



# DOES 'CETERIS PARIBUS' WORK?

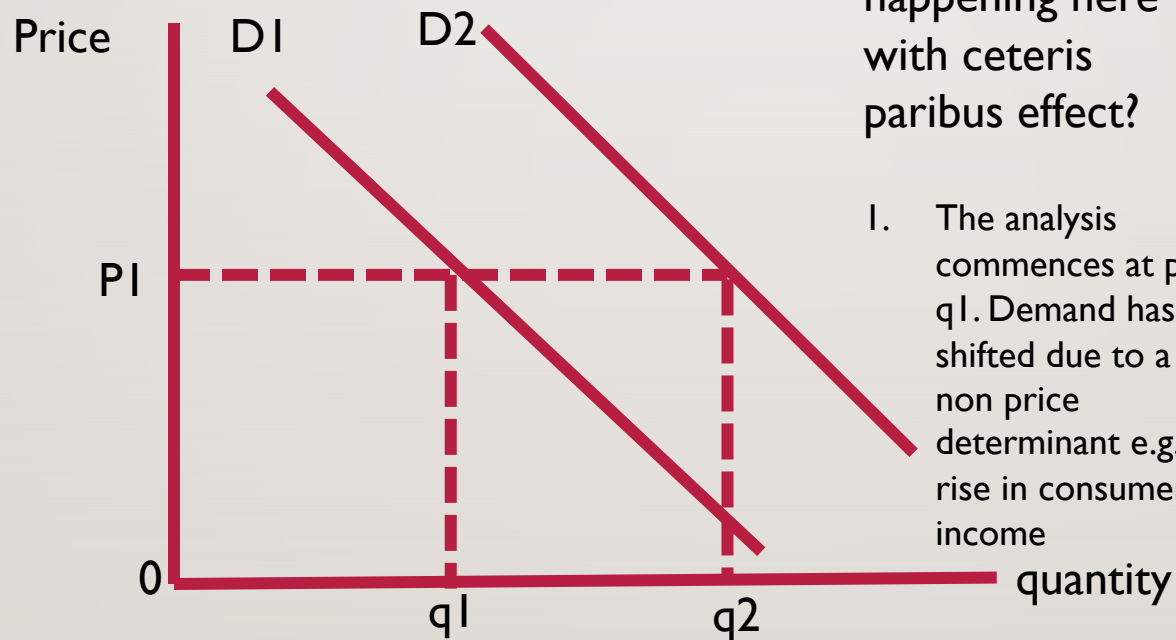
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CETERIS PARIBUS IS A THEORETICAL CONCEPT THAT ALLOWS ONLY ONE VARIABLE TO CHANGE IN A SUPPLY OR DEMAND FUNCTION WHILE ALL OTHER VARIABLES ARE HELD CONSTANT E.G. IF INCOME INCREASES IN THE DEMAND FUNCTION THEN DEMAND WILL SHIFT OUTWARDS TO THE RIGHT BUT PRICE OR ANY OTHER VARIABLE REMAINS UNCHANGED.



**Demand function:  $Q_d$  of good  $X$  is a function of ( $P_x$  (price of  $x$ ),  $P_s$  price of substitutes),  $P_c$  (price of complements),  $P$  (population),  $Y$  (income),  $T$  (taste /fashion),  $A$  (advertising), ...etc)**

## 2 YES!



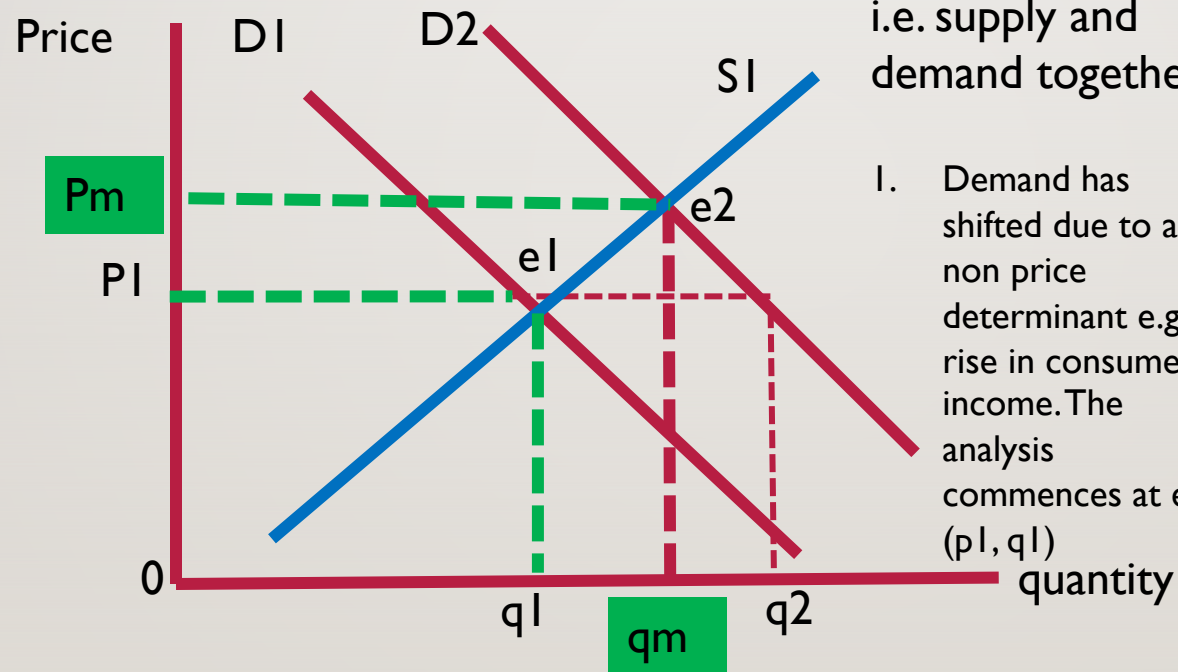
So what is happening here with ceteris paribus effect?

1. The analysis commences at  $p_1$ . Demand has shifted due to a non price determinant e.g. rise in consumer income

2. Ceteris paribus effect: quantity demanded increases from  $q_1$  to  $q_2$  as the demand curve shifts. No change in price or any other variable. Only income is changed.

3. Resource allocation increases significantly along the X axis (resources = FOP) allocation line. Income has a significant impact on quantity demanded and resource allocation

### 3 **NO! FULL MARKET OUTCOME IS DIFFERENT (SUPPLY CURVE ADDED)**



So what is with full market effect i.e. supply and demand together?

1. Demand has shifted due to a non price determinant e.g. rise in consumer income. The analysis commences at  $e_1$  ( $p_1, q_1$ )

2. This results in a movement along the supply curve and a new equilibrium is located at  $e_2$  ( $p_m, q_m$ ).

$Q_2$  is no longer valid.

3. Resource allocation increases along the X axis (resources =FOP) but only as far as  $q_m$  (not  $q_2$  as under ceteris paribus) and notice that price has increased as consumers have more money and prices are driven upwards.