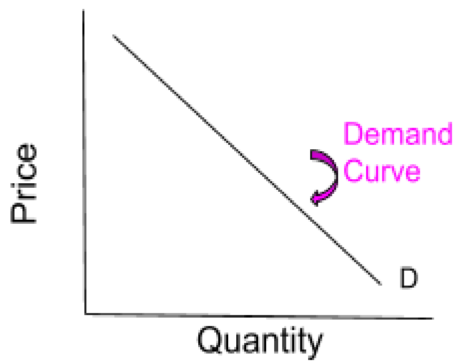
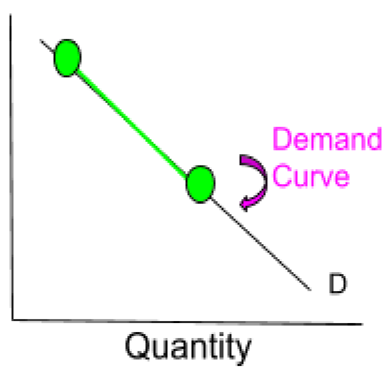
Unit 2: Demand and Supply

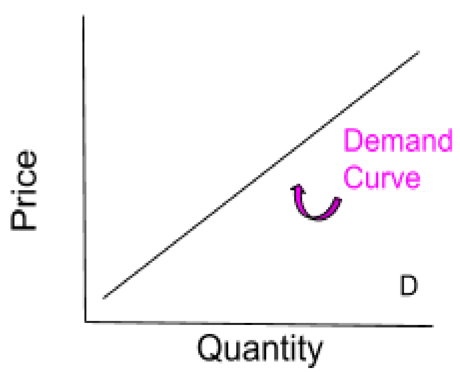
Demand: The relationship between the various possible prices of a product and the quantities of that product that consumers are willing to purchase
Quantity Demand: The amount of a product that consumers are willing to purchase at each price (dependent variable)



The inverse relationship between P and Quantity Demanded is known as The Law Of Demand



A change in the quantity demanded produces a movement along the demand curve



The Veblen Effect: When the law of demand is broken, the curve has a positive slope (ex. Luxury or collectible item)

<u>CHANGES IN DEMAND (DEMAND DETERMINANTS):</u>

1) **Number of Buyers:**

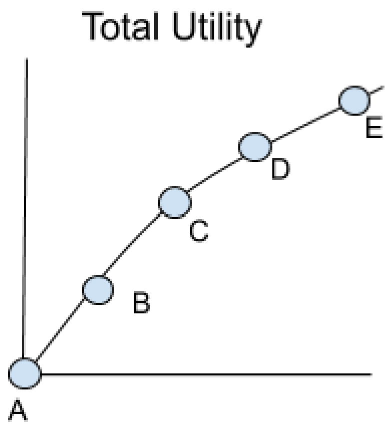
- Increase in demand, shift right
- Decrease in demand, shift left

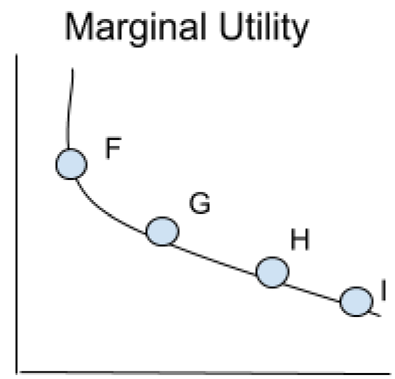
2) **Income:**
    - Normal Goods:
        - Increase in income shifts curve right
        - Decrease in income shifts curve left
    - Inferior Goods:
        - As income increases, quantity demanded decreases
        - As income decreases, the quantity demanded increases
3) **Prices of Other Products:**
    - Substitute goods: products that can be consumed in place of another
    - As the price of the product increases, more people buy the substitute which shifts the substitutes demand curve to the right. The inverse is also true.
    - Complementary goods: products that are consumed together
4) **Consumer Preferences:**
    - More new people want the product, curve shifts right
    - less people want the product, curve shifts left
5) **Consumer Expectations:**
    - If people think that the price of a house will increase in the future, they will want to buy now, which will make the curve shift right.
    - If people think that computer prices will decrease in 6 months, there will be a decrease in demand NOW.

* A change in quantity demanded is a movement along a single demand curve
* A change in demand is a shift in the entire demand curve

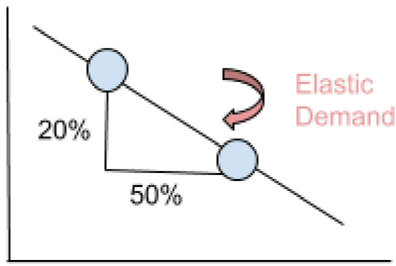
<u>THE LAW OF DIMINISHING MARGINAL UTILITY:</u>

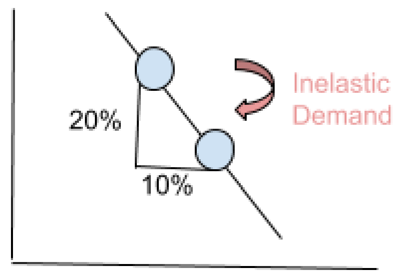
- Marginal means one more
- Utility means satisfaction that an individual gains from consuming a variety of goods and services
- Jevons is known for applying the concept of utility to economics & developing a model of consumption. He believed that a consumer's total utility gained from consuming a particular product depends on the number of units he/she purchases.





PRICE ELASTICITY OF DEMAND:

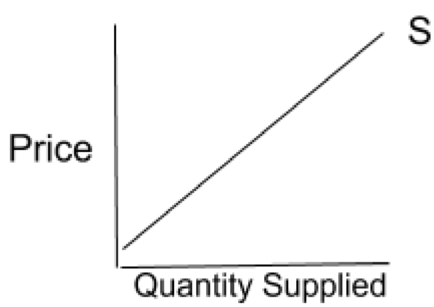




Inelastic demand curve is steeper than the elastic demand curve

SUPPLY:

- The relationship between the various possible prices of a product and the quantities of the product that businesses are willing to put to market



There is a direct relationship between Price and Quantity Supplied (ceteris paribus)

SUPPLY DETERMINANTS:

1) **Number of Producers:**
    - Increase in number of business, increase in supply ∴ shift right
    - Decrease in number of business, decrease in supply ∴ shift left
2) **Resource Prices:**
    - If material price increase cost to produce increases and Qs decrease ∴ shift left
3) **State of Technology:**

- Process = increase efficiently = cheaper to produce ∴ quantity supplied increases, ∴ shifts right

4) **Change in Nature:**
   - Agricultural products mostly
   - Rainy summer = less crops = decrease in quantity supplied, ∴ shift left
5) **Prices of Related Products:**
   - Farmers switch products, increase the supply of another product.

* A change in quantity supplied is the effect of change in the price of a product and causes a movement along the supply curve

* A change in supply is caused by a change in a supply determinant, causes the entire supply curve to shift

FACTORS THAT AFFECT PRICE ELASTICITY OF DEMAND:

1) **Portion of Consumer Incomes:**
   - If the item costs a lot, ex: a big screen awesome tv, a price change can affect whether to buy it or not∴ more elastic

2) **Access to Substitutes:**
   - Demand for NIKE is more elastic than the demand for running shoes
3) **Necessities or Luxury:**
   - Necessities have inelastic demand
   - Luxury items have elastic demand
4) **Time:**
   - In the short run, people don't change then buying habits because of price. Overtime, people can change than habits and needs.

SUPPLY ELASTICITY:

- Measures the responsiveness of producers to changes in the product's own price

ELASTIC SUPPLY:

- $\% \Delta P > \% \Delta Qs$

INELASTIC SUPPLY:

- $\% \Delta P < \% \Delta Qs$

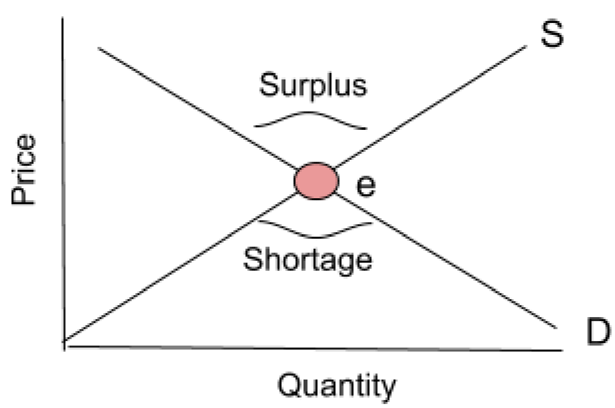
FACTORS THAT AFFECT SUPPLY ELASTICITY:

1) **Immediate Run:**

- No changes in Qs of resources
2) **Perfectly Inelastic Supply:**
    - Resources used are constant, regardless of prices
3) **Short Run:**
    - At least one of the resources cannot be changed
4) **Long Run:**
    - All quantities can be changed
5) **Constant Cost Industry:**
    - Not a major use of any resources
6) **Perfectly Elastic Supply:**
    - Price remains constant regardless of Qs

<u>INCREASING COST INDUSTRY:</u>
- Increase Qs = increase P of a single resource
- Industry is a major user one resource, therefore if the price of the resource increases, Pproduct increases.

<u>MARKET EQUILIBRIUM:</u>
- Where demand and supply intersect



<u>PRICE CONTROLS:</u>
Price Floor: minimum price set above equilibrium
Price Ceiling: maximum price set above equilibrium

<u>WHY HAVE PRICE CONTROLS:</u>
- Stabilize prices
- Stabilize farm incomes
- Maintain agricultural history

<u>WHY NOT HAVE PRICE CONTROLS:</u>

- Cost (government covers the surpluses)

WHAT DOES GOVERNMENT DO WITH SURPLUS?:
- Foreign aid
- Destroy

RENT CONTROLS:
- Adv: people can afford housing
- Dis: less landlord willing to rent at low prices ∴ shortage of rental housing and less construction of new dwellings, buildings get converted to other uses.