Chapter 4

Supply and Demand Made Easy

A market is a place where buyers and sellers come together to trade for goods and services. It doesn't have to be a physical place thanks to the internet.

Supply curve for the producer

Demand curve for the consumer

Deconstructing Demand

Demand is what consumers are **willing and able** to buy at various possible prices

Quantity demanded is what consumers are willing and able to buy at a given price

Prices and other stuff: Looking at what affects quantity demanded

1. Tastes and Preferences

2. Other Prices (If movie ticket prices go up the quantity demanded for concert tickets will be affect even if concert ticket prices haven't changed)

3. Income – as you income changes so does your quantity demanded

    Normal good- a good that is consumed more as income increases

    Inferior good – a good that is consumed less as income increase

Graphing the Demand Curve

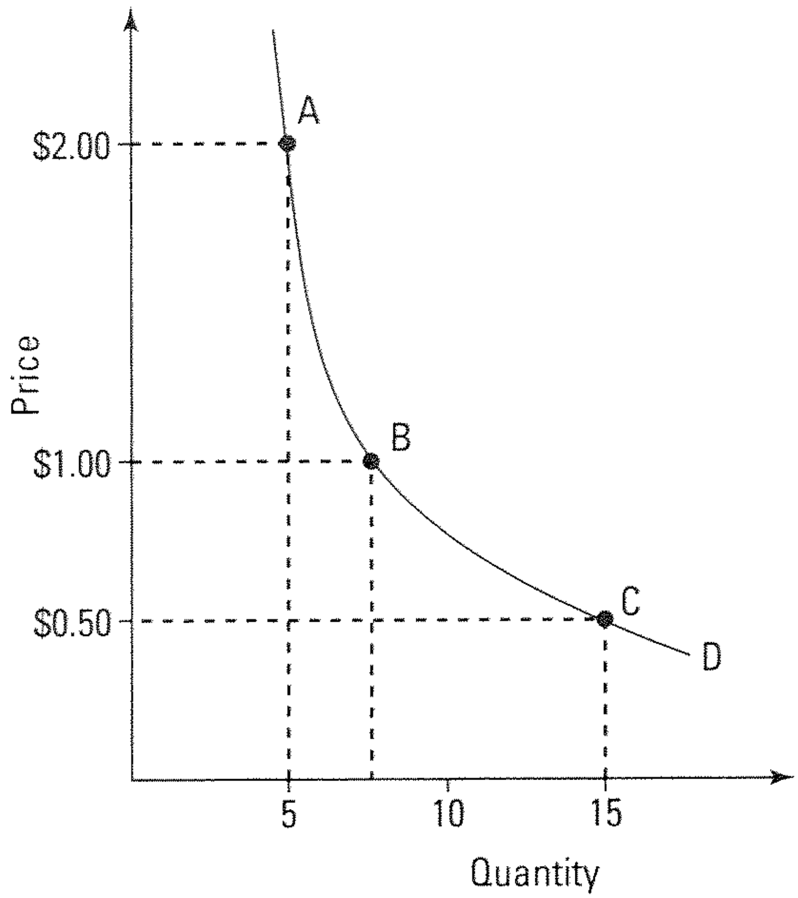

Figure 4-1: Demand curves slope downward because when prices fall, people buy more.

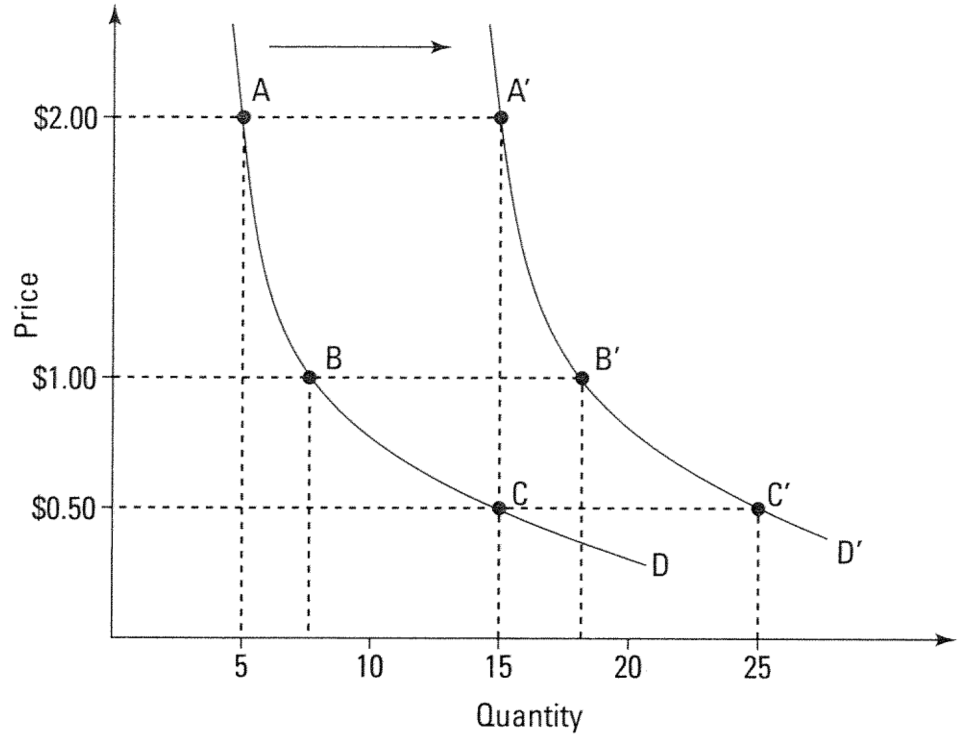

Figure 4-2: An increase in demand causes the demand curve to shift right from *D* to *D*′.

Moving along the curve due to increase or decrease of price

Shifting of the curve do to non price factors

Quantities demanded either increase or decrease while holding prices constant

Opportunity costs: Setting the slope of the demand curve

A product's price is a measure of sacrifice that must be given up to get what you want

So how do you really feel about getting that good or service?

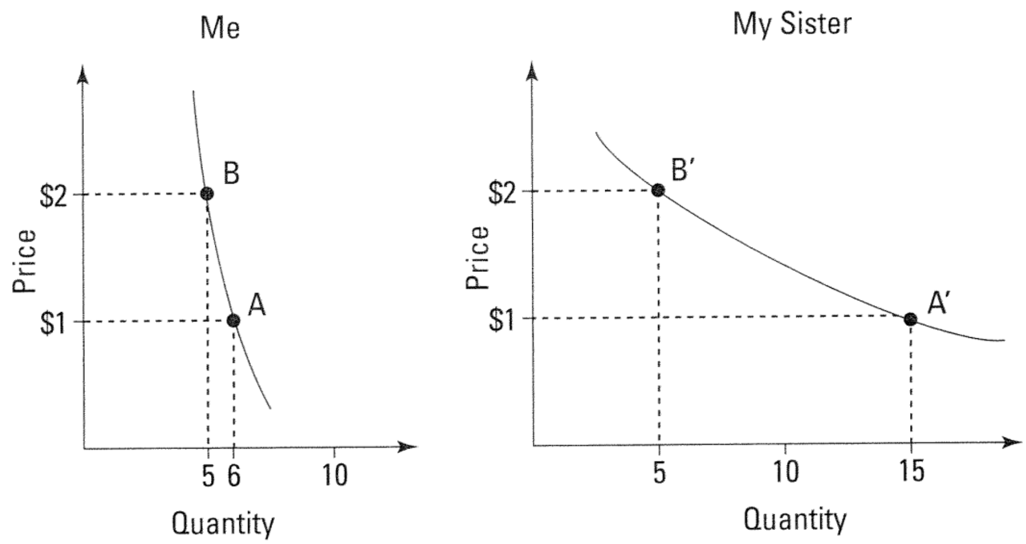

Figure 4-3: Two demand curves for pecans.

My sister is much less attached to pecans!

Elasticity: Looking at extreme demand cases

Inelastic – no matter what the price you buy it.   eg. Life saving drugs, gasoline

Elastic – any change in price means you don't buy it. If two things are exactly the same even a one penny change in price will get you to buy the other product.

Sorting out Supply

Supply Curve – the minimum prices someone is will and able to sell various goods and services.

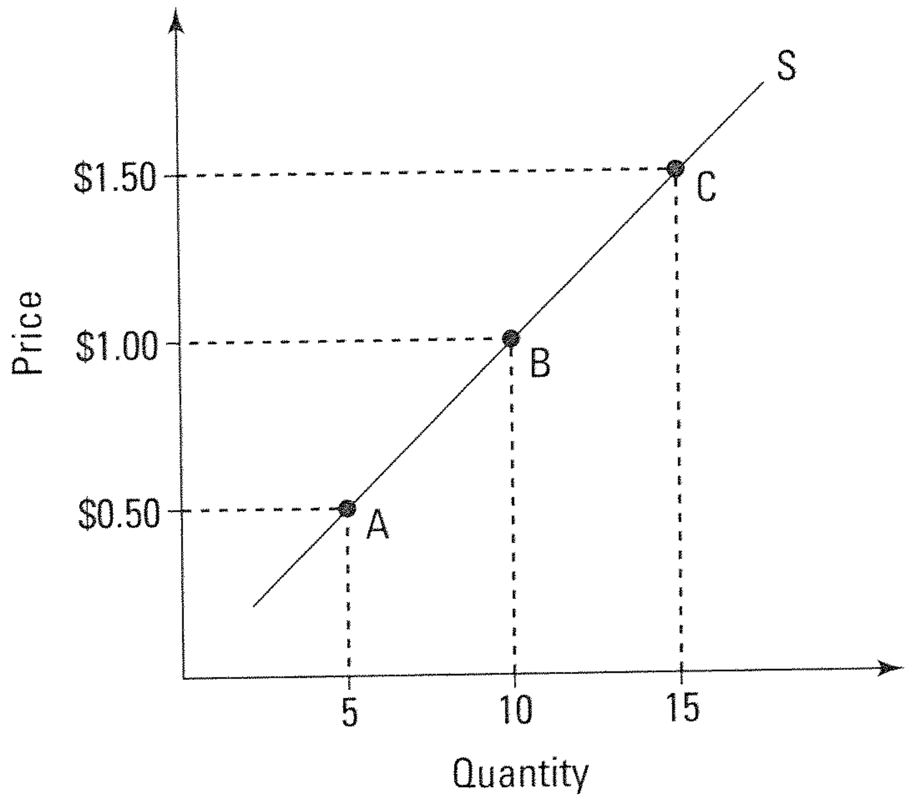

Figure 4-5: Supply curves have an upward slope because of increasing production costs.

Separating sales price and production price

1. price changes – moving along the supply curve
2. cost changes – shifting the supply curve

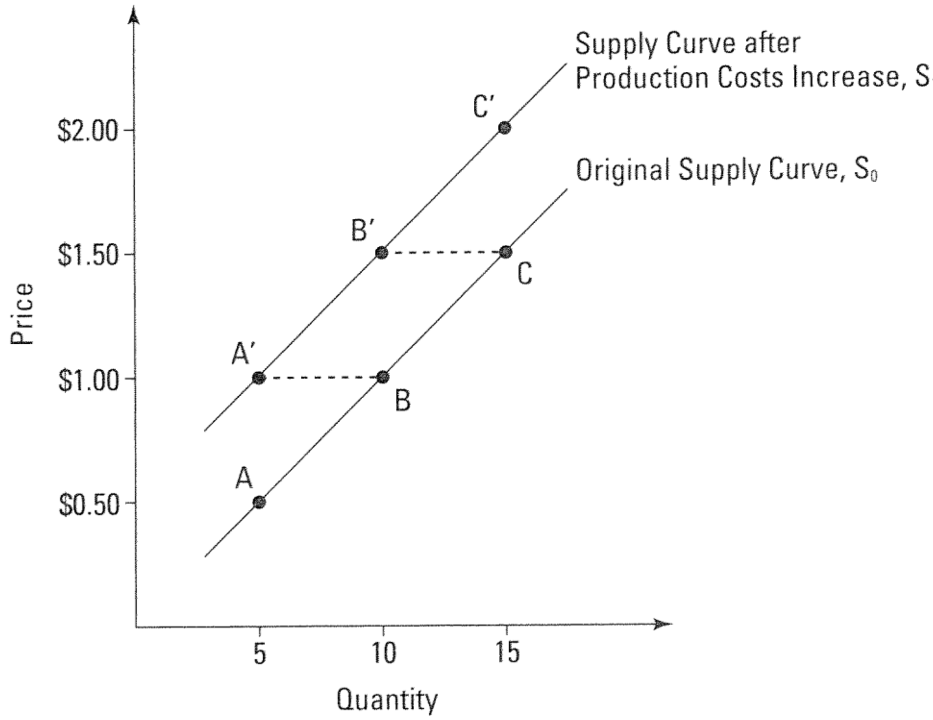

Figure 4-6: Increased production costs shift the supply curve.

Using elasticity to understand extreme supply cases

1. perfectly inelastic supply – the Hope Diamond or land (taxing land)
2. perfectly elastic supply – doesn't cost much to make more pencils

Bring supply and Demand together

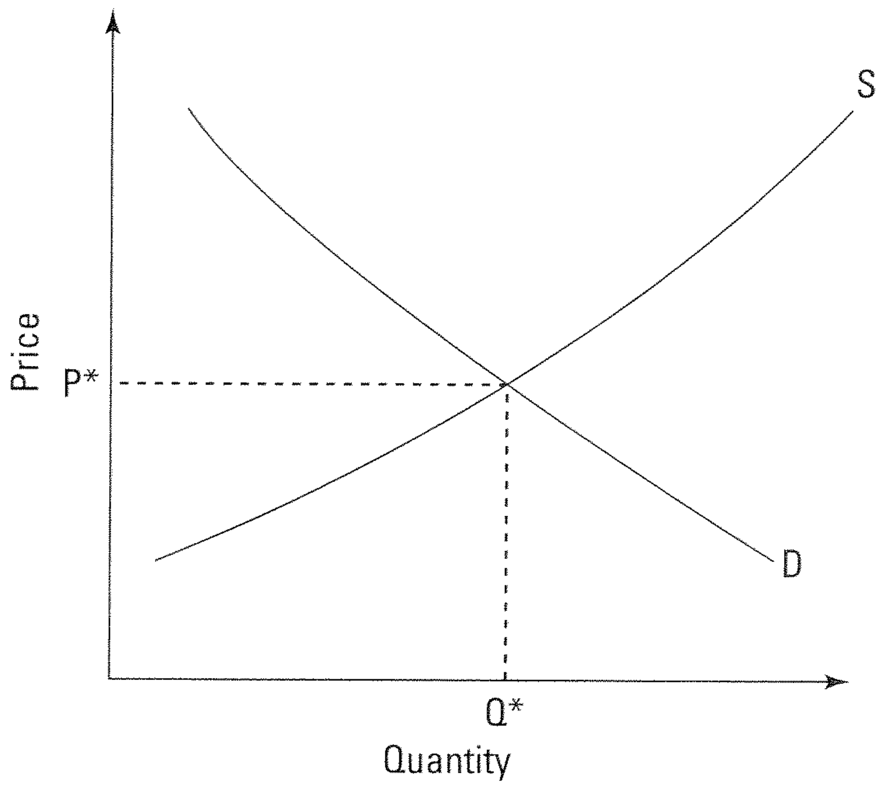

Figure 4-8: The market equilibrium price and quantity happen where the demand curve crosses the supply curve.

Market Equilibrium: Seeking a Balance

Where happiness meets: market price meet market quantity! We have found equilibrium!

Demonstrating the Stability of market equilibrium

Stable equilibrium – markets, in theory, are self correcting

Excess supply

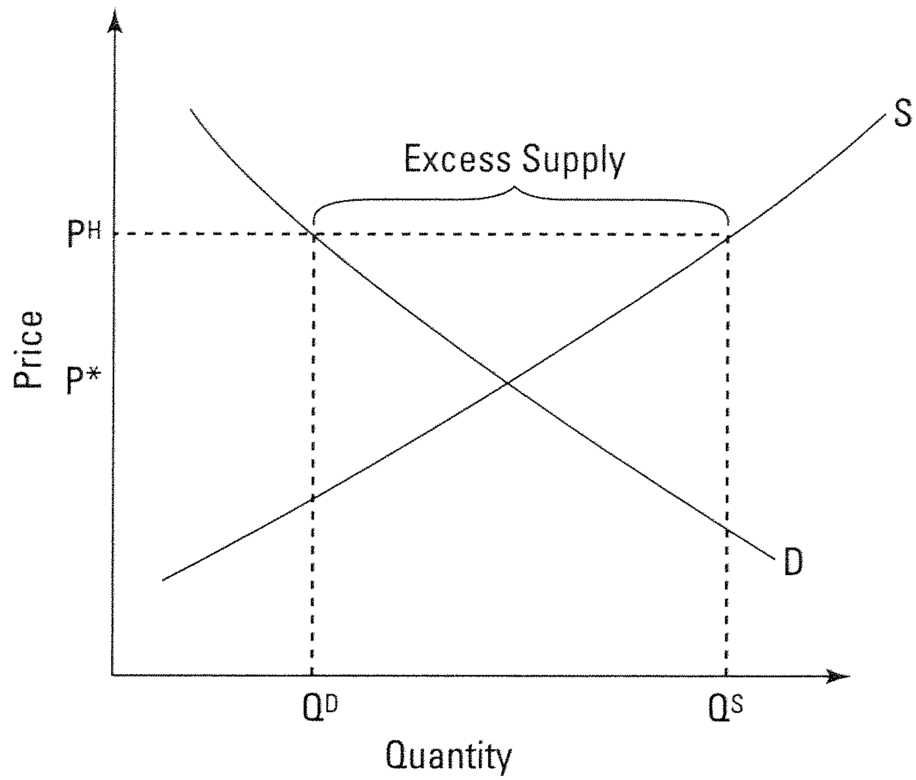

Figure 4-9: Excess supply.

Excess Demand:

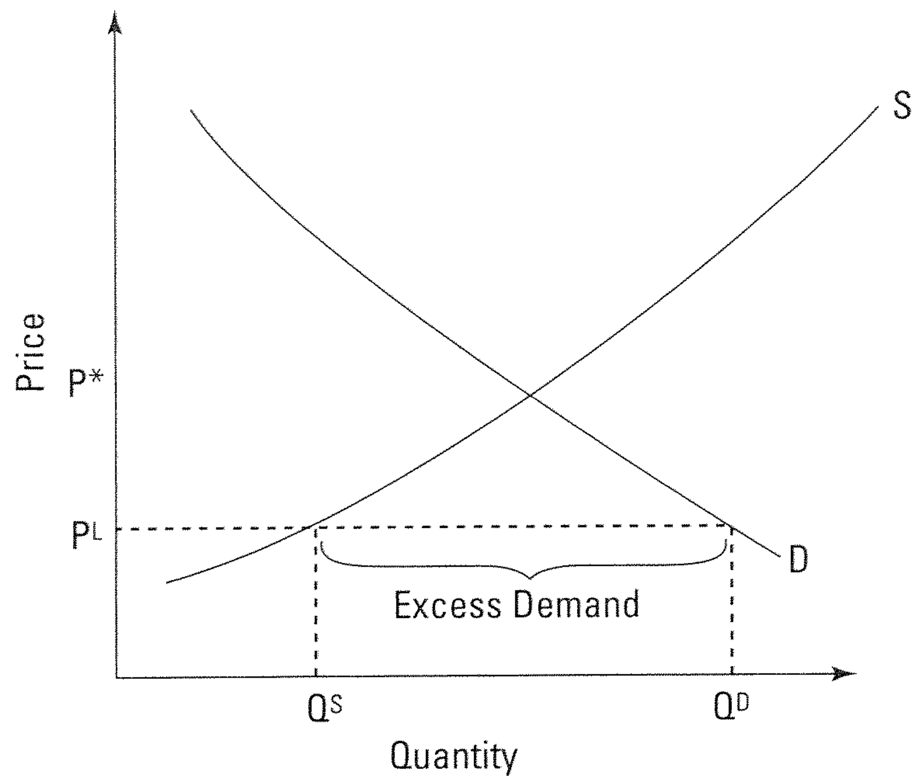

Figure 4-10: Excess demand.

Adjusting to new market equilibriums

Reacting to an increase in demand

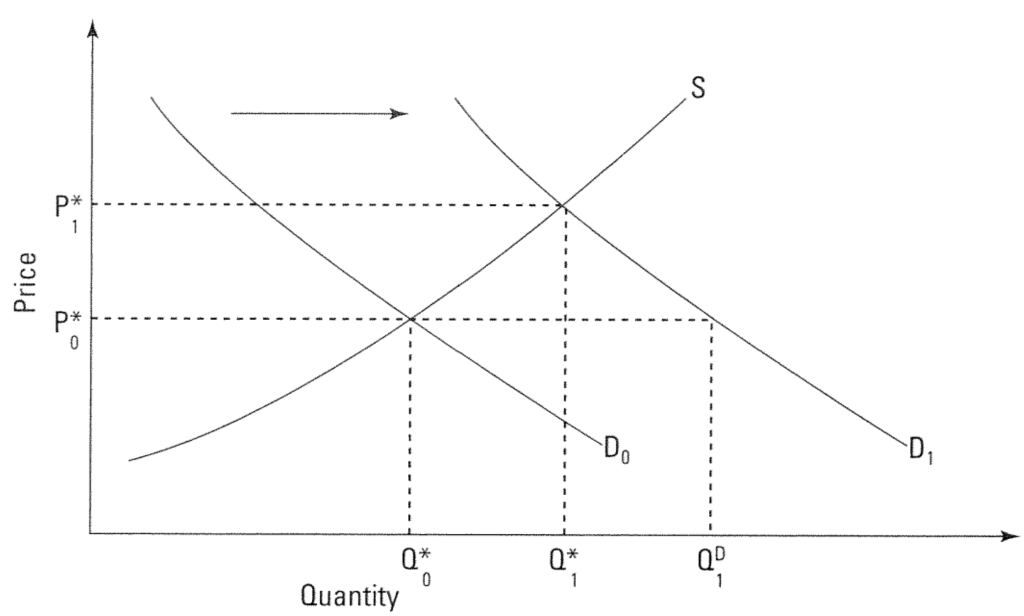

Figure 4-11: A rightward shift of the demand curve.

Reacting to a decrease in supply

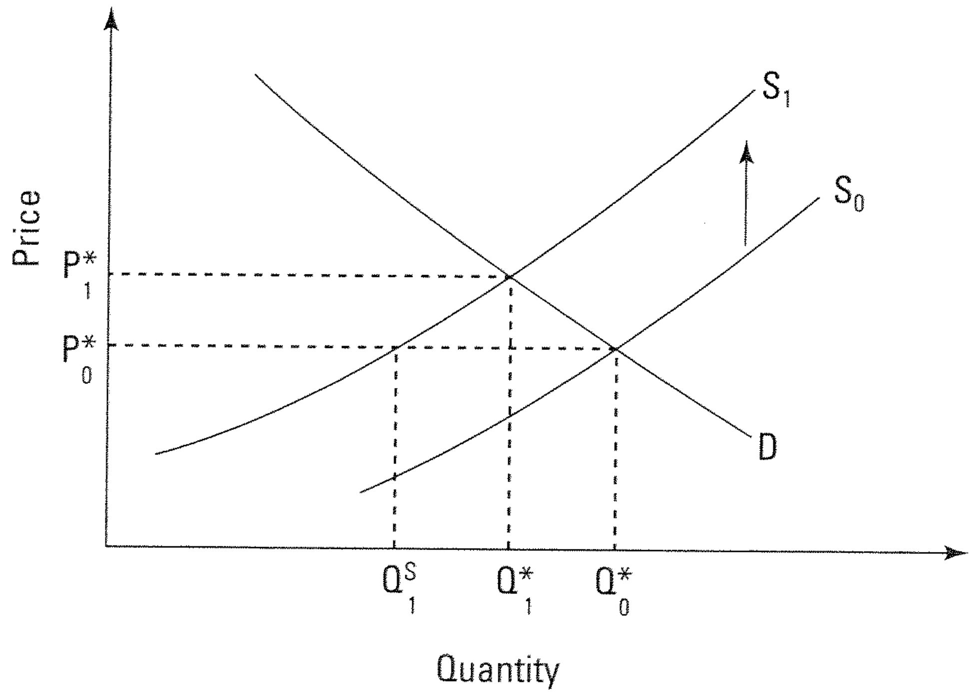

Figure 4-12: A vertical shift of the supply curve.

Price Controls: Keeping prices away from Market Equilibrium

When the government steps in.

Price ceilings: Rent control? Get in line!

Price floors: a lot of wasted food! Or heck we will pay not to even grow anything!