An Introduction to Demand

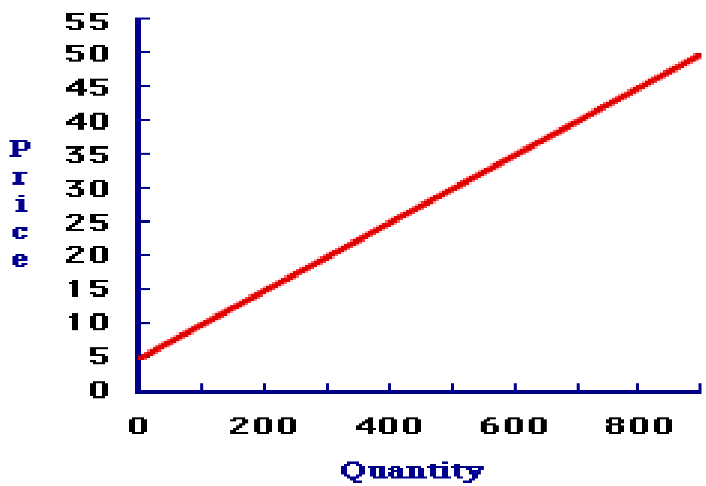
- **Demand** depends on two variables: the **price** of a product and the **quantity** available at a given point in time.
- In general, when the price of a product goes down, people are willing to buy, or demand, more of it. When the price goes up, they are willing to buy less.

- A **demand curve** shows the quantity of a product demanded at each price that might prevail in the market.
- The **Law of Demand** states that the quantity demanded of a product varies **inversely** with its price.

An Introduction to Supply

- **Supply** is the amount of a product offered for sale at all possible prices in a market.

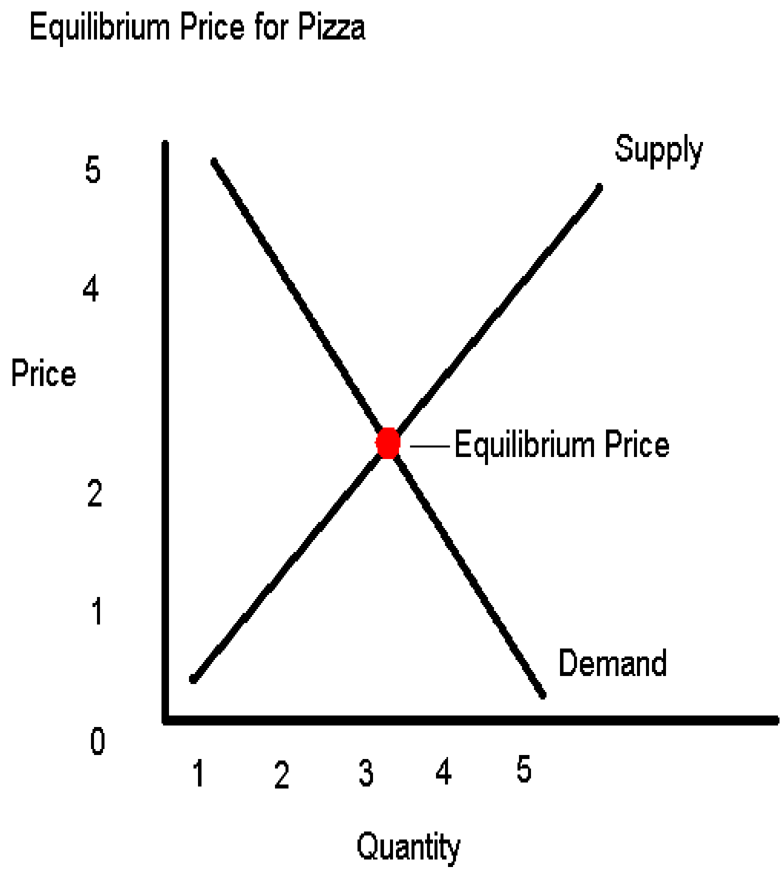
- The **Law of Supply** states that more product will be offered for sale at higher prices than at lower prices.

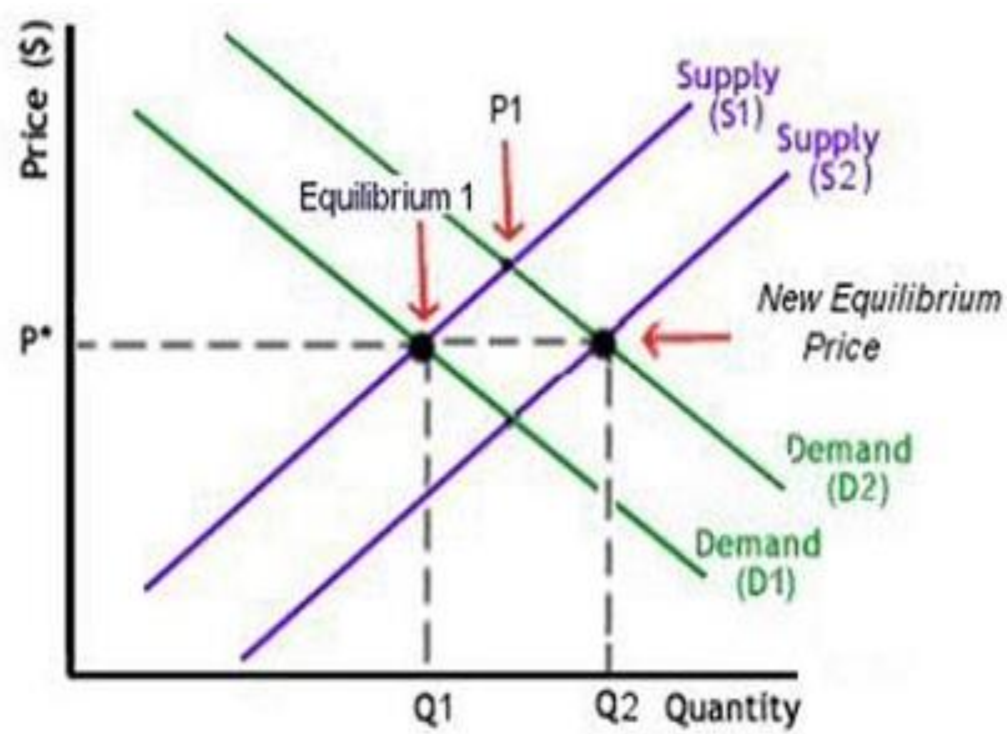


- Normal **individual supply curves** have a positive slope that goes up from left to right; if price goes up, quantity supplied goes up as well.

- **Change in quantity supplied** refers to a change in the quantity of a product offered for sale in direct response to a change in price.

<u>Equilibrium price:</u> the price at which the amount producers are willing to supply is equal to the amount consumers are willing to buy.



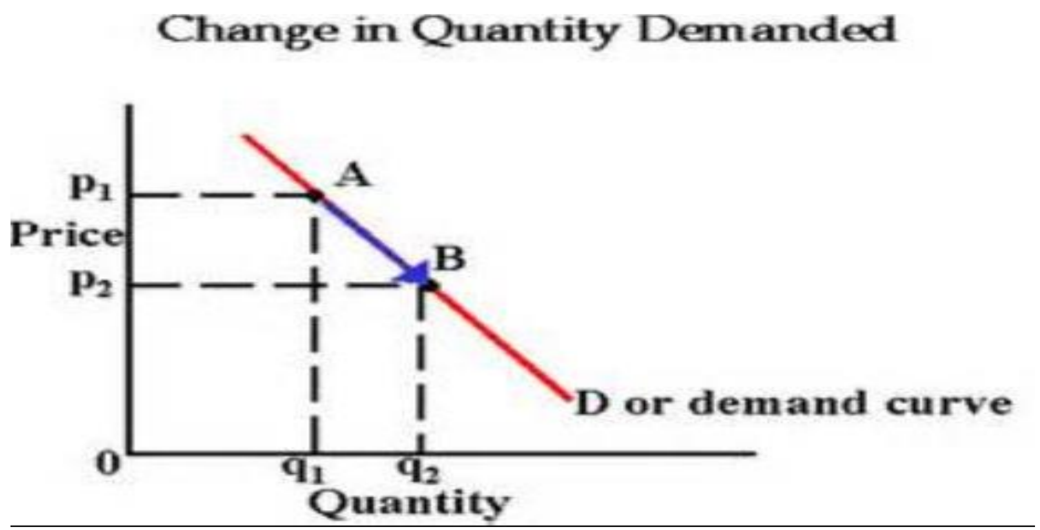


Demand and Marginal Utility

- **Marginal utility** is the extra satisfaction or additional usefulness obtained by acquiring multiple units of a product.
- As we use more and more of a product, the extra satisfaction we get from using additional quantities begins to decline; this is known as **diminishing marginal utility**.
- Because of diminishing marginal utility, people are not usually willing to pay as much for the second, third, or fourth unit as they did for the first unit.
- **Microeconomics** is the branch of economic theory that deals with behavior and decision making by small units such as individuals and firms.
- **Complements**-products that increase th use of other products; products related in such a way that an increase in the price of one reduces the demand for both.
- **Economic model- a simplified version of a complex behavior expressed in the form of an equation, graph, or illustration.**

A Change in the Quantity Demanded

- The only event that can cause a change in quantity demanded is a **change in price**.
- A **change in the quantity demanded** due to a change in price is represented on a demand curve as movement along the curve.

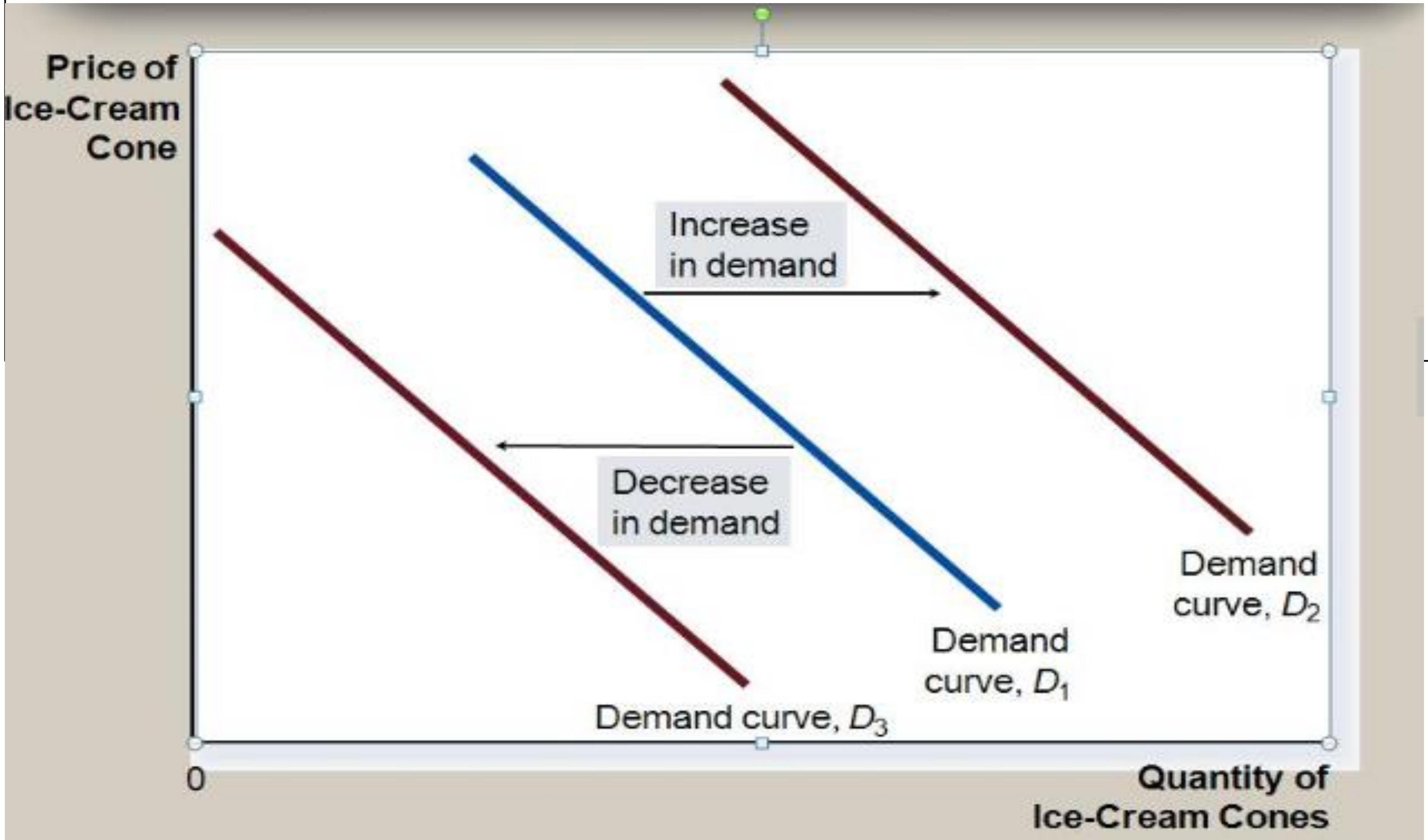


- The **income effect** is a change in quantity demanded because of a change in price that makes consumers feel richer or poorer.
- A shift in relative prices may cause a **substitution effect**, in which consumers substitute an alternative less expensive product for one that has become more expensive.

A Change in Demand

When a change in demand occurs, the entire demand curve shifts to the left or right due to something **other than price**.

Determinants of demand: change in population, income, tastes and preferences, substitutes, complementary goods and expectations.

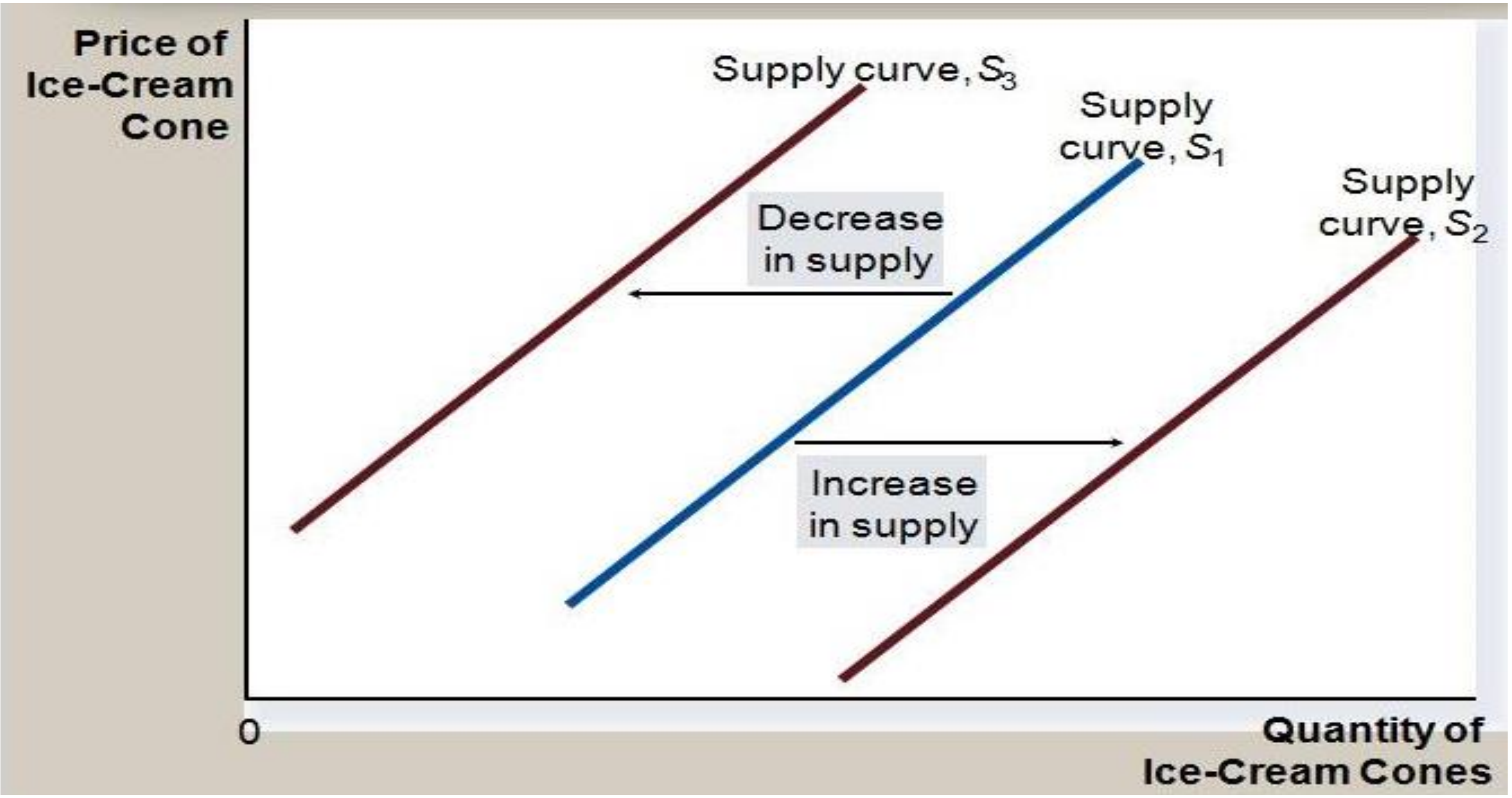


Three Cases of Demand Elasticity

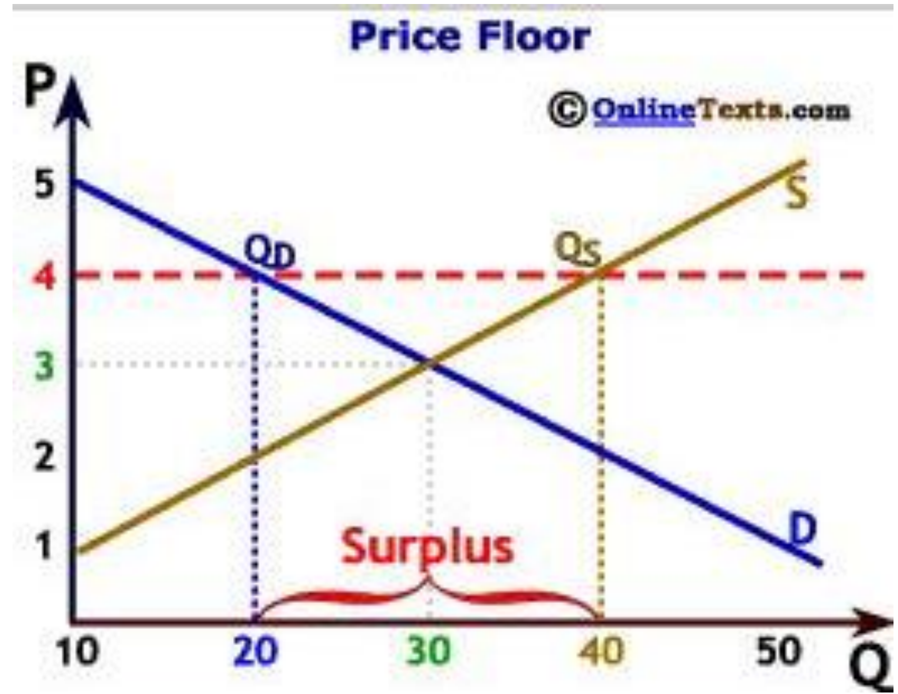
- **Demand elasticity** is the extent to which a change in price causes a change in the quantity demanded.
- Demand is **elastic** when a change in price causes a relatively larger change in quantity demanded. Things like luxury items and/or items with many substitutes.
- Demand is **inelastic** when a change in price causes a relatively smaller change in quantity demanded. These would be necessities or items with very few substitutes.
- To measure the elasticity of demand, compare the percentage change in quantity demanded to the percentage change in price.
- The **total expenditures test** compares the direction of a price change to the direction of change in total revenue or total expenditures.
- With **elastic demand**, a change in price moves in the opposite direction from the change in revenue.
- With **inelastic demand**, the price and change in revenue move in the same direction.

Change in Supply

- Whereas a change in quantity supplied occurs only when prices change, a **change in supply** occurs when quantities change even though price remains constant.



- Factors that can cause a change in supply include cost of resources, productivity, technology, taxes, subsidies, government regulations, number of sellers, opportunity cost and expectations.



<u>Price ceiling: </u>a legal maximum price that may be charged for a particular good or service. Resulting in a **shortage,** where quantity supplied is less than quantity demanded.

<u>Price floor: </u>a legal minimum price below which a good or service may not be sold. Resulting in a **surplus,** where quantity supplied is greater than quantity demanded.