What are the determinants of demand and supply

Demand determinants Changes in one of the following options either increase (right shift) or reduce (shift left) demand curve:1. Tastes, preferences, and/or popularity 2. Number of buyers 3. Buyer income 4. The price of a replacement good5. Price of additional goods 6. Expectations of future item prices Supply determinants Changes in any of the following factors will either increase (shift to right) or reduce (shift left) the supply curve:1. Prices of resources/inputs/factors or raw materials 2. Technology 3. Taxes and subsidies 4. Price expectations 5. Number of vendors in structural change policy in the market In our lecture on structural adjustment, we discussed the various policies that countries adopt all around the word to promote economic growth (increasing output instead of increasing their capabilities) and achieving productive and allocated efficiency. Structural adjustment policies 1. Privatisation 2. Promotion of the competition 3. Limited and reoriented role of government 4. Price reform: Remove controls 5. Entry into the world economy 6. Macroeconomic stability Although supply and demand concepts are microeconomic concepts, this macroeconomy course examines, as not all students have adopted microeconomy (ECO 211) and are fundamental principles that every economic student should master. We will study supply and demand in this macroeconomics course of the global economy to better understand why there is a global movement to remove price controls and let supply and demand determine prices. In a capitalist economy, prices are very important. They have two basic functions: ration goods and services, and GUIDE resources to where they are wanted most by helping the economy maintain active efficiency and productive efficiency. In a 5Es lesson on allocated effectiveness we discussed that it was good for the price of plywood to increase in Florida after the hurricane. When the price increased two things happened: (1) plywood was rationed for its most important use (not dog house or deck), and (2) high prices were the impetus for more plywood to be kept to Florida so that they had more plywood. If the price of plywood was too low, the result was an allolar inefficiency (lack thereof). Prices are also very important in maintaining productive efficiency. In the lecture 5Es on productive efficiency, we defined it as production at minimal cost. In order to minimise costs, producers need to know the prices of resources. If these resource prices are determined by demand and supply, then they will reflect the relative scarcity of resources and their relative importance (rarer and more important resources will be at a higher price) and the economy can achieve productive efficiency. In a capitalist society, prices are determined by the interaction of demand and supply. Since the prices so important, we need to better understand how they are intended. Why is the price of gasoline $2.09 per gallon. Why does a stick cost $0.75? Why is the price of plywood usually $10 per letter, but a $30 letter after a hurricane? This chapter focuses on competitive markets. A market as referred to in Chapter 2 is an institution or mechanism which brings together buyers (requesting) and sellers (suppliers) of specific goods and services. Competitive markets have: 1. a large number of independent buyers and sellers. 2. standardised goods. 3. prices which are discovered through the interaction of buyers and sellers. No individual can dictate the market price. In a competitive market (i.e. net capitalism), product prices are determined through demand-supply interaction. Demand If the price of a product increases, what happens to the demand for that product? For example, if the price of pizza increases, then the demand for pizza does what? - - - - NOTHING! If the price of pizza increases, the demand for pizza does not change. This is because we have a more precise and different definition of demand in economics. In economics, demand is not the amount that people buy. DEFINITION: So what is demand? Demand is a schedule that shows the different quantities that consumers are willing and able to buy at different prices in a given time period, ceteris paribus. We should take a closer look at this definition. Demand is a table of numbers (schedule). Check out the table below. The whole table could represent my demand for pizza because it shows the amount that I am willing to buy at different prices. That doesn't mean how much to buy. Demand Schedule and Curve As we learned in the previous lesson, any point on the chart represents two numbers so that we can render our demand table as in the chart below. Assuming that there are quantities and prices in-between those in the table (for example, if the price was $4.50, how many pizzas would I buy?), we can mount points and we get a demand curve (chart). This is my pizza request. This demand curve won't tell us what the price will be. In order to know what the price will be, we need both demand and supply. But we can see what happens to demand if the price of pizza increases. If the price of pizza increases from, say, $6 to $9, nothing on the table changes (demand doesn't change) because demand already includes different prices and different quantities. Demand (full table or chart) does not change when the price changes because the demand includes different prices and different quantities. Demand is not how much we buy. Note that our definition of demand includes the ceteris paribus assumption. As we develop the demand curve, only the price and quantity required have changed. Everything else is expected to remain constant. I don't have a big increase in my income. I'm not going to win the lottery. Does not exist study that states pizzas cause cancer. All other factors remain the same - only the price and quantity of the required changes. The law of demand As we can see on the demand chart, there is an inverse relationship between the price and the required quantity. Economists call it the law of demand. If the price goes up, the required quantity decreases (but the demand itself remains the same). If the price is reduced, the quantity requested shall be increased. This is the law of demand. On the chart, the inverse relationship is represented by a descending oblique line from left to right. Why? Why is the law of demand true? Why is the demand curve down from left to right? Why do people buy more at lower prices and less at higher prices? As social scientists, economists try to explain human behavior. It's common sense that people behave this way - but how can we explain it? Economists have three explanations: reducing the marginal effects of utility income substitution effects by reducing margin utilities We learned in a 5Es lesson that equity helps reduce scarcity because the law reduces marginal utilities. This economic principle also explains why the demand curve is decreasing. Usefulness is why we consume good or service. You could call it satisfaction. I have satisfaction (utilities) when I drive my boat. I have utilities (satisfaction?) when I go to the dentist or go skiing. Marginal means EXTRA or ADDITIONAL. Thus, under the Decreasing Marginal Utility Act, the extra (not total) instrument is reduced for each additional unit consumed. If we receive less of an extra tool when we buy one more product, we will not be willing to pay the same price. After all, it is a marginal usefulness for which we pay. I really enjoy the first piece of pizza I eat. It gives me a lot of usefulness. But after a few pieces, I don't get as much more satisfaction from one piece as I did from the first piece. I'm starting to get sick of it. Getting sick of it is reducing marginal utilities. So I'll only buy the second piece if it has a lower price because I'm getting less and more utilities from the second piece. This explains why we only buy more if the price goes down and why we only buy less if the price goes up. That explains the law of demand. Income Effect Another explanation of why the law of demand explains human behavior is the income effect. Remember, we try to explain why the required amount increases, if the price decreases or why the demand curve decreases from left to right. If the price of pizza decreases, what happens to your income? price of pizza ?? the required amount of pizza (NOTE: indicates the causes.) Nothing happens to your income when the price of pizza goes down? (Do you increase when Pizza Hut has a sale?), but your actual income (or purchasing power of your income will be the price of a real income pizza amount of pizza demanded so when pizza prices reduce their real income increases. (This is like the price of pizza staying the same, but you get a raise.) As a result, we buy more pizza (the amount of pizza required increases when the price goes down.) This explains why the law of demand is true. Substitution effect The third explanation of the Demand Act is the substitution effect. Remember, we try to explain why the required amount increases, if the price decreases or why the demand curve decreases from left to right. price of pizza ?? the price of Chinese food amount of pizza required If the price of pizza decreases, what happens to the price of Chinese food in the restaurant down the street? Probably nothing. (I know the Chinese restaurant where my wife and I are at doesn't change their prices when Pizza Hut has a sale.) But the relative price of Chinese food is increasing. compared to pizza, Chinese food looks more expensive. the price of pizza relative to the price of Chinese pizza food demanded now, as my wife and I go around Pizza Hut on our way to a Chinese restaurant and we see that Pizza Hut has a sale (the price of pizza) we start to think that Chinese food seems more expensive compared to the now cheaper pizza (relative price of Chinese food). So we can choose to eat at Pizza Hut and replace pizza with a relatively more expensive Chinese dish (the amount of pizza demanded). This helps explain why we buy more pizza when the price goes down. Market demand definition: Market demand is the horizontal sum of individual demand curves. Or, instead of just my individual demand for the product, what if there were two people, or more, on the market. the result would be tat for any price, the required quantities would be larger because there are more people. Prices remain the same, but quantities increase or the demand chart moves horizontally (right). Graphically: Sample Problem: Given the following individuals' demand plans for product X, and assuming they're just three X consumers, which set prices and production levels below will the market demand curve for that product? ANSWER Demand determinants Product price Economists stress the importance of price in determining how many people will buy. That's why they put the price on the demand chart, but there are other things that affect how much product we buy in addition to the price. When we developed my pizza demand curve, we used the assumption ceteris Paribus. I didn't get a big increase in my income. I didn't win the lottery. There was no new study indicating that pizzas cause cancer. All other factors remained the same - only the price and the quantity requested changed. But there are other determinants of how much we require (or buy) in addition to price. Call disproportionate demand determinants. Non-price determinants demand let's talk about pizza already and use the new product in our examples. - - What about vodka? We know that when the price of vodka goes up we buy less, and when the price goes down we buy more (that's the law of demand). But what else could cause us to buy more vodka in addition to the price? In other words, if the price of vodka remained the same, what could cause us to buy more or less vodka? Economists classify disproportionate demand determinants into 5 groups: expected price (Pe) price of other goods (Pog) income (I or Y) (In macroeconomics I usually means investment and Y means income.) number of potential consumers (Npot) and tastes and preferences (T). Let's take a brief look at each one here and in more detail later. Pe – If we hear that there will be a new $5 tax on a bottle of vodka early next week, what happens to the amount of vodka sold this week at the current price? This is likely to increase because some people will buy more now to avoid higher future prices. Pog - What happens to the amount of vodka sold if the price of gin increases? Maybe not some people who were going to buy gin buy water instead because the price of gin went up? Or what could happen to the sale of vodka if the price of tomato juice goes down? Maybe now with cheaper tomato juice prices some people will want to drink more bloody marys (vodka mixed with tomato juice)? If so, the sale of vodka would be picked up. Y (or I) – If I get an increase and my income increases I could buy more vodka – or if my income goes down I would probably buy less vodka. (And if I lost my job, I could buy a lot of vodka :-) Npot – What would happen to the sale of vodka if they lowered the drinking age. This would increase the number of potential consumers of vodka and would probably sell more vodka. Finally T - Taste and preference really means everything else. There are hundreds of factors that affect the amount of vodka sold. We don't want to remember hundreds of different determinants for each product, so economists group everything else into tastes and preferences. Anything that could cause consumers to want more or less water will change the quantity sold. For example, if a new study says that drinking vodka causes blindness - people will buy less. Just before the holiday, people can buy more. To remember these demand determinants, think of someone who has had too much vodka to drink and are coming staggering into the liquor intensive, G-g-give m-me an-n-n-nother p-p-p-pint-in-vodka. Will you get it? p-p-p-pint or P, P, P, I, N, T or Px, Pe, Pog, I, Npot, T To save me time while writing, I will write P, P, I, N, T instead of non-price determinants of demand. Two types of changes involving demand If the price of a product increases, what happens to the demand for that product? For example, if the pizza increases, then the demand for pizza does what? NOTHING, demand does not change when the price changes, but the required quantity changes. This section will help us better understand the difference between changing the required quantity (Qd) and the actual change in demand (D). [Triangle, means change.] Change in required quantity (Qd) Change in the quantity requested caused only by a change in the price of the product. The chart is represented by a movement along one demand curve. So if the price of pizzas increase from $6 to $9 we get a reduction in the required amount (Qd) from 5 pizzas to 3 pizzas. This does not change the demand plan (the numbers in the table do not change) or the demand curve (the demand curve does not move). Demand is unchanged. But this results in movement along the same demand curve. Change in demand (D) When it comes to changing demand itself we get a new demand plan (new numbers) and curves (it moves). We need to change the numbers in the demand plan, and that will shift the demand curve. If the increase in demand (D) numbers on the table get bigger, and when we plot these larger numbers the demand curve moves right. When we say that demand curves are shifting to the right, it means that we need to change the numbers in the demand plan. At the same prices, quantities increase. This moves the curve to the right. The drop in demand then shifts the demand curve to the left. For each price in the demand plan, the quantities are reduced. Be sure to draw arrows right and left. Many students want to draw arrows perpendicular to the demand curve. Don't do it. Always draw arrows horizontally because it indicates that the prices are the same, and only the quantities change. This is not a shift up, nor up and right. It moves horizontally to the right. Look for the black arrows in these charts. They're horizontal. This is important, please always draw arrows horizontally. This is particularly true when we are discussing a change of offer later. The change in demand is due to a change in non-price demand determinants: Non-price demand determinants: Pe, Pog, I, Npot, T If these changes we get a new demand plan and curve. In order to understand why prices are what they are and why they are changing, we need to understand very well how these determinants are shifting the demand curve. This is where it all starts. In our definition of demand we have kept these things constant (ceteris paribus), but in the real world these things are changing, demand changing, and ultimately changing prices. So let's take a look at each determinant individually to understand how each impacts on demand. these determinants are very important. Make sure you know how they work (i.e. learn the direction of the arrows). Pe - the expected price of Pe in the future D today Pe in D today If you expect the price to go up in the future demand will increase today (shift right). For example, if we read that from next week there will be a new vodka tax, people will want to buy more now before prices rise. Retailers understand that. How often have you heard THE SALE END MONDAY? They want you to expect the price to increase in the future, so you buy it today. The opposite occurs when you expect the price to go down in the future. In the past, when my wife and I shopped, whenever I put something in the basket, she would take it and put it back on the shelf! I'd like to ask, Why are you doing this?. She would say she expects it to go on sale soon and we should wait until she does. If you expect the price will fall in the future demand is falling today. (f) In the future ÞD today). But every time I put something in the basket, she'd take it with the fact that she expects it to go on sale soon. After a while I got a little upset when I asked her about the items she put in the cart and she would say that they were on sale last week and we missed them. Eventually I went to talk to the store manager and explained the situation to him. He saved our marriage by explaining that most chain stores have a policy that states that if an item goes on sale after you have purchased it, you can bring a receipt within 30 days and get a refund. Retailers understand how price expectations affect demand. Pog - price of other goods The effect of changing the price of another item on demand depends on what type of other goods we are talking about. There are three types: 1) equivalent goods Equivalent goods are goods where if you buy more from one, you buy less of the other. Examples of substitutes are vodka and gin, hot dogs and burgers, chicken and beef, Coca-Cola and Pepsi. Let's take a look at Coke and Pepsi. If the price of coke increases, demand for Pepsi will increase (the graph will move to the right). I f you buy can coke, you can walk right past the Pepsi machine, but if you notice that the price of coke has increased, you'll probably turn around and buy Pepsi. You didn't want to buy Pepsi before, but now, at the same price, you're willing to buy it. So demand for Pepsi has increased. The demand curve has shifted to the right. At the same prices, the quantities applied for are greater. If the price of coke increases, what happens to the demand for coke? - - - NOTHING. The price does not change the demand (as we defined it), but changes the required quantity. You saw a good example of this at your local grocery store. For example, I might want to buy coffee. So I go to the coffee aisle and grab the Can Folgers and continue down the aisle. But at the end of the aisle I see a view of Maxwell House coffee for sale! What should I do with Folgers in my shopping cart? - - - - - I'm not going to put it back. I'm taking him out of my wheelchair and i'm going to put him on the Maxwell House display. Have you seen different brands mixed with these displays? Demand for Folgers has decreased (I no longer want it at that price, so I take it out of my cart) because the price of Maxwell House has decreased. If: P Maxwell House Coffee D Folgers Coffee 2) Complementary goods Complementary goods are goods where if you buy more of them you also buy more of the other. They go along like vodka and tomato juice, rum and coke, film and film development, hot dogs and hot dog buns. Let's say you want to eat hot dogs tonight and you go to your local grocery store and put a bag of buns in a basket and head down the aisle to the wieners. When you get to the wiener display you will notice that their price has increased significantly, so you decide not to eat hot dogs. What are you going to do with the buns? You should give them back, but if you're like a lot of people, you'll put them in wiener displays and move on quickly. But the point is that you were going to buy buns at their current price (they were already in your cart), but when you learned that the price of hot dogs increased your demand for buns dropped (the demand curve has shifted to the left - at the same prices the required quantities have fallen). P wieners D buns Of course, if the price of one product decreases (cheaper movie development), the demand for its supplement (film) increases. P one product D its compliment 3) independent goods Independent goods are goods where if the price of one changes, it has no effect on the demand for another. For example, what happens to the demand for paper clips if the price of surfboards rises? Nothing. Summary (Pog): P one product D of its replacement P one product D its replacement P one product D its compliment P one product D its compliment I - receipt 1) normal goods For most goods, so-called ordinary goods, if consumer income increases, demand will increase and vice versa. Income D for ordinary goods Receipt D for ordinary goods So if revenues increase, the demand curve for restaurant meals and cars and ships shifts to the right. At the same prices people will buy more. 2) lower goods For some goods, called lower goods, if consumer income increases demand will decrease, and vice versa. If only you had more money, you should buy less of this product income D for lower D income goods for lower goods Term worse good does not mean they are of low quality. the definition of worse good is one where if your income increases, demand decreases. There is an inverse relationship between income and demand. Examples of lower goods may include used clothing, potatoes, rice, possibly generic foods. If you lose your job (so your income decreases), you can buy clothes in the Salvation Army Thrift Store (demand for used increases). What is normally good for one consumer could be worse good for another. For example, if one family's income increases, they can buy a second small car (normal good), but for another family, an increase in income may mean that they no longer buy a small car (worse good) and instead buy a mini van. Npot - number of potential consumers Increasing the number of potential consumers will increase demand and vice versa. Npot D Npot D We previously say that if they lowered the drinking age, the demand for water would increase. Economists often say that an increase in the number of consumers will increase demand. I prefer to use terminology to a number of potential consumers, because if K-Mart has sales on Pepsi (the price of Pepsi is falling), what happens to the demand for Pepsi? -- Nothing (price does not change the demand plan). But if K-Mart has sales on Pepsi (the price of Pepsi is falling), what happens to the number of consumers buying Pepsi? It's going to increase. (The law of demand says that if the price goes down, the required amount goes up.) So, if they have more customers because the price has dropped, what happens to demand? Nothing - (price does not change the demand plan). However, if the number of leads changes, the demand changes. Four circumstances may change the number of potential consumers: population change If new housing developments are built in an empty area behind a small shop, the number of potential consumers will increase and demand will increase. expanded marketing area Coors beer used for sale only to the West. President Ford used to have him fly to the House because he couldn't buy it somewhere else. Then, as Coors expanded to all states, demand rose because now there are more potential consumers. new competitor (changes in the demand curve faced and individual trades, but not the market demand curve) If a new liquor store moves across the street from an existing store, the demand for alcohol of an existing store will decrease because now there are fewer potential consumers because some consumers walking around the store will have already bought something in the new store. change of legitimate consumers (i.e. drinking age) If they lower the drinking age, there will be more potential drinkers of vodka, so the demand for vodka will increase. T -- tastes and preferences There are hundreds of factors that affect the amount of vodka sold. We don't want to remember hundreds of different determinants for each product, so economists group everything else into tastes and preferences. Taste and preference really refers to everything else. Anything that increases the consumer's preference for a product will increase the demand for that product. This will include advertising and fads. Supply Home Supply is harder for students to understand than demand. We are all consumers but few of us own a company (suppliers). So, don't forget to think of yourself as a business owner when we discuss the offer. Definition Delivery is a schedule that shows the different quantities businesses are willing and able to offer for sale at different prices in a given time period, ceteris paribus. A shipment is not a quantity that is available for sale. This is the way the term is often used in the popular press. The offer is the entire schedule with many prices and many quantities. As with demand, there is a difference between changing the quantity delivered and changing the supply itself. So, if the price increases, what happens to the offer? The best wrong answer would be to increase supply, but it isn't. The price does not change the offer, it changes the quantity delivered, because delivery means the whole schedule with different prices and different quantities. The delivery plan and the curve below is a hypothetical timetable for pizza deliveries. If we plot these points (remember any point on the chart simply represents two numbers) we get the chart below. Assuming that there are quantities and prices between those on the plan we get a bid curve. Right of supply The supply law states that there is a direct relationship between the price and the quantity delivered. In other words, when the price increases the quantity delivered also increases. It is represented by upward oblique lines from left to right. Why? Why is the supply law true? Why is the menu curve facing up? Why will businesses deliver more pizzas only the ID price is higher? I think it's just common sense. If you want pizza places to work harder and longer and produce more pizza, you have to pay them more for pizza. But economists, like social science, want to explain common sense. We know that businesses behave like this, but why? There are two explanations for supply law and both have a bee with increasing costs. Businesses require a higher price for pizza to produce more pizza because they have higher pizza costs. Why? Firstly, costs are increasing because of rising costs from the law. In a previous lecture, we explained that the curve of production possibilities is concumpive to origin due to the law of rising costs. the cost increase law is true because not all sources are identical. Let's just say the pizza spot is opening. The owner figures that they will need five employees. After inserting ads into the paper there are twenty applicants. Five already had experience working in a pizzeria. They came to the interview clean and on time. Another fifteen had no work experience. Many arrived late. Several of them were caught steel pepperoni on the way out. One spilled flour all over the floor. Which applicants will be accepted? Of course it will be five with experience and another fifteen will be rejected because it would be too costly to hire. Now, if pizza instead wants more pizza will need more staff. This means that they will have to hire some of those who were rejected because they were more expensive (less experienced, etc.). So they will hire more expensive employees only if they can get a higher price to cover higher costs. That's one explanation for why the bid curve is upwards. Secondly, costs are increasing because some resources are set. This shouldn't make sense to you. Why would costs increase if we used the same amount of a resource? Well, let's say the size of the kitchen and the number of furnaces (capital resources) are determined. That means they won't change. Now, if we want to produce more pizza, you will need to cram more staff into the same size kitchen. As they bump into each other and wait for the oven to be free they still get paid, but the cost of pizza increases. Therefore, they will not produce more pizza if they can get a higher price to cover these higher unit costs. So the supply curve should be upwards. Supply on the market supply market is the horizontal sum of the individual supply curves. Instead of looking at how much pizza there is one place for pizza willing and able to produce at different prices (individual offer), we keep prices the same and add a lot of extra places to pizza. Prices remain the same, but the quantity increases because there are more pizza suppliers. So the pizza menu on the market is further to the right (horizontal) than the individual pizza instead of the delivery curve. price determinants of the product price (P) Economists stress the importance of the price in determining how much will be produced. That's why they put the price on the supply chart, but there are other things that affect how much the product will be produced in addition to the price. When we developed the pizza menu curve, we used the assumption ceteris Paribus. we assumed that all other things remained constant. For example, there were no new technological breakthroughs, resource prices remained the same, or no change in taxes. All other factors remained the same - only the price and quantity delivered changed. But there are other determinants of how much the business offers in addition to price. We call it non-price determinants of the offer. Disproportionate supply determinants Economists classify disproportionate bid determinants into 6 groups: a. Pe -- expected price b. Pog -- the price of other goods also produced by company c. Pres -- price of resources d. T --technology e. T --tax and subsidies f. N -- number of manufacturers/sellers Non-price determinants of deliveries: Pe, Pog, Pres, Tech, Tax, Nprod Two types of changes involving a change in delivery in the quantity delivered (Qs) Change in the quantity delivered caused only by a change in the price of the product. It is represented by movement ALONG one supply curve. Change shipment (S) Change is a shift in the delivery curve because there is a new delivery schedule. The shipment curve moves left or right (horizontally) because the prices remain the same, and only the quantity and quantity change on the horizontal axis. Be sure to draw arrows right and left. Many students want to draw arrows perpendicular to the supply curve. Don't do it. Always draw arrows horizontally because it indicates that the prices are the same, and only the quantities change. Also, if you draw the arrows perpendicular to the supply curve and the up arrow will indicate a decrease in the shipment. This could be confusing! The change in supply is due to a change in the prices of the supply determinants. These are the factors that we assumed were constant when we used the ceteris paribus assumption to develop the supply curve. Menu increase If there is an increase in supply (S), the supply curve moves to the right. At the same prices, the quantities delivered will be greater Reduction of supply If the offer (S) is reduced, the bid curve will be moved to the left. At the same prices, the quantities delivered shall be smaller. Increasing the menu does not move the chart up or up and to the left. It moves horizontally to the right. Be sure to draw an arrow horizontally. If you draw an arrow perpendicular to the supply curves as you scroll the chart in the wrong way! Look for the black arrows in these charts. They're horizontal. This is important, please always draw arrows horizontally. This is particularly true when we are discussing a change of offer later. The drop in supply does not move the chart down or down and to the right. Moves horizontally to the left. Changes in shipments are due to a change in the non-price determinants of the offer Pe -- change in the expected price of Pog -- change in the price of other goods also produced by Pres - change in the price of Resources Tech - change in technology Taxes - change in taxes and subsidies Nprod - change in the number of manufacturers / sellers Let's take a look at these determinants on in time. We need to know how they change the supply curve if we are to use the supply and demand instrument to understand how prices are set in a market economy. Pe – expected price If a business expects to be able to get a higher price in the future, what happens to the offer today? They will be less willing to sell products there today because they will know that if they were expecting they could get a higher price, so the offer today would be reduced, shift left. (Remember that a shipment is not a quantity that is available for sale.) Let's say you want to sell you a car, someone's offering you $1,500 today, and you're going to accept it. You are willing to sell your car for $1500 today. Then, someone says they will dive you $2000 for your car if you could wait three days. Now you expect you can get a higher price ($2000) in so you probably won't want to sell your car for $1500 today. Pe S today Pe S today Pog - the price of other goods also produced by the company First, think of a business that produces two products, such as farmers who can either grow corn or soybeans. Then the price of one increases, which happens to the offer of the other. So if the price of soybean increases, what happens to the supply of corn? If the price of soya beans increases the supply of maize will be reduced. The supply curve of corn shifts to the left as farmers plant more soybean and less corn. P Soybeans S Corn P Soybeans S Corn If the price of soybeans increases, what happens to the supply of soybeans? - - - Nothing. Remember that the price does not change the shipment, it changes the quantity delivered. so if the price of soya beans increases, we get an increase in the quantity delivered (same delivery curve, higher quantity). The cost of resources (Pres), improved technology (Tech) and taxes and subsidies (tax) all affect supply, because they change the cost of production costs S (shifts left) cost S (shifts right) Pres - price of resources If the price of the resource used to produce the product increases, this will increase the cost of production and the manufacturer will no longer be willing to offer the same quantity at the same price. They will want a higher price to cover the higher costs. This moves the power curve to the left (S). For example: if car workers' unions receive a significant increase in wages, this will increase the cost of producing cars and reduce the supply of cars (S). P Autoworkers Wage Cost of Making Cars With Cars Pres Cost S Pres Cost With Tech--Technology Does Better Technology Increase or Decrease Product Production Costs? Improved technology reduces costs and thus increases supply. If the technology had not reduced costs, it would not have been used. If there is a high-tech expensive way to produce a product and a low-cost, low-tech, way to produce the same product, companies that use low-cost methods will be able to sell the product at a lower price and beat high-cost manufacturers. Better technology costs S What has technology improved to do with the cost of medical care? Improved medical technology has increased medical costs, but has also changed the outcome. Let us say, for example, that there is a disease in which half of patients die with existing low-cost technology. Now that they invent a new high-cost technology that will save all lives, which technology will be used? Of course, the new high-cost technology will be used, but the product has changed. One of the products is when half the patients die, the other medicine is when all the patients live. We cannot put two products on one supply curve. Let us use one more medical example. Why do doctors still use low-tech stethoscopes? used similar stethoscopes a hundred a few years ago. Isn't there a high-tech electronic stethoscope? yes, it is, so why don't the doctors use it? Because it is more expensive and gives the same results. Doctors will use cheaper technology if the results are the same. but obstetricists are using a more expensive high-tech stethoscope because it gives them better results. Low-tech stethoscopes can not always select the heartbeat of the fetus. newer high-tech and higher-cost electronic stethoscopes can. The product will change. Improved technology will thus reduce costs and increase supply, otherwise it will increase costs and change the product that we cannot put on a single chart. Taxes --taxes and subsidies Here we will discuss excise duties. Excise duties are the unit tax levied on the production or sale of a product. Examples include a tax on petrol (so much per gallon), a tax on cigarettes (so much per pack) and an alcohol tax (so much per bottle). Let's talk about the gasoline tax. If the petrol tax is raised will this have an impact on the demand for petrol or the supply of petrol? If you said demand – then which non-price determinant of demand has changed? remember the price does not change demand. If the gasoline tax increases, it will increase the cost of selling gasoline, and reduce supply. Taxes Cost With Taxes Cost S Who Pays Gasoline Tax? Who pays wages to the employees of the service station? Whether you answer the consumer of the service station owner, you must give the same answer to both questions. Both taxes and wages are costs for the manufacturer or seller. Higher taxes on petrol do not shift the demand curve, but can lead to a higher price and thus a reduction in the required quantity. Subsidies are the opposite of taxes. Instead of paying the government, the government pays the company. Subsidies are less than taxes. But let's just say the government wants to encourage the use of solar power, so give a subsidy (or raise one) to solar power installations. this will reduce the cost of producing or selling equipment because they will receive a refund (subsidy) from the government when one is produced or sold. Cost of subsidies S Cost of subsidies S N - number of producers/sellers Increase in the number of producers of the product will increase the supply of this product. If the number of computer manufacturers increases, the supply of computers (shift to the right) increases. Nprod S Nprod S Market Equilibrium - Equilibrium price and quantity Now we are ready to discuss prices. At the top of this online lecture I said: In capitalist society prices are determined by the interaction of demand and supply. As prices are so important, we need to better understand how they are designed. Why is the price of gasoline $1.59 per gallon. Why does a stick cost $0.75? Why is the price of plywood usually $10 per letter, but $30 per letter after a hurricane? Market Balance means that there is no further tendency to change. When something is in balance, it's calm, it doesn't change. Like a pendulum. When it's in the water, it changes. We call it balance. Eventually, he stops swinging and strikes a balance. Prices do something similar. They move towards balance, where they come to rest and do not change. But just as you can push the pendulum and cause it to swing and then slow down and reach balance again, prices can be pushed and they turn into a new balance. It's the non-price determinants of demand and supply that push prices to a new equilibrium. We call it market equilibrium. The equilibative price shall be the price at which the quantity applied for is equal to the quantity delivered. (Market clearing or market price is another name for the equilibly price.) Qd=Qs Sometimes I hear people say that balance is where demand equals supply. It is not possible for the entire demand curve to be the same as the entire supply curve because the demand curve is falling downwards and the supply curve is tilted upwards. (NOT: D = S), but there is one price where the quantity requested is equal to the quantity delivered.   Market Disequilibrium Why will the price of pizza be $9? Well, let's take a look at what happens if the price is not in balance. If the price is USD 12, the quantity requested is 2000 (Qd = 2000) and the quantity that businesses are willing to deliver is 4000 (Qs = 4000). The result will be a surplus of 2000 pizzas (4000 - 2000 = 2000). If there is a surplus (available more than consumers are willing to buy), the price will change - a decrease. Twelve dollars is not a balance - it will change. See chart. If the price is USD 6, the quantity requested is 5000 (Qd = 5000) and the quantity that businesses are willing to deliver is 2000 (Qs = 2000). The result will be a shortage of 3000 pizzas (5000 - 2000 = 3000). If there is a shortage (consumers are willing to buy more than is available), the price will change - an increase. Six dollars is not a balance - it will change. See chart. Changes in demand and supply Now that we can find a balance and know what is causing the change in supply or demand, we will see what happens to the equilibrium price and quantity if supply and/or demand change. When we do that, we'll put it all together. It all starts with a change in one of eleven non-price determinants: DEMAND: Pe, Pog, I, Npot, T SUPPLY: Pe, Pog, Pres, Tech, Tax, Nprod, so you need to know how they affect the charts. We discussed this above and will review it again shortly. Here, let us focus only on what happens to price and quantity if demand and/or supply changes. Case 1: D changes and supply will remain the same if demand increases (shifts to the right), what impact this will have on price and quantity. Be sure to draw charts. You can probably guess what happens to the price and and get it right quite often, but why guess when you can draw charts and get it right almost all the time? BE SURE TO DRAW CHARTS! So, if demand increases and supply stays the same you get (see chart): Demand increases: increase in quantity increases If demand decreases (shifts left) and supply stays the same as you get (see chart): Demand decreases: price decreases the amount decreases This is quite simple, but the key to understanding this are non-price determinants of supply and demand. We'll examine them soon. Case 2: With change and demand remains the same if supply increases (shifts right), what impact it will have on price and quantity. Be sure to draw charts. You can probably guess what happens to price and quantity and get it right quite often, but why guess when you can draw charts and get it right almost all the time? BE SURE TO DRAW CHARTS! So, if supply increases and demand stays the same you get (see chart): Increase in supply: price decreases the amount increases if supply decreases (shifts left) and demand stays the same you get (see chart): Supply decreases: price increase amount decreases Case 3:D and S how to change What if supply and demand change at the same time? That is, what happens to price and quantity if non-price determinant and supply and non-price determinant change demand shifts charts at the same time? 1. S increases, D drops do not look!!! Chart them right now and determine what would happen to price and quantity if supply increases and demand decreases. In a face-to-face class I would make my students do it themselves and tell me what happens to P and Q. So let's do it in this distance learning class. What happens to price and quantity if supply increases (shifts to the right) and demand decreases (shifts to the left)? - - If the supply increases and demand decreases: the price decreases the quantity is uncertain the price will decrease, but we can not say what will happen to the quantity. The quantity could be increased, reduced or left the same. What happens to quantity depends on the extent to which supply and demand curves change, and since we have not been told, we cannot determine what will happen to the quantity. The amount is uncertain. See chart below where we can see that if demand drops a little (D2), then the equilibly state will increase, but if the demand curve decreases a lot (D4), the equilibly amount will decrease. 2. With decreases, D increases What happens to price and quantity if supply decreases and demand increases? CHART IT! - - - - If supply decreases and demand increases: the amount of price increase is uncertain The price will increase, but we can not say what will happen to the quantity. The quantity could be increased, reduced or left the same. What happens to the quantity depends on how much and demand curve shift, and because we have not been told, we can not determine what happens to the quantity. The amount is uncertain. Try charting different shifts in D and S and see what happens to the quantity. 3. With increases, D increases What happens to price and quantity if both supply and demand increase (shift to the right)? Chart IT before scrolling (or looking) below on this page. - - - - If supply increases and demand increases: the increase in the price of the quantity is uncertain The quantity will increase, but we cannot say what will happen to the price. The price could increase, it could be reduced or it could remain the same. What happens to the price depends on the extent to which the supply and demand curves change, and since we have not been told, we cannot determine what will happen to the price. The price is uncertain. See chart below where we can see that if the bid increases a little (S1), then the equilibly price increases, but if the bid curve increases a lot (S3) the equilibative price will decrease. 4. With decreases, D decreases What happens to price and quantity if supply decreases and demand increases? CHART IT! - - - - If supply decreases and demand decreases: the amount of price decreases is an indeterminate quantity is reduced, but we can not say what will happen to the price. price could increase, be reduced or remain the same. What happens to the price depends on the extent to which the supply and demand curves change, and since we have not been told, we cannot determine what will happen to the price. The price is uncertain. Try charting different shifts in D and S and see what happens to the price. Using supply and demand now let's put it all together. We can use our supply and demand model to understand why prices are changing. It all starts with non-price demand determinants (Pe, Pog, I, Npot, T) and non-price supply determinants (Pe, Pog, Pres, Tech, Tax, Nprod). These are the factors in the real world that cause price changes. We will use supply and demand curves to illustrate how changes in these disproportionate determinants will affect the price and quantity of the ceteris paribus product. Before you guess, answer the following questions: (1) Which determinant has changed? 2. Will this affect supply or demand? (3) Will supply or demand increase or decrease? (4) CHART IT! What happens to price and quantity? EXAMPLE 1 Suppose the chart above represents a market for computers. The equilibative price is P1 and the equilibrate quantity is Q1. What happens to the price and amount of computers if consumer revenues increase ceteris paribus? Our goal is to understand what happens to price and quantity, but not just guess. If you just think about it and try to figure it out in your head, you'll probably get it right a lot of the time. But wouldn't you rather get it right the most, or so, time? We now have a tool (supply and demand) that we can use to better understand in price and quantity. So use the tool. Once you get used to it you will see its benefits. Answer four questions and the chart (tool) will give you an answer. (1) Which determinant has changed? Sometimes it's obvious. In this example, it's income. 2. Will this affect supply or demand? Income is a determining factor in demand. But other times it's harder. Pe and Pog, for example, are both demand and supply determinants. (3) Will supply or demand increase or decrease? This is the key to using the tool correctly. We discussed above how non-price determinants shift curves. Computers are normal goods. This means that if revenue increases, the demand for computers will increase. (4) Finally, CHART IT! the chart will tell you what happens to the price and quantity. See chart below. The chart shows that if demand increases, the price will increase and the quantity will increase. A: So if consumer incomes increase, ceteris paribus, the price of computers will increase and consumers will buy more. EXAMPLE 2 Suppose the graph above illustrates the market for electronic calculators. If improved technology reduces the cost of making calculators, what happens to the price of calculators and the quantity sold? (Be sure to use our tool.) (1) Which determinant has changed? TECHNOLOGY (2) Will this affect supply or demand? SUPPLY (3) Will supply or demand increase or decrease? MENU WILL INCREASE (move right) (4) CHART IT! What happens to price and quantity? A: If the technology for making calculators improves, the price of calculators will decrease and the quantity sold will increase EXAMPLE 3 Let's do one more way. If the chart above for Nintendo 64 Video Game Systems, what happens to price and quantity if the price of personal computers is reduced? (1) Which determinant has changed? Pog - the product on the chart is Nintendo Video Gaming Systems and the price of another product, computers, has changed (2) Will it affect supply or demand? Non-price determinant, Pog, is a determining factor for both supply and demand. We said with the offer that it refers to the price of other goods produced by the same company. Does Nintendo also produce computers? Not. With demand, Pog refers to the price of compensation and the price of complements. Are video game systems and home computers refunds or compliments? Most people would say they're surrogates. If you buy a new home PC, you can play games on your computer and you might not buy a new video game system. So, if there is a reduction in the price of personal computers, the demand for video gaming systems will change. (3) Will supply or demand increase or decrease? if the price of personal computers has been reduced, the demand for VIDEO GAME SYSTEMS will decrease (shift to the left). (4) CHART IT! What happens to price and quantity? A: If there has been a reduction in the price of personal computers, the demand for video game systems will decrease (shift left) and the price of video game systems will decrease and the amount sold will reduce Real World Examples Real World determinants are not so easy to choose. The tool still works, but it requires a little more practice. If you read a news or internet news article about a product whose price and/or quantity has changed, you can use supply and demand to analyze why the price and/or quantity have changed. We know that changes in disproportionate demand and supply determinants cause prices and quantities to change. So, to understand why, we need to look for non-price determinants in the article. REAL-WORLD EXAMPLE 1 Below is part of an article from CNNFN.COM Read the article looking for the cause of price changes and then use our graph of supply and demand to illustrate what happened. This will be similar to the extra credit questions that you will have on Exam 1. Remember to use our tool correctly: (1) Which determinants have changed? 2. Will they affect supply, demand or both? (3) Will supply or demand increase or decrease? (4) CHART IT! Then show what happens to price and quantity? Top PC makers cut prices Compaq erases old models; Dell passes on lower cost components February 1, 2000: 2:44 p.m. ET NEW YORK (CNNfN) - Two of the world's largest computer manufacturers on Tuesday announced they have cut prices on their commercial desktop computers.   Compaq, the No 1 PC maker, said it cut prices by up to 13 per cent on most of its commercial Deskpro series computers. Price reductions are being scored for nine new Deskpro models. .   Dell (DELL: Research, Estimates), the world's second largest computer supplier, said it was cutting prices because of the cost of the components it uses to make them also fall.   Effective Monday, a Dell Precision WorkStation 210 with a Pentium III processor running at 650 million cycles per second will sell for $1,740, a 17.1 percent reduction, the company said. Dell also said it had cut prices for mid-range models in its Precision WorkStation 410 range by as much as 15.5 percent. (1) Which determinants have changed? The article says Dell (DELL: Research, Estimates), the world's second largest computer supplier, said it was cutting prices because of the cost of the components it uses to make them also fall. This indicates that there has been a change in the price of resources (Pres) (2) Will they affect supply, demand, or both? SUPPLY (3) Will supply or demand increase or decrease? MENU WILL INCREASE (move right) (4) CHART IT! Then show what happens to price and quantity? A: As the article says, the price is falling. REAL-WORLD EXAMPLE 2 Below is part of the article CNNFN.COM read the article looking for the cause of the price change and then use our supply and demand chart to illustrate what happened. This will be similar to the extra credit questions that you will have on Exam 1. Remember to use our tool correctly: (1) Which determinants have changed? 2. Will they affect supply, demand or both? (3) Will supply or demand increase or decrease? (4) CHART IT! Then show what happens to price and quantity? Airline customers pay for fuel With demand for seats still strong, most carriers announce fuel surcharges Staff Writer Chris Isidore February 21, 2000: 3:54 p.m. ET NEW YORK (CNN) - Airlines are finding a source of relief for oil price shocks that they've rarely tapped before: their passengers.   With oil prices hitting a post-Gulf war high Friday, three other carriers - US Airways, America West and Trans World Airlines - announced surcharges, charging customers $20 for a return ticket on virtually all domestic flights.   That meant eight of the nine largest carriers in the country now had fees, with only No. 7 Southwest Airlines (LUV), a Dallas-based discount carrier, postponing at this time.   Demand for seats opens the door Surcharge is unique in its adoption of the typically cutthroat aviation industry, and is a sign that demand for air travel remains strong.   The Air Transport Association reports that 71.3 percent of its members' seats were occupied last year, the best rate in the history of passenger aircraft travel.   With demand remaining strong despite the spike, airlines are in a better position to look for higher fares.   In the past, when we had a huge run in fuel, we also had a recession, said David Swierenga, THE ATA's chief economist. These two things have put the industry together. Now the economy is progressing and carriers will have a little more flexibility on the price side. . . . ANSWER: I highlighted in red important parts of this article. Let's analyze each one. With oil prices hitting a post-Gulf war high Friday, three other carriers - US Airways, America West and Trans World Airlines - announced surcharges, charging customers $20 for a return ticket on virtually all domestic flights. (1) Which determinant has changed? COST OF RESOURCES. Oil (fuel) is a resource used by the aviation industry (2) Will they affect supply or demand? SUPPLY (3) Will supply or demand increase or decrease? DELIVERY IS REDUCED (shift left) (4) CHART IT! Then show what happens to price and quantity? So due to higher fuel prices are higher prices, but our chart shows the amount of decreases and the article suggests that the amount remained the same or somewhat increased. therefore, we should continue to search for which have changed. The article also says the surcharge is unique in its acceptance of the typically thud airline industry, and is a sign that demand for air travel remains strong. And now the economy is progressing. (1) Which determinant has changed? INCOME (The economy is advancing means that incomes are growing.) 2. Will they affect supply or demand? DEMAND (3) Will supply or demand increase or decrease? Demand will increase (assuming air travel is a normal good) (4) CHART IT! Then show what happens to price and quantity? So, as a result of a good economy, we would expect prices to rise and passenger numbers to increase. NOW LET'S PUT BOTH CHANGES ON THE SAME CHART. To see the overall effect of all changes, you need to do it. We have a drop in supply caused by higher resource prices and an increase in demand caused by higher revenues, resulting in higher prices (see chart) and the quantity remains about the same as the article states (therefore, I have shifted the curve to the same amount). Other articles that you can analyze yourself: Supply, demand and economic efficiency around the world countries are undertaking structural adjustment programs that eliminate price controls set by governments and allow the market (supply and demand) to set prices. Why? Why do countries let the market set prices and not the government? Please don't think it's still not universal, but it's definitely a trend. This is due to a better reduction of the deficiency. A purely competitive market economy is an efficient economy, both allocated and productive, but there is no mechanism for achieving equality or full employment. (5Es). EQUITY - There is nothing built into capitalism or a market economy that would guarantee the achievement of equity. Remember, economists can't tell us when we've made equity. The distribution of income, which maximises the satisfaction of the company, cannot be calculated, so it is a question left to the government. Economists may explain that equality is good for society (as we did in the 5Es lecture), but they can't tell us when we've achieved justice. PRODUCTIVE EFFICIENCY – Competition or capitalism through freedom of entry and exit ensures that production is at the lowest possible average cost and that there is no waste in production. Competition ensures that production takes place at minimal cost or other undertakings are able to produce and sell the product at a cheaper price. Inefficient businesses beat their productively efficient competitors. If there is competition, the capitalist economy will achieve productive efficiency. ALLOCATIVE EFFICIENCY - Location efficiency creates the right amount of different goods and services to maximize company satisfaction. Will the business produce the amount that the company wants? Businesses aim to maximise their profits. Businesses produce a profit maximizing quantity. This is the equilibrate quantity where Qd = Qs . That's what we get in a market economy. Businesses are not trying to be efficient, they are trying to maximise their profits. If a business could make more money by being inefficient, it would be inefficient. The business seeks to produce profit maximizing quantity, whether it is allocated efficiently or not. But the company wants an allocatively effective amount. We can use the benefit-cost analysis we studied in Chapter 1 to draw a chart that shows an allocatedly effective quantity, or a quantity that would maximize company satisfaction. Remember that alloding efficiency means that we use our limited resources to produce a number of goods and services that maximize company satisfaction. For example, use resources to produce more MP3 players that people want, and fewer CD players that they don't want. Benefit Cost Analysis is a selection of all possible alternatives where marginal benefits are higher than marginal costs to choose all where: MB > MC up where: MB =MC, but never where: MB < MC We made the best decision when we stop at an alternative where MB=MC. (Review page 13 textbook, see REVIEWS, and use a discussion committee if you still don't understand this important concept.) The allocated effective quantity of goods where the company receives maximum satisfaction is the amount in which marginal social benefits (MSBs) are equal to marginal social costs (MSCs). MSB = MSC. Marginal social benefits (MSBs) are additional benefits that a company (or a consumer who is part of a company) receives when one or more units of goods or services are consumed. MARGINAL SOCIAL COASTLINE is an additional cost for a company (or for a manufacturer that is part of a company) when one more unit of good or service is produced. We find that if there are no negative externalities (spillover costs) then: S=MSC, and if there are no positive externalities (side benefits) D=MSB,(We will study externalities in Chapter 4) THEREFORE: if D=MSB and if S=MSC, when businesses produce profit maximizing quantity (where Qd=Qs) they will also produce an allocated effective quantity (where MSB=MSC). Capitalism achieves all-proactive efficiency! This is why countries are abandoning price controls that make it possible to maximise the profits of businesses in order to set their own prices. As long as there is competition, as businesses try to maximise their profits, they will also achieve all-proactive efficiency and there will be no shortages and no surpluses. DOES D = MSB? Your demand curve for any good is based on the marginal benefits (usefulness) you would receive from consuming various possible good values, as we discussed when we explained the law of demand. Our assumptions mean that the marginal usefulness you receive from consumption is also marginal received by the company. This means that your profit is also the profit of the company because you are a member of the company. When we sum up all consumer requirements, we derive the market demand curve for an industry product that is also a marginal social benefit (MSB) for the whole company, from having one more unit of good. Therefore, D = MSB. Does S=MSC have a delivery curve for a product that shows different quantities that an enterprise is willing to produce to measure additional costs for the company? There are two ways we can approach this. Firstly, as the bid curve represents the cost of resources for the company. It costs them more because they produce more, so they need a higher price to be able to get these higher costs - that explains the Supply Act. But when a company uses more resources to produce more it's also a cost to the company because the company loses use of that resource. Remember that all costs in the economy are casual costs. Just as more product is produced marginal (extra) costs for the company for one more unit increases. Another way to look at it is to discuss what could be produced. If an enterprise produces more product using multiple sources, then less of something else is produced, i.e. there is a price of opportunity. If we apply the drop law to marginal utilities then as a business produces more of one product then the company will have to accept fewer other products. What happens to the marginal instrument received from the last unit if less is consumed? If less is consumed then the marginal utility is higher. As undertakings produce more product A, they then produce less product B. Therefore, as undertakings produce more of product A, the cost to the company of product A increases because, since undertakings produce more of product A, they have to produce less of product B. SUMMARY: If a purely competitive industry is in long-term equilibrium, the quantity delivered is equal to the quantity requested (this is the maximising amount of profit) and therefore the marginal social costs are equal to the marginal social benefit (MSC = MSB) , this is an allocated effective quantity. The industry produces where the marginal social benefit from the last unit produced is equal only to the marginal social costs of the resources needed to produce that unit of the product. This concept is shown in the figure below. MSB = msc status is optimal from the company's point of view. This is the amount in which the satisfaction of the company will be maximized or the allocated effective quantity and deficiency will be reduced as much as possible. Consider an output level slightly lower than the above effective quantity. The social benefit (MSB) per unit is higher than the cost of resources needed to produce a little more good (MSB>MSC). So society as a whole could if more resources were used to produce this good. And in a competitive industry, they will. If this small quantity were originally produced and sold, existing undertakings in the competitive sector would have an economic gain. This would cause industry to grow until an allocatedly efficient amount is achieved. The adjustment process is simply reversed if industrial production exceeds the effective level of production. WHY ARE MARKETS EFFICIENT? Businesses will produce profit maximizing quantity. This is the equilibrate quantity where Qd = Qs (see chart below on the right). That's what we get. The company wants an allocated effective quantity. This is the quantity where MSB =MSC (see chart above left). That's what we want. If there are no negative externalities (spillover costs) S=MSC, and if there are no positive externalities (side benefits) D=MSB, THEREFORE: WHAT WE GET= WHAT WE WANT AND SELF-INTEREST, MAXIMIZING PROFIT, BUSINESSES END UP DOING WHAT'S BEST FOR THE COMPANY – achieving allocation efficiency – as if there is some invisible hand keeping their decisions. SUMMARY: Businesses will produce profit maximizing or equilibrium market quantity - the quantity where Qd = Qs; (WHAT WE GET) The company wants an allocated effective quantity - the quantity where MSB = MSC ; (WHAT WE WANT) WHAT DO WE GET = WHAT DO WE WANT IF: Market demand = marginal social benefits (D = MSB) (and this applies, if there are no positive externalities (spillover benefits)) Market supply = marginal social costs (S = MSC) (and this is true if there are no negative externalities (spillover costs)) Therefore, if there are no negative externalities (spillover costs) and no positive externalities (spillover advantages) competitive markets (capitalism) achieves all-proactive efficiency what we get = what we want This is the invisible hand of capitalism. In a market economy with no positive externalities (spillover benefits) and no negative externalities (spillover costs): maximizing profit or market equilibly (what we get) will be the same as the allocation effective amount (what we want) Adapted from microeconomy by Ralph T. Burns and Gerald M. Stone, Harper Collins, New York 1993, p. 210-212 Is ticket scaling good or bad? (From textbook p. 55): Consider this ... Ticket scalping: Bum Rap! 1. Scalping refers to the practice of resale tickets at a higher-than-original price, which often happens with athletic and artistic events. Is ripping off justified? 2. Ticket sales are voluntary-like buyers and sellers must feel they will gain or would not agree to the transaction. 3. The scalping market simply redistributes assets (tickets) from those who value them less than money to those who value them more than the money they are willing to pay. 4. Sponsors may be injured, but if so, they should have tickets above. 5. Viewers are not harmed, according to economic theory, because those who want to go the most are still tickets. 6. Conclusion: Both the seller and the buyer benefit and the sponsors of the event are the only ones who can lose, but this is due to their own error in prices and they would lose out from this error whether scalping occurred or not. Efficient allocation of resources – productive and allocative efficiency 1. Competitive markets create productive efficiency - producing any particular good in the least costly way. Sellers who do not achieve the least cost combination of inputs will be unprofitable and will have difficulty competing in the market. 2. The competitive process also creates an all-over efficiency that creates a combination of goods and services that society most appreciates. 3. Alloding efficiency requires productive efficiency to exist. Productive efficacy can occur without the allocation of efficacy. Goods can be produced by the least costly method without being the most wanted company. 4. All-purpose and productive efficiency occurs at a steady price and quantity in a competitive market. Resources are not over- nor under-replaced on the company's wish. ANSWERS Market offer: correct answer B [RETURN] [RETURN]

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