DEMAND, SUPPLY, AND MARKET EQUILIBRIUM

I. DEMAND

a. DEMAND – a schedule or curve that shows the various amounts of a product that consumers will purchase at each of several possible prices during a specified period of time.
   i. Simply a statement of a buyer's plans or intentions, with respect to a purchase of a product.

b. LAW OF DEMAND – other things being equal (ceteris parabis), as price falls, the quantity demanded will rise, and as prices rise, the quantity demanded will fall
   i. INVERSE RELATIONSHIP
   ii. The fact that businesses reduce prices to clear unsold goods is evidence of the law of demand.

c. THE DEMAND CURVE
   i. Measure QUANTITY DEMANDED on the horizontal axis and PRICE on the vertical axis
   ii. Downward slope of the demand curve reflects the Law of Demand.
   iii. There is an INVERSE relationship between price and quantity demanded.

d. MARKET DEMAND – by adding ALL the quantities demanded by all consumers at each of the various prices, we move from individual demand to MARKET demand: Review figure 3.2 on page 61
   i. DETERMINANTS OF DEMAND (all non-price determinants) are held constant

when the demand curve is drawn. Review figure 3.3 on page 61

1. Also called DEMAND SHIFTERS (since they shift the curve)
    a. Consumer tastes and preferences
    b. Number of consumers in the market
    c. Consumers' incomes
    d. Price of related goods (complements and substitutes)
    e. Future expectation of prices

e. CHANGES IN QUANTITY DEMANDED
    i. CHANGE IN DEMAND- shift in the total curve either to the right (increase in demand) or to the left (decrease in demand)
    ii. CHANGE IN QUANTITY DEMANDED – change in price of the graphed good or service; move up (decrease in quantity demanded) or down (increase in quantity demanded) the curve. See graph 3.3 on page 61

II. SUPPLY

a. SUPPLY is a schedule showing the amounts of a product that producers will make available for sale at each of a series of possible prices during a specific period.
    i. Figure 3.4 on page 65 graphically represents quantity supplied in a curve
b. LAW OF SUPPLY – Figure 3.4; positive or DIRECT relationship; as prices rise, the quantity supplied rises; as prices fall, the quantity supplied falls.

        i. To a supplier, price represents REVENUE, which is needed to cover costs and earn a profit.

c. MARKET SUPPLY – derived from individual supply schedules the same as demand; horizontally adding the supply curves of individual producers
d. DETERMINANTS OF SUPPLY (supply shifters) – If one of these changes, SUPPLY CHANGES and the SUPPLY CURVE WILL SHIFT INWARDS (decrease in supply) or OUTWARDS (increase in supply). Review figure 3.5 on page 66. DETERMINANTS ARE:
    i. RESOURCE PRICES (inputs)
    ii. TECHNOLOGY
    iii. TAXES, SUBSIDIES AND REGULATIONS
    iv. PRICES OF OTHER GOODS (substitutes)
    v. FUTURE EXPECTATION OF PRICES
    vi. NUMBER OF TOTAL SUPPLIERS IN MARKET
e. CHANGES IN SUPPLY
    i. RESOURCE PRICES (inputs)- higher resource prices raise production costs and squeeze profits; reduces producers' incentive to supply output.
    ii. TECHNOLOGY – improvements in technology enable firms to produce units of output with fewer resources.
    iii. TAXES, REGULATIONS AND SUBSIDIES- Taxes and regulations are costs and subsidies are "taxes in reverse."

iv. PRICES OF OTHER GOODS (substitutes)- If it is advantageous to produce other goods in the same plant due to higher profitability, supply will decrease. The opposite is also true.

v. FUTURE EXPECTATION OF PRICES - If input prices are expected to rise in future, supply will increase NOW; if input prices are expected to lower in the future, supply will decrease NOW. Direct relationship.

vi. NUMBER OF SELLERS – Ceteris parabis, the larger the number of suppliers, the greater the market supply. Think MACROECONOMICALLY!!

f. CHANGES IN QUANTITY SUPPLIED- parallels demand

i. CHANGE IN SUPPLY means non-price determinants (shifters) and the total curve moves inward or outward.

ii. CHANGE IN QUANTITY SUPPLIED- is a movement from one point on the curve to another due to a change in the price of the graphed good or service.

III. MARKET EQUILIBRIUM

a. EQUILIBRIUM AND PRICE

i. EQUILIBRIUM PRICE (or market-clearing price) is the price at which the intentions of buyers and sellers match. It is the price where quantity supplied and quantity demanded meet. Review figure 3.6 on page 69. On the vertical axis.

1. EQUILIBRIUM QUANTITY – the quantity demanded and quantity supplied that occur at the

equilibrium price in a competitive market. On the horizontal axis on figure 3.6.

2. If quantity demanded exceeds quantity supplied, a SHORTAGE occurs. Also known as EXCESS DEMAND.
3. If quantity supplied exceeds quantity demanded an INVENTORY GLUT OR EXCESS SUPPLY exists.

b. RATIONING FUNCTION OF PRICES
   i. Competitive forces of supply and demand establish a price which selling and buying decisions are consistent.
   ii. Review Ticket Scalping example on page 70

IV. CHANGES IN DEMAND, SUPPLY AND EQUILIBRIUM

a. CHANGES IN DEMAND – An increase in demand raises both equilibrium price and equilibrium quantity. A decrease in demand lowers both equilibrium price and equilibrium quantity. Review figure 3.7a and 3.7b on page 72.
b. CHANGES IN SUPPLY- An increase in supply REDUCES equilibrium price but INCREASES equilibrium quantity. A decrease in supply INCREASES equilibrium price but DECREASES equilibrium quantity. Review 3.7c and 3.7d on page 72.
c. COMPLEX CASES:
   i. SUPPLY INCREASE; DEMAND DECREASE: Both changes DECREASE

PRICE; price drop GREATER than either's resulting change.

1. EFFECT ON EQUIILIBRIUM QUANTITY INDETERMINATE
2. If increase in supply is GREATER than decrease in demand, equilibrium quantity will INCREASE.
3. If increase in supply is LESS than decrease in demand, equilibrium quantity will DECREASE.

ii. SUPPLY DECREASE; DEMAND INCREASE: A decrease in supply and an increase in demand will INCREASE PRICE; price increase GREATER than either's resulting change.

1. EFFECT ON EQUILIBRIUM QUANTITY INDETERMINATE
2. If decrease in supply is GREATER than increase in demand, equilibrium quantity will DECREASE.
3. If decrease in supply is LESS than increase in demand, equilibrium quantity will INCREASE.

iii. SUPPLY DECREASE; DEMAND DECREASE; Both decreases decrease the equilibrium quantity

1. EFFECT ON EQUILIBRIUM PRICE INDETERMINATE.
2. If the supply decrease is GREATER than the demand decrease, equilibrium price will INCREASE.

3. If the supply decrease is LESS than the demand decrease ,equilibrium price will DECREASE.

V. GOVERNMENT-SET PRICES

a. Review the Price Ceilings on Gasoline on page 73
    i. Price ceiling sets the maximum legal price a seller may charge for a product or service. Price at or below the ceiling is legal; a price above is not
    ii. Example: Rent control in NYC
    iii. Review figure 3.8 on page 74
b. Review the Price Floors on Wheat on page 75
    i. Price floor is a minimum price fixed by the government. A price at or above the price floor is legal. A price below the floor is illegal.
    ii. Example: Minimum wage
    iii. Review the graph in figure 3.9 on page 76.