

Unit D: Applying Basic Economic Principles in Agribusiness

Lesson 2: Understanding the Effects of
Supply and Demand Shifts

Terms

- Competition
- Inputs
- International Trade
- Scarce
- Speculation
- Shortage
- Surplus

Influence of International Trade on Supply and Demand

- I. *International trade* is the exchange of goods and services between different countries. It basically works the same as trading from village to village or from province to province only sometimes the trading rules are stricter.
 - A. All around the world, people are consuming products that are often available year-round. Transportation, communication, and trading between nations have made this possible. Consumers are all happy that they can have products that are not in-season in their own country, but are still concerned about the safety of what they consume.

Influence of International Trade on Supply and Demand

1. Security is just one issue that must be taken into consideration when trading. Every country takes measures to insure the safety of their people.
 - a. We still need to make sure that the products that have been imported are safe and healthy to eat. We need to know that the products we are consuming are free of hazardous pesticide residue and other foreign materials that could cause us harm.

Influence of International Trade on Supply and Demand

- b. Only products that are free from disease and other pests are permissible to trade. Pests can be imported into a country with food and crop imports. It is important that harmful pests are not introduced into another country by trading infected products or commodities.
- 2. Other issues include mutual assistance, monetary balances, economic growth, economic development, and technical advancement.

Influence of International Trade on Supply and Demand

- B. The largest benefit to international trade is to keep the workforce productive and efficient.
 - 1. With international trade, businesses and organizations can compare prices to obtain the lowest price possible.
 - 2. If we did not have foreign *competition*, many items would be more expensive to buy than what you currently pay. Competition is rivalry between two or more businesses or organizations.

Influence of International Trade on Supply and Demand

- C. Another advantage to international trade is that some products that we cannot grow in this country are still available to us. Many products are imported because our country does not grow enough to satisfy the demand for them.
 - 1. Many countries could increase the supply of products, but it is beneficial for countries to specialize in just a few things.
 - 2. As environmental conditions are different in each region, it is wise to grow crops that are best suited for those environmental conditions. For example, almonds which are easily grown in Afghanistan can be exported. Wood products that are readily available and easily grown in other regions of the world can be imported.

Influence of International Trade on Supply and Demand

- D. Nations that participate in international trade benefit their consumers in many respects:
 1. A wider distribution of **scarce** resources is made available.
Scarce is not having enough product or commodity to meet consumer demand.
 2. Specialization is encouraged and promotes a comparative advantage. This usually lowers production costs and therefore lowers consumer's costs.
 3. A peaceful coexistence is promoted because the countries are communicating.
 4. Improved technology can be exchanged between countries which works faster than if each country had to figure out everything for themselves.

Influence of International Trade on Supply and Demand

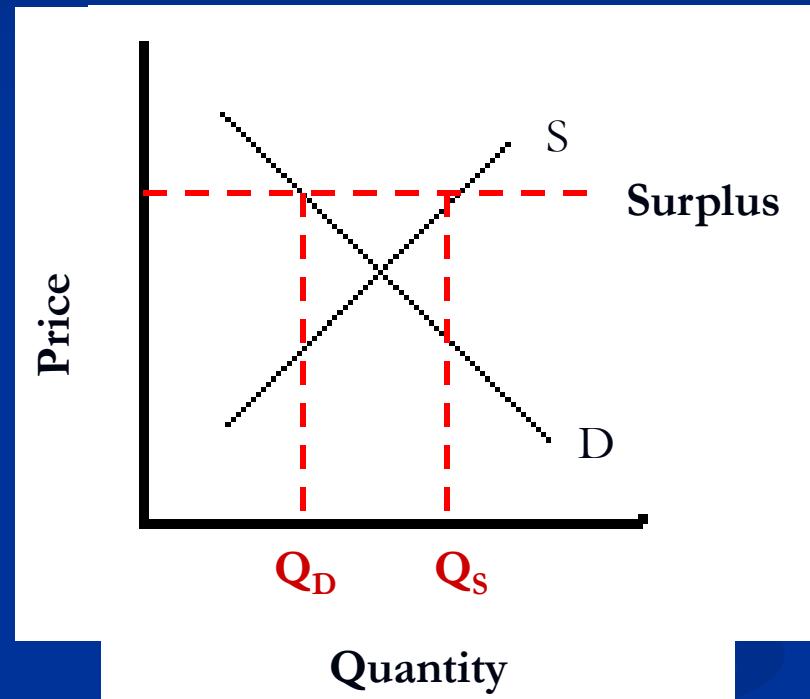
- E. International trade works because of rules and agreements made between countries. There are many trade barriers set up to protect countries from hurting themselves by trading.
- F. Because international trade exists, when supply in one region decreases due to uncontrollable circumstances such as weather, trade can be used to supplement and increase supply in that region.
- G. In the same way, other regions may desire a particular product grown in our region, increasing the demand for that product. This desire may be caused by a low supply in their region or simply having more need for our product.

Market Surpluses and Shortages

- II. Within an economy, there are times that too much or too little of a product or commodity is on the market. This occurs when supply or demand is increased or decreased.
 - A. A *surplus* is when there is an excess amount of a product. Consumers can purchase as much product as they want at the current price and a significant amount of product remains unsold.

Market Surpluses and Shortages

1. Several reasons can cause a surplus:
 - a. Increased supply. Too much product in the market causes excess supply to remain unsold.
 - i. More businesses begin producing the product.
 - ii. For crops that are grown, weather conditions may be just right that an unusually high amount of the commodity is produced.

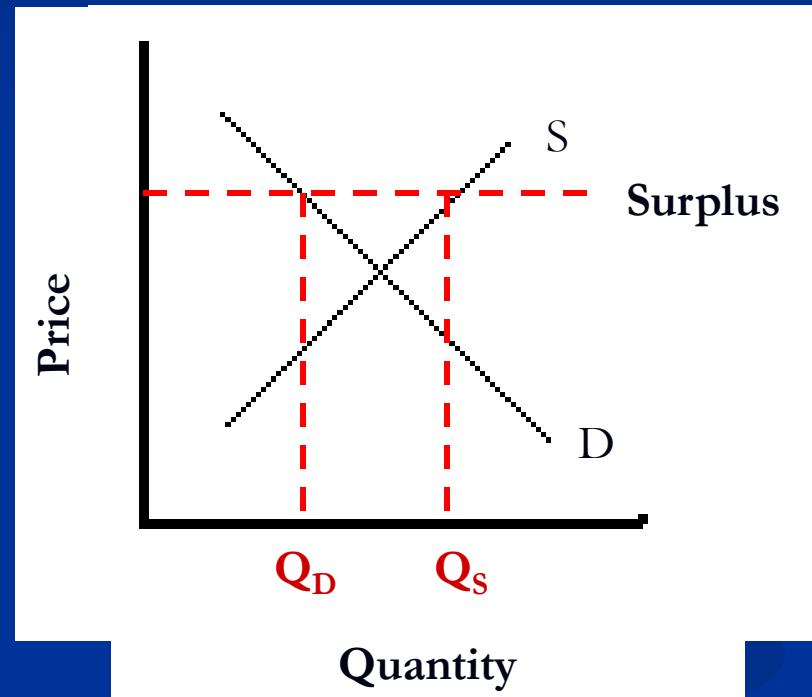


Market Surpluses and Shortages

- b. Decreased demand.

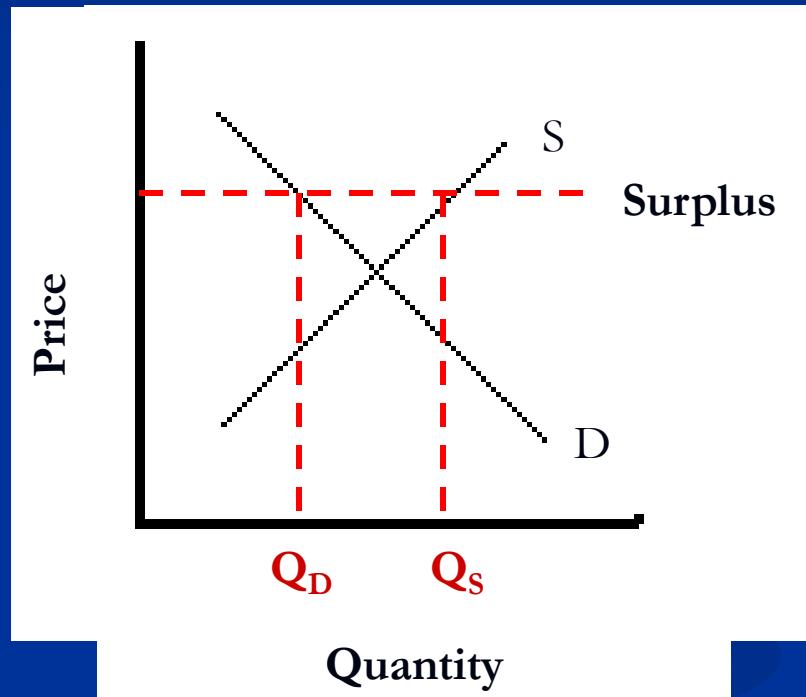
When demand decreases,
consumers do

- i. Price may be too high and consumers are buying other products.
- ii. Better products are being produced and consumers prefer to buy these better products.



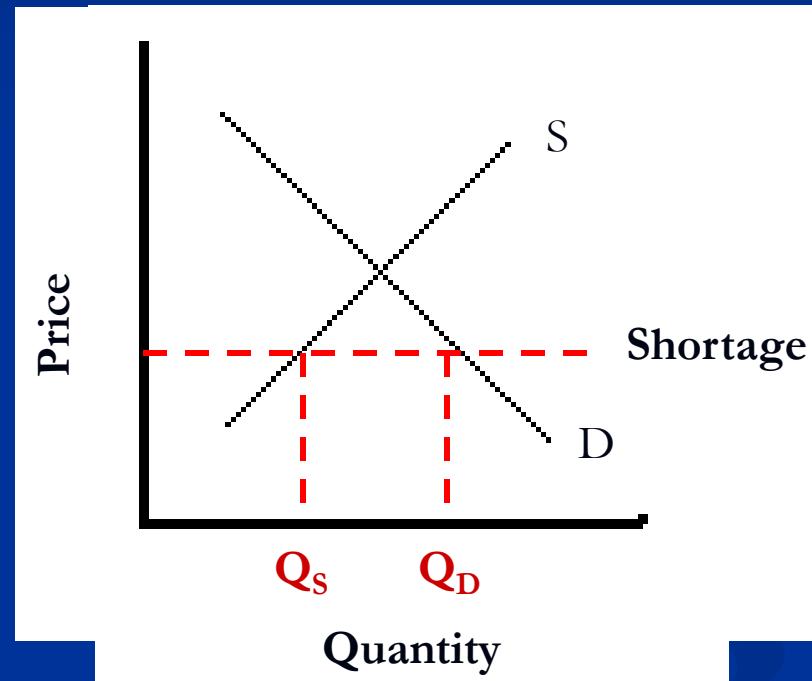
Market Surpluses and Shortages

2. As a result of the surplus, some businesses will offer to sell their product at a lower price. Meanwhile, other business may choose to stop producing the product. Some businesses might fail due to lower profits and be forced to stop producing the product.
3. A graphic shows how supply and demand are affected during a surplus and a new equilibrium price is discovered.
 - a. Since the quantity demanded (Q_D) is less than the quantity supplied (Q_S), a surplus exists



Market Surpluses and Shortages

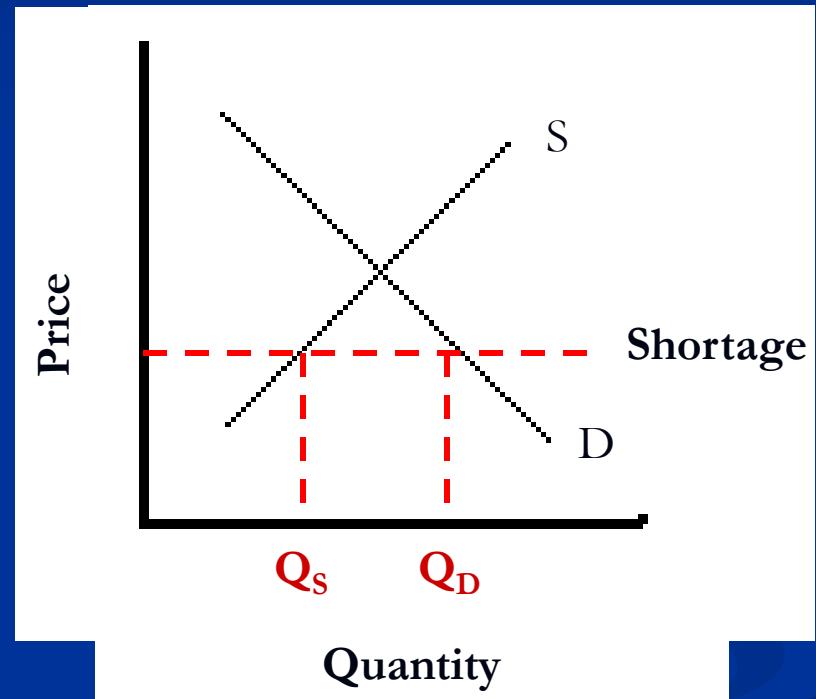
- B. A *shortage* is when there is not enough of a product. Consumers desire to buy more product, but all of the product is sold.
1. Several reasons can cause a shortage:
 - a. Decreased supply. Not enough product on the market causes a scarcity.
 - i. Businesses may have stopped producing the product. This could be a result of higher production expenses.
 - ii. For crops that are grown, weather or environmental conditions (not enough rain, too much rain, pest invasion, etc.) may have caused an unusually low amount of the commodity to be produced.



Market Surpluses and Shortages

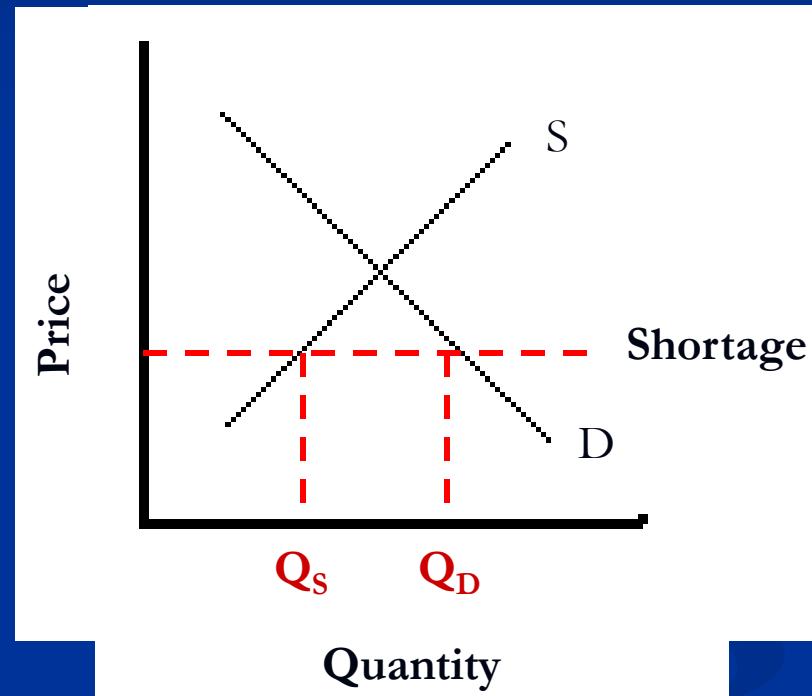
b. Increased demand.

- i. Price may be too low and consumers want to buy an extra amount to store and use at a later time.
- ii. Increased population means there are more consumers to purchase products.
- iii. Increased demand may also be caused by a sudden interest in the product. Consumers may have found a new use for the product or believe the product to be better than other similar products.



Market Surpluses and Shortages

2. As a result of the shortage, some businesses will increase their production so that they can sell more products at the higher price. Other businesses may begin to produce the product in order to take advantage of their high price.
3. A graphic shows how supply and demand are affected during a shortage and a new equilibrium price is discovered.
 - a. Since the quantity supplied (Q_S) is less than the quantity demanded (Q_D), a shortage exists.



Supply and Demand Principles in Agribusiness

III. When operating a business, it is important to consider world and local supply and demand. The laws of supply and demand affect each business and in order to operate a successful business, changes may need to be made as a result of shifts in supply and demand.

A. When planning a business, consider how the product or commodity will be sold and marketed.

Supply and Demand Principles in Agribusiness

1. If the product will be sold to local consumers, the business planner should ask himself:
 - a. Is there enough local demand to support the production and profitable sale of this product?
 - b. How many other businesses are providing the supply for this market? Could our business offer supply at a lower price?
 - c. Could a ***niche market*** be developed?
 - i. A niche market is a special or unique product or service that is being sold to a specific group of consumers who desire the product or service. Other businesses do not address the needs or desires of the group of consumers.
 - ii. One way to indicate if a niche market could be developed is to ask several consumers if they would be interested in the proposed product. A survey could be developed about the product, its price, and how consumers might use it to indicate if the product would be successful.

Supply and Demand Principles in Agribusiness

2. If the product will be sold to a buyer who will sell the product at another location, the business planner should ask himself:
 - a. Is there enough regional or global demand to support the production and profitable sale of this product?
 - b. Does the buyer have standards for the product that he buys? How can I be sure that the product I produce will meet these standards?
 - i. Standards may include a minimum weight, disease and pest free, a certain maturity.
 - c. Could a written contract be made to guarantee a set price for my product?
3. It is also important to consider the *inputs* that are needed to produce the product or commodity. An input is something that is needed to be "put in" or used to produce the product or commodity.
 - a. Are the inputs affordable?

Supply and Demand Principles in Agribusiness

- B. When operating a business, it is important to know up-to-date information about your consumers and the global status of your product.
 - 1. Information can be obtained by reading periodicals, the internet, or by contacting an extension educator.

Supply and Demand Principles in Agribusiness

- a. If information shows that supply or demand for the product is shifting, steps should be taken to compensate for this change. When this is done, the business should remain profitable.
- b. For example, if the demand is increasing for almonds, an almond grower should consider increasing the amount of almonds he produces.
- c. Inputs for the business also need to be considered. If supply or demand is shifting for the inputs, changes within the business may be required in order to remain profitable.
- d. For example, if the cost of fertilizer to produce cotton increases significantly, a cotton grower should consider alternatives such as growing cotton with less fertilizer and producing less cotton or growing a different crop that does not require fertilizer.

Supply and Demand Principles in Agribusiness

2. Some questions the business owner should ask himself are:
 - a. Is the demand for the product I produce remaining the same? Will it change in the near future? What changes does the business need to make to remain profitable?
 - b. Is the supply of the product I produce remaining the same? Will it change in the near future? What changes does the business need to make to remain profitable?
 - c. Is the price I sell my product to local consumers comparable to the price of this product in other regions? Or am I receiving a comparable price from buyers that are taking this product?

Supply and Demand Principles in Agribusiness

- C. It is important to remember that with agribusinesses that produce crops or raise livestock the amount of time to make changes is longer than with other businesses.
 - 1. Although a grower plans to change the amount of a certain commodity that he produces, this may not actually occur until the next growing season.

Supply and Demand Principles in Agribusiness

2. For example, if the price of melons decreases and the price of apples increases in June, several melon growers might decide to stop growing melons and plant an apple orchards instead. Although the melon growers have made their decision, they will still harvest their melons in July and August. It will not be known until next harvest that there is a decreased supply of melons.
 - a. If enough melon growers stop producing melons, the actions by these growers will cause a major decrease in supply, if all other things remain constant, the price of melons will increase. Also, they will be placing apples on the market, increasing the total supply of apples. If all other things remain constant, the price of apples will decrease.

Supply and Demand Principles in Agribusiness

3. By owning and operating a business, it is known that a certain amount of risk is involved. In order to remain profitable, some changes may need to be made to the business. If changes are made at the wrong times, an adverse affect may be true, causing the business to lose profit. Some *speculation*, or predicting what will happen in the future, needs to be made correctly for the business changes to have the best possible outcome.

Review

- How does international trade influence supply and demand?
- What are market surpluses and shortages?
- How can supply and demand principles be used in agribusiness?