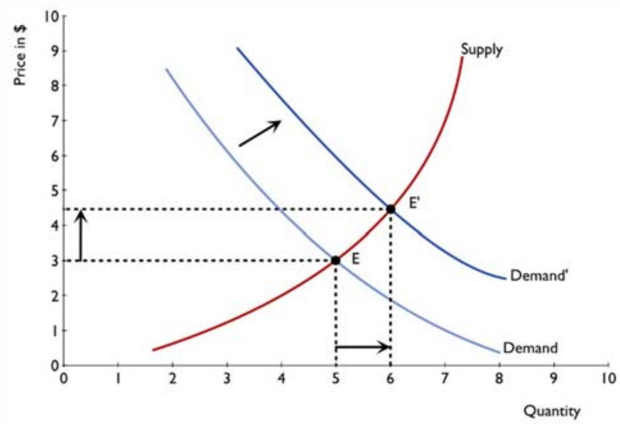
SECTION 2: Supply and Demand
Need to Know:

Law of Demand:

1. **Other things being equal, as the price increases, the corresponding quantity demanded falls.**
2. **Restated, there is an inverse relationship between price and quantity demanded.**

Change in price causes a movement along the curve (quantity demanded)



Shifts in Demand Curve

- **If demand has increased, it has shifted to the right. At any price, consumers wish to buy more.**
- **If demand has decreased, it has shifted to the left. At any price, consumers with to buy less.**

1. Prices of related goods

- **Substitute goods (those that can be used in place of each other): Price of substitute and demand for the other good are directly related.**
- **Complementary goods (those that are used together like tennis balls and rackets): When goods are complementary, there is an inverse relationship between the price of one and the demand for the other.**

2. Income

- **Normal goods: More income leads to an increase in demand; less leads to decrease in demand for most goods and services.**
- **Inferior goods: For a few goods, more income leads to a decrease in demand.**

3. Tastes - favorable change in tastes leads to an increase in demand; an unfavorable change to a decrease.

4. Expectations - Consumers have expectations about future prices, product availability, and income, and these expectations can shift demand.

5. Number of buyers - More buyers lead to an increase in demand; fewer buyers lead to decrease.

The Law of Supply is believed to hold true for most products.

1. **All else equal, as the price rises, quantity supplied rises.**
2. **Restated: There is a direct relationship between price and quantity supplied.**

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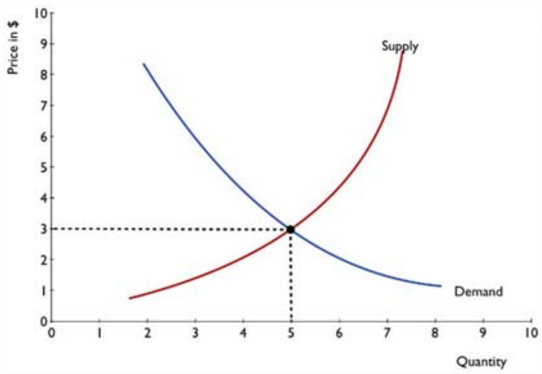


Equilibrium
Equilibrium price
Equilibrium quantity
Market-clearing price

Change in price causes a movement along the curve (quantity supplied)

Shifts in the Supply Curve

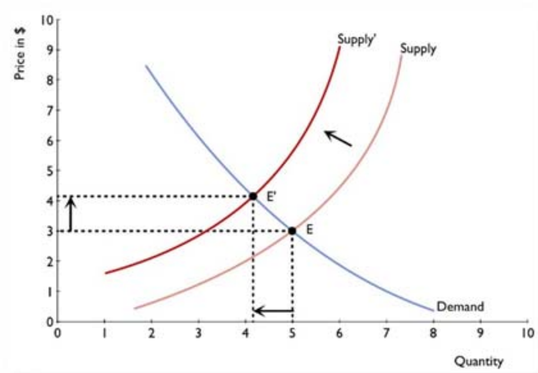
- If supply has increased, it has shifted to the right. At any price, firms wish to produce more.
- If supply has decreased, it has shifted to the left. At any price, firms with to produce less.

1. Input (Resource) prices

A rise in an input price will cause a decrease in supply or leftward shift in supply curve; a decrease in an input price will cause an increase in supply or rightward shift in the supply curve.

2. Prices of related goods or services

If the price of a substitute production good rises, producers might shift production toward the higher priced good causing a decrease in supply of the original good. An increase in the price of soybeans may cause a farmer to decrease the supply of corn.



3. Technology - more efficient production and lower costs, so an increase in supply or rightward shift in the curve results.

4. Expectations - Expectations about the future price of a product can cause producers to increase or decrease current supply.

5. Number of sellers - Generally, the larger the number of sellers the greater the supply.

Demand and Supply move in opposite directions.

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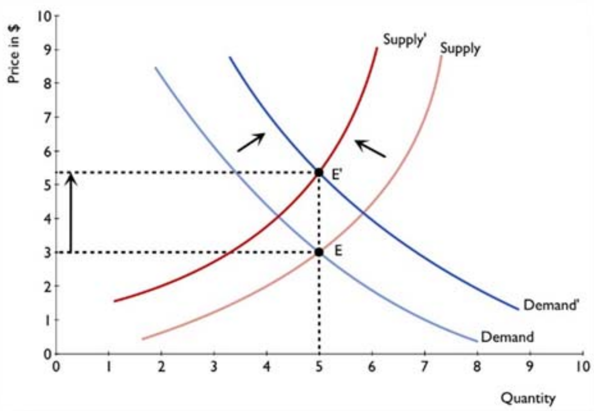


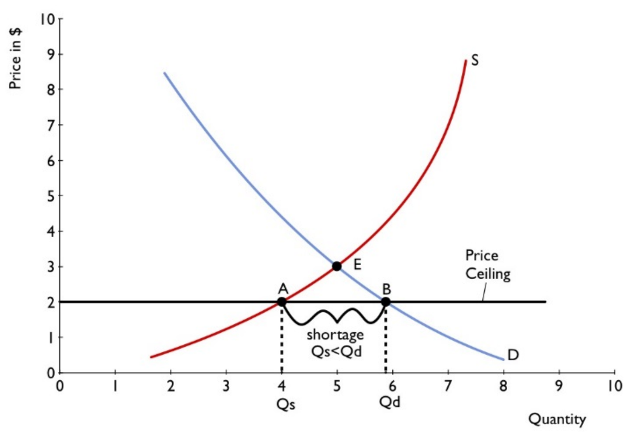
When demand increases and supply decreases, the equilibrium price rises but the change in the equilibrium quantity is ambiguous.

When demand decreases and supply increases, the equilibrium price falls but the change in the equilibrium quantity is ambiguous

Demand and Supply move in the same direction. When both demand and supply increase, the equilibrium quantity increases but the change in equilibrium price is ambiguous.

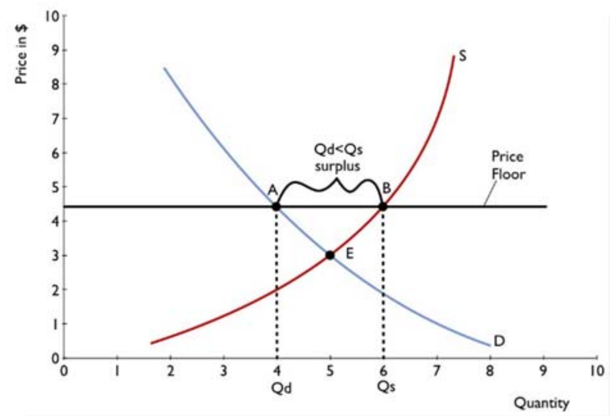
When both demand and supply decrease, the equilibrium quantity decreases but the change in equilibrium price is ambiguous.

A price control is a legal restriction on how high or low a market price may go.
Price controls are enacted by governments in response to political pressures from buyers and sellers.
A price ceiling is a maximum price sellers are allowed to charge for a good.



Shortage at Pc = Qd - Qs

A market or an economy is inefficient if there are missed opportunities: Some people could be made better off without making other people worse off.



A price floor is a legal minimum price buyers are required to pay for a good.

The minimum wage is a legal floor on the wage rate, which is the market price of labor.

Surplus at Pf

Price floors lead to excess supply; the quantity supplied is greater than quantity demanded.

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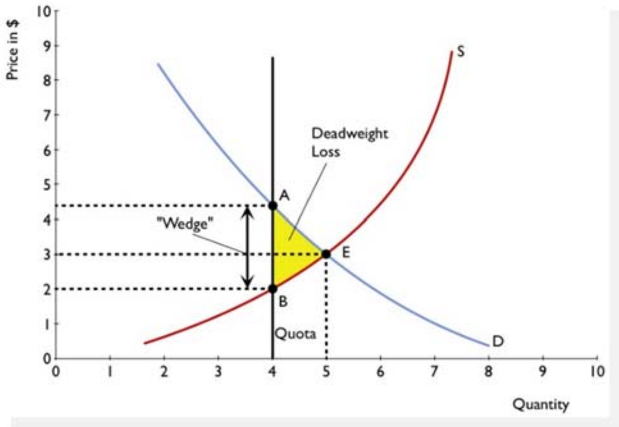
- **Inefficiently Low Quantity**
- **Inefficient Allocation of Sales Among Sellers**
- **Wasted Resources**
- **Inefficiently High Quality**
- **Illegal Activity**



Quantity control, or quota: an upper limit on the quantity of some good that can be bought or sold.
The total amount of the good that can be legally transacted is the quota limit.

A quantity control, or quota, drives a wedge between the demand price and the supply price of a good.

Deadweight Loss is the lost gains associated with transactions that do not occur due to market intervention