Demand and Supply

Chapter 2

pages 18-24, 27-3-, 33-34

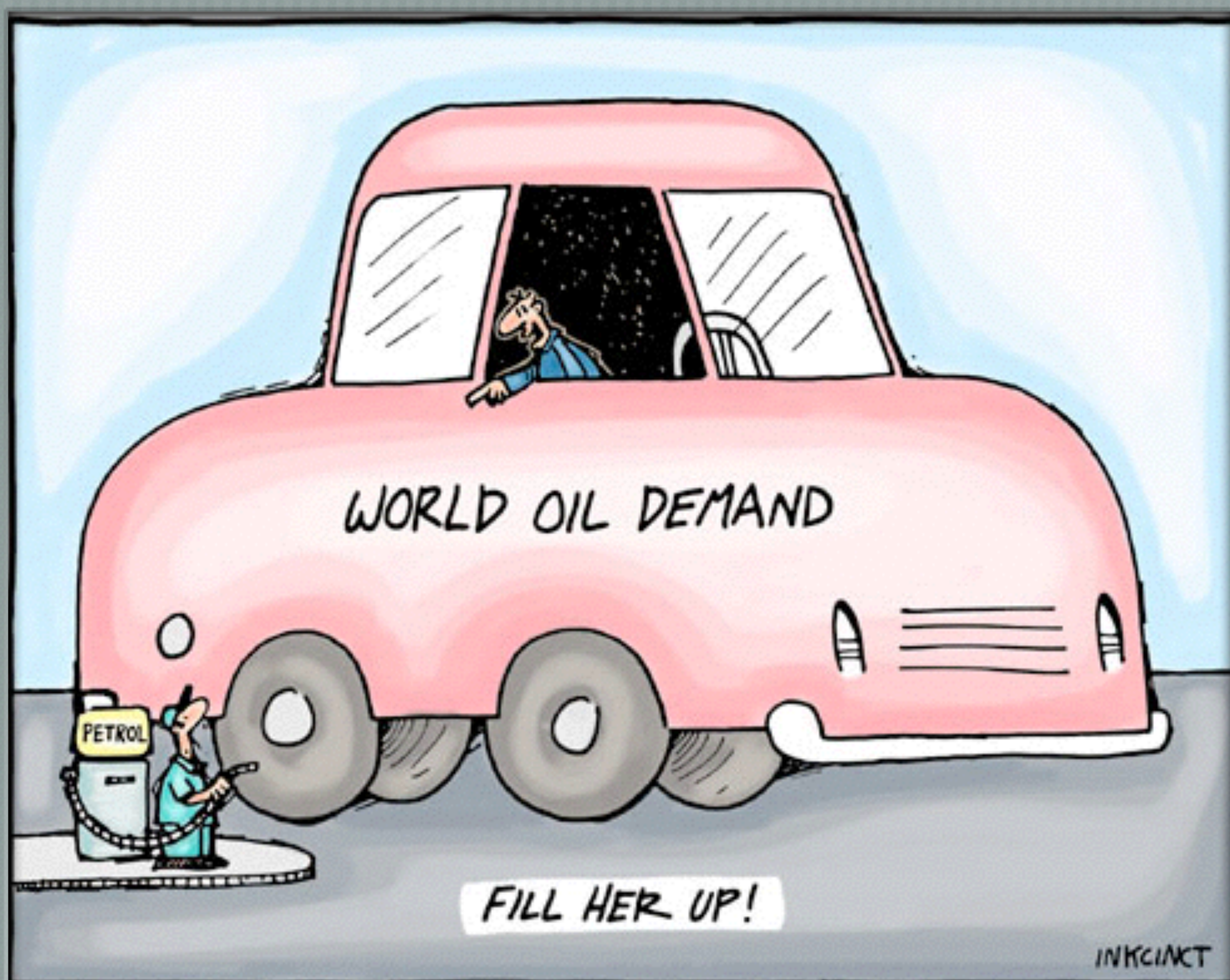
Markets

- Market- where buyers and sellers come together to carry out an economic transaction
  - Markets can be physical places where goods/services are exchanged for money
  - Online markets sell goods/services sold with the use of credit cards or money transfers

Markets

- Product Markets
  - Goods/services are bought and sold
- Factor Markets
  - Labor market- factors of production are bought and sold
- Financial Markets
  - Foreign exchange market- international currencies are traded
  - Stock markets- shares in companies are bout at sold

Demand



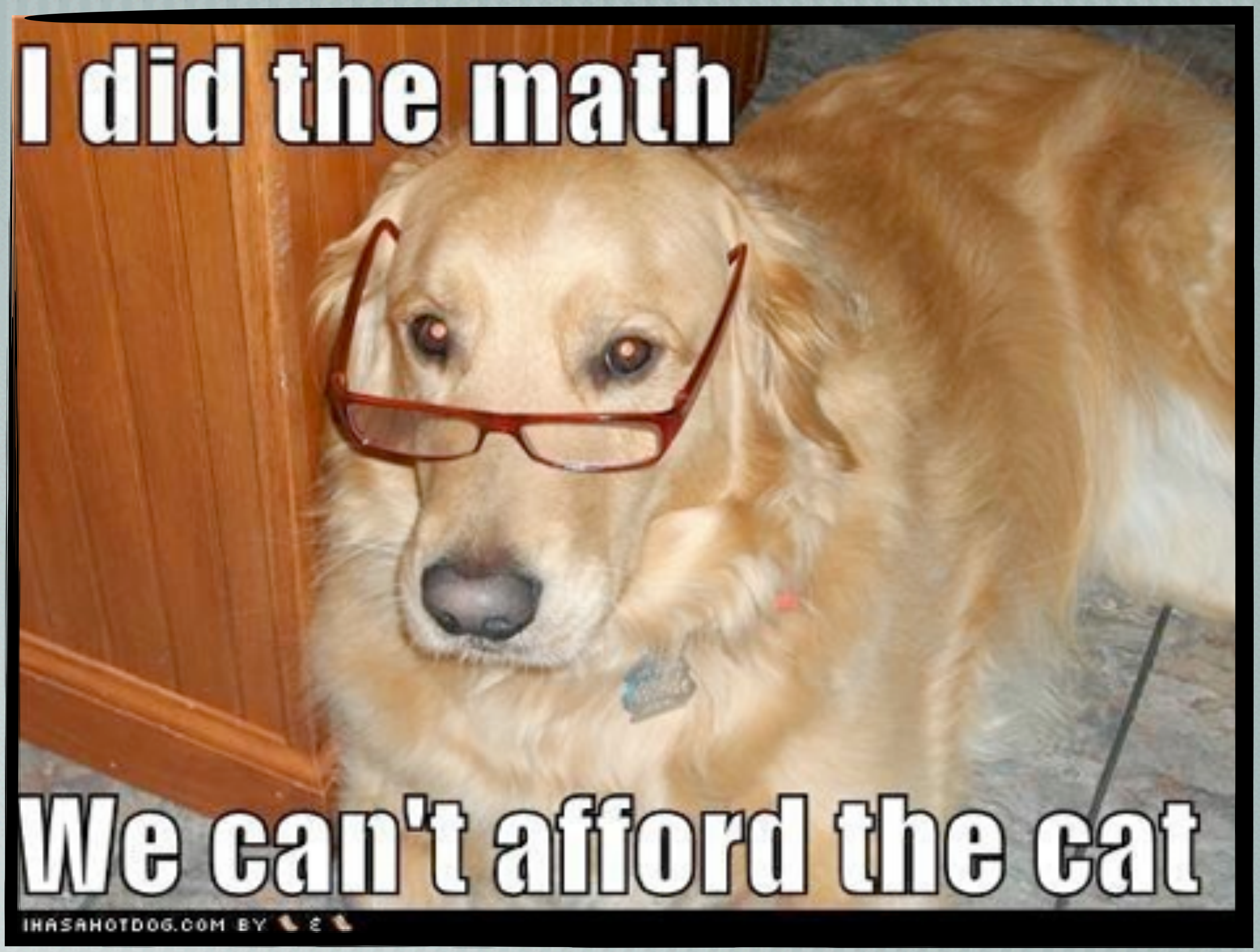
Demand- the quantity of a good/service that consumers are willing and able to purchase at a given price at a given time period

Demand

- Example:
  - Group of people buy 150 sodas at a price of $1.20 each in an afternoon
  - Demand= Consumer group, quantity, price, given time
  - *Demand for soft drinks at a price of $1.20 would be 150 units an afternoon*

Demand

- "Willingness and ability"
  - not enough for consumers to be willing to purchase a good/service, but they must also be ABLE!
  - Must have the financial means to buy a product= ABILITY



The Law of Demand

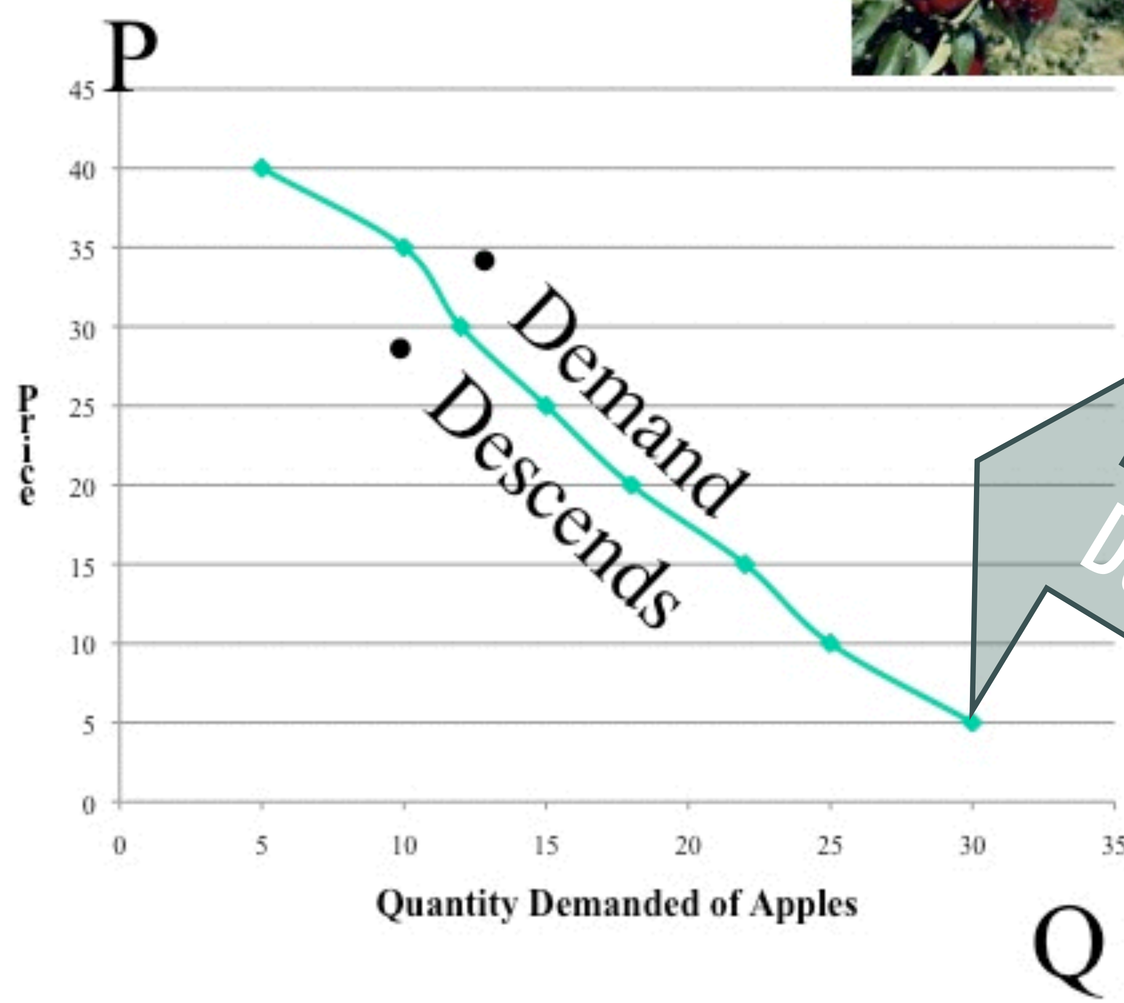
- Law of Demand
  - “As the price of a product falls, the quantity demanded of the product will usually increase, ceteris paribus”
  - Demand curve normally slopes downward
  - Ceteris Paribus- in this case, price is changing but any other determinants of demand are assumed to be unchanging.

The Law of Demand

Demand Schedule

Demand for apples

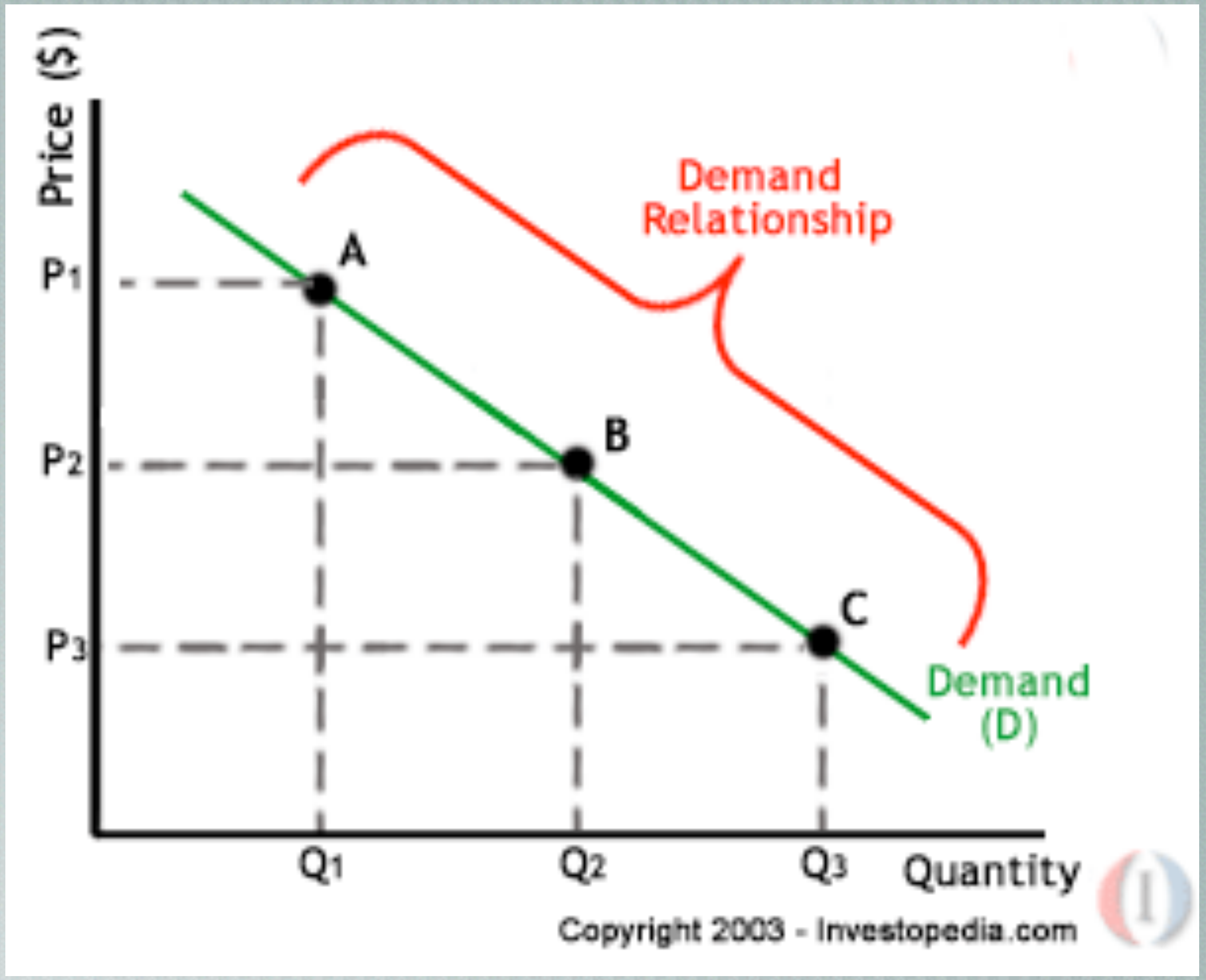
Price	No. of Apples
5	30
10	25
15	22
20	18
25	15
30	12
35	10
40	5



Demand Curve

The Law of Demand

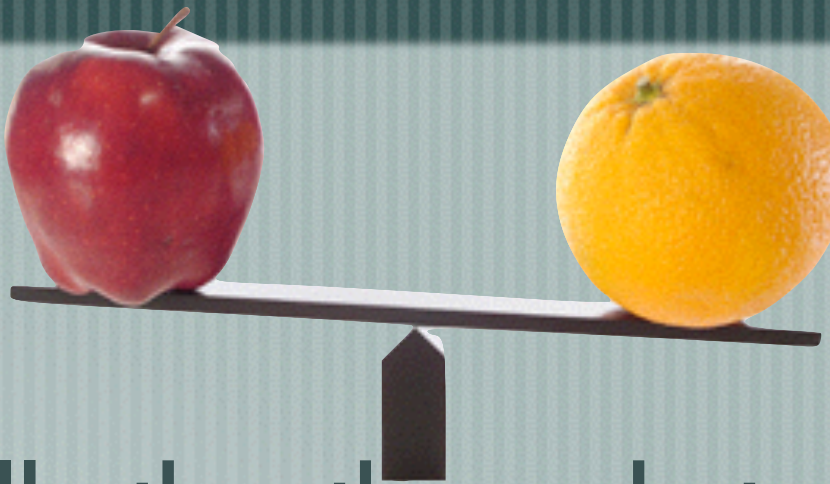
- Quantity demanded goes up as price goes down
- Demand curve shows the relationship between price of the product (vertical, y axis) and the quantity demanded (horizontal, x axis)
- Change in Q_d (quantity demanded) results in movement along the demand curve



Increase in Demand

- Income Effect
  - When the price of a product falls, then people will have an increase in their “real income”, which reflects the amount that their incomes will buy.
  - With this increase in real income, then people will be more likely to buy more of the product

Increase in Demand



- Substitution Effect
  - When the price of a product falls, then the product will be relatively more attractive to people than other products, whose prices have stayed unchanged
  - So it is likely that consumers will purchase more of the product, substituting it for products that were previously purchased

Non-Price Determinants of Demand

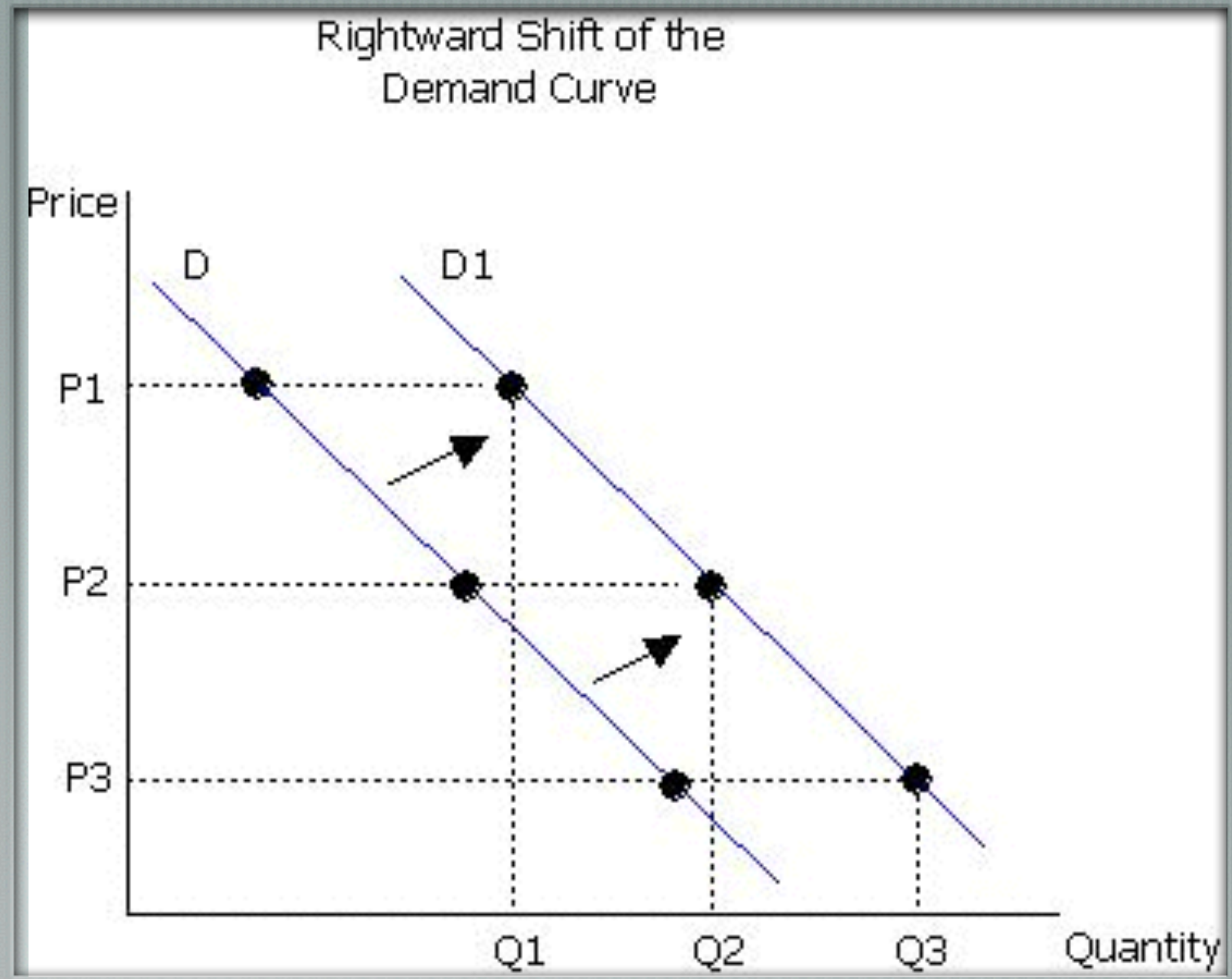
- Factors that determine demand and lead to a shift in the demand curve to the right or left, ceteris paribus
  - Income
  - Price of Other Products
  - Tastes and Preferences
  - Other Factors

The Non-Price Determinants of Demand

- Income- there are two types of products to consider when looking at how income affects the demand for a product
  - Normal Goods
  - Inferior Goods

Normal Goods

- Normal goods= when income rises, the demand for the good will also rise
    - demand curve will shift to the right



Inferior Goods

- Inferior Goods= the demand for a product will fall as income rises and starts buying higher priced substitutes in place of the inferior good
  - As income rises, the demand curve for the inferior good will shift to the left

Price of Other Products

- There are three possible relationships between products:
    - Substitutes
    - Complements
    - Unrelated Goods

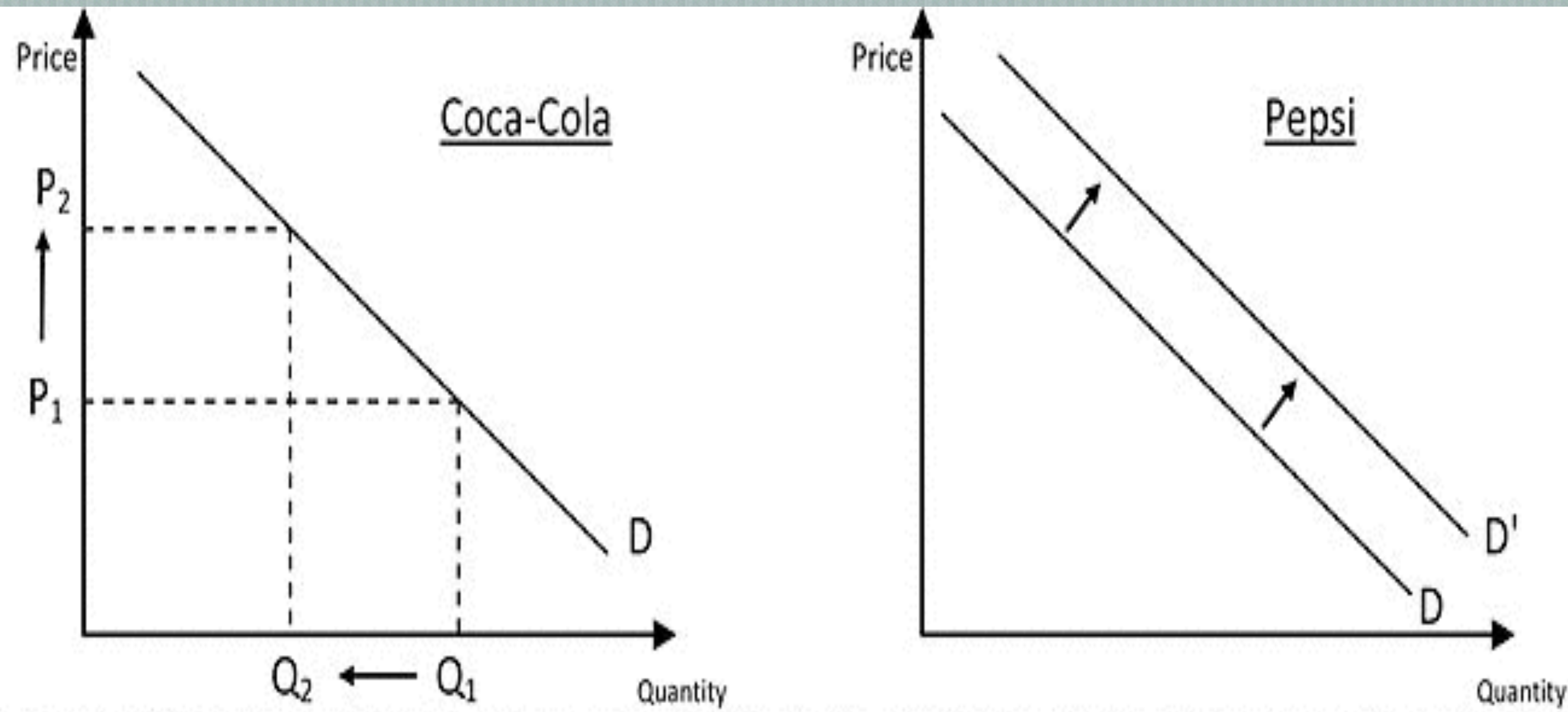
Substitutes

- If products are substitutes for each other, then a change in price of one of the products will lead to a change in the demand for the other product

Substitutes

- Example: if there is a fall in the price of chicken, then there will be an increase in the quantity demanded of chicken and a fall in the demand for beef (a substitute for chicken)

Substitutes



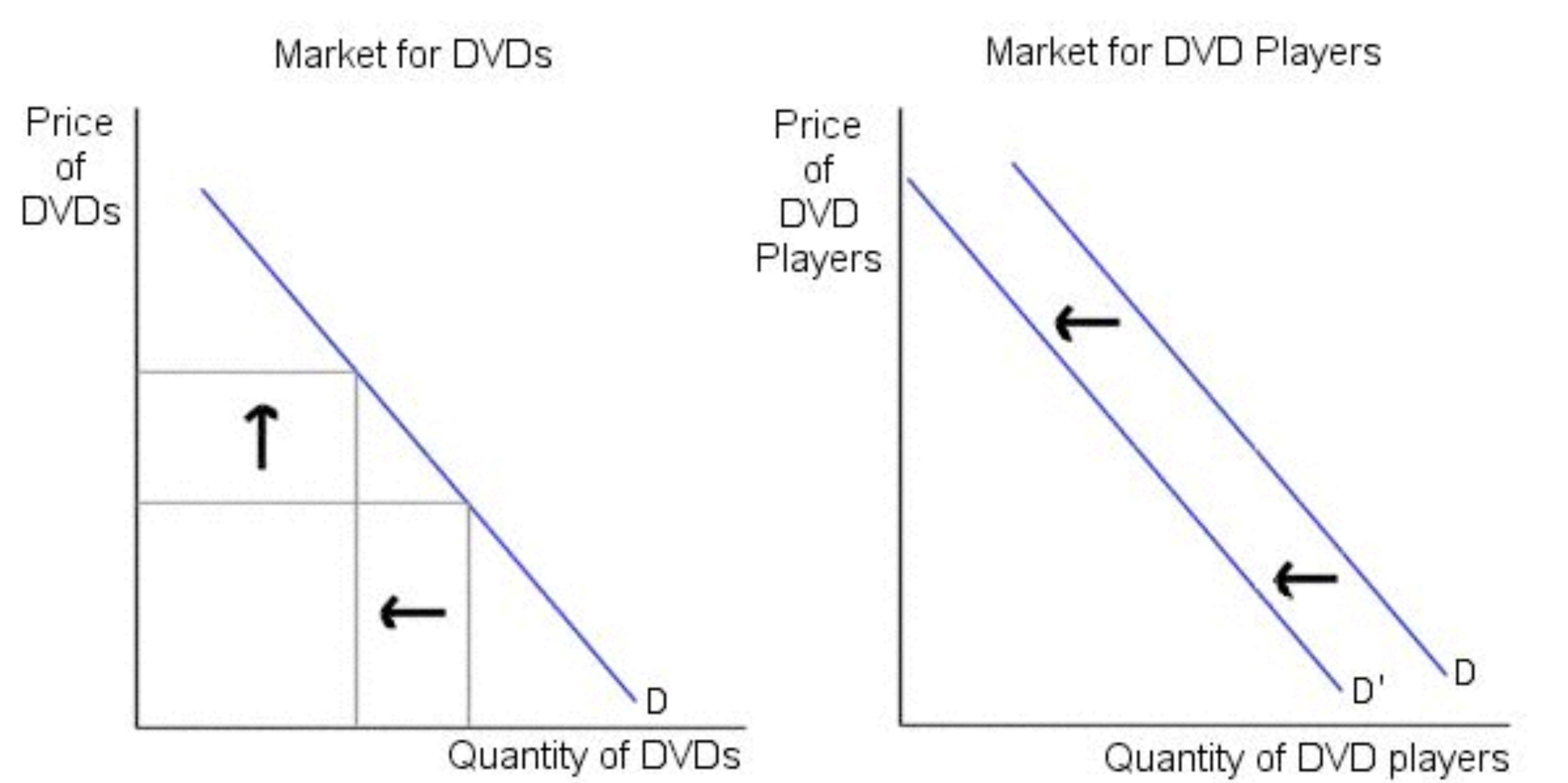
Suppose the price of Coca-Cola rises from P_1 to P_2 because one of the inputs rises in price. This would cause people to consume less coke, quantity decreases from Q_1 to Q_2. For the substitute good Pepsi the demand curve shifts out for all price levels, from D to D', leading to more of the substitute good consumed.

Complements

- Complements are often products purchased together like printers and ink cartridges.
- If products are complements to each other, then a change in the price of one will lead to a change in demand for the other

Complements

Complements



Unrelated Goods

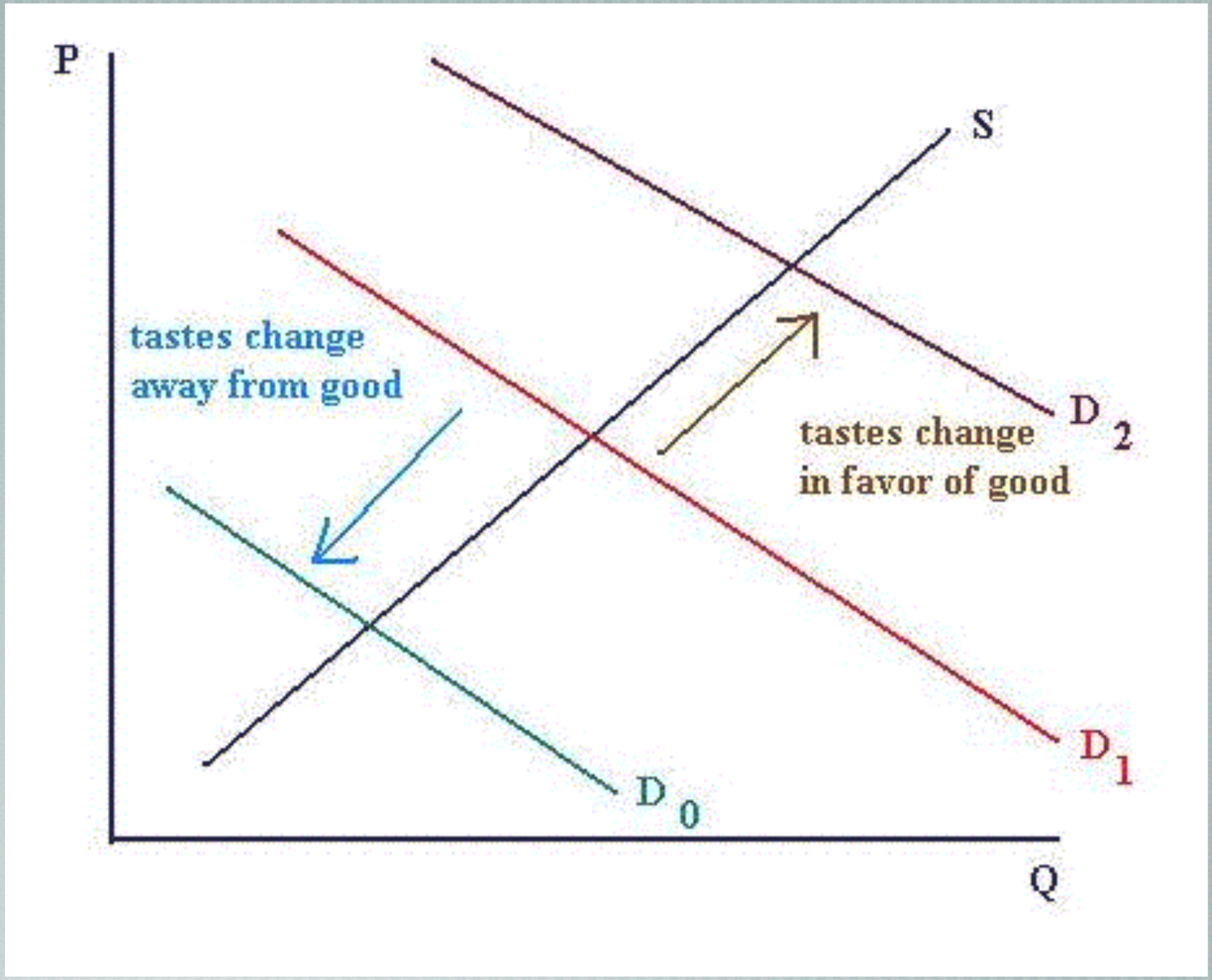
- If products are unrelated, then a change in the price of one product will have no effect upon the demand for the other product.
- Example: an increase in the price of toilet paper will have no effect upon the demand for pencils

Tastes and Preferences

- Marketing can alter tastes and firms attempt to influence tastes so they can shift the demand curve for their product

Tastes and Preferences

- Example: There is an advertising campaign to encourage the purchase of skateboards, of if the world skateboarding championships are televised and it leads to more people wanting skateboards. Demand increases for skateboards



Other Factors

- Size of the population
- Changes in age structure
- Changes in income distribution
- Gov't policy changes
- Seasonal changes

Size of Population

Population grows, then the demand for most products will increase and demand curves will start to shift to the right

Changes in Age Structure of the Population

- If the percentage of older people in an economy starts to increase, then there may be an increase for certain products.
  - Example: elderly population goes up, then there might be an increase for medical walkers and demand would shift to the right
  - demand for skateboards would go down

Changes in Income Distribution

- If there is a change in income distribution, such that the poor are better off and the rich slightly worse off, then there may be an increase in demand for basic necessity goods like meat. The demand for meat would shift to the right.

Government Policy Changes

- Changes in taxes, ay affect the money that people have to spend and thus their demand.
- Policies like helmet laws for bicycles could change demand for certain products

Seasonal Changes

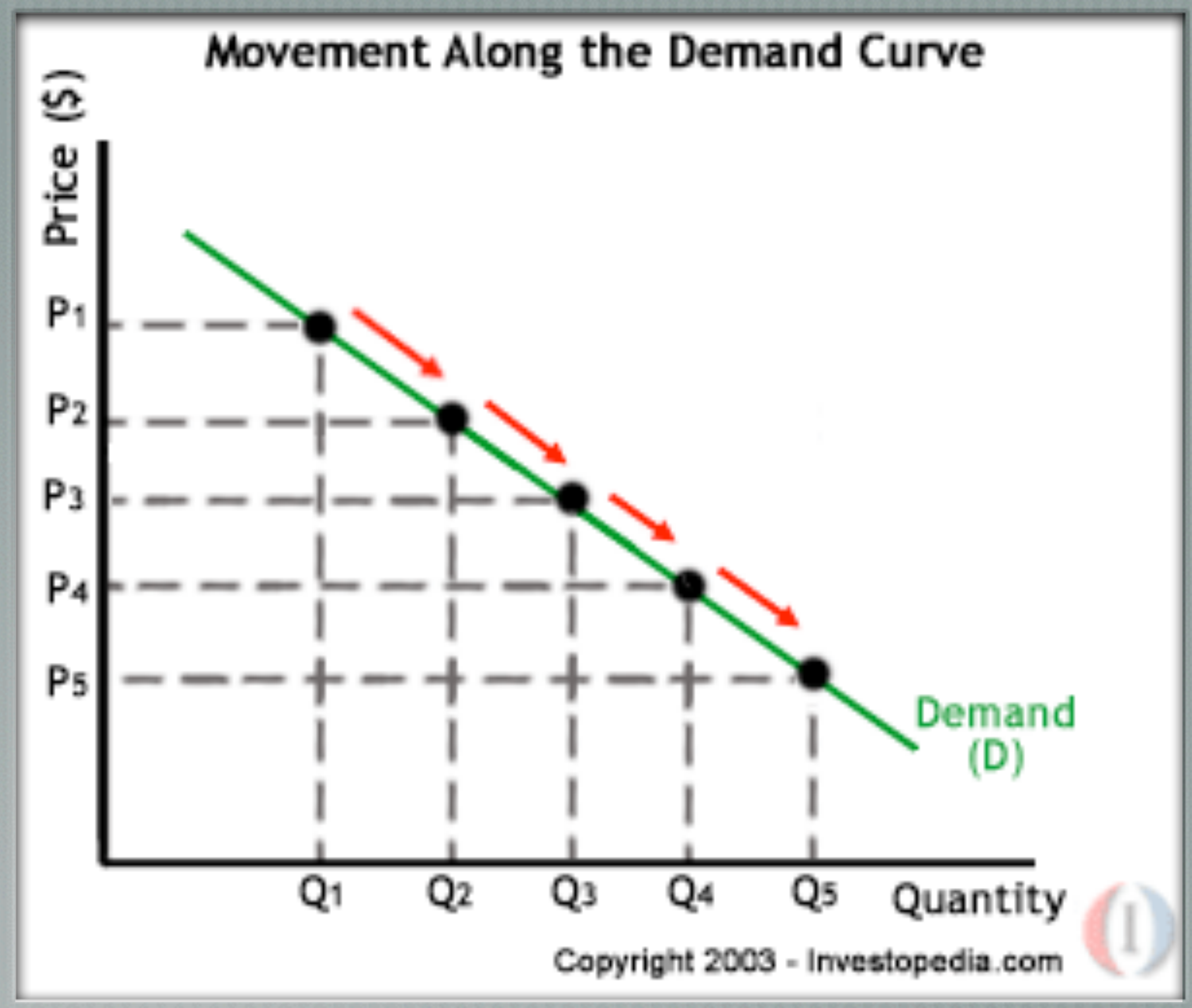
- Changes in seasons may lead to changes in pattern of demand.
  - Examples: pumpkins in the fall, turkeys at Thanksgiving, bathing suits in summer

Movement Along and Shift in a Demand Curve

- Sometimes there are movements along the demand curve and sometimes the demand curve actually shifts to the left (in) or right (out)

Movement Along a Demand Curve

- A change in the price of the good itself leads to movement along the demand curve
  - Example: A decrease in the price of iPhones would lead an increase in quantity demanded of iPhones



Shift in a Demand Curve

- A change in any of the determinants of demand will always lead to a shift in the demand curve for a product
  - Example: A new government policy allowing 18 year olds to drink would shift the demand curve out

Conspicuous Consumption

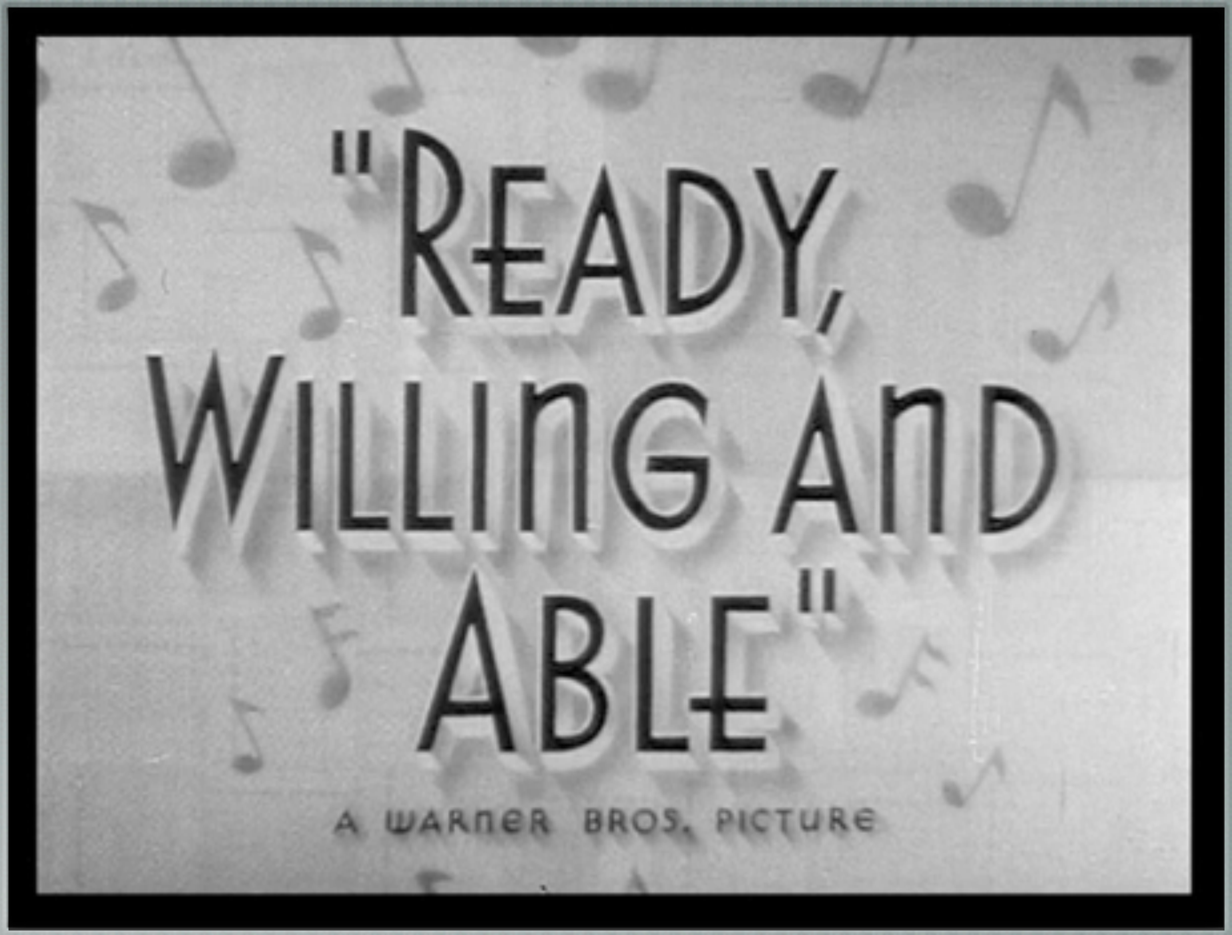
- Theory of Knowledge pg 23
  - read about Veblen goods
  - come up with some of your own examples of a Veblen good
  - why do you believe people behave this way?

Supply

- Supply is the willingness and ability of producers to produce a quantity of a good or service at a given price in a given time period.
  - Example: Firms may produce 4000 frozen pizzas per week at $3 each

Supply

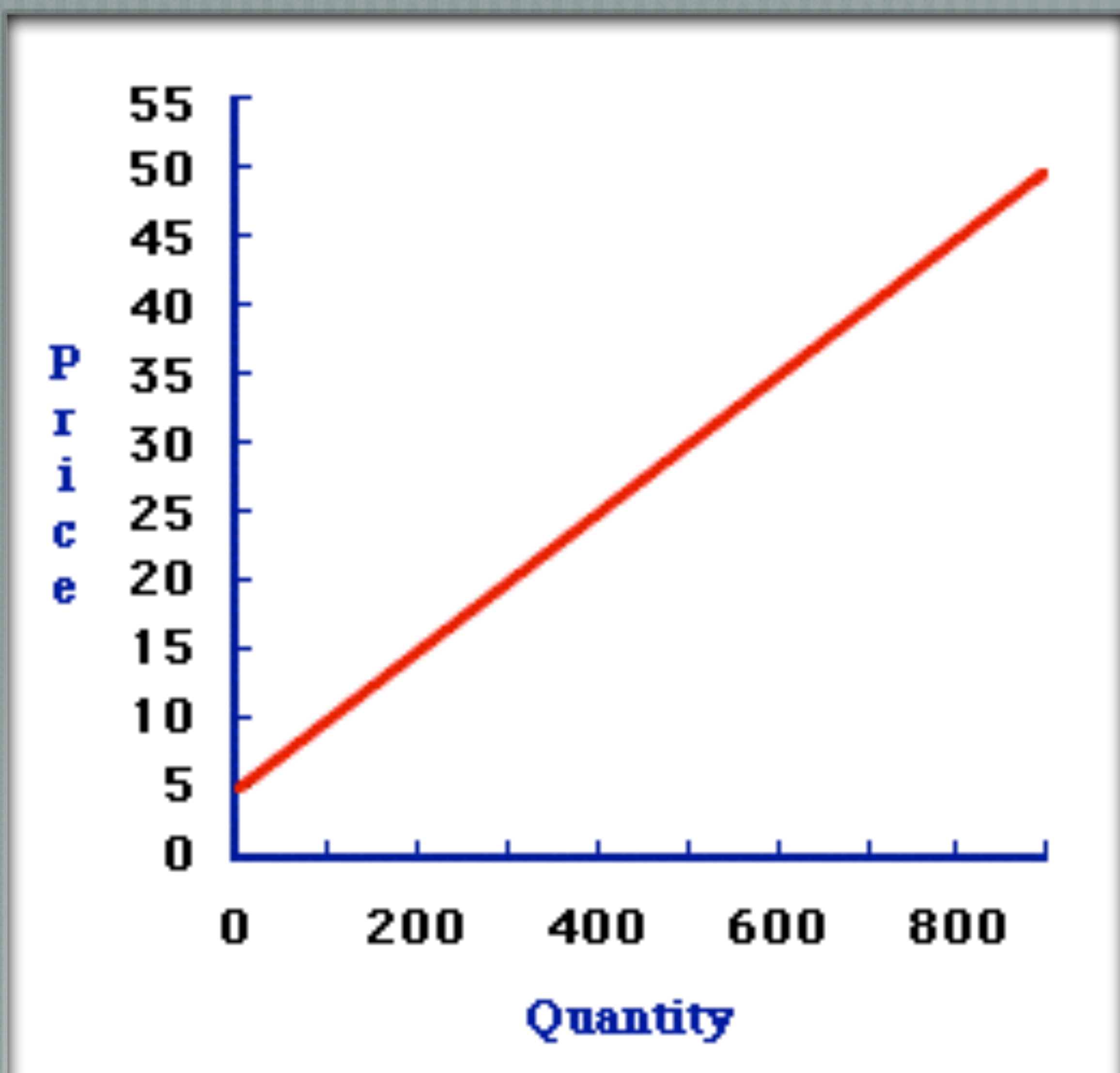
- “Willingness and ability”
  - It’s not enough for producers to be willing to produce a good, they must also be able
  - Example: must have the money to supply the product



The Law of Supply

- Law of Supply- as the price of a product rises, the quantity supplied will usually increase, ceteris paribus
  - supply curve slopes upward
- A change in price of the product itself will change the quantity supplied (movement along the existing curve)

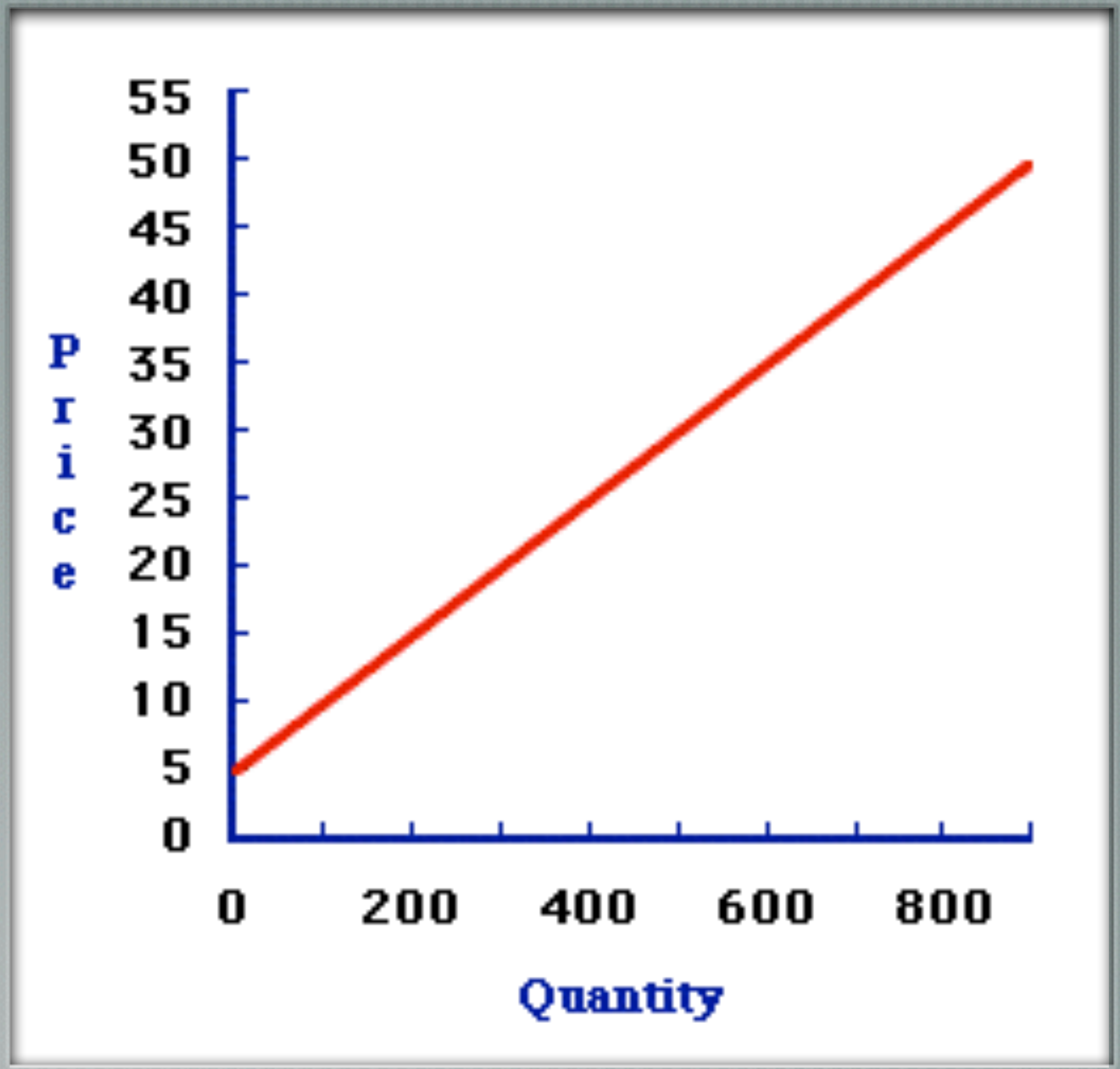
The Law of Supply



- Example: As the price of wine increases, so does the supply
  - Who wouldn't want to produce more of a product in which consumers are willing to pay a higher price for?

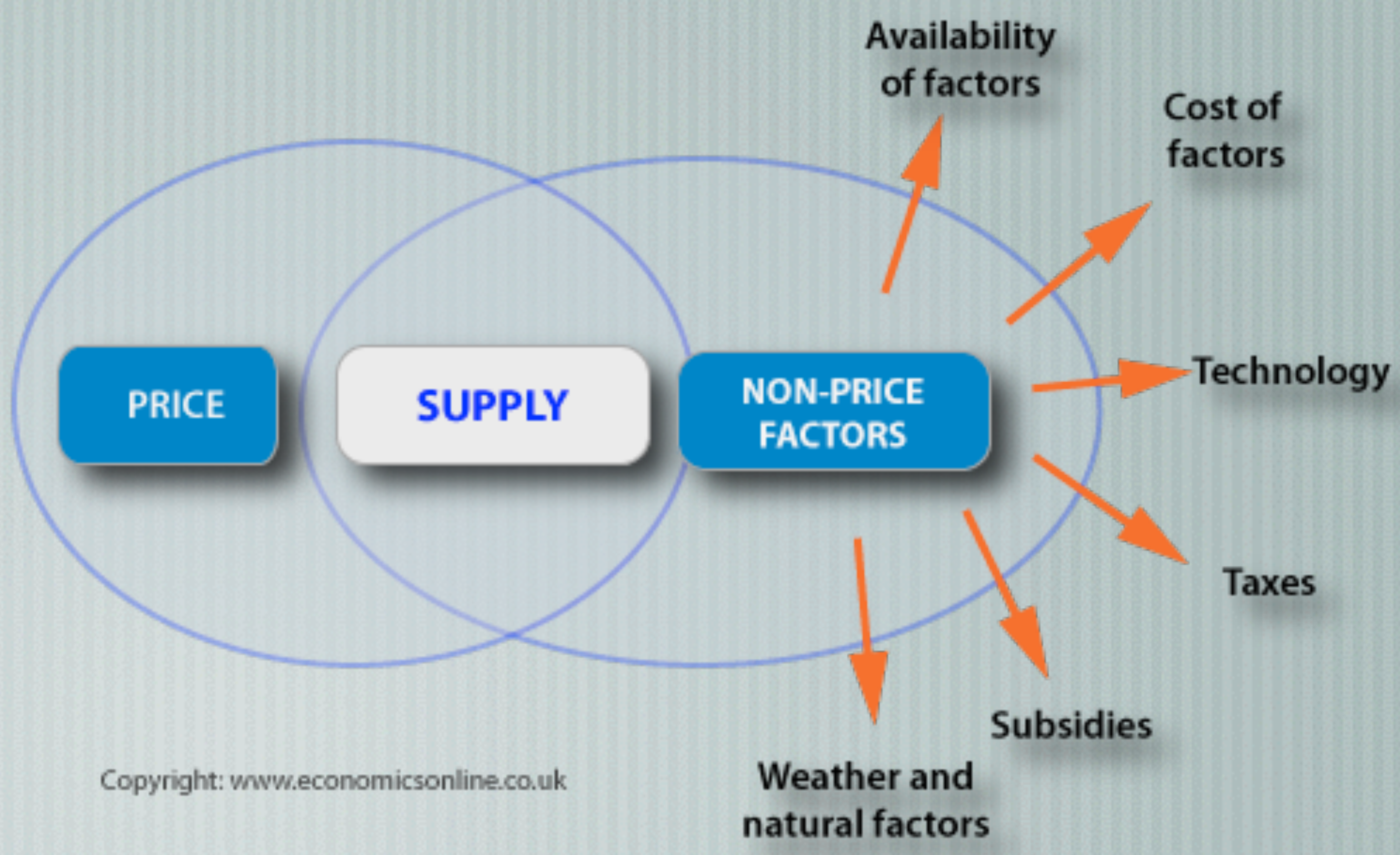
The Law of Supply

- Supply curves are normally curved and get steeper as price rises.
  - Economists usually draw them as straight lines



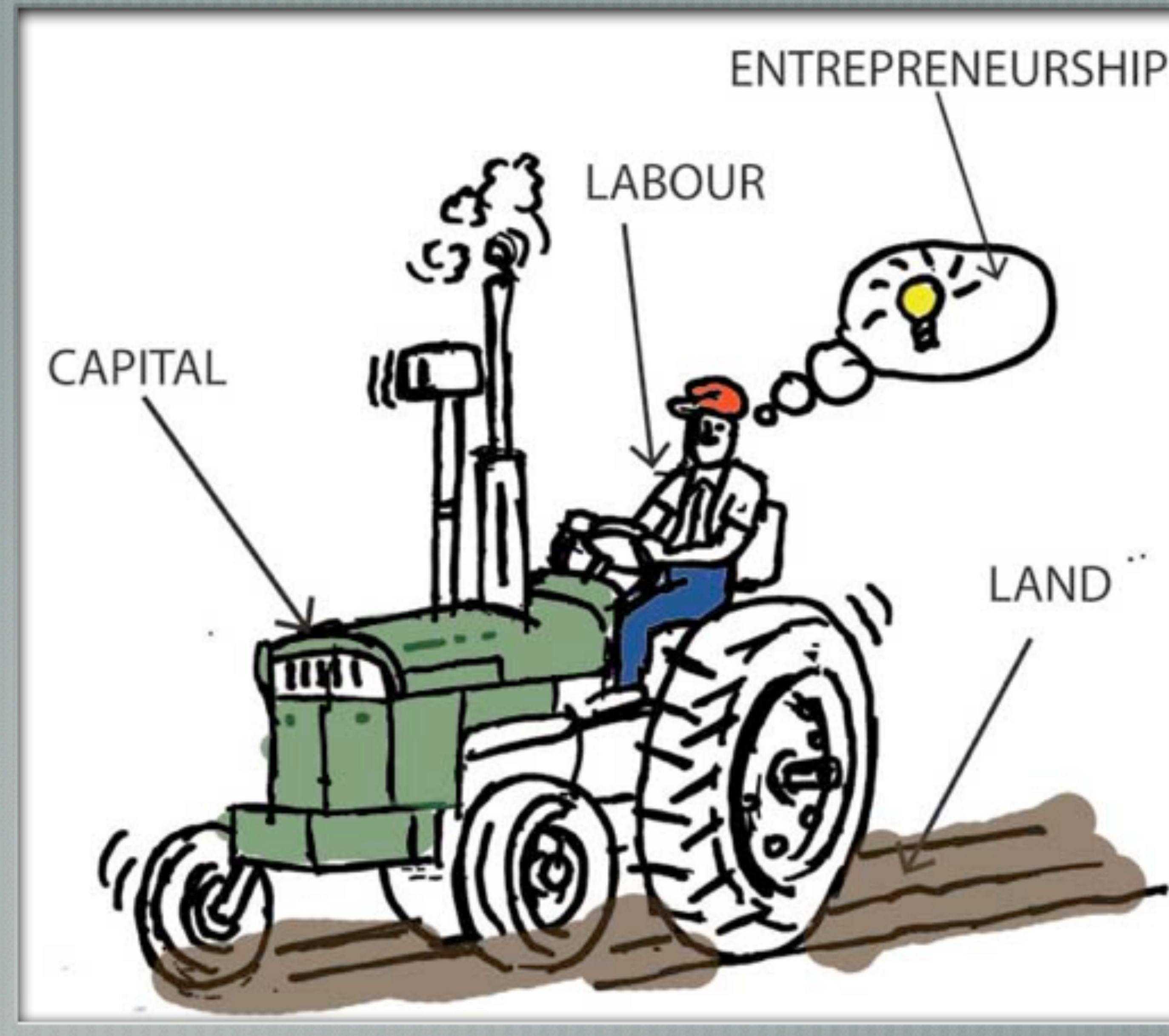
Non-Price Determinants of Supply

- There are many factors that determine supply and lead to an actual shift in the supply curve to the left (in) or right (out)
  - Cost of factors of production
  - Price of other products, which the producer could produce instead of the existing product
  - The state of technology
  - Expectations
  - Government intervention

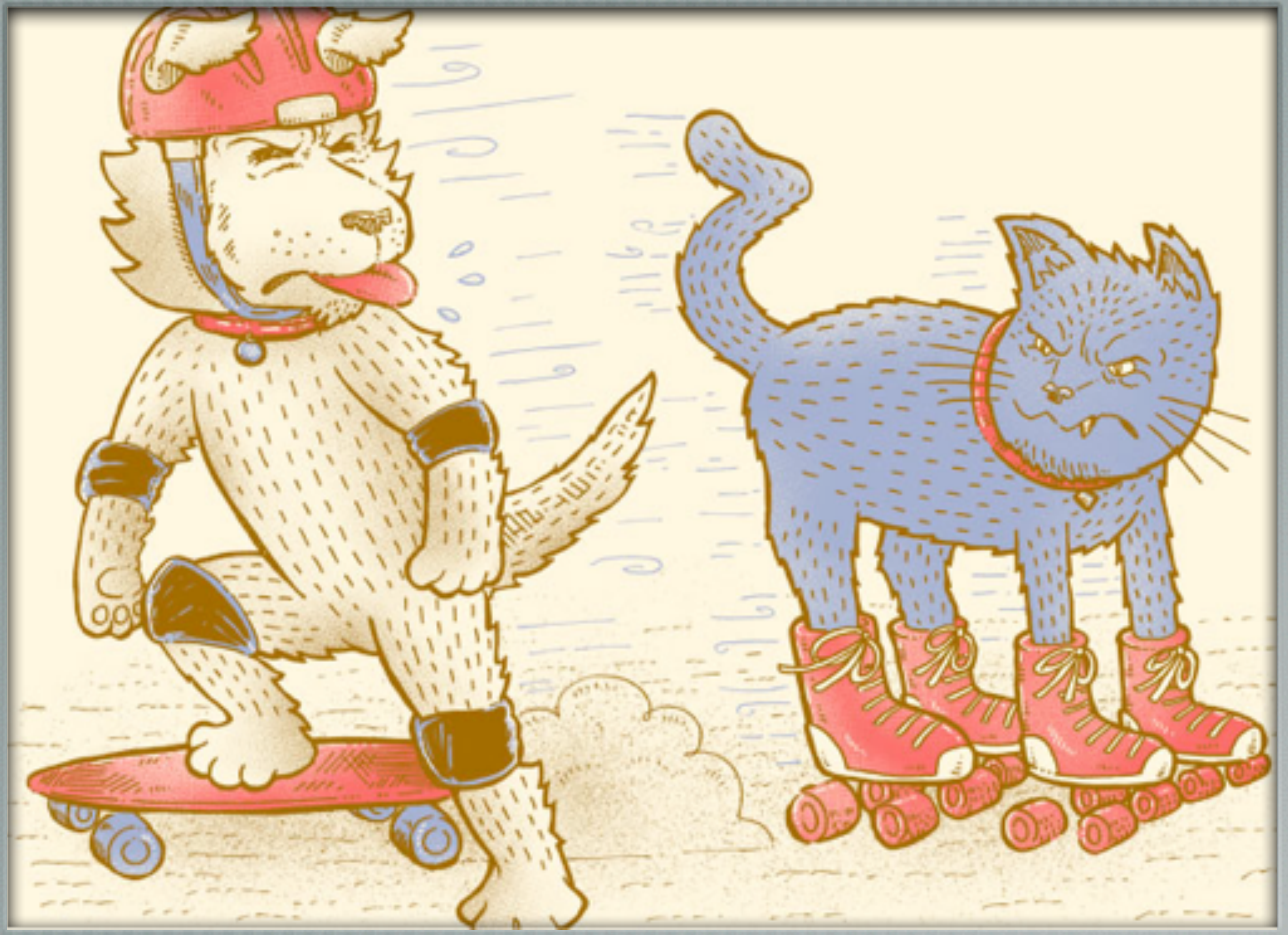


Cost of Factors of Production

- If there is an increase in the cost of a factor of production (land, labor, capital, management) then the firms costs will increase, producers supply less, shifting the supply curve to the left

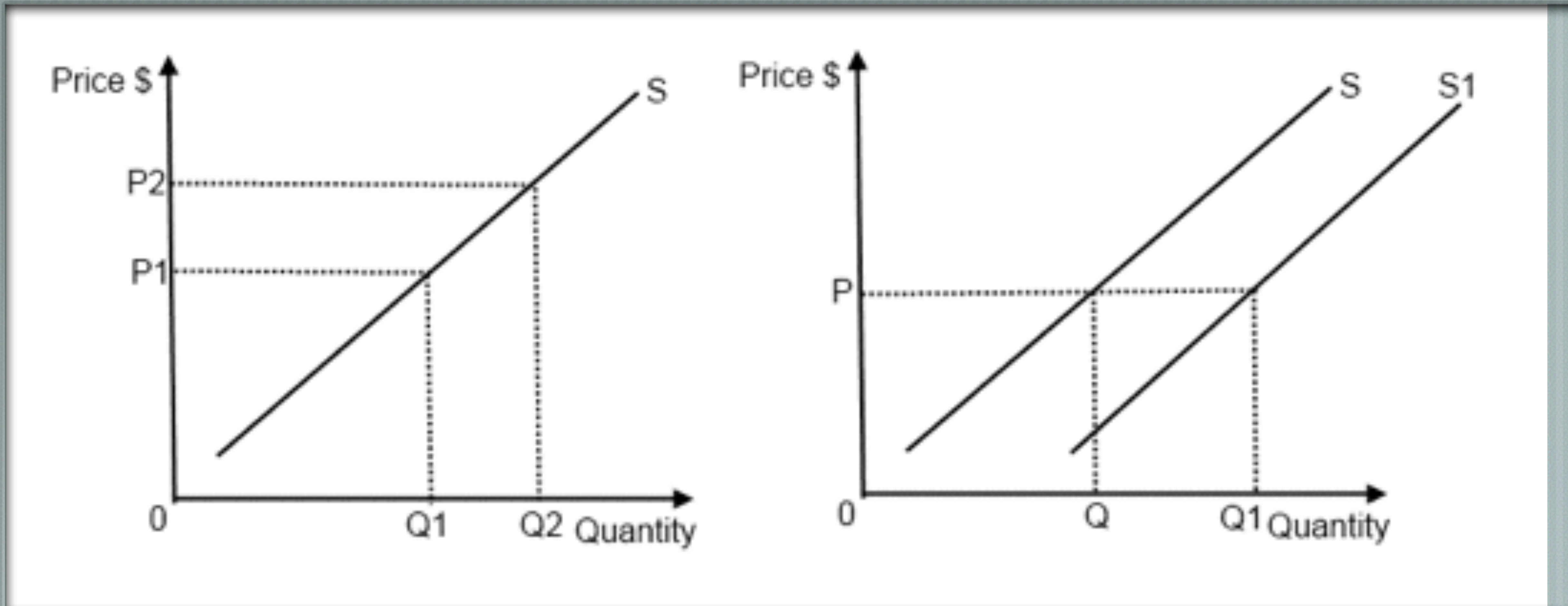


Price of other products, which the producer could produce instead of the existing product



- Most producers have a choice of what they want to produce.
  - Example: a producer of roller skates may also be able to produce skateboards with minimal change in production facilities
  - Price of skateboards goes up, producer may want to supply more skateboards and fewer roller skates

Price of other products, which the producer could produce instead of the existing product



- This would lead to a movement in the supply curve of one product and shift to the left (or right) for the other product

State of Technology

- Improvements in the state of technology in a firm or industry should lead to an increase in supply and thus a shift to the right of the supply curve

Expectations

- Producers make decisions about what to supply based on their expectations of future prices
  - The effect that expectations might have on production decisions may vary

Expectations

- Example: Producers who expect the demand for their product to rise in the future may assume the higher demand will lead to a higher price
  - If it is possible to store the product they might withhold the product from the market in order to be ready to supply more in the future and gain a higher price

Government Intervention

- Governments sometimes intervene in markets in ways that alter supply
  - Indirect taxes
  - Subsidies

Government Intervention

- Indirect taxes (expenditure taxes) are taxes on goods and services that are added to the price of a product.
- Because these taxes force up the price of the product, they have the effect of shifting the supply curve upwards by the amount of the indirect tax

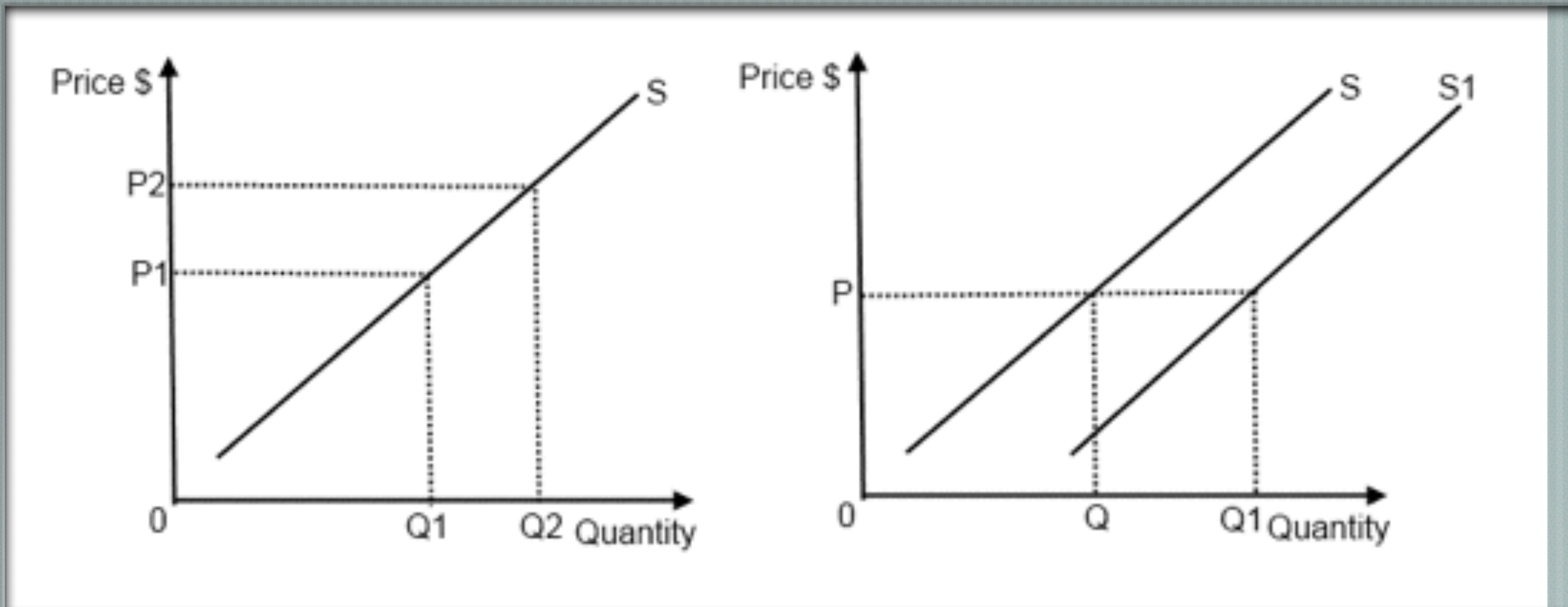
Government Intervention

- Subsidies are payments made by the government to firm that will reduce their costs which will shift the supply curve downwards by the amount of the subsidy.
  - More of the product will be supplies at every price

Movement and Shift in Supply Curve

- Sometimes there is just movement along the supply curve (up or down) and sometimes the supply curve actually shifts to the left (in) or right (out)
  - Movement- a change in price of the good itself causes movement along the existing supply curve
  - Shift- a change in any of the other determinants of supply, will always lead to a shift of the supply curve either to the left or right

Movement and Shift in Supply Curve



Movement

Shift