

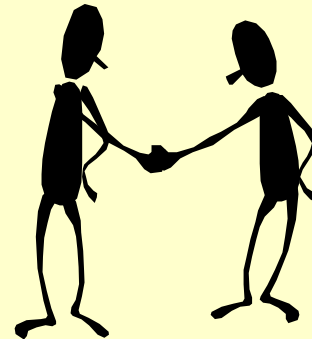
Chapter 4

Demand, Supply and Markets

**These slides supplement the
textbook, but should not
replace reading the textbook**

What is a market?

A group of buyers and sellers with the potential to trade



What is demand?

A relation showing the quantities of a good consumers are willing and able to buy at various prices during a given period of time, other things constant

What is a demand curve?

A curve showing the quantities of a commodity demanded at various possible prices, other things constant

What is a change in quantity demanded?

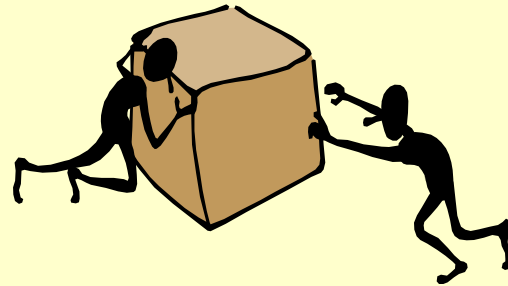
A movement along the demand curve in response to a change in the price, other things constant

Why do demand curves have a negative slope?

At a higher price, consumers will buy fewer units; at a lower price, they will buy more units

What does an inverse relationship between price and quantity mean?

It means that the two move in opposite directions



What is the law of demand?

The quantity of a good demanded is inversely related to its price, other things constant

What is a demand schedule?

Shows the specific quantity of a good or service that people are willing and able to buy at different prices

The Demand Schedule for Milk

	Price per quart	Quantity demanded per Month (millions of quarts)
--	------------------------	---

<i>a</i>	\$1.25	8
----------	---------------	----------

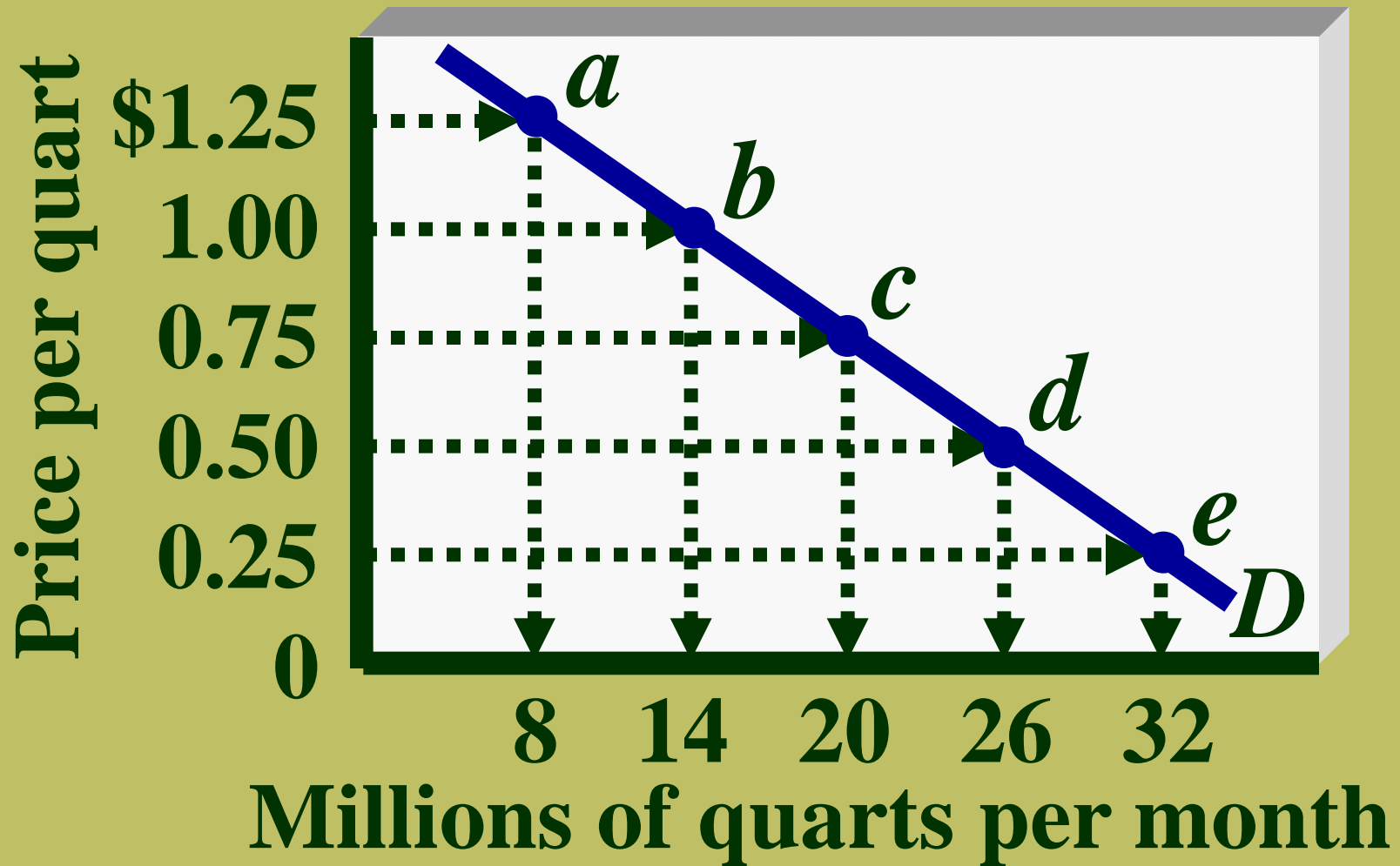
<i>b</i>	1.00	14
----------	-------------	-----------

<i>c</i>	0.75	20
----------	-------------	-----------

<i>d</i>	0.50	26
----------	-------------	-----------

<i>e</i>	0.25	32
----------	-------------	-----------

The Demand Curve for Milk



Why do consumers buy more as price decreases and less when price increases?

Substitution effect

Income effect

What is the substitution effect?

When the price of a good falls, consumers will substitute it for other goods, which are now relatively expensive

What is money income?

The number of dollars received per period of time, such as \$100 per week

What is real income?

Income measured in terms of the goods and services it can buy



What is the income effect?

A fall in the price of a good increases consumers' real income, making them more able to purchase all goods, so the quantity demanded increases

What is individual demand?

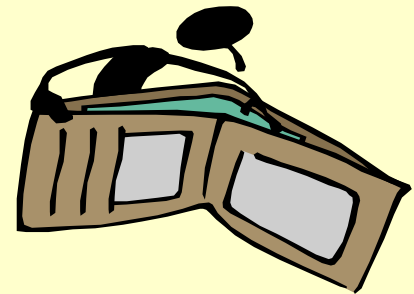
The demand for an
individual consumer

What is market demand?

The sum of the individual demands of all consumers in the market

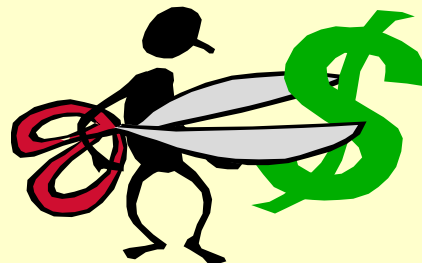
What is a normal good?

A good for which demand increases as consumer income rises



What is an inferior good?

A good for which demand decreases as consumer income rises



What are complements?

Goods that are related in such a way that an increase in the price of one leads to a decrease in the demand for the other

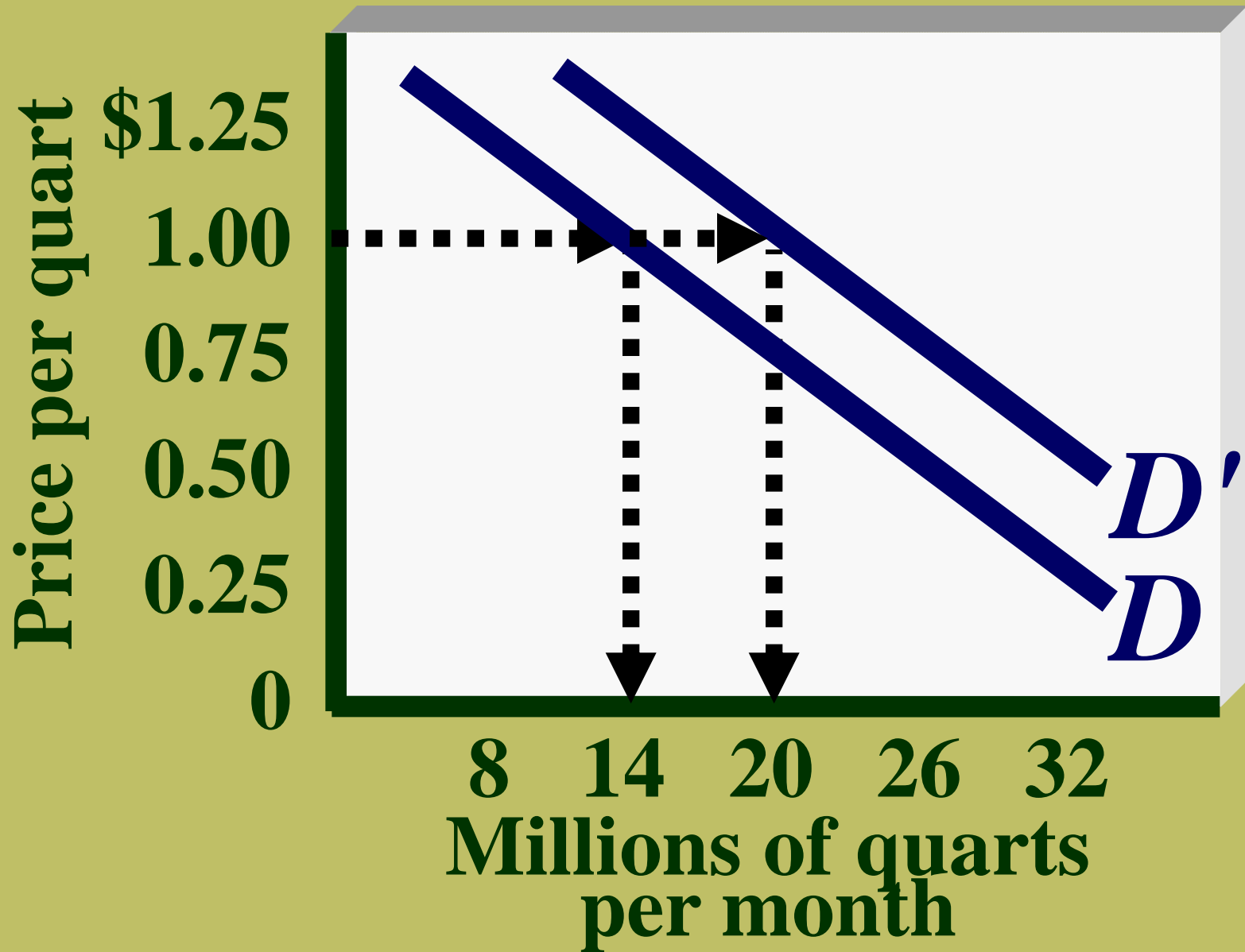
What are substitutes?

Goods that are related in such a way that an increase in the price of one leads to an increase in the demand for the other

What is a change in demand?

A shift in a given demand curve caused by a change in one of the nonprice determinants of demand for the good

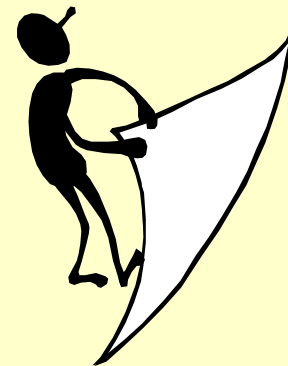
An Increase in the Demand for Milk



**IMPORTANT - KNOW
THE DIFFERENCE
BETWEEN A CHANGE
IN THE QUANTITY
DEMANDED AND A
CHANGE IN DEMAND**

What can cause a change in the demand of a good or service?

A change in ...



- **Number in the market**
- **Consumer income**
- **Prices of related goods**
- **Consumer expectations**
- **Consumer demographics**
- **Consumer tastes**

What is supply?

A relation showing the quantities of a good producers are willing and able to sell at various prices during a given time period, other things constant

What is a supply curve?

A curve showing the quantities of a good supplied at various prices, other things constant

What is the law of supply?

The quantity of a product supplied in a given time period is usually directly related to its price, other things constant

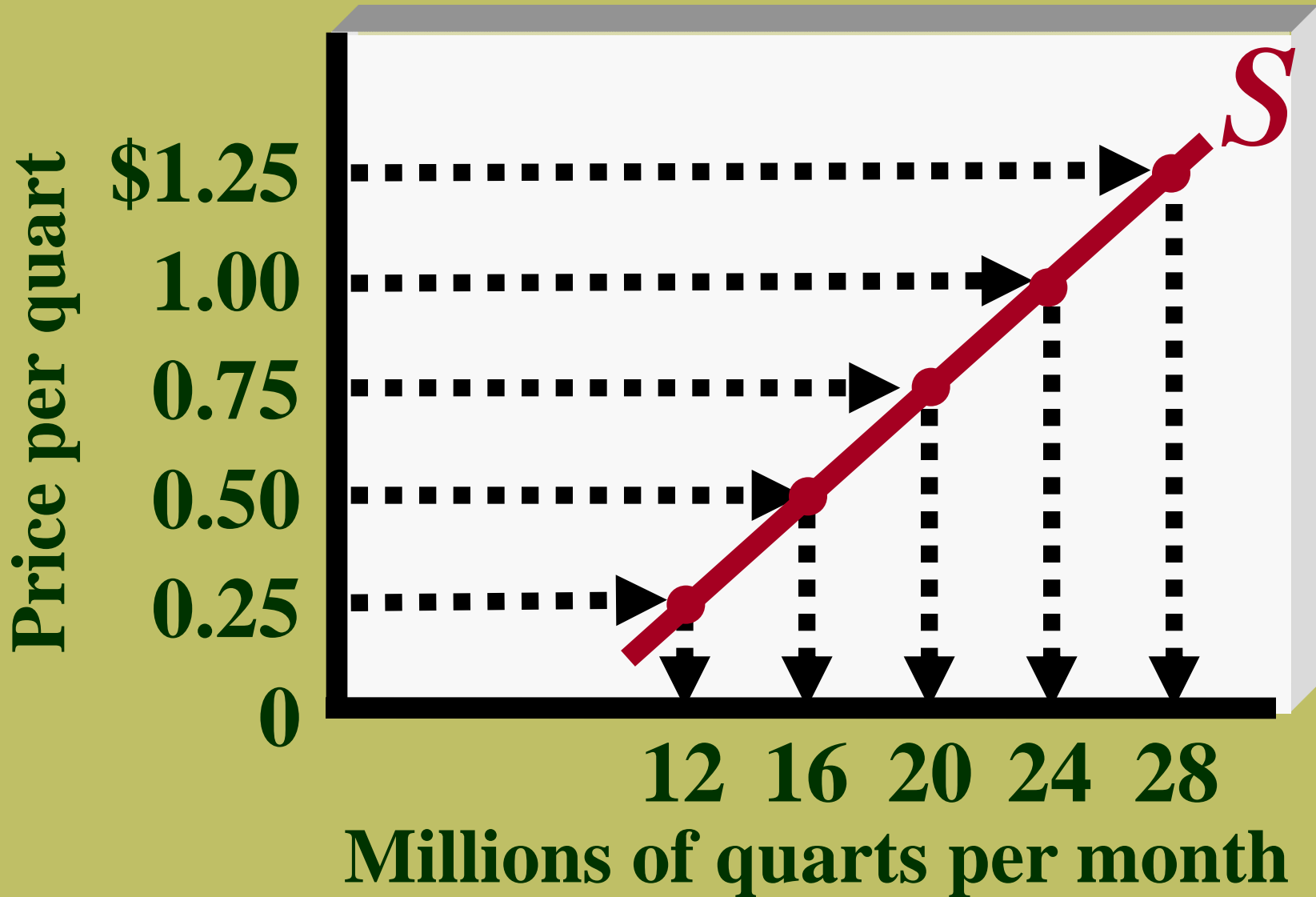
What is a change in quantity supplied?

A movement along the supply curve in response to a change in the price, other things constant

The Supply Schedule for Milk

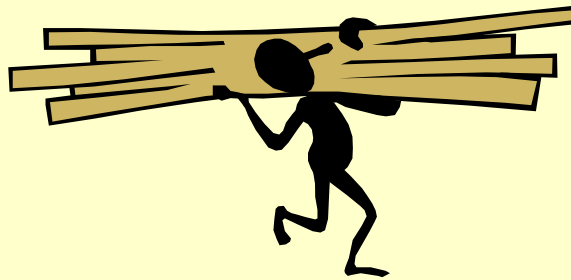
Price per quart	Quantity supplied per month (millions of quarts)
\$1.25	28
1.00	24
0.75	20
0.50	16
0.25	12

The Supply Curve for Milk



What are relevant resources?

Resources used to produce
the good in question



What are alternative goods?

Other goods that use some of the same types of resources used to produce the good in question

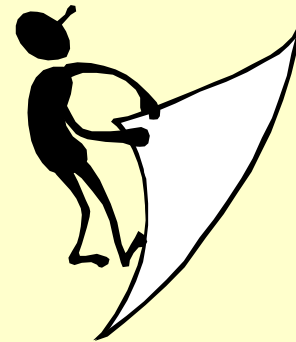
**IMPORTANT - KNOW
THE DIFFERENCE
BETWEEN A CHANGE
IN THE QUANTITY
SUPPLIED AND A
CHANGE IN SUPPLY**

What is a change in supply?

A shift in a given supply curve caused by a change in one of the nonprice determinants of the supply of the good

**What can cause a
change in the supply
of a good or service?**

A change in ...



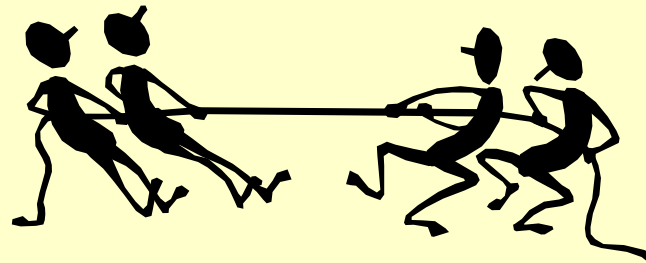
- Technology
- Prices of relevant resources
- Prices of alternative goods
- Producer expectations
- Number of producers

**What happens
when we put
demand and
supply together?**

Equilibrium

What is an equilibrium?

An equilibrium is the point toward which the economy tends



What is disequilibrium?

Usually a temporary mismatch between quantity supplied and quantity demanded as the market seeks equilibrium

What is a surplus?

An excess quantity
supplied over
quantity demanded
at a given price



Why is a surplus a disequilibrium?

When there is a surplus the supplier will lower the price to get rid of the surplus

What is a shortage?

An excess of quantity demanded over quantity supplied at a given price

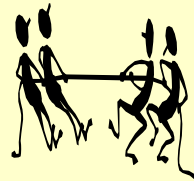


Why is a shortage a disequilibrium?

When there is a shortage consumers will bid up the price to determine who gets and who does not get

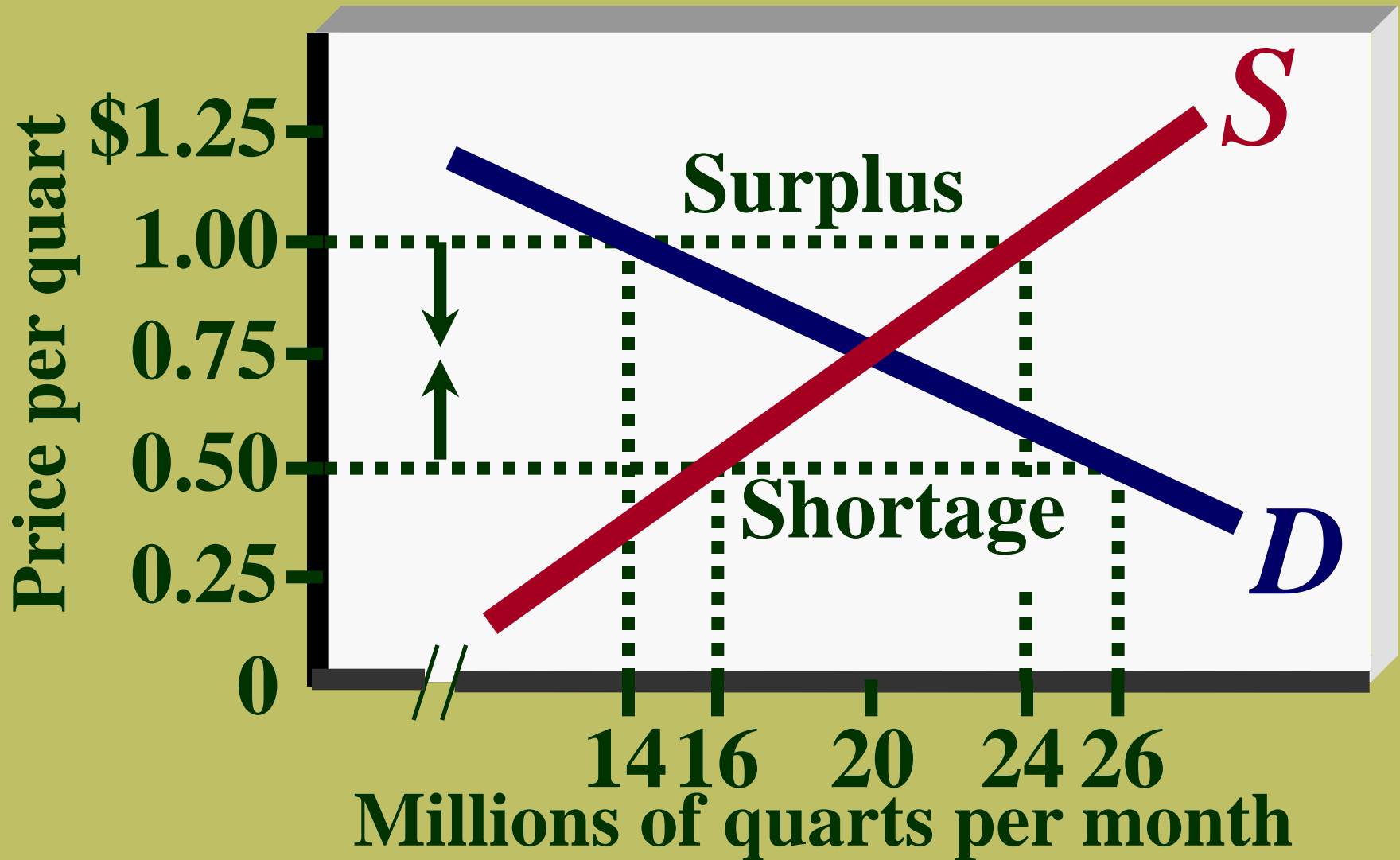
What is market equilibrium?

The condition that exists in a market when the plans of the buyers match the plans of the sellers



Equilibrium in the Milk Market

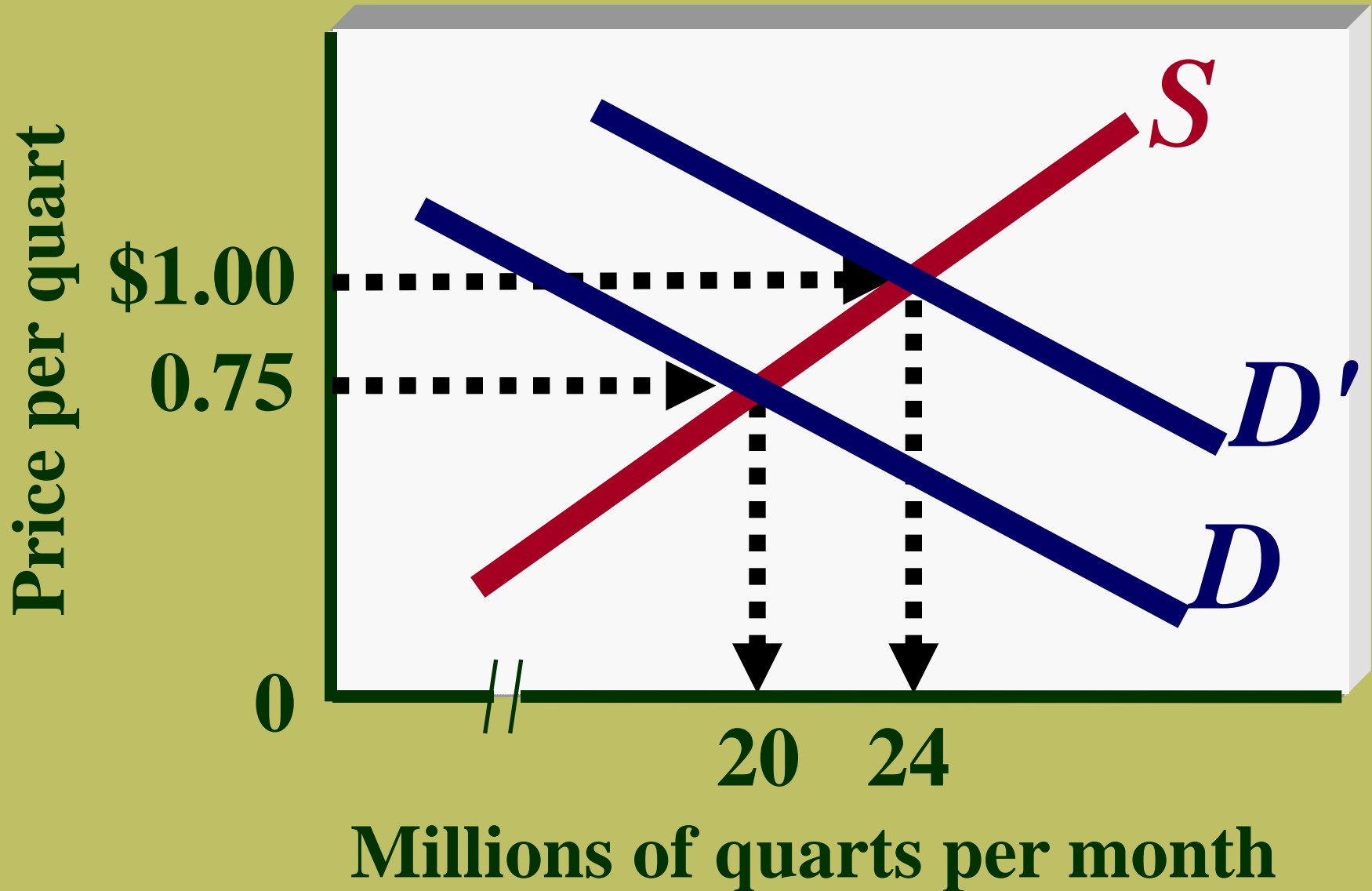
Panel B: Market Curves



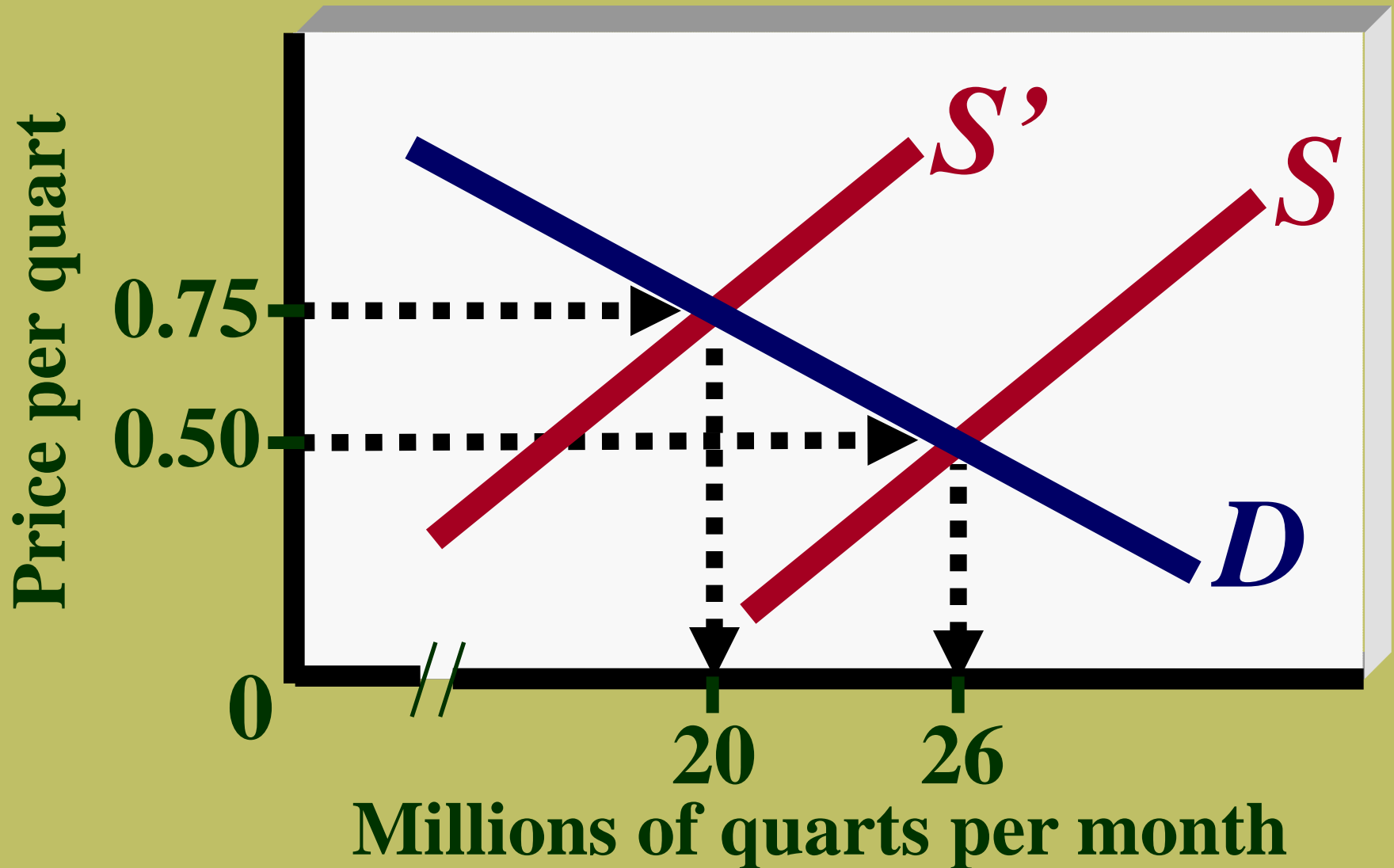
**What causes an increase
in equilibrium price?**

An increase in demand
or a decrease in supply

Effects of an Increase in Demand



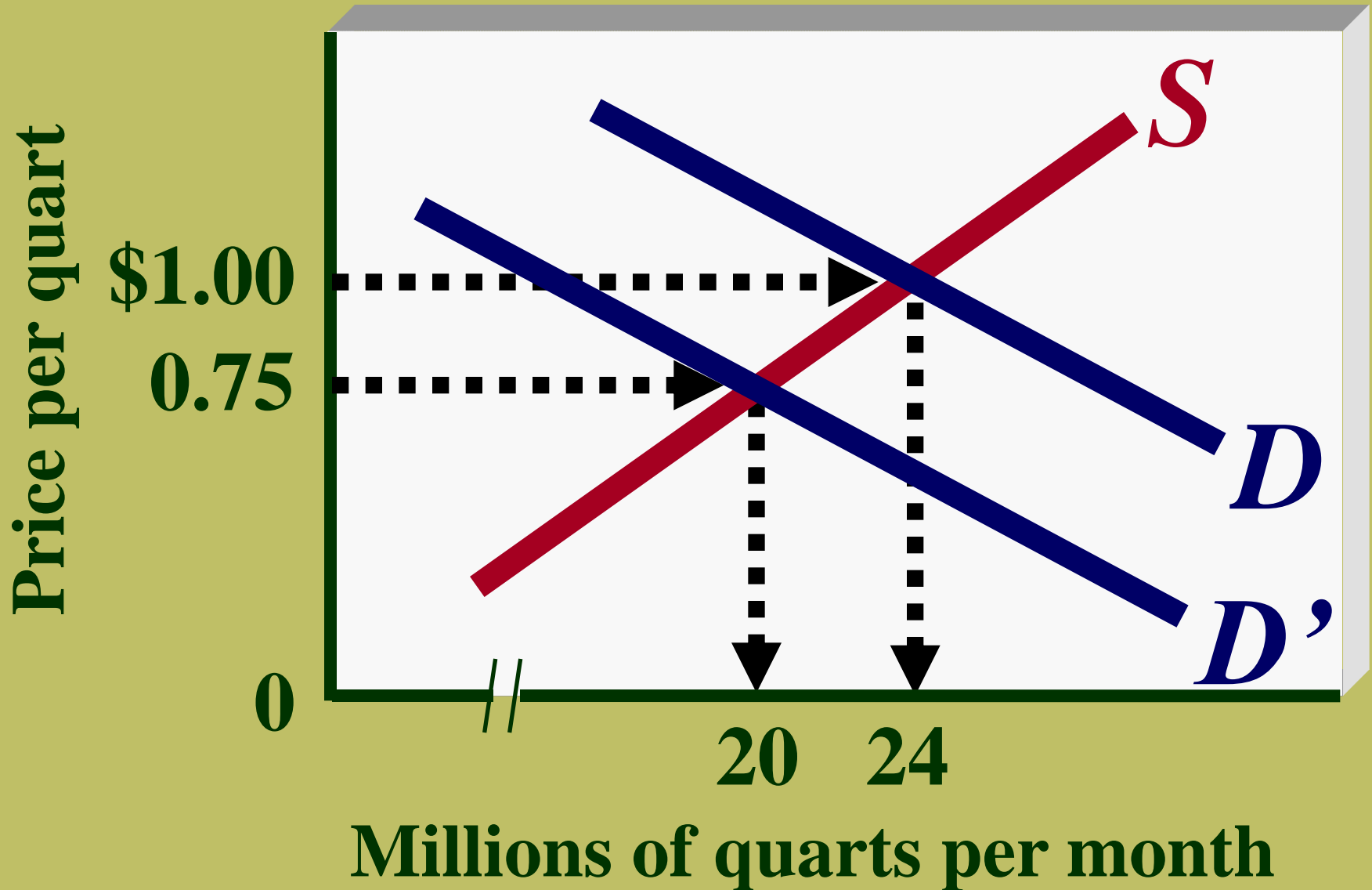
Effects of a Decrease in Supply



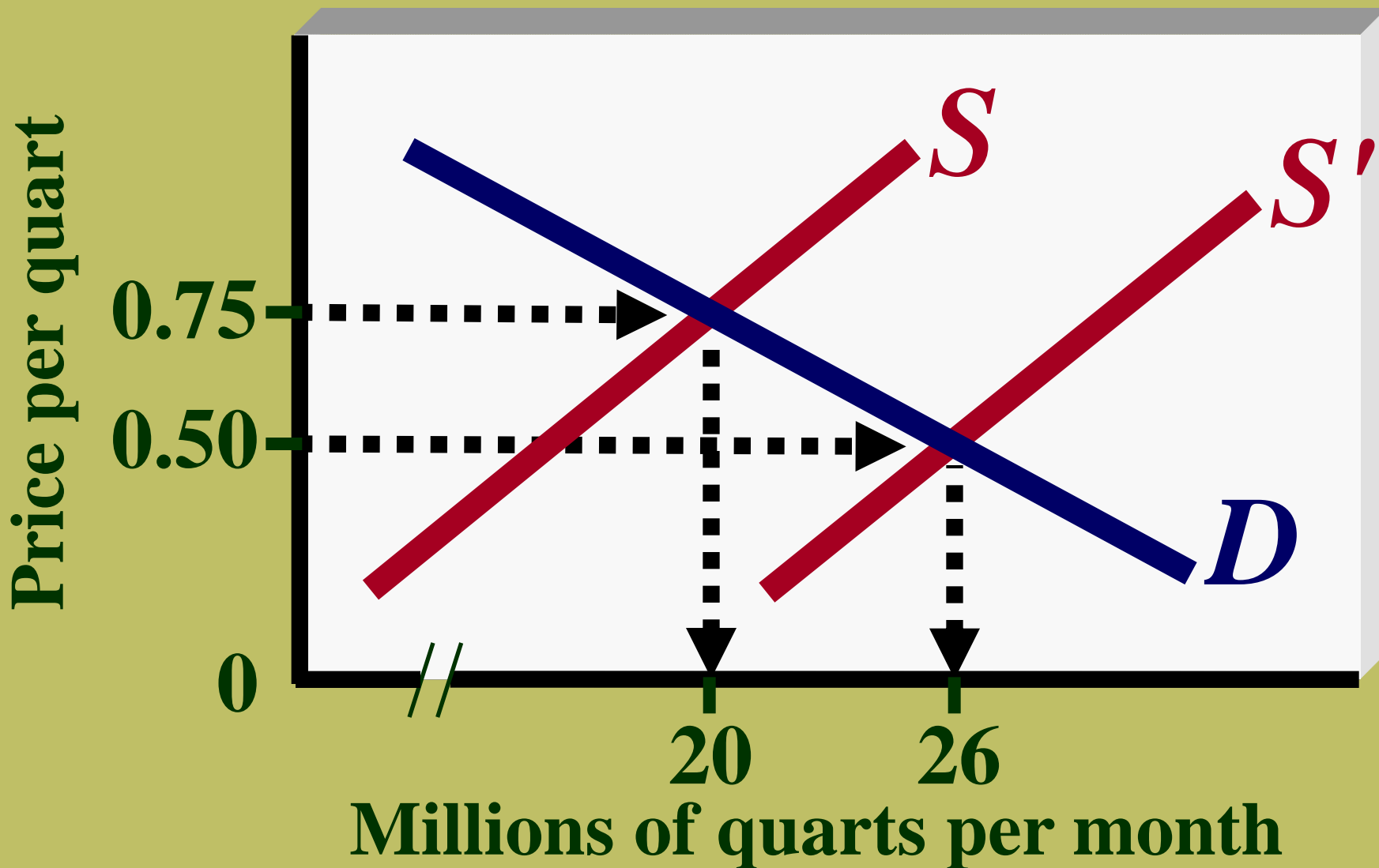
**What causes a decrease
in equilibrium price?**

A decrease in demand or
an increase in supply

Effects of a Decrease in Demand

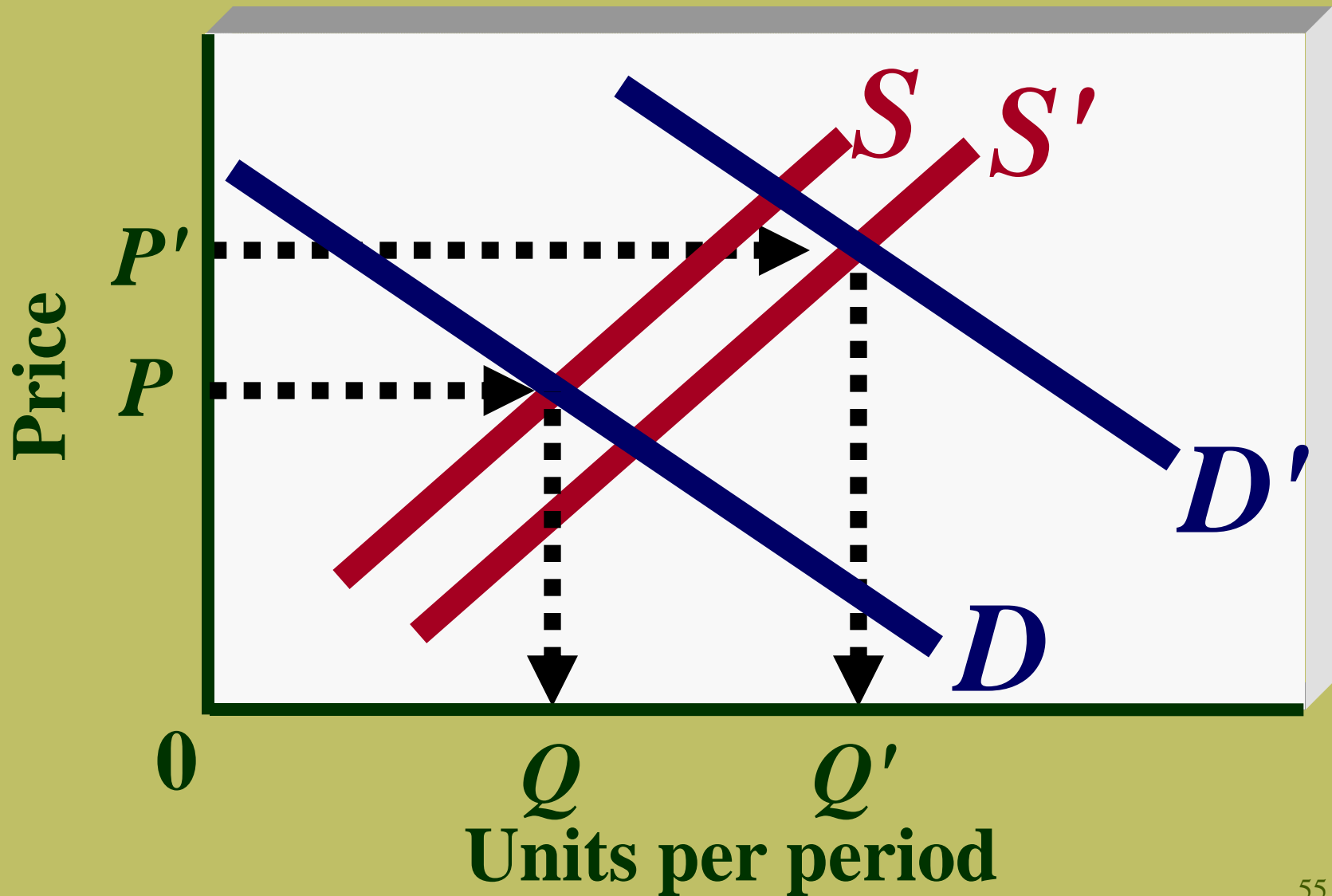


Effects of an Increase in Supply



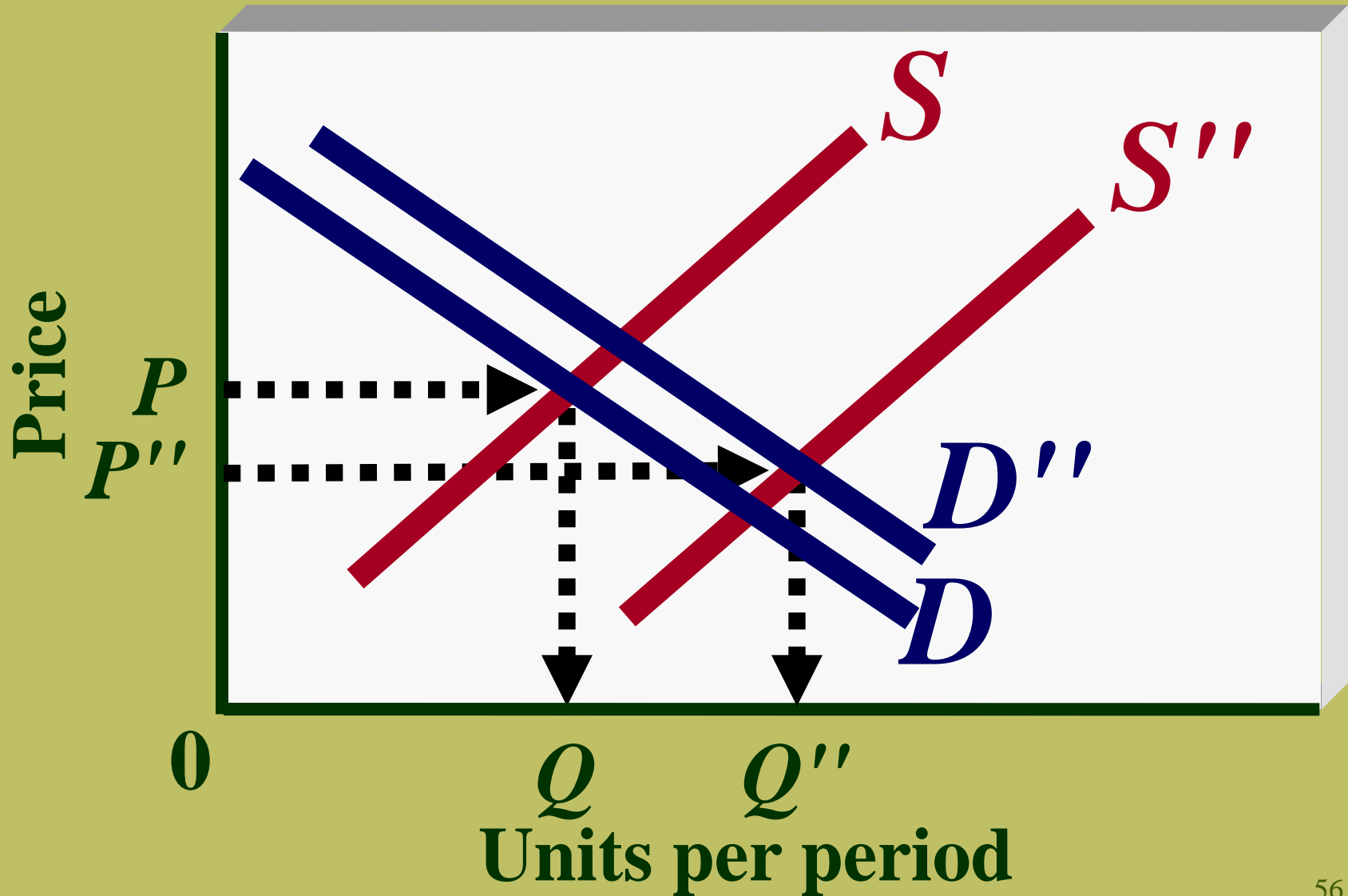
An Increase in Supply and Demand

Panel A: Shift in Demand Dominates



An Increase in Supply and Demand

Panel B: Shift in Supply Dominates

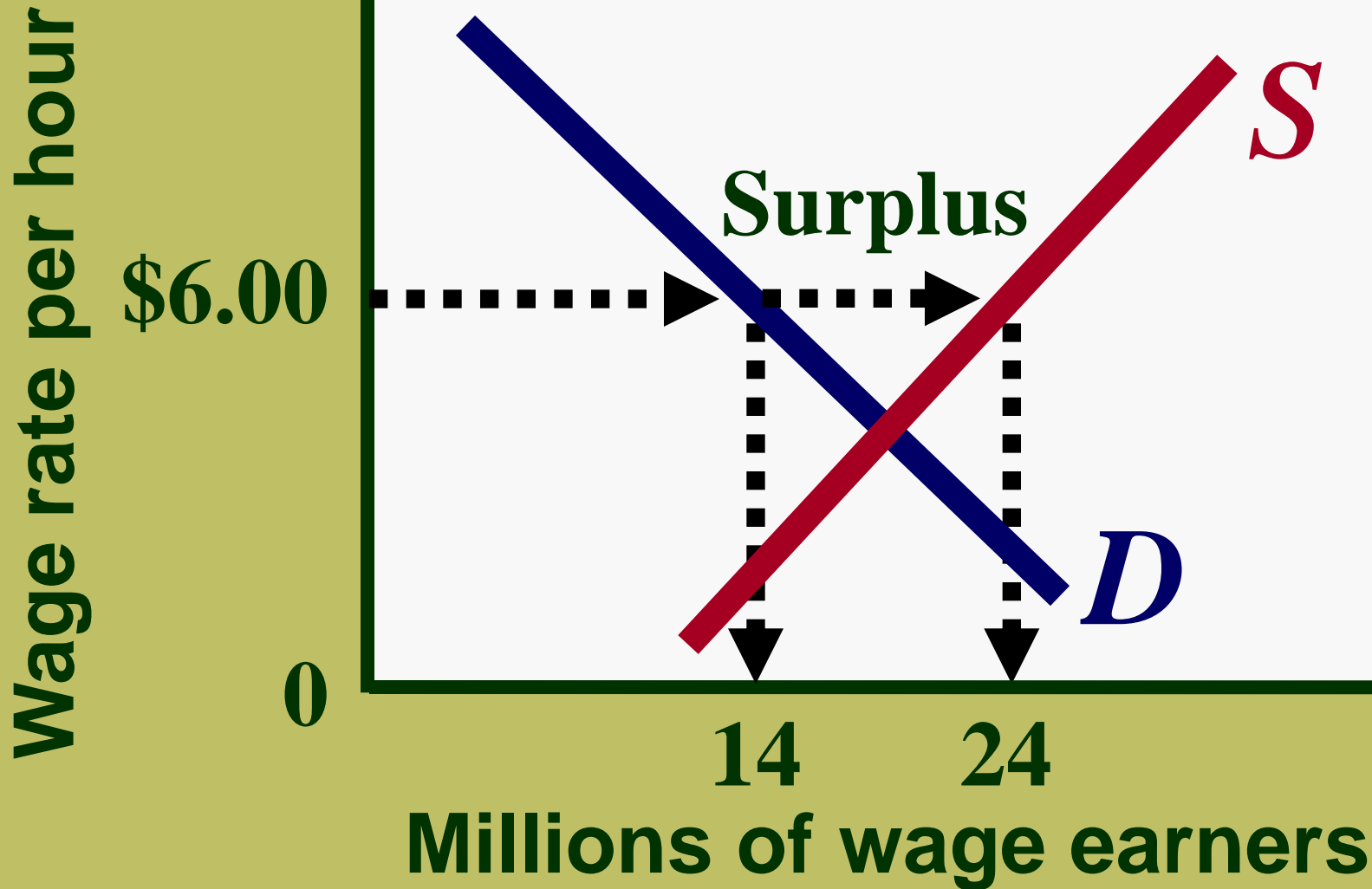


What is a price floor?

A minimum legal price below which a good or service cannot be sold



Effects of a Price Floor for Labor (minimum wage)

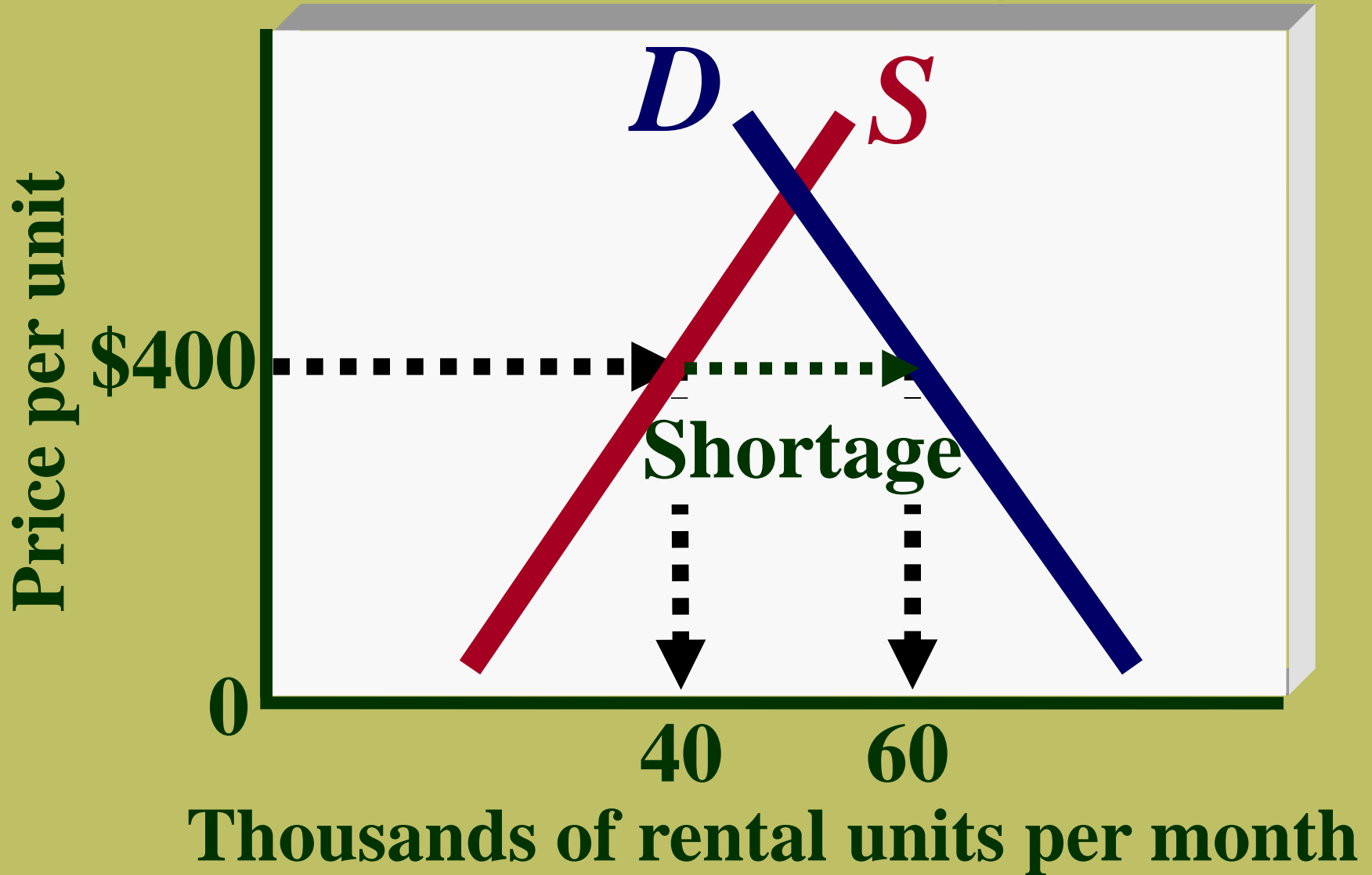


What is a price ceiling?

A maximum legal price above which a good or service cannot be sold



Effects of a Price Ceiling for Rent



END