Market Economy

Demand
Supply
Price

MARKET ECONOMY
• Recall that a market is an arrangement through which buyers/sellers communicate in order to trade goods/services
• Allocation problem - how do we distribute (allocate) these scarce resources to all those who want them
• MARKET SYSTEM - has a mechanism that deals with this allocation problem ——PRICE
• There are a couple of different market systems - the one we will look at now is a competitive market, where there are a large number of buyers and sellers
• DEFINITION Price is the exchange value of a commodity; it is the power of a commodity to command some other commodity, usually money, in exchange for itself

DEMAND: THE BUYER’S DECISION
Each one of these will influence how much of a particular item is purchased
Influences of demand:
1) "own" price 2) price of alternative items
3) income 4) expectations of future price changes
5) tastes/preferences 6) population/demographics
7) wealth 8) legality of the purchase
Demand

- **DEFINITION:** The *quantity demanded* is the amount of an item that buyers are willing and able to purchase over a period of time at a certain price, *ceteris paribus*.

- Thus, quantity demanded is a fixed number.

- **DEFINITION:** A *demand schedule* is a table that shows how an item quantity demanded would vary with its own price, *ceteris paribus*.

<table>
<thead>
<tr>
<th>Price ($)</th>
<th>Demanded/wk</th>
</tr>
</thead>
<tbody>
<tr>
<td>A $0.50</td>
<td>9</td>
</tr>
<tr>
<td>B $1.00</td>
<td>8</td>
</tr>
<tr>
<td>C $2.00</td>
<td>6</td>
</tr>
<tr>
<td>D $3.00</td>
<td>4</td>
</tr>
<tr>
<td>E $4.00</td>
<td>2</td>
</tr>
</tbody>
</table>

Demand Curve

The Demand Curve is the graphical representation of the demand schedule.
**Demand Curve**

- **LAW OF DEMAND:** Ceteris paribus, the lower the own price of an item, the greater the quantity of that item will be purchased. (Higher price--- lower quantity demanded)

- Price/Quantity demanded - Negative (Inverse) relationship

- *This is the idea that consumers “WANT MORE FOR LESS”*

- **DEFINITION:** “Demand” is the relationship between price of an item and the quantity demanded, ceteris paribus. (Not a fixed point)

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**Other Influences on Demand**

- The “other” influences on demand - how do they affect demand??

  1) Price of alternative items ---- Substitutes

  2) Income ---- Normal goods

  Inferior goods

  3) Expected price changes

  4) Tastes/Preferences

  5) Pop/demographics

  6) Wealth

  7) Other - legality,weather,etc.

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**Other Influences on Demand**

So what happens when one of these influences changes??

1) When the “own” price changes, this will reflect a movement along the demand curve. This is known as a **change in the quantity demanded.**

2) When one of the “other factors” changes, this will reflect a shift of the demand curve. This is known as a **change in demand.**
OTHER INFLUENCES ON DEMAND

Peer Pressure / Trends
Location of product in the store / convenience
Word of Mouth
Need versus Want
Celebrity Endorsement
Domestic or Imported Product
Region of Country/Seasonal Conditions
Impact on environment
Familiarity of product

SUPPLY: THE SELLER’S DECISION

• Influences on supply (Each of these will influence how much of an item will be supplied):

1) "own" price
2) input prices
3) current technology available
4) prices of other goods that use same resources (inputs)
5) expectations of future prices
6) number of sellers in the market
7) legality of the sale

Quantity Supplied and Schedule

DEFINITION: The quantity supplied is the amount of a good sellers are willing and able to make available in the market over a given period of time, ceteris paribus.

• Thus, quantity supplied is a fixed number for a given price.

• A supply schedule is a table that show how quantity supplied would vary with its own price, ceteris paribus.
Supply Schedule

DVD Rentals

<table>
<thead>
<tr>
<th>Price($)</th>
<th>Supplied per week</th>
</tr>
</thead>
<tbody>
<tr>
<td>M $0.50</td>
<td>1</td>
</tr>
<tr>
<td>N $1.00</td>
<td>2</td>
</tr>
<tr>
<td>P $2.00</td>
<td>4</td>
</tr>
<tr>
<td>Q $3.00</td>
<td>6</td>
</tr>
<tr>
<td>R $4.00</td>
<td>8</td>
</tr>
</tbody>
</table>

Supply Curve and Schedule

The Supply Curve is the graphical representation of the supply schedule.

More on Supply

• **LAW OF SUPPLY** Ceteris paribus, the higher the price of a good, the greater the quantity of the good sellers will supply.

• Price/Quantity supplied - Positive (Direct) relationship

• **DEFINITION** Supply is the relationship between price and quantity supplied.
More on Supply II

QUESTION: Why does higher price lead to higher quantity supplied?

ANSWER: Sellers seek to maximize net gains from their activities – 2 ways to see this.

1) Opportunity cost example
2) Production cost example

The “other” influences on supply?

• The “other” influences on supply - how do they influence supply??

1) Input price
2) Technology
3) Change in the price of alternative goods
4) Expected price changes
5) # of sellers in the market
6) Legality of the sale

Shift/Movement of Supply Curve

So what happens when one of these influences changes??

1) When the “own” price changes, this will reflect a movement along the supply curve. This is known as a change in the quantity supplied.

2) When one of the “other factors” changes, this will reflect a shift of the supply curve. This is known as a change in supply.
Market Demand and Supply

• What we have seen previously are “individual” demand and supply schedules, and curves.

• QUESTION: how do we get “market” (“aggregate”) curves so we can look at the market as a whole???
• (NOTE: influences on individual demand/supply curves will affect market curves in the exactly the same fashion)

• MARKET DEMAND - Horizontal sum of all individual demand curves.
• MARKET SUPPLY - Horizontal sum of individual supply curves

Market Demand/Supply

What can we observe from this??

1) Rise in price will bring in more producers

2) There are exceptions to the law of supply - not always does higher price mean more production from an individual.