

## A REVIEW ABOUT PARTIAL EQUILIBRIUM THEORY OF TRADE

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### **ABSTRACT**

*In partial equilibrium theory, the policy actions and effects are examined only in the directly affected markets. The Demand and Supply curves are used to describe the price effects policies. Producer and consumer surplus are used to measuring the welfare effects on participants in the market. A partial equilibrium theory either fails to consider the effects on other industries of the economy. The supply and demand model is a partial equilibrium model where the acceptance on the market of some goods is obtained separately from prices and quantities in other markets. Partial equilibrium is one which is related on a minimum range of data, a standard example is the price of a product, the prices of all other products are being held static during the entire review program. It is valid only under some limited situations, which may not always hold in practice, but may be reasonable approximations. Partial equilibrium is a condition of economic equilibrium which takes under consideration where only a part of the market and all other will remains the same to attain an equilibrium state. A partial equilibrium analysis will either ignore the effects on different industries in the economy or assumes that the sector is very small and hence little if any impact on other sectors of the economy.*

**KEYWORDS:** *Effects on Participants in the Market, Partial Equilibrium, Perfect Competition*

### **INTRODUCTION**

Equilibrium is the state of the stable condition without any change in the market. The price buyer wants to pay equal to the price offered by the seller. In such a situation there is no tendency to change the price or quality arises. Partial equilibrium theory of trade is an extension of the basic microeconomics theory of equilibrium. Partial equilibrium theory is considered as a condition of economic equilibrium which takes into attention in which only a part of the market to gain equilibrium state. Partial equilibrium is one which is occupying only a tethered range of data a general example is the price of a product, the prices of all other products being held intent during the analysis. Partial equilibrium analysis uses supply and demand curves in an appropriate market and avoids the effects that happened beyond the market. Economic analysis under partial equilibrium target on the effects of policy within a single market and does not locate the effects external to the market. It is a synonym for demand and supply analysis. It is often used in trade policy because of its simplicity. Partial equilibrium theory is based on the assumption of perfect competition which is characterized by a large number of procedures and consumers of a commodity. For a small common economy, the equilibrium will involve domestic demand and supply to a given world price. The supply and demand model is a partial equilibrium model where the approval on the market of some specific products is obtained separately from the price and quantity of other market products. These types of models allow us to predict changes in key economic variables of interest, including prices, the volume of trade, revenue, and measures of economic efficiency

### Assumptions

The entirely competitive market holds under the following assumptions:

- Product Price is granted and fixed for the consumers.
- Customers' taste, preferences, habits, incomes also seems to be fixed.
- The industry is easily applicable to factors of production at a familiar and fixed price compliant with the methods of production in use.
- Cost of the products that the factor of production helps in producing and the price and quantity of other factors are familiar and fixed.
- There is perfect flexibility of factors of production between occupation and places

### Limitations

- It is reduced to a convenient portion of the economy.
- It reduces the capability to study the interconnections of all the parts of the economy.
- This study will become unsuccessful if the unsubstantial expectations, which cut off the study of the specific market from the rest of the economy, are not taken into attention.
- It has been failed to explain the outcome of economic disruption in the market that have supremacy in demand and supply changes, moving from one market to another and thus influence second- and third-order waves of change in the entire economy.

### Partial Equilibrium Theory from the View Point of Export

The exporter has lower costs of production, so the equilibrium of supply of Hair Oils,  $S_H$ , and the demand for Hair Oils,  $D_H$ , is at a low price level,  $P'_A$ , than the world price,  $P'_W$ . Opening up trade brings the world price into the picture. So producers can now export this at the world price,  $P'_W >$  domestic price,  $P'_A$ . The result is that producer can gain the area  $e + f + g$ . Consumers lose consumer surplus of  $e + f$  and transfer that gain to domestic producers

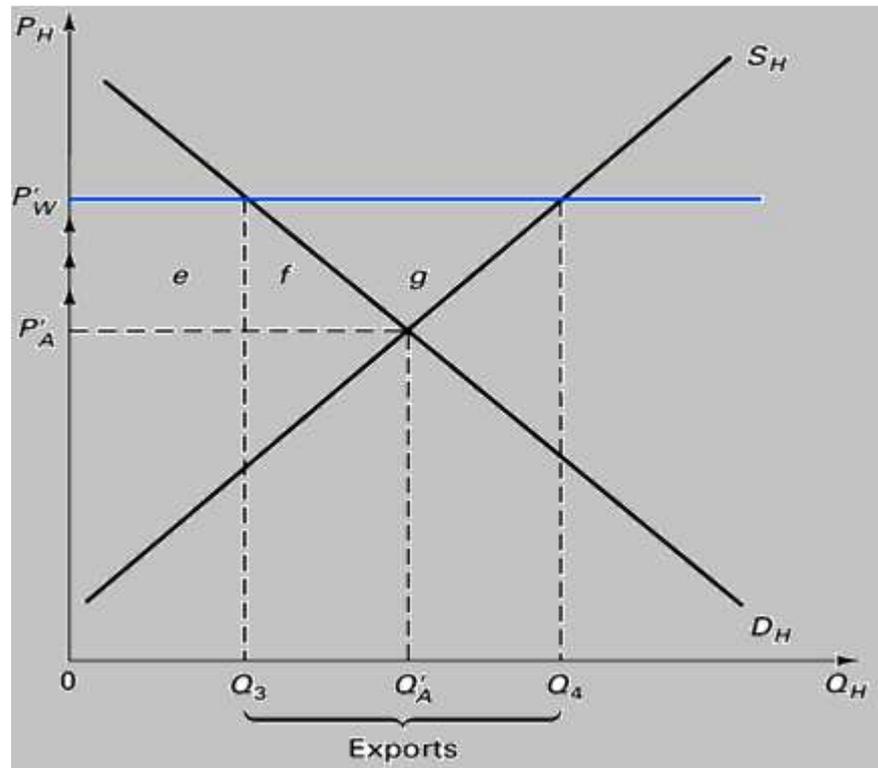
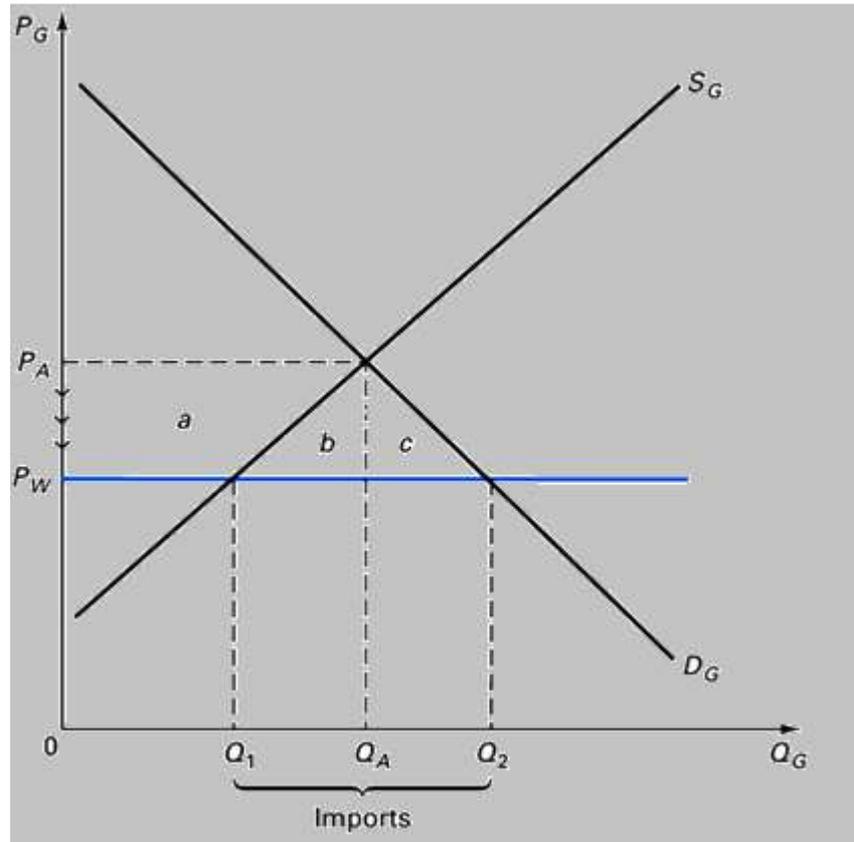


Figure 1

When Domestic demand is low, (because of high price), to  $Q_3$  while supply is incremented to  $Q_4$  as producers respond to the high prices for Hair Oils. So the export rate is calculated to  $Q_4 - Q_3$ . The net gain is area G, but consumers lose while there is overall gain.

**Partial Equilibrium Theory from the View Point of Import**

The equilibrium price is  $P_A$  decided by the intersection of supply of goody,  $S_G$ , and demand for a goody,  $D_G$  but this price is greater than that of the world price,  $P_W$ , as determined by the low-cost producer in the world. Opening up to trade reduces price to the world price,  $P_W$ . Consumers gain the areas,  $a + b + c$  in consumer surplus, while producers transfer producer surplus of the area  $a$  to consumers.



**Figure 2**

At the low price in the world, the domestic manufacturer only has the motivation to manufacture at  $Q_1$ , but domestic consumers demand  $Q_2$ . So imports are used to make up the difference. There is overall gain  $b + c$ , but domestic manufacturer loses manufacturer surplus. In partial equilibrium the welfare effects on consumers who acquire and the manufacturer manufacture in the market differentiated by consumer surplus and producer surplus.

### Consumer Surplus

The rate that a consumer is organized to pay for an appropriate good minus the rate that the consumer really pays. The rate that the customer is ready to pay has to be greater. In the representation given here is  $P_1$  is the price that a customer is willing to pay for a suitable product. But the manufacturer may deduct the price to  $P_2$  expecting that either more people would purchase at the deducted price or the person who are willing to pay  $P_1$  will acquire more of the same. The manufacturer may further deduct the rate to  $P_3$  again expecting more customers or the same customers purchasing more.

The rate keeps on declining until  $P'$  where the demand and supply curve divides their intersection is the equilibrium point. Therefore the consumer surplus for the primary consumer can be calculated as  $P_1 - P'$ , reducing for the succeeding consumer to  $P_2 - P'$  and so on. So the total consumer surplus in the market can be acquired by totaling up by three rectangles.

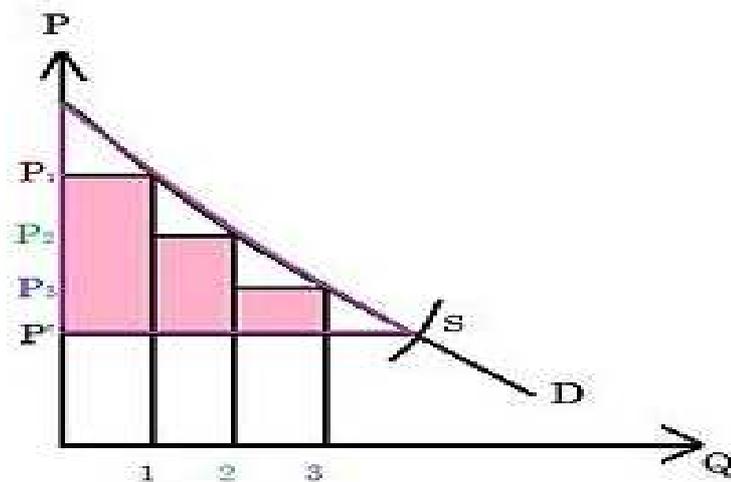


Figure 3

Graphical representation of Consumer Surplus

P denotes Price Q denotes Quantity

D denotes Demand Curve S denotes Surplus Curve

**Producer Surplus**

The rate that a manufacturer eventually given by selling suitable goods minus the rate the manufacturer is ready to receive for those goods. The rate that the manufacturer receives should be greater. If only a single unit of product was demanded at a price rate  $P_1$  this becomes the rate which the manufacturer awaits to receive. But if a pair units are demanded the low price at which the manufacturer would be ready to increment the supply shifts to  $P_2$ . This will continues and the final amount that eventually prevails in the market is  $P'$ , the rate that is obtained by the bisection of the demand and supply in the market. The producer's surplus here would be the initial rate minus the final rate. And the total consumer surplus in the market will be the total of the three rectangles.

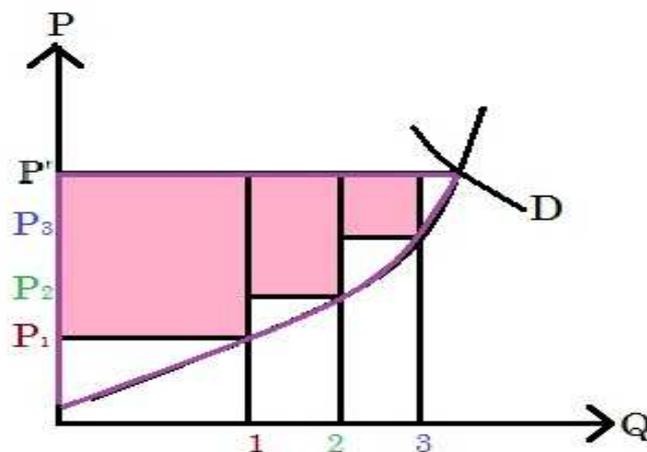


Figure 4

Graphical representation of Producer Surplus

P denotes Price Q denotes Quantity

D denotes Demand Curve S denotes Surplus Curve

## CONCLUSIONS

Partial equilibrium understands that the evaluation only considers the result of given policy action in the market(s) that are openly affected. That is the review does not account for the economic bisections between the different markets in a given economy. Partial equilibrium theory of trade applied to one good is not very meaningful because it ignores the interaction between goods. In any case, it will not tell anything about the pattern of trade between the two countries. It identifies the changes in policy action in constructing equilibrium only in that particular sector or market which results affected ignoring its influence in any other market or industry believe that they being small will have little impact if any. Therefore this review is examined to be useful in constricted markets. Partial equilibrium emphasis that the society is better off with trade than autarky (no trade). if a government restrict trade.

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