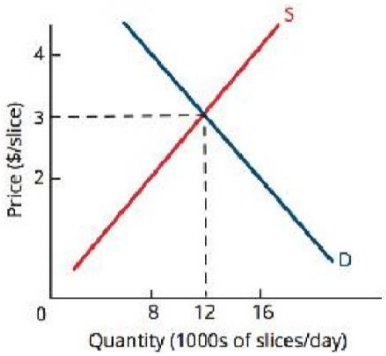
Week 3: Topic 2 – Introduction to the competitive market model – demand, supply and equilibrium



Competitive market

- A market in which there're many buyers and many sellers, each of whom has little or no influence on the market price.
- For markets to be *perfectly competitive*:
  - The goods offered for sale are all exactly the same
  - The buyers & sellers are so numerous that no single buyer or seller has any influence over the market price
  - The perfectly competitive model has 2 key elements: Demand & Supply

Demand

- A market's demand curve for a product shows, given the price of the product, the total amount of the product all people would like to buy, holding all other relevant factors fixed
- The demand curve: the relationship b/w price and quantity demanded

Law of demand

- As the price of a good falls, the quantity demanded rises
- Therefore the demand curve slopes downward

Marker demand Vs Individual demand

- The market demand is the sum of all the individual demands for a particular good or service
- The market demand curve shows how the total quantity demanded of a good varies as the price of the good varies, while all the other factors that affect how much consumers want to buy are held constant

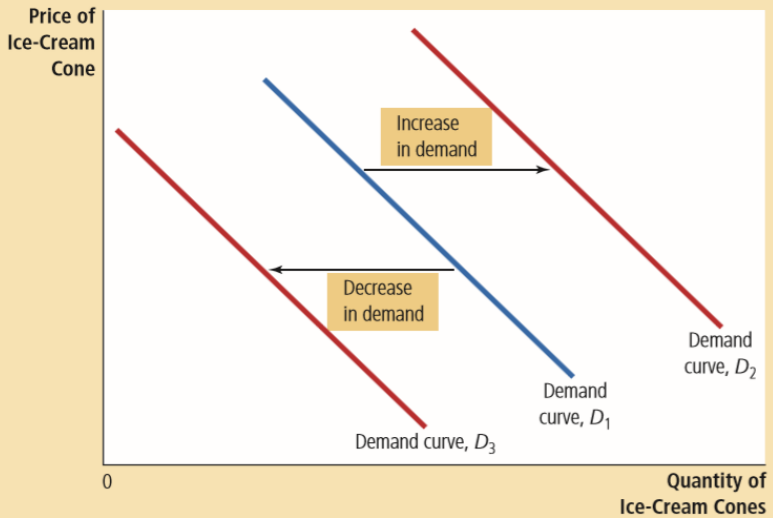
Shifts in the Demand Curve

- If something happens to alter the quantity demanded at any given price, the demand curve shifts
- Increase in demand: shifts to the RIGHT due to drop in price of complement, rise in price of substitute, increased preference by buyers, increased population of buyers and expectation of future higher price
- Decrease in demand: demand curve shifts to the LEFT

Figure 3

Shifts in the Demand Curve

Any change that raises the quantity that buyers wish to purchase at any given price shifts the demand curve to the right. Any change that lowers the quantity that buyers wish to purchase at any given price shifts the demand curve to the left.



Variables that shift the demand curve:

Income

- Lower income means less spent on goods
- *Normal good*: a good for which, other things equal, an increase in income leads to an increase in demand
    - Demand falls when income falls (E.g. luxury car)
- *Inferior good*: a good for which, other things equal, an increase in income leads to a decrease in demand
    - Demand rises when income falls (E.g. bus ride over taking a cab)

Prices of Related Goods

- *Substitutes*: two goods for which an increase in the price of one leads to an increase in the demand for the other
    - They are pairs of goods that are used in place of each other
      E.g. Hot dogs and hamburgers
- *Complements*: two goods for which an increase in the price of one leads to a decrease in the demand for the other
    - They are pairs of goods that are used together (E.g. Peanut butter and jelly)

Variables That Influence Buyers

This table lists the variables that affect how much consumers choose to buy of any good. Notice the special role that the price of the good's price represents a movement along the demand curve, whereas a change in one of the other variables shifts the demand curve.

Variable	**A Change in This Variable …**
Price of the good itself	Represents a movement along the demand curve
Income	Shifts the demand curve
Prices 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 market supply curve tells, given the price, how much of the product all individual producers would like to sell, holding everything else constant
- Everything else: Input prices, Technology, Expectations
- The supply curve: The relationship between Price and Quantity Supplied

Law of supply

- As the prices of a good rises, the quantity supplied rises
- Therefore the supply curve slopes upward
- And when the prices fall, the quantity supplied falls as well

Market Supply Vs Individual Supply

- Market supply is the sum of the suppliers of all sellers
- 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 influence producers' decisions about how much to sell
- To find the total quantity supplied at any price, all the individual quantities are added