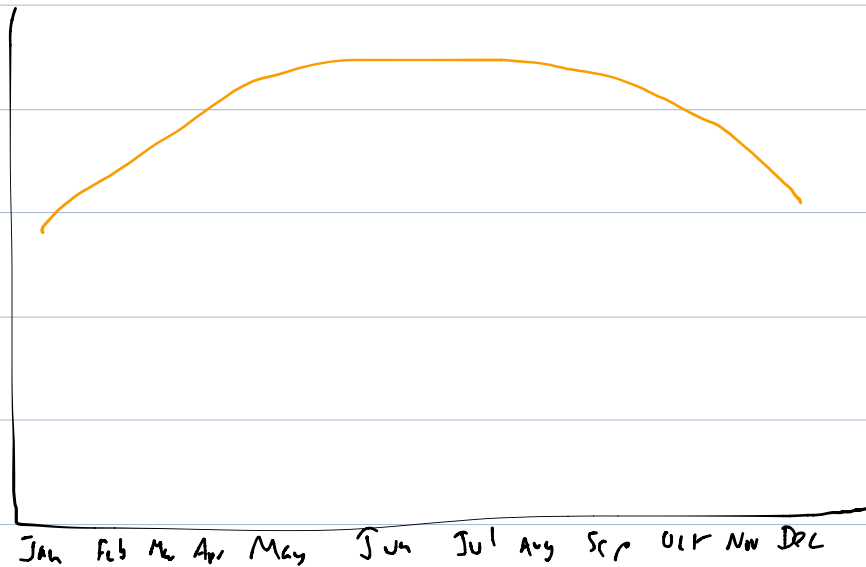
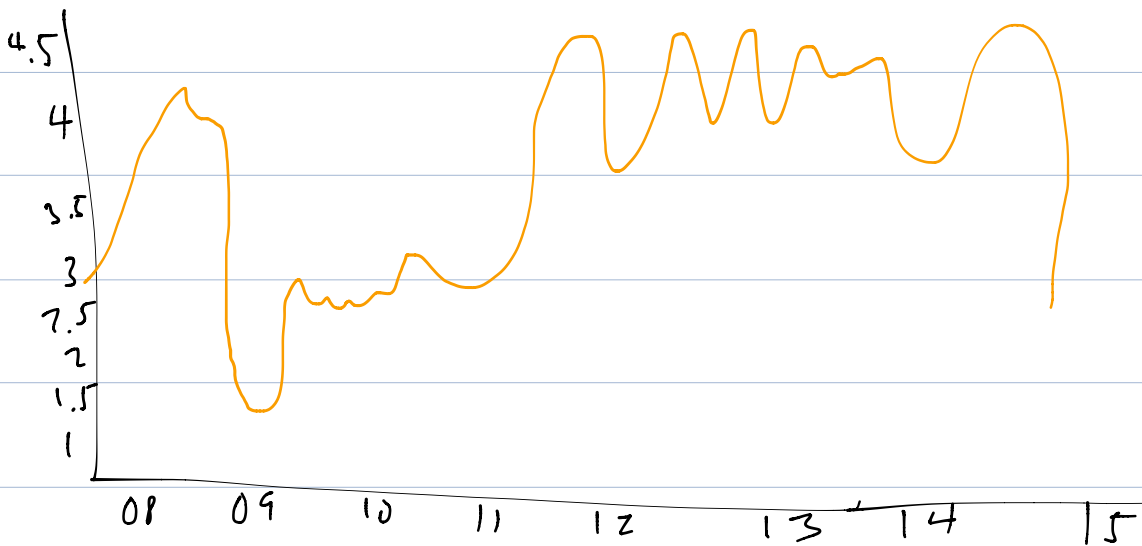


# Price Theory

What determines price?

→ The interaction of <sup>demand</sup> buyers and <sup>supply</sup> sellers

US Gasoline Price 2008-2014 monthly



Demand

The buying / consuming side of the market

Many factors influence, including:

1. Price (-). ← negative relationship — Movement along


Change in quantity demanded

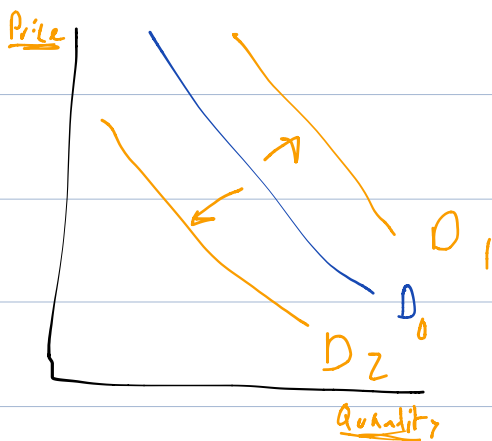
Law of Demand:

All else equal, quantity demanded falls when price rises,

and rises when price falls



 Incentives affect behavior



2. Consumer Income (+)

- 3. Price Expectations (+)
  - 4. Tastes and Preferences (+/-)
  - 5. Taxes (-)  
Sales & Excise
- } Shifts
- change in demand

## Supply

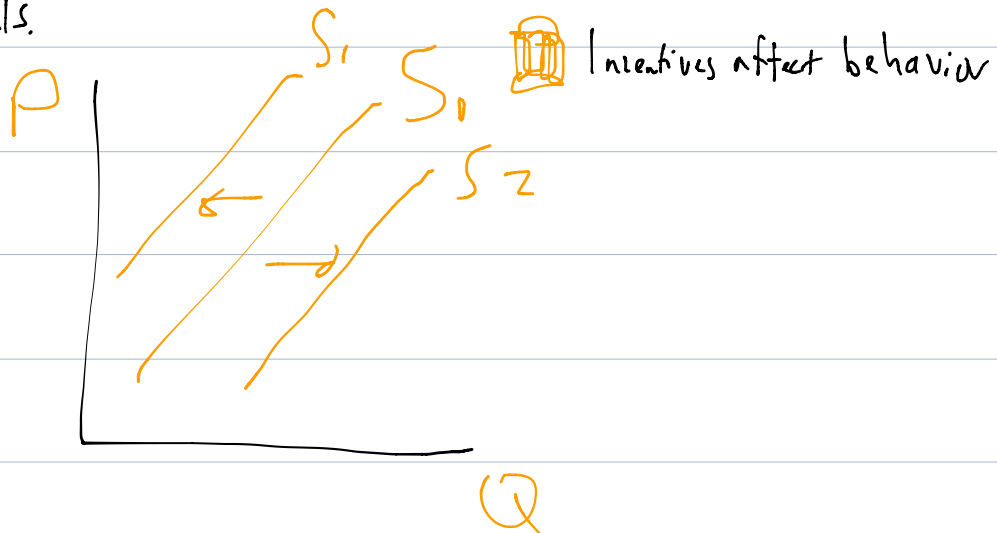
The selling/producing side of the market

Many factors influence including:

1. Price (+)

Law of Supply:

All else equal, quantity supplied rises when price rises, and falls when price falls.



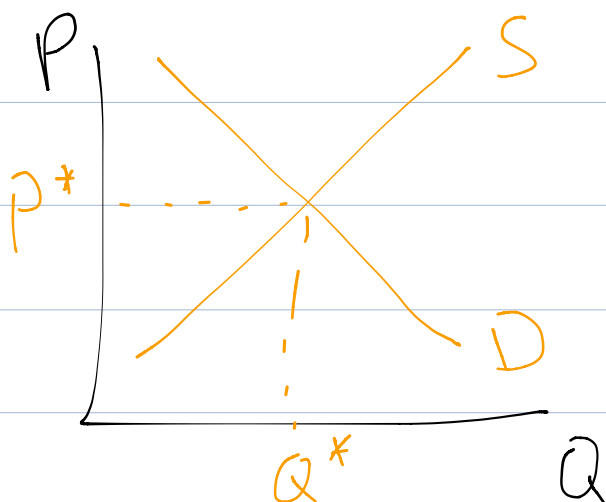
2. Cost of inputs/resources (-)
3. Technology (+)

4. Price Expectations (-)

5. Taxes (-)

What determines price?

→ The interaction of <sup>demand</sup> buyers and <sup>supply</sup> sellers



Equilibrium: when plans of buyers match plans of sellers  
 $Q^S = Q^D$

1. Why can't  $P > P^*$ ?

$Q^S > Q^D \rightarrow \text{surplus } P \downarrow$

2. Why can't  $P < P^*$ ?

$Q^D > Q^S \rightarrow \text{shortage}$