COMPETITIVE EQUILIBRIUM
INITIAL EQUILIBRIUM
Suppose an “auctioneer” calls out prices of fruit and fish.

The first set of prices is given by the budget line $p'p'$ which has a slope of $-(p^1/p^2)$.

At these prices:

- Consumer A is in equilibrium at point A.
- Consumer B is in equilibrium at point B.
- A’s supply of good 1 > B’s demand for good 1.
- A’s demand for good 2 > B’s supply of good 2.
INITIAL PRICES
B’s demand for 1

A’s supply of 1
For competitive equilibrium:

- price of fruit \( p^1 \) must fall
- price of fish \( p^2 \) must rise

The equilibrium set of prices is given by the budget line \( p''p''' \), whose slope is less than \( p'p' \)

The competitive equilibrium is at point M where:

- \( -\left(\frac{p^1}{p^2}\right) = MRS^A_{1,2} = MRS^B_{1,2} \)
- Demand and supply of good 1 are equal
- Demand and supply of good 2 are equal