Supply and Demand Issues

Supply and demand are the starting point of all economic analysis

The essence of choice is being able to balance the two

SUPPLY

The different quantities that a producer or producers will make available to the market at different prices over a given period of time.

LAW OF SUPPLY

As price increases, producers are willing to produce and sell more

As price decreases, producers are willing to produce and sell less

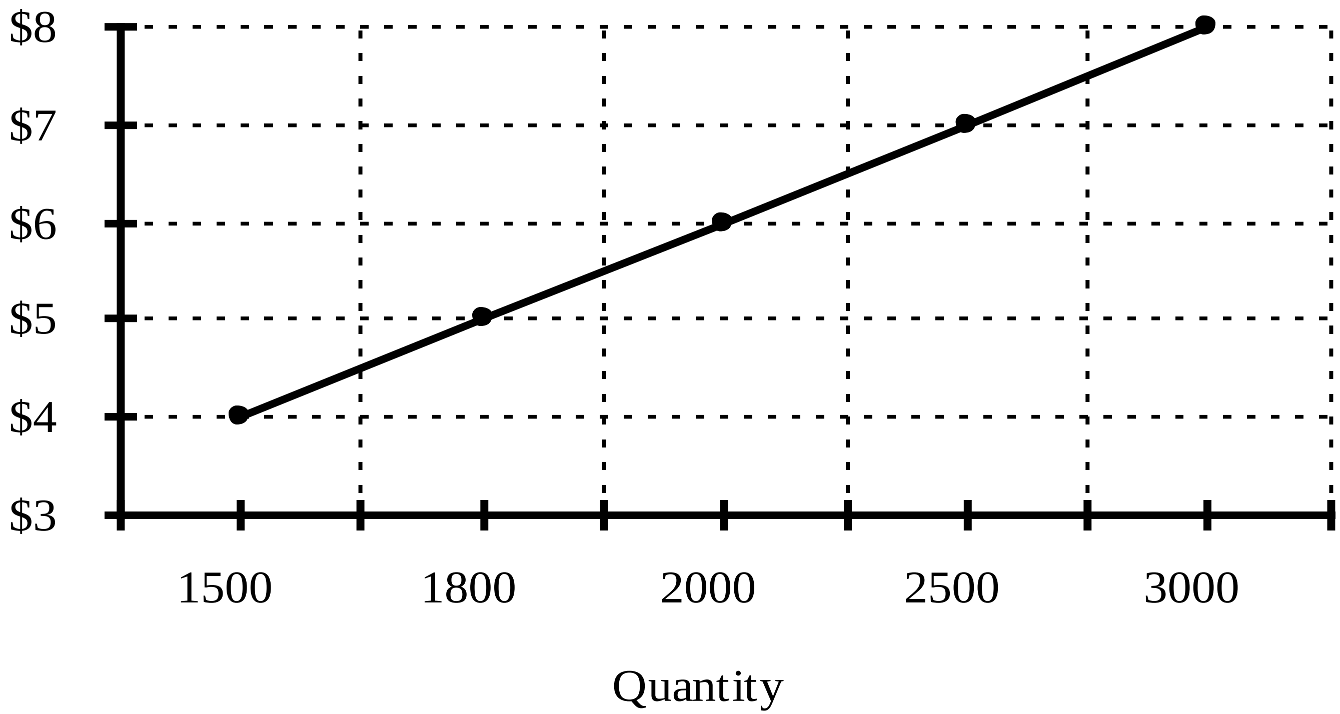
Price and Quantity Supplied are directly related

Supply Table

Widgets Per Week

Price	Quantity
$4.00	1500
$5.00	1800
$6.00	2000
$7.00	2500
$8.00	3000

Supply Graph



Producer Costs

Fixed Costs:

Costs that don't change as production levels change

Ex: Rent, Insurance, Loan Payments, Taxes

Variable Costs:

Costs that increase and decrease with changes in the production levels

Ex: Labor costs, Materials, Utilities

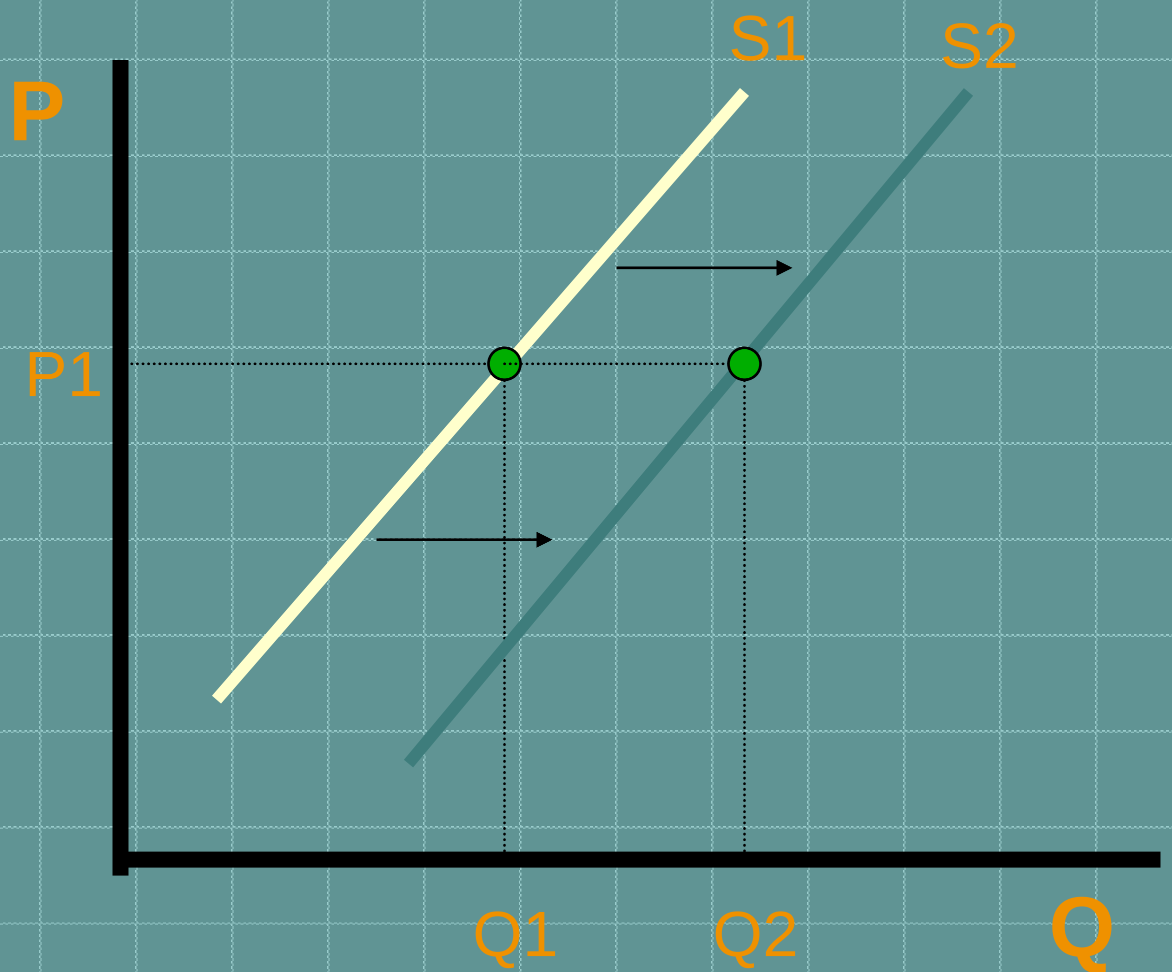
Total Costs = Fixed Costs + Variable Costs

Changes in Supply

Supply in the market will change if there is a change in:

- Production Costs
  - Ex: Materials, Labor, Technology, Taxes
- Number of Producers in the Market
- Profitability of other production options
- Expectation of *future* market price

Increase in Supply



DEMAND

The various quantities that a person or group is willing to buy at various prices

Law of Demand

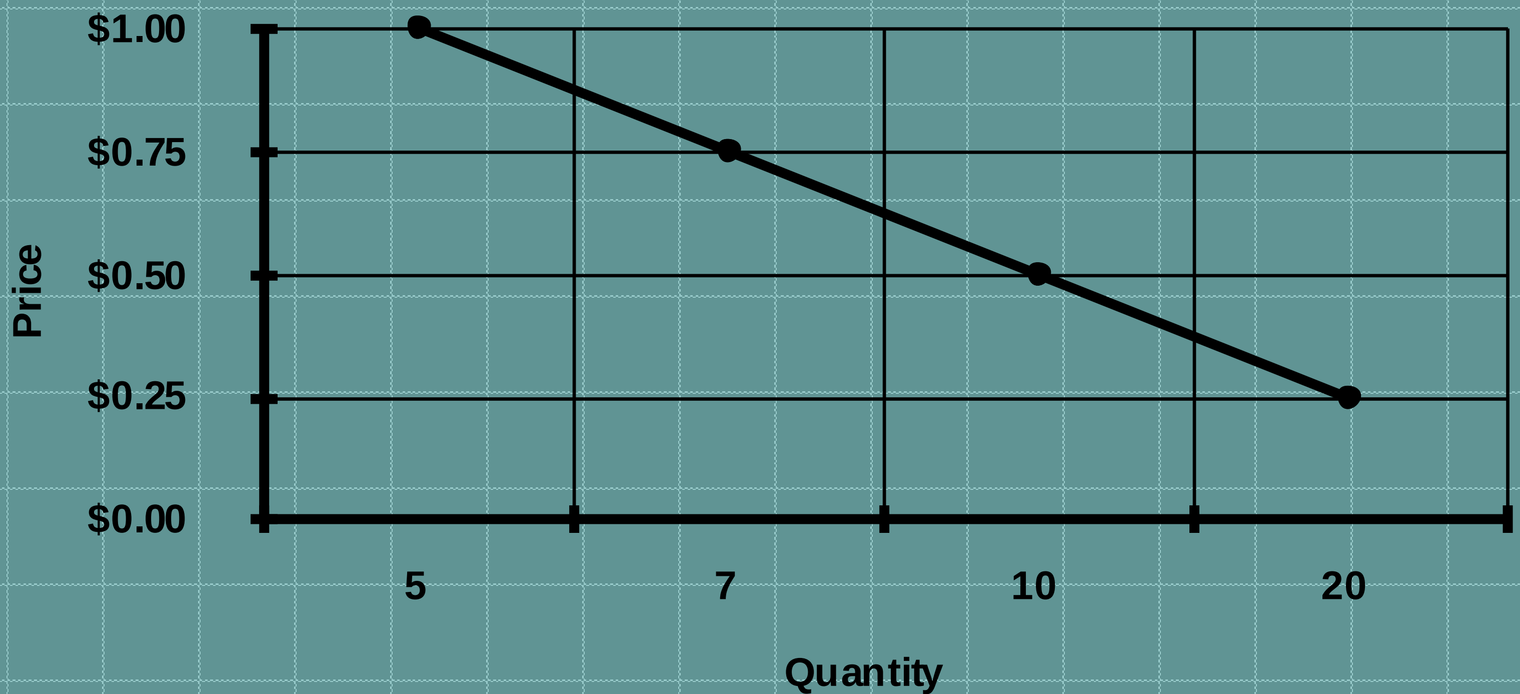
- As prices increase, the quantity people are willing to buy decreases
- As prices decrease, the quantity people are willing to buy increases
- Indirect price/quantity relationship

DEMAND TABLE

(Coca-Colas per week)

Price	Quantity
$.25	20
$.50	10
$.75	7
$1.00	5

Demand Graph



REASONS FOR DEMAND

Income Effect (Price Effect)

When price rises, a consumer cannot afford to buy as much. But, when price declines, a consumer can afford to buy more. Price changes affect “purchasing power” of income

REASONS FOR DEMAND

Substitution Effect

When prices increase on one product, consumers will buy a substitute product instead. But when prices decrease on a product, consumers will switch to that product from other substitutes.

Substitutes are products that can be used in place of each other.   **Complements** are products that are used together

REASONS FOR DEMAND

Law of Diminishing Marginal Utility

As we have more and more units of a product, the satisfaction we get from each additional unit decreases.

Marginal = additional, next, or last

Utility = satisfaction

Changes in Demand

If Demand changes, then people want more or less of the product even when the price remains constant

There are several reasons why Demand might change……

Changes in Demand

A change in people's income...

When people have more money, they buy more of everything, and when they have less, they buy less.

Change in Demand

People's tastes and preferences change.....

Advertising changes people's attitudes, desires, etc. Styles change, fads come and go.

Change in Demand

Situation and needs change...

Get a new job? You might need different clothes. Move? A baby on the way? A new product get invented?

Changes in Demand

There's a change in the number of consumers in the market...

When there are more consumers, Demand goes up, and visa-versa

Changes in Demand

Expectations of future price...

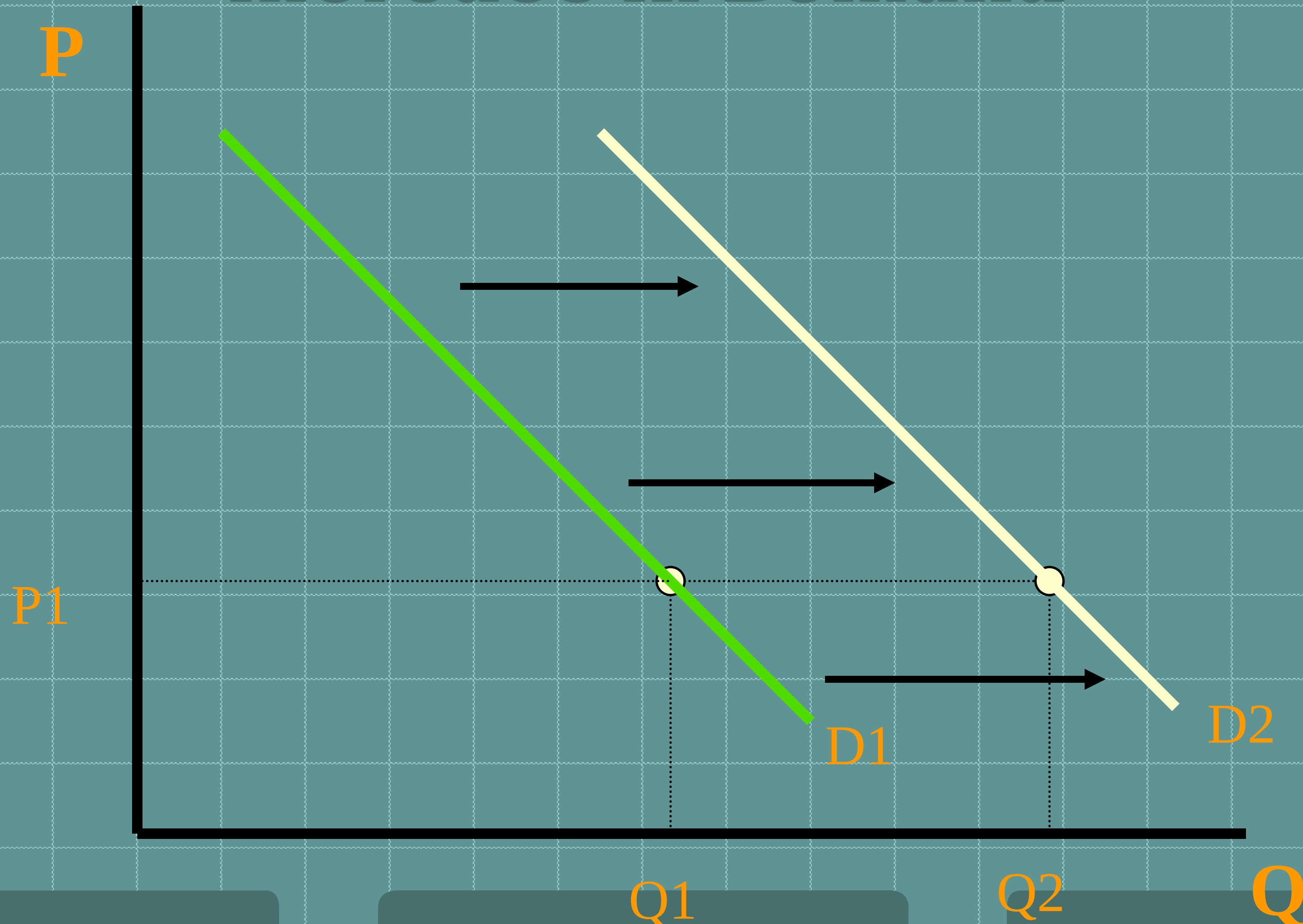
If we expect the price to go down soon, we will have reduced Demand now, and visa-versa

Changes in Demand

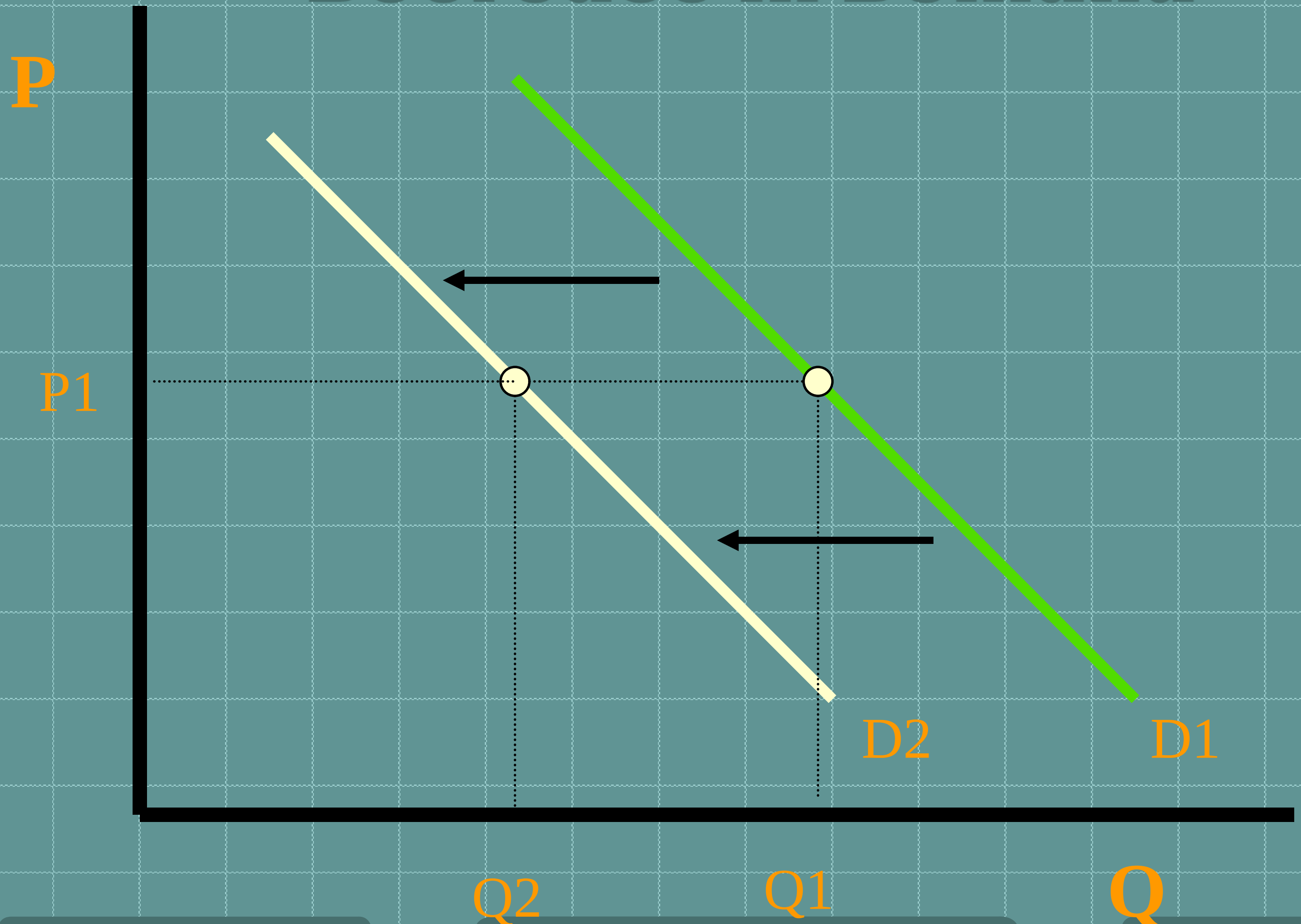
The prices of substitutes or complements change….

If apples go up in price, the Demand for pears might increase because people will substitute pears for apples.

Increase in Demand



Decrease in Demand



CHANGES IN DEMAND

Demand will change if there are changes in:

- **Income, Wealth, Credit**
- **Personal Tastes and Preferences**
- **Situation**
- **Number of Consumers in the Market**
- **Expectation of Future Price**
- **The prices of Complements or Substitutes**

Putting Demand and Supply Together

Equilibrium

The situation when quantity supplied equals quantity demanded at a particular price

Putting Demand and Supply Together

Shortages

- The situation when quantity demanded is greater than quantity supplied
- Exists at any price below the equilibrium price
- Is not the same as scarcity

Putting Demand and Supply Together

Surpluses

- The situation when quantity supplied is greater than quantity demanded
- Exists at any price above the equilibrium price

Summary

The law of demand says that prices and quantity demanded are inversely related.

Relative prices must be distinguished from money, since people respond
to changes in relative prices.

Summary

- A change in quantity demanded versus a change in demand
  - A change in quantity demanded is a movement along a demand curve
  - A change in demand is a shift of the demand curve
- The law of supply states that price and quantity supplied are directly related.

Summary

- A change in quantity supplied versus a change in supply
  - A change in quantity supplied is a movement along a supply curve
  - A change in supply is a shift of the supply curve

Summary

Determining market price and equilibrium quantity

- The demand and supply curves intersect at the equilibrium point.
- Shortages exist when the price of a good is below the market price.
- Surpluses exist if the price of the good is greater than the market price.