Econ 532
Wohlgemuth

# Lecture 2: Supply & Demand

**Reading: Baye Chapter 2**

**A. Market Demand Curve**

Defn: Relationship between the number of units consumers are willing and able to purchase at every price

Law of Demand
Other Factors Held Constant
Consumer Surplus
The Demand Function
An equation representing the demand curve $Q_{xd} = f(P_x, P_y, M, H)$
$Q_{xd}$ = quantity demand of good X.
$P_x$ = price of good X.
$P_y$ = price of a substitute good Y.
M = income.
H = any other variable affecting demand

**Terms for Demand Factors**

Income: Normal and Inferior
Price of Other Products: Substitutes and Complements

**B. Market Supply Curve**

Def'n: Relationship between the number of units firms are willing and able to produce and sell at every possible price

Law of Supply
Other Factors Held Constant
Producer Surplus

**C. Market Equilibrium**

Interaction between Supplies and Demanders
$Q_s(P) = Q_d(P)$
Shortage and Surplus

EXAMPLES: Find Equilibrium P & Q mathematically & graphically

Price Restrictions or Controls
Price Ceilings: The maximum legal price that can be charged
Price Floors: The minimum legal price that can be charged

**D. Comparative Statics**

Def'n: What happens to the Equilibrium Price and Quantity when one of the "other factors held constant" changes?

**E. Taxes**

Excise tax – a per unit tax (e.g. 38.4 cents per gallon of gas)
Ad Valorem Tax – a tax based on the price of a product (+7% on price of jeans)

**F. Welfare Analysis**

With and without market interventions (price floor/ceiling), excise tax, etc.
Use #'s to represent areas on the market supply and demand graph