CHAPTER 3

Chapter 3 - Market Demand and Supply

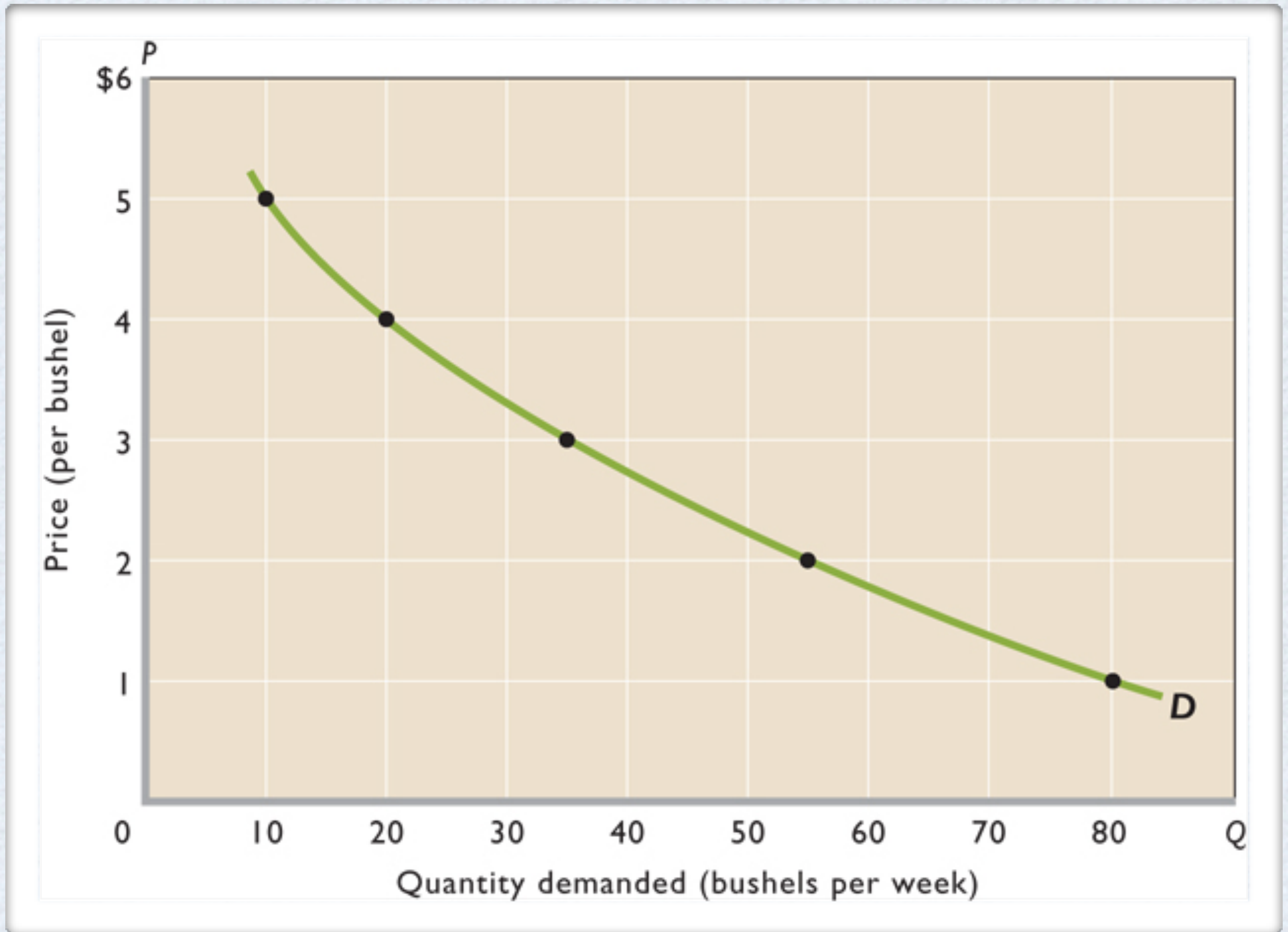
- **Markets** bring together buyers (demand) and sellers (supply).
- Markets are could be local, national, international
- Competitive market
  - Large number of buyers and sellers, selling standardized products

Demand

- **Demand** - is a schedule or a curve that shows the various amounts of a product that consumers are willing and able to purchase at each price level during a specified period of time.

Demand for Corn

Price per Bushel	Quantity Demanded per Week
$5	10
4	20
3	35
2	55
1	80

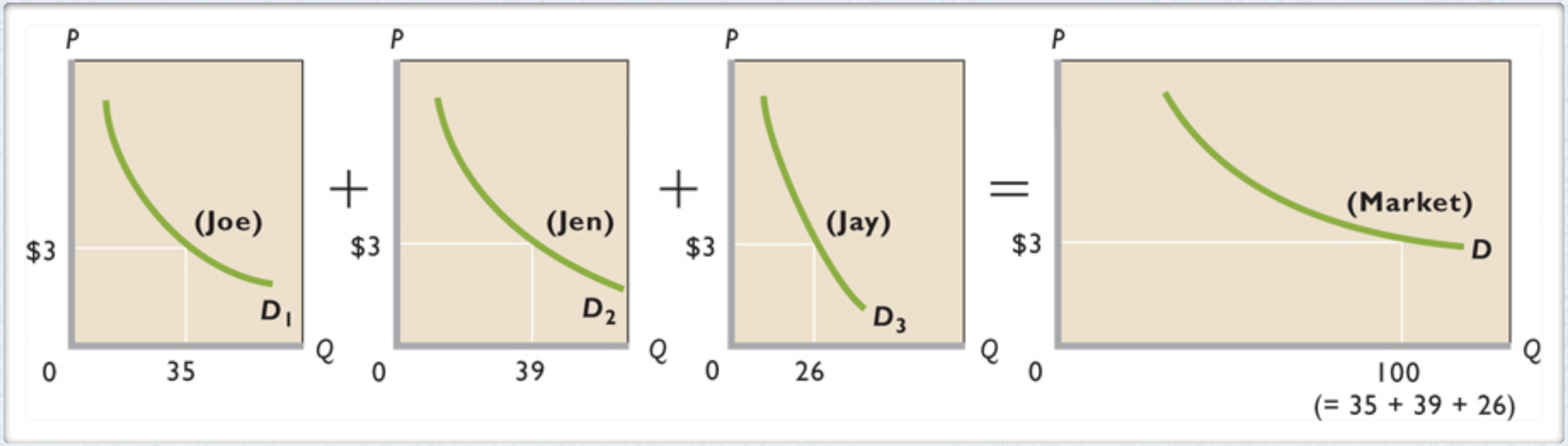


Law of Demand

- *Other things equal*, as price falls, quantity demanded rises, and as price rises, quantity demanded falls. ➠ There is a **negative or inverse relationship between price and quantity demanded**. This inverse relationship is called the **law of demand**.

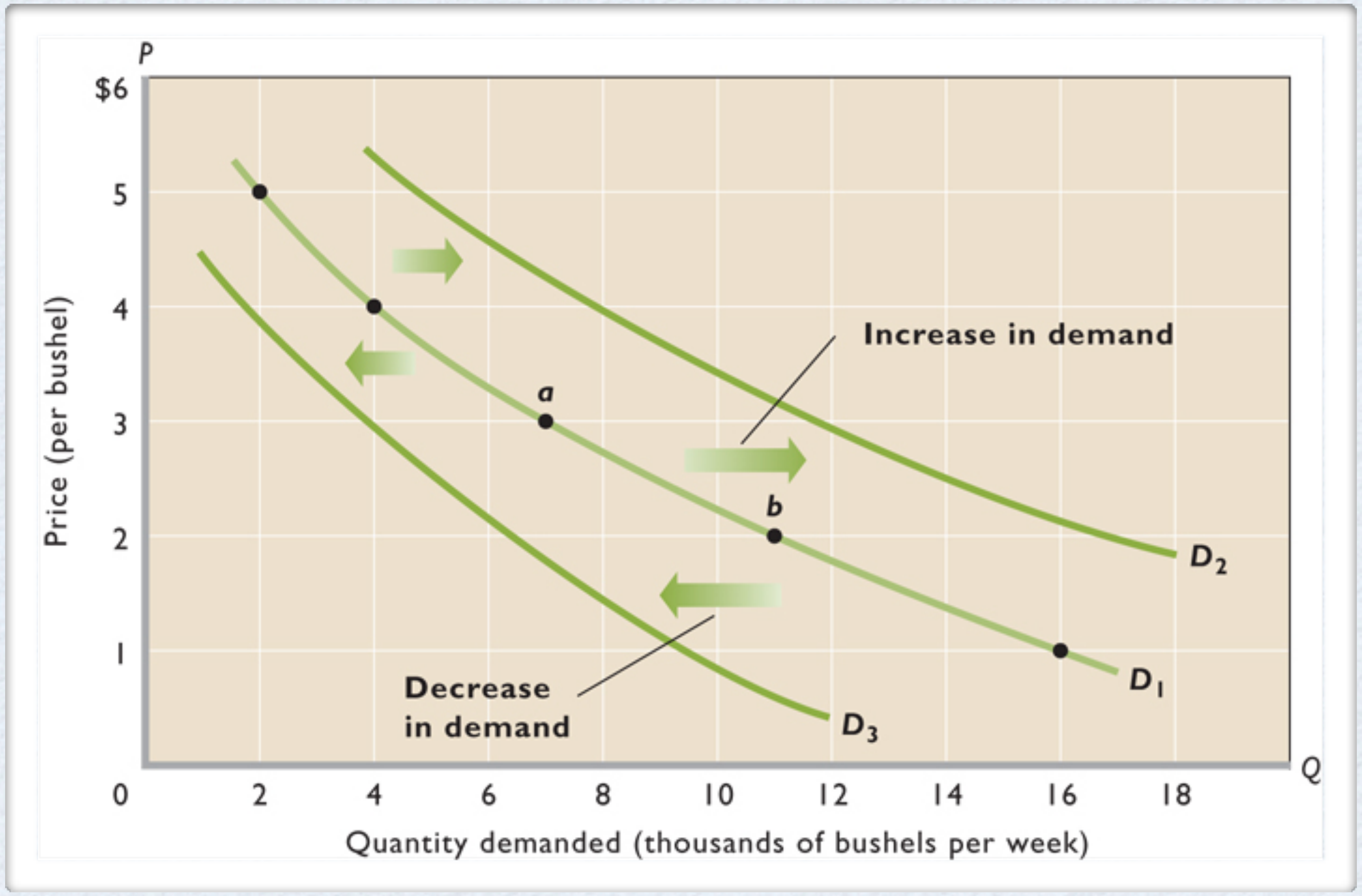
Market Demand

- By adding the quantities demanded by all consumers at each of the various possible prices, we can get from individual demand to **market demand**. Graphically, market demand is the horizontal summation of individual demand curves.



Demand - continued

- **Changes in quantity demanded** ➠ move from a ➠ b
- **Changes in demand** ➠ move from D_1 ➠ D_2 or D_3



Demand - continued

- A *change in* one or more of *the determinants of demand* will change the demand ➠ **demand curve will shift**.
- The **determinants of demand**
  1. **Number of buyers** - # of buyers in the market ⇑ ➠ D⇑
  2. **Tastes and preferences** - Tastes ⇑ ➠ demand at all price levels ⇑ ➠ D⇑
  3. **Income** - Products whose demand varies directly with income are called **superior goods or normal goods**. Y⇑ ➠ D⇑ Products whose demand varies inversely with income are called **inferior goods**. Y⇑ ➠ D⇓
  4. **Expectations** - P_{gas}⇑ tomorrow ➠ D_{gas}⇑ today
  5. **Prices of related goods**
     a. **Substitutes** - $P_{chicken}$⇑ ➠ D_{beef}⇑
     b. **Complementary** - P_{cds}⇓ ➠ $D_{cd\ players}$⇑
     c. **Unrelated** - P_{cars} X $D_{bananas}$ ➠ Independent goods

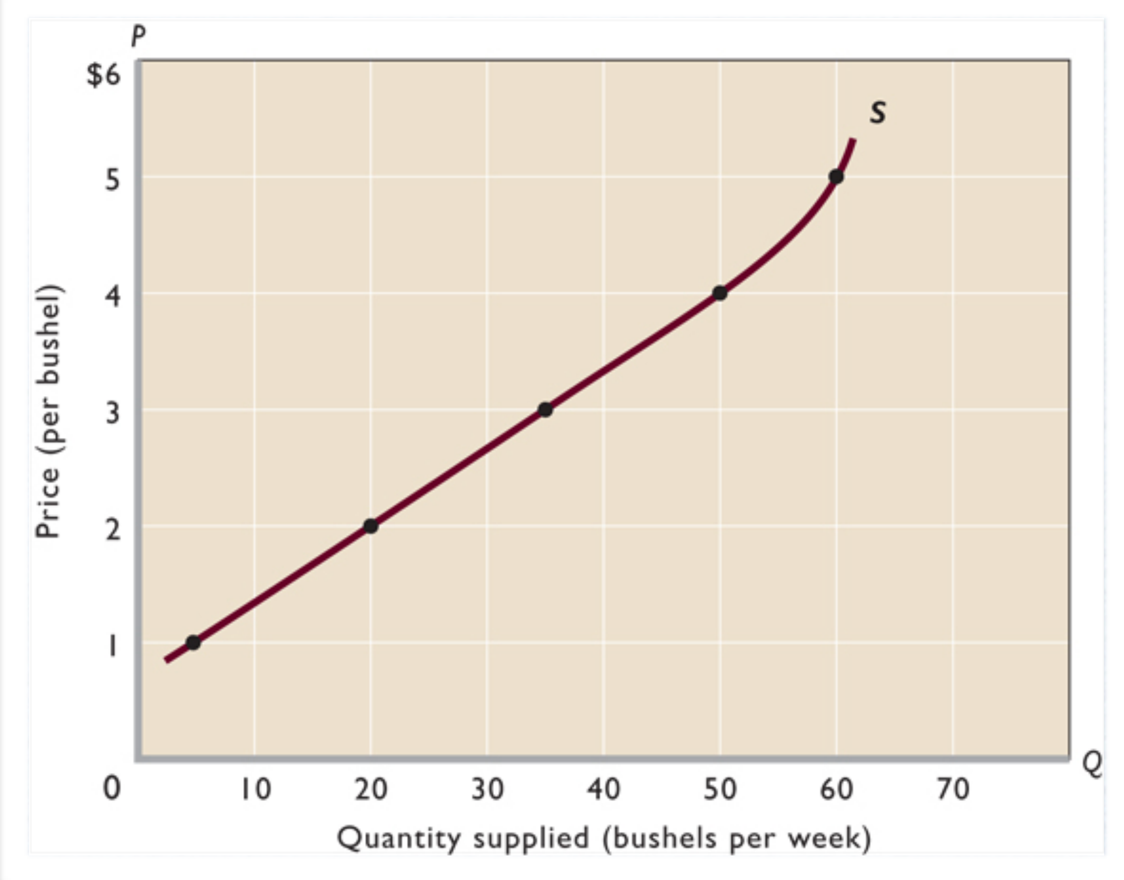
Supply

- **Supply** is a schedule or a curve showing the various amounts of a product that producers are willing and able to make available for sale at each of a series of possible prices during a specific period.

- **Market supply** is the sum of the quantities supplied by each producer at each price level. Graphically, the horizontal summation of each individual supply curve at each price level.

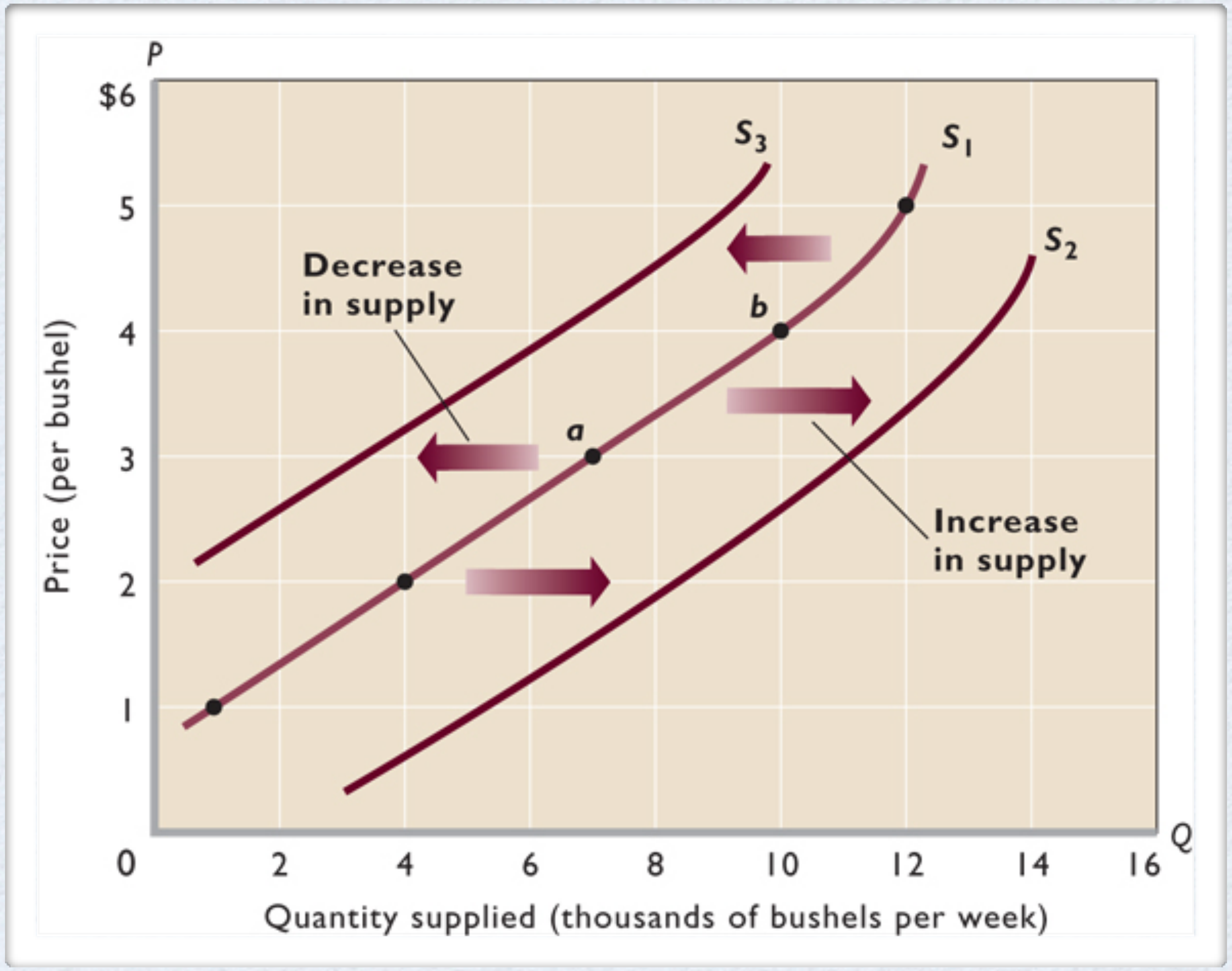
Supply of Corn

Price per Bushel	Quantity Supplied per Week
$5	60
4	50
3	35
2	20
1	5



Supply - continued

- **Changes in quantity supplied** ➠ move from a ➠ b
- **Changes in supply** ➠ move from S_1 ➠ S_2 or S_3



Supply - continued

- **Changes in the determinants of supply will cause the supply curve to shift.**
- **Determinants of supply**

1. **Number of sellers** - The # of suppliers ⇑ ➠ market supply ⇑
2. **Technology** - Technology ⇑ ➠ Cost ⇓ ➠ ∏⇑ ➠ production ⇑ ➠ S⇑
3. **Resource prices** - $P_{resources}$ ⇑ ➠ Cost ⇑ ➠ ∏⇓ ➠ no more incentive to supply products ➠ S⇓
4. **Taxes and subsidies** - *Taxes are costs, subsidies are extra income*. Taxes ⇑ ➠ Cost ⇑ ➠ ∏⇓ ➠ no more incentive to supply products ➠ S⇓. Subsidies ⇑ ➠ Cost ⇓ ➠ ∏⇑ ➠ greater incentive to produce ➠ S⇑.
5. **Producer expectations** - Farmers anticipate P⇑ next year withhold grains this year ➠ S_{grain} ⇓ today
6. **Prices of other goods** - $P_{soccer\ balls}$ ⇓ and $P_{basket\ balls}$ ⇑ ➠ suppliers produce basket balls instead of soccer balls ➠ $S_{soccer\ balls}$ ⇓ ➠ $S_{basket\ balls}$ ⇑

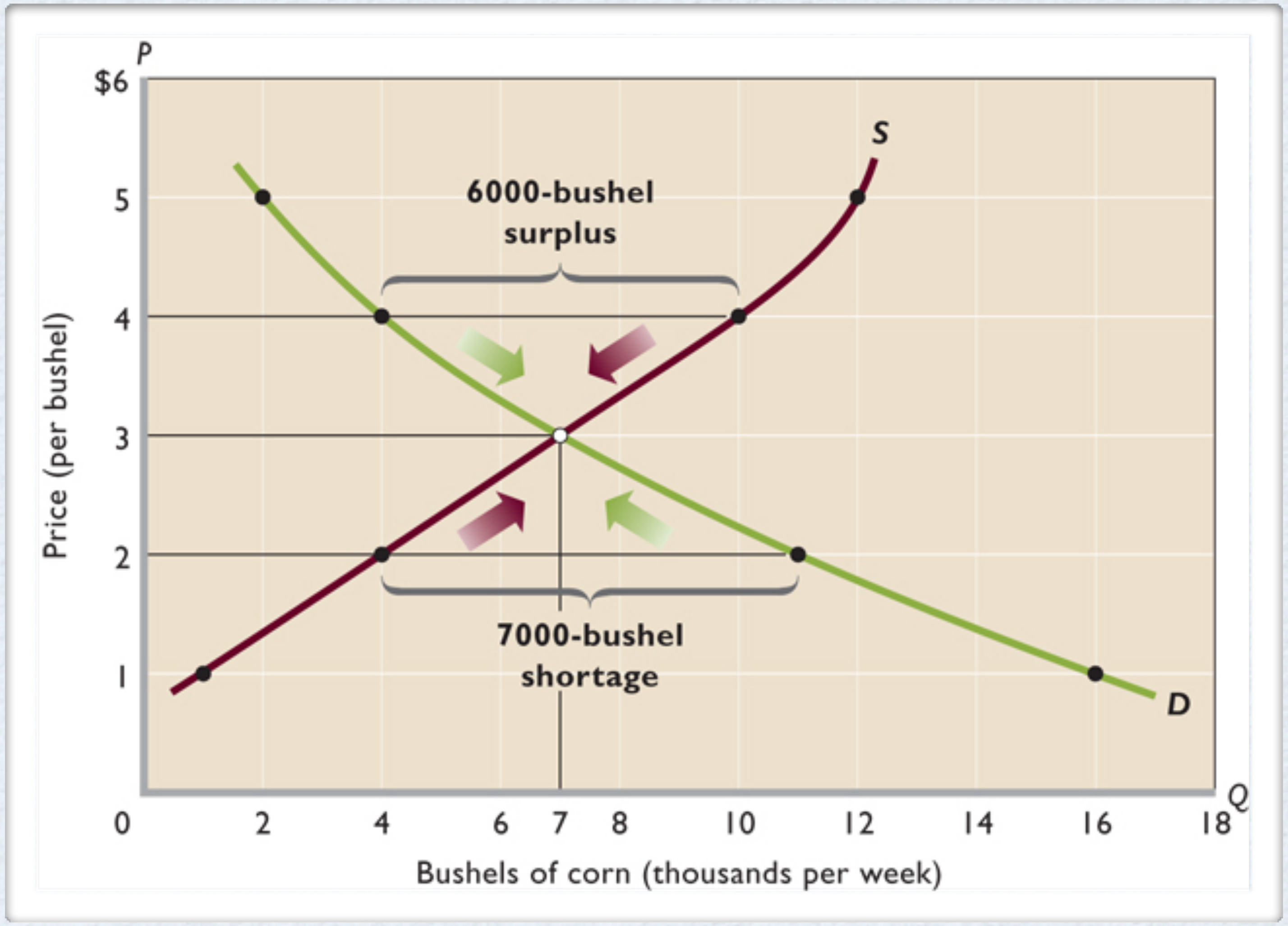
Market Equilibrium

- **Equilibrium Price and Quantity**
  - The **equilibrium price** is where quantity demanded = quantity supplied

Market Supply of and Demand for Corn

(1) Total Quantity Supplied per Week	(2) Price per Bushel	(3) Total Quantity Demanded per Week	(4) Surplus (+) or Shortage (−)*
12,000	$5	2,000	+10,000 ↓
10,000	4	4,000	+6,000 ↓
7,000	***3***	***7,000***	***0***
4,000	2	11,000	−7,000 ↑
1,000	1	16,000	−15,000 ↑

*Arrows indicate the effect on price.

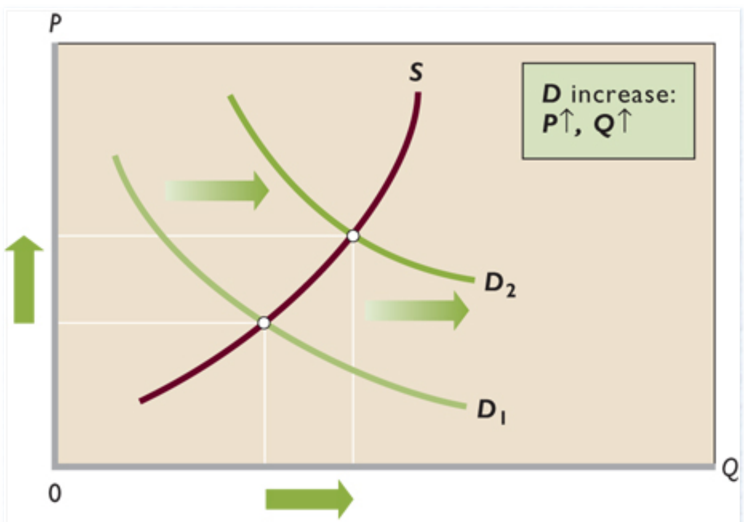


Market Equilibrium - continued

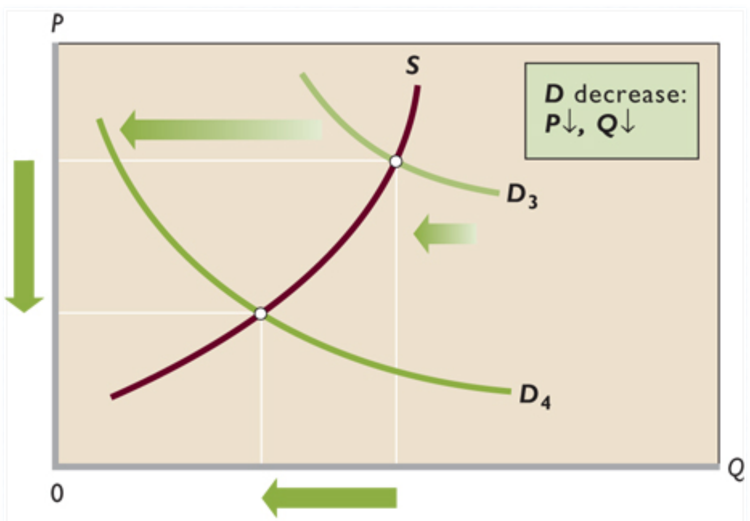
- **Rationing function of prices** - the ability of the competitive forces of supply and demand to establish a price at which selling and buying decisions are consistent.

CHAPTER 4

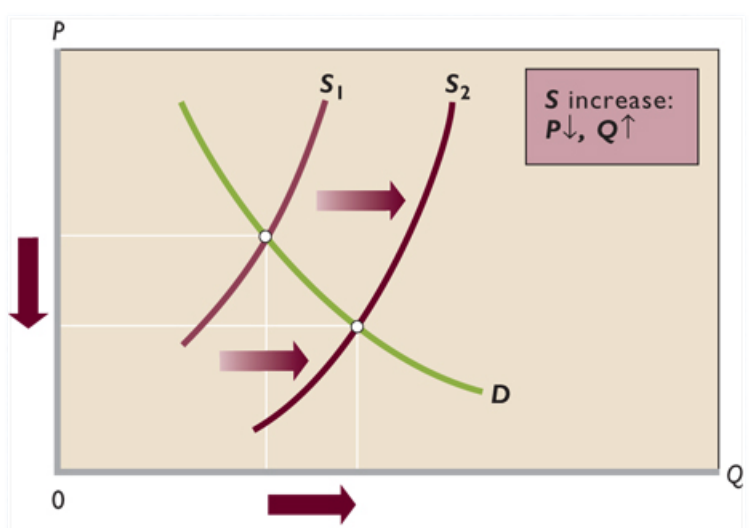
Changes in Supply, Demand, and Equilibrium



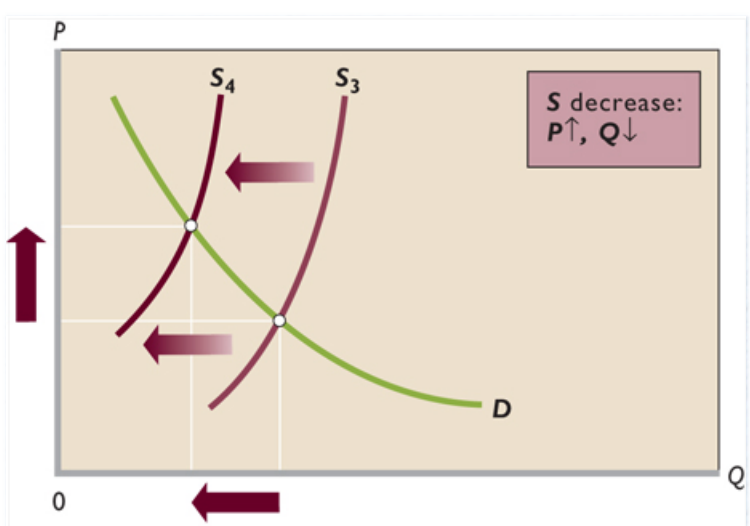
(a)
Increase in demand



(b)
Decrease in demand



(c)
Increase in supply



(d)
Decrease in supply

Application: Government Set Prices

- **Price ceiling** - sets the ***maximum legal price*** a seller may charge for a product or a service. When the ceiling price is below the equilibrium price, a chronic product shortage results. An imposed price disrupts the rationing function of the markets.
- **Price floors** - a ***minimum price*** fixed by the government. If the price floor is above the equilibrium, a chronic product surplus result. An imposed price disrupts the rationing function of the markets.