firms}$$

16. Suppose the demand and supply curves of salt are given by: $0 < p < 15$

$$q^D = 1,000 - p$$

$$q^S = 700 + 2p$$

- Find the equilibrium price and quantity.
- Now suppose that the price of an input used to produce salt has increased so that the new supply curve is $q^S = 400 + 2p$. How does the equilibrium price and quantity change?
- Suppose the government has imposed a tax of ₹ 3 per unit on sale of salt. How does it affect the equilibrium price and quantity?

Hint:

- At equilibrium, $q^D = q^S$

$$\text{It means, } 1,000 - p = 700 + 2p$$

$$p = ₹ 100$$

Putting the value of equilibrium price in the equation of demand curve, we get:

$$q^D = 1,000 - 100 = 900$$

$$\text{Equilibrium Price} = ₹ 100, \text{Equilibrium Quantity} = 900 \text{ units}$$

- When price of input increases, the new supply curve becomes: $q^S = 400 + 2p$

To calculate new equilibrium price and quantity, equating q^D and q^S

$$1,000 - p = 400 + 2p$$

$$p = ₹ 200$$

Putting the value of equilibrium price in the equation of demand curve or supply curve, we get:

$$q^D = 1,000 - 200 = 800$$

$$\text{Equilibrium Price} = ₹ 200, \text{Equilibrium Quantity} = 800 \text{ units}$$

Thus, the equilibrium price increases and equilibrium quantity falls due to rise in the price of inputs.

- When tax of ₹ 3 per unit of sale is imposed on the commodity, then the new supply curve becomes:

$$q^S = 700 + 2(p - 3)$$

$$q^S = 700 + 2p - 6$$

$$q^S = 694 + 2p$$

To calculate new equilibrium price and quantity, equating q^D and q^S

$$1,000 - p = 694 + 2p$$

$$p = ₹ 102$$

Putting the value of equilibrium price in the equation of demand curve or supply curve, we get:

$$q^D = 1,000 - 102 = 898$$

$$\text{Equilibrium Price} = ₹ 102, \text{Equilibrium Quantity} = 898 \text{ units}$$

Thus, the equilibrium price increases & equilibrium quantity falls due to tax of ₹ 3 per unit on sale of salt.

17. The market demand curve for a commodity and the total cost for a monopoly firm producing the commodity is given by the schedule below:

Quantity	0	1	2	3	4	5	6	7	8
Price	52	44	37	31	26	22	19	16	13
Total Cost	10	60	90	100	102	105	109	115	125

Use the information to calculate the following:

- The MR and MC schedules;
- The quantities for which the MR and MC are equal;
- The equilibrium quantity of output and the equilibrium price of the commodity;
- The total revenue, total cost and total profit in equilibrium.

Hint:

(a)

Quantity (Q) (in units)	Price (P) (₹)	TC (₹)	TR (₹) $TR = Q \times P$	MR (₹) $TR_n - TR_{n-1}$	MC (₹) $TC_n - TC_{n-1}$
0	52	10	0	—	—
1	44	60	44	44	50
2	37	90	74	30	30
3	31	100	93	19	10
4	26	102	104	11	2
5	22	105	110	6	3
6	19	109	114	4	4
7	16	115	112	-2	6
8	13	125	104	-8	10

(b) At 6 units, $MR = MC$

(c) Equilibrium is achieved when $MR = MC$.

So, Equilibrium Quantity = 6 units and Equilibrium Price = ₹ 19.

(d) Total Revenue (TR) = ₹114

Total Cost (TC) = ₹ 109

Total profit = $TR - TC = 114 - 109 = ₹ 5$

HOTS: HIGHER ORDER THINKING SKILLS QUESTIONS

Q. 1. Explain the effect of increase in income of buyers of a 'normal' commodity on its equilibrium price.

Ans. An increase in income of buyers will increase the demand for normal goods at the given price. It will lead to excess demand. This leads to competition among buyers, which raises the price. Increase in price leads to rise in supply and fall in demand. These changes continue till supply and demand become equal at a new equilibrium price. As there is an increase in demand only, equilibrium price rises.

Refer 'Increase in Demand' given in Section 11.5 for diagrammatic explanation.

Q. 2. What will be the effect on equilibrium price and equilibrium quantity, when price of complementary goods increases?

Ans. When price of complementary goods increases, keeping other factors constant, then demand for the given commodity decreases since it becomes relatively expensive to consume the two commodities (the given commodity and its complement) together. It will lead to excess supply. This leads to competition among sellers, which reduces the price. Fall in price leads to decrease in supply and rise in demand. These changes continue till supply and demand become equal at a new equilibrium price. As there is a decrease in demand only, both equilibrium price and equilibrium quantity will fall.

Refer 'Decrease in Demand' given in Section 11.5 for diagrammatic explanation.

Q. 3. It is expected that replacement of all existing taxes on good X by the proposed single Goods and Services Tax (GST) will bring down overall tax on good X substantially. Explain its likely chain of effects on price and quantity of good X. Use diagram.

Ans. With decrease in overall taxes, keeping other factors constant, total supply in the market will increase due to reduction in the cost of production. It will lead to excess supply. This leads to competition among sellers, which reduces the price. Fall in price leads to decrease in supply and rise in demand. These changes continue till supply and demand become equal at a new equilibrium price. As there is an increase in supply only, equilibrium quantity will rise, but equilibrium price will fall.

Refer 'Increase in Supply' given in Section 11.6 for diagrammatic explanation.

Q. 4. Explain the effect on equilibrium price when price of inputs increases.

OR

The market for cars is in equilibrium. Suppose the price of aluminium parts (used in cars) increases. Explain the effect of rise in the price of aluminium parts on the equilibrium price and quantity of cars. (Use diagram)

Ans. When price of inputs increase, assuming no change in other factors, then the cost of production rises. As a result, supply decreases due to fall in the profitability level. It will lead to excess demand. This leads to competition among buyers, which raises the price. Increase in price leads to rise in supply and fall in demand. These changes continue till supply and demand become equal at a new equilibrium price. As there is a decrease in supply only, equilibrium quantity will fall, but equilibrium price will rise.

Refer 'Decrease in Supply' given in Section 11.6 for diagrammatic explanation.

Q. 5. Suppose the functions of demand and supply curves of a commodity are given by:

$$q^D = 100 - p$$

$$q^S = 60 + p \text{ for } p \geq 15$$

$$= 0 \text{ for } 0 \leq p < 15$$

- (i) What does $p = 15$ indicate?
- (ii) Find the equilibrium price and equilibrium quantity.
- (iii) Whether the given commodity comes under the category of viable industry.
- (iv) Calculate market demand and supply at price of ₹ 25 and ₹ 16. Show that at price of ₹ 25, there is excess supply and at price of ₹ 16, there is excess demand.

Ans. (i) $p = 15$ indicates that the minimum average cost of the firm is ₹ 15 and firm will not supply the commodity for any price less than ₹ 15.

(ii) Calculation of Equilibrium Price and Equilibrium Quantity

$$\text{At equilibrium, } q^D = q^S$$

$$\text{It means, } 100 - p = 60 + p$$

$$2p = 40 \text{ or } p = 20 \text{ or Equilibrium Price} = ₹ 20.$$

Putting the value of equilibrium price in the equation of demand curve:

$$q^D \text{ or Equilibrium Quantity} = 100 - 20 = 80 \text{ units.}$$

- (iii) Yes, the given commodity comes under the category of viable industry as there is some price, at which supply and demand happen to coincide.
- (iv) At price of ₹ 25: Market Demand = $100 - 25 = 75$ units;
Market Supply = $60 + 25 = 85$ units. There will be excess supply at price of ₹ 25.
At price of ₹ 16: Market Demand = $100 - 16 = 84$ units;
Market Supply = $60 + 16 = 76$ units. There will be excess demand at price of ₹ 16.

Q. 6. Mention the various cases in which equilibrium price remains same.

Ans. The equilibrium price remains same when:

- (i) Increase in demand = Increase in supply.
- (ii) Decrease in demand = Decrease in supply.

- (iii) Demand increases and supply is perfectly elastic.
- (iv) Demand decreases and supply is perfectly elastic.
- (v) Supply increases and demand is perfectly elastic.
- (vi) Supply decreases and demand is perfectly elastic.

Q. 7. "Demand and supply are like two blades of a pair of scissors". Comment

Ans. The given statement is correct. Both the blades of a pair of scissors are equally important to cut a piece of cloth. Similarly, both demand and supply are needed for determining price in the market. There is no use for demand for a product if there is no supply for the product and supply is not needed if there is no demand for the product. One of the two may play more active role in price determination in the short run. But, both are needed to determine the price in the long run.

Q. 8. If market demand function is given as: $Q_{MD} = 25 - 2P$ and market supply as: $Q_{MS} = 3P$, then what will be the equilibrium price and equilibrium quantity?

Ans. At equilibrium, $Q_{MD} = Q_{MS}$

It means, $25 - 2P = 3P$

Or, $5P = 25$

P or Equilibrium Price = ₹ 5.

Putting the value of equilibrium price in the equation of market demand function:

Equilibrium Quantity = $25 - 2 \times 5 = 15$ units.

Q. 9. There are 10,000 identical individual buyers in the market for commodity X, each with a demand function given by $Q_{dx} = 12 - 2P_x$ and 1,000 identical producers of commodity X, each with a supply function given by $Q_{sx} = 20P_x$.

- (i) Find the market demand function and the market supply function for commodity X.
- (ii) Obtain the equilibrium price and equilibrium quantity.
- (iii) Suppose the government decides to collect a tax of ₹ 2 per unit sold from each of the 1,000 sellers of commodity X. What effect will this have on the equilibrium price and quantity of commodity X?

Ans. (i) Market Demand function: $Q_{Mdx} = 10,000 (12 - 2P_x) = 1,20,000 - 20,000 P_x$

Market Supply function: $Q_{Msx} = 1,000 (20 P_x) = 20,000 P_x$

(ii) At equilibrium, $Q_{Mdx} = Q_{Msx}$

It means, $1,20,000 - 20,000 P_x = 20,000 P_x$

or, $P_x = ₹ 3$

Putting the value of equilibrium price (P_x) in the market demand function, we get:

$Q_{Mdx} = 1,20,000 - 20,000 \times 3 = 60,000$ units.

Equilibrium Price = ₹ 3, Equilibrium Quantity = 60,000 units.

(iii) When tax of ₹ 2 per unit is imposed and collected from each of the 1,000 sellers of commodity X, then the new equilibrium price becomes: $P_x - 2$.

New Market Supply function: $Q_{Msx} = 20,000 (P_x - 2) = 20,000 P_x - 40,000$

For equilibrium, $Q_{Mdx} = Q_{Msx}$

It means, $1,20,000 - 20,000 P_x = 20,000 P_x - 40,000$

or, $P_x = ₹ 4$

Putting the value of equilibrium price (P_x) in the market demand function, we get:

$Q_{Mdx} = 1,20,000 - 20,000 \times 4 = 40,000$ units.

New Equilibrium Price = ₹ 4, New Equilibrium Quantity = 40,000 units.

Thus, the equilibrium price increases and equilibrium quantity falls due to tax of ₹ 2 per unit.

Q. 10. Market for a good is in equilibrium. There is simultaneous “decrease” both in demand and supply but there is no change in market price. Explain with help of a schedule how it is possible.

Ans. A simultaneous decrease in both demand and supply may not influence the market price. This can be illustrated with the help of following schedule:

Price of (₹)	Original Demand (units)	Original Supply (units)	New Demand (units)	New Supply (units)
2	100	20	90	18
4	80	40	72	36
6	60	60	54	54
8	40	80	36	72
10	20	100	18	90

As seen in the given table, initially, the equilibrium (market) price is ₹ 6 per unit and the equilibrium demand and supply is 60 units.

When both demand and supply decrease by 10%, then both demand and supply fall from 60 units to 54 units. It means, at market price of ₹ 6, both demand and supply are equal. So, a simultaneous decrease in both demand and supply may not change the market price.

Q. 11. Why does the government of India fix ‘support price’ for some crops? Explain.

Ans. For some crops, fall in price below a certain level is not good for the farmers. Hence, the government fixes minimum price for these crops.

Q. 12. Explain the meaning and need for ‘Maximum Price Ceiling’.

Ans. When government imposes an upper limit on the price of a good, it is called Price Ceiling. It is generally imposed on essential items and is fixed below the market determined price. The reason being the equilibrium price is too high for the common people to afford.

Q. 13. Government reduces the price of inputs used in the production of commodity X. Describe the chain of effects of this change in the market.

Ans. The chain of effects of this change can be summarised as under:

- Reduction in prices of inputs lowers the cost of production.
- Revenues remaining unchanged, profits increase.
- Increase in profits induces the producers to supply more.
- Demand remaining unchanged, excess supply emerges.
- This leads to competition among sellers because they are not able to sell as they want to sell.
- As a result, price starts falling.
- Due to fall in price, demand expands and supply contracts till demand equals supply, creating new equilibrium at a lower price.

Q. 14. Explain the meaning and need for ‘Price Floor’.

Ans. Price Floor means that producers are not allowed to sell the good or service below some price fixed by the government.

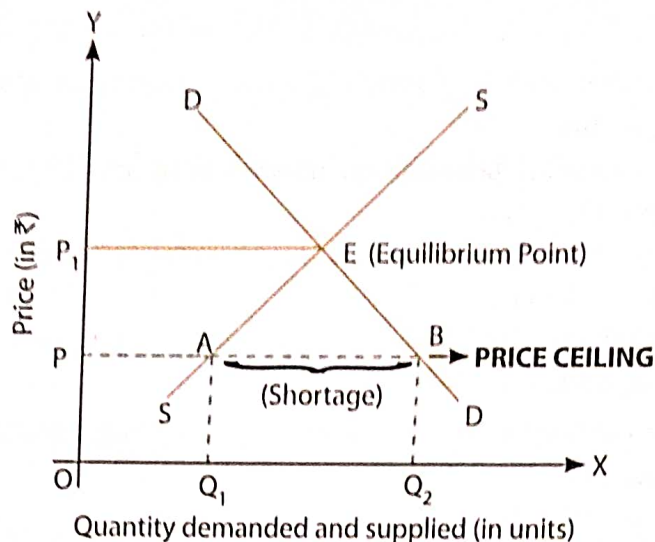
The need for price floor arises when government finds that the equilibrium price is too low for the producers.

Q. 15. Explain ‘black marketing’ as a direct consequence of price ceiling.

Ans. Black marketing may be termed as a direct consequence of price ceiling as it implies a situation where the commodity under the government’s control policy is illegally sold at a price higher than the one fixed by the government. It may primarily arise due to the presence of consumers who may be willing to pay higher price for the commodity than to go without it.

Q. 16. Explain the effects of 'Maximum Price Ceiling' on the market of a good. Use diagram.

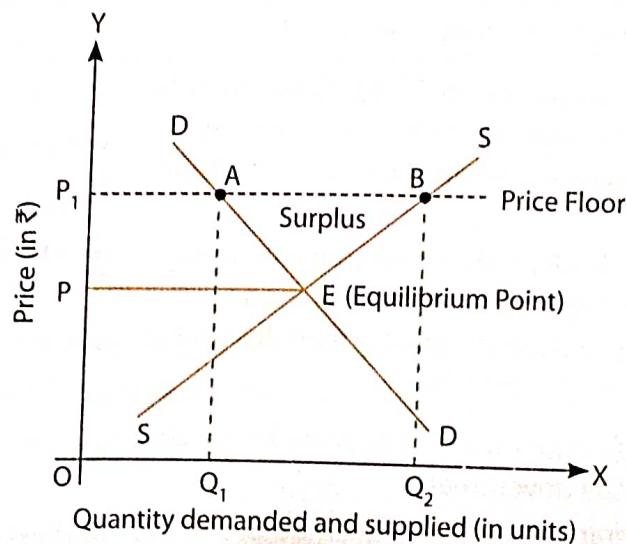
Ans.



Maximum Price Ceiling refers to imposition of upper limit on the price of a good by the government. For example, in the diagram, OP is Price Ceiling, while equilibrium price is OP_1 . At this price, the producers are willing to supply only PA (Or OQ_1), while consumers demand PB (Or OQ_2). The effect of the ceiling is that shortage, equal to AB (Q_1Q_2), is created, which may further lead to black marketing.

Q. 17. What are the effects of 'price-floor' (Minimum Price Ceiling) on the market of a good? Use diagram.

Ans. When government imposes lower limit on a price that may be charged for a particular good or service, it is called Minimum Price Ceiling, e.g. price OP_1 . At this price, the producers are willing to supply P_1B or (OQ_2), while consumers demand only P_1A ($= OQ_1$). Unable to sell, all they want to sell, the producers may try to illegally sell below the minimum price.



Q. 18. Explain the concept of 'buffer stock' as a tool of price floor.

Ans. Buffer stock is an important tool in the hands of government to ensure price floor. If in case, the market price is lower than what the government feels should be given to the farmers / producers, it would purchase the commodity at higher price from the farmers / producers so as to maintain stock of the commodity with itself, to be released in case of shortage of the commodity in future.

Q. 19. Suppose the demand and supply curves of a Commodity X is given by the following two equations simultaneously:

$$Q_d = 200 - p \quad Q_s = 50 + 2p$$

(i) Find the equilibrium price and equilibrium quantity.

- (ii) Suppose that the price of a factor of production producing the commodity has changed, resulting in the new supply curve given by the equation:

$$Q_s' = 80 + 2p$$

Analyse the new equilibrium price and new equilibrium quantity as against the original equilibrium price and equilibrium quantity.

Ans. (i) We know that the equilibrium price and quantity are achieved at:

$$\begin{aligned} Q_d &= Q_s \\ 200 - p &= 50 + 2p \\ (-) 3p &= (-) 150 \end{aligned}$$

Therefore, Equilibrium Price (p) = 50

And, Equilibrium Quantity (q) = $200 - 50 = 150$ units

- (ii) If the price of factor of production has changed, then under the new conditions:

$$\begin{aligned} Q_d &= Q_s' \\ 200 - p &= 80 + 2p \\ (-) 3p &= (-) 120 \end{aligned}$$

Therefore, Equilibrium Price (p) = 40

And, Equilibrium Quantity (q) = $200 - 40 = 160$ units

Thus, as the equilibrium price is decreased, the equilibrium quantity is increased.

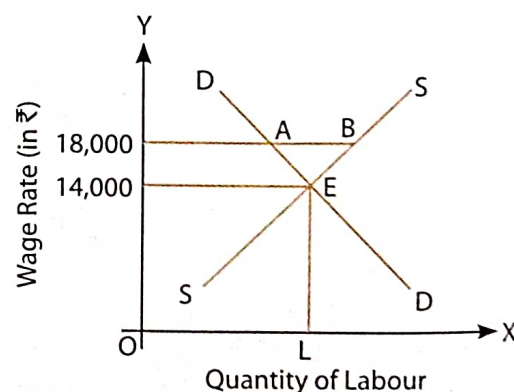
Q. 20. Explain the meaning and implications of maximum price ceiling and minimum price ceiling.

Ans. When the government imposes upper limit on the price of a good it is called maximum price ceiling. It is fixed below the equilibrium price. Implication: It will lead to excess demand. This in turn may lead to black marketing of goods.

When the government imposes lower limit on the price of a good, it is called minimum price ceiling. Implication: It leads to excess supply. This in turn may lead to illegal selling below the ceiling price as the producers are not able to sell what they desire to sell.

Q. 21. The equilibrium market wage rate is ₹ 14,000 per month. The government finding it low fixes minimum wage rate at ₹ 18,000 per month. Examine the implications of this decision. Use diagram.

Ans. Payment of wage rate (₹ 18,000) higher than equilibrium wage rate (₹ 14,000) leads to excess supply of labour as shown in the diagram, equal to AB. Since supply is greater than demand, it may lead to unemployment equal to AB.



Q. 22. In the given diagram, OP is the market determined price and OP is the price fixed by the government.

- Identify if the diagram represents, price ceiling or price flooring.
- Discuss the likely behaviour of the market in the given condition.

Ans. (a) 'AB' in the given diagram represents 'Price Floor'.
 (b) In the situation of price floor, the Government sets the price above the equilibrium price, it creates the situation of excess supply in the market that leads to surplus of unsold stock with the producer. Since producers are not able to sell all they want to sell, they illegally sell the good or service below the minimum price.

