Assume the current price of good X is too high, i.e., it is above the equilibrium price. Describe the changes that would occur in a market as a result, i.e., explain how the market would adjust to equilibrium.

Answer:

If the current price of good is above the equilibrium price, i.e. P` > P* (Figure 1), the demand is less than supply. That`s why some suppliers will not be able to sell the amount that they expected to sell. This market situation is called a surplus of the good.

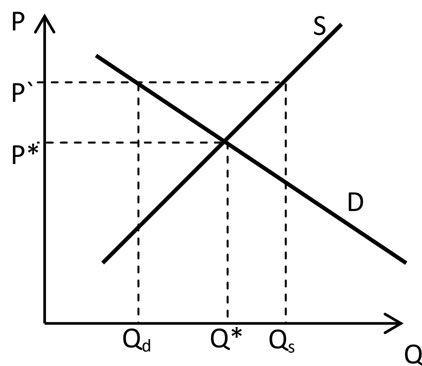

Figure 1

The surplus will be: $S = Q_s - Q_d$.

If sellers realize, that the surplus has occurred (stocks have increased), they will understand that the price for the good is higher than equilibrium one. In order to sell more items of good sellers will compete with each other by lowering the price.

So the existence of surplus gives sellers an incentive to lower their price, thus sending the price downward toward its equilibrium level.