Worksheet 3.2

Gas Prices: From Disequilibrium to Equilibrium

From the Wall Street Journal comes a great example of a market in disequilibrium: read the quick roundup here.

We learn in IB Economics that markets are generally efficient thanks to the signals that prices send from consumers to producers to determine where scarce resources should be allocated. We've also learned how supply and demand interact in a market (such as that for natural gas) to determine equilibrium price and quantity. In the above example, there exists a disequilibrium, where either the quantity demanded exceeds the quantity supply (a shortage), or the quantity supplied exceeds the quantity demanded (a surplus). Based on your initial reading of the situation, which do you think it is?

The signals sent by the price system help society answer the question 'What to produce?' Producers of goods whose prices are rising receive very different information than those for whom the price is falling. Based on the excerpt above, discuss the causes and effects of the disequilibrium in the natural gas market.

Discussion questions:

1. What is meant by 'soft prices' in the natural gas market? Assuming output by gas producers remained constant, what must have changed to cause the soft prices? Using a diagram show this change in the market.
2. How have firms responded to soft prices? Does the reaction of the gas companies support the law of supply? Explain
3. With the soft prices in effect, are resources being under-allocated or over-allocated towards gas production at the moment?
4. In the next month, what will happen to supply of natural gas? Why?
5. What may happen in the natural gas market if firms reduce capital spending in the next two years?