Tutorial 1

4 Lessons from Economics

Readings: Chapter 4 (until page 84 included) - **done**

Chapter 4 – The market forces of supply and demand

The terms *supply* and *demand* refer to the behaviour of people as they interact with one another in competitive markets.

MARKETS AND COMPETITION

What is market?

A ***market*** is a group of buyers and sellers of a particular good or service. The buyers as a group determine the demand for the product and the sellers as a group determine the supply of the product.

What is competition?

Competitive market is a market in which there are so many buyers and so many sellers that each has a negligible impact on the market price.

- Each seller has limited control over the price because other sellers are offering similar products.

Perfectly competitive

To reach the highest form of competition, a market must have 2 characteristics:

1. The goods offered for sale are all exactly the same;
2. The buyers and sellers are so numerous that no single buyer or seller has any influence over the market place.

Because the buyers and sellers in a perfectly competitive market must accept the price the market determines, they are said to be *price takers*. At the market price, buyers can buy all they want, and the sellers can sell all they want.

DEMAND

The demand curve: The relationship between price and quantity demanded

The **quantity demanded** of any good is the amount of the good that buyers are willing and able to purchase.

- Because the quantity demanded falls as the price rises and rises as the price falls, the quantity demanded is *negatively* related to the price.
- Known as the **law of demand**
  - **Law of demand** is that claim that, other things being equal, the quantity demanded of a good falls when the price of the good rises.

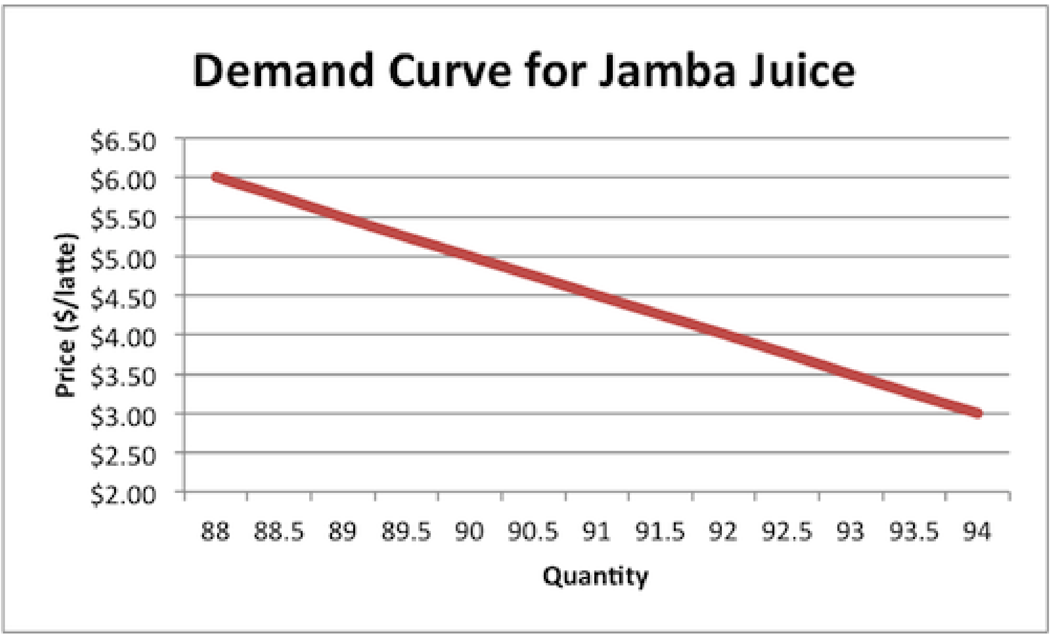
Demand schedule

Smith Family's Individual Demand Schedule for Babysitting Hours	
Price per Hour	**Hours of Babysitting per Month**
$4.00	55
$5.00	45
$6.00	38
$7.00	32
$8.00	27
$9.00	23
$10.00	20
$11.00	18
$12.00	17

The above is an example of a ***demand schedule***.

- A ***demand schedule*** is a table that shows the relationship between the price of a good and the quantity demanded, holding constant everything else that influences how much of the good consumer want to buy.

Demand curve



The **demand curve** uses the numbers from the **demand schedule** to illustrate the law of demand.

- **Note**: the price of the item is on the **vertical axis** and quantity demanded is on the **horizontal axis**.

Market demand versus individual demand

The above demand curve shows an individual's demand for a product.

To analyse how market work – need to determine ***market demand***, which is the sum of all the individual demands for a particular good/service.

To find the total quantity demanded at any price, add the individual quantities found on the

Shifts in the demand curve

If something happens to alter the quantity demanded at any given price, the demand curve shifts.

For example – if medical research suddenly announces people who eat ice-cream live longer lives, the discovery would raise demand for ice-cream.

- At any given price, buyers would now want to purchase a larger quantity of ice-cream and the demand curve for ice-cream would **shift**.

Any change that **increases quantity demanded** at any given price = **shifts the demand curve** to the **<u>right</u>** and is called ***an increase in demand***.

Any change that **reduces quantity demanded** at every price **shifts the demand curve** to the **<u>left</u>** and is called ***a decrease in demand***.

There are many variables that can shift the demand curve. These include:

Income

If the demand for a good falls when income falls, the good is called a ***normal good***.

Not all goods are normal goods. If the demand for a good rises when income falls, the good is called an ***inferior good***.

Price of related goods

When a gall in the price of 1 good reduces the demand for another good, the 2 goods are called **substitutes**.

- Substitutes are often pairs of goods that are used in place of each other, i.e. butter and margarine and movie tickets and DVD rentals.

When a fall in the price of one good raises the demand for another good, the 2 goods are called **complements**.

- Complements are often pairs of goods that are used together, i.e. petrol and cars, computers and software.

Other variables:

- Tastes;
- Expectations;
- Number of buyers.

Summary

Variables that influence buyers	
Variables that affect quantity demanded	**A change in this variable…**
Price	Represents a movement along the demand curve
Income	Shifts the demand curve
Price of related goods	Shifts the demand curve
Tastes	Shifts the demand curve
Expectations	Shifts the demand curve
Number of buyers	Shifts the demand curve

SUPPLY

The supply curve: the relationship between price and quantity supplied

The **quantity supplied** of any good/service is the amount that sellers are willing and able to sell.

- When the price of a good is high, selling the good is profitable and so the quantity supplied is large.
- When the price of good is low, selling the good is less profitable, so sellers produce less of the item.

This relationship between price and quantity is called the **law of supply** – other things being equal, when the price of a good rises, the quantity supplied of the good also rises, and when the price falls, the quantity supplied falls as well.

A **supply schedule** is a table that shows the relationship between the price of a good and the quantity supplied, holding constant everything else that influences how much producers of the good want to sell.

Market supply v individual supply

Add individual curves horizontally to obtain the market supply curve.

The market supply curve shows how the total quantity supplied varies as the price of the good varies, holding constant all the other factors beyond price that influences producers' decisions about how much to sell.

Shifts in the supply curve

Because the market supply curve is drawn holding other things constant, when one of these factors changes the supply curve shifts.

- Any changes that **raises quantity supplied** at every price, **shifts** the supply curve to the **right** and is called ***an increase in supply***.
- Any change that **reduces the quantity** supplied at every price **shifts** the **supply curve** to the **left** and is called a ***decrease in supply***.