

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

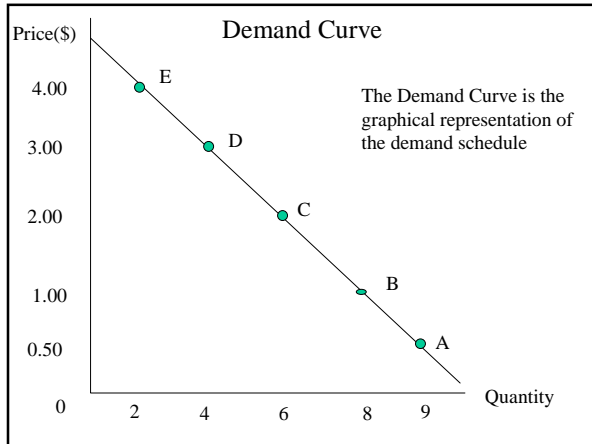
Demand

- **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.

Demand Schedule

Suppose that we are interested in DVD Rentals

	<u>Price (\$)</u>	<u>Demanded/wk</u>
A	\$0.50	9
B	\$1.00	8
C	\$2.00	6
D	\$3.00	4
E	\$4.00	2



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

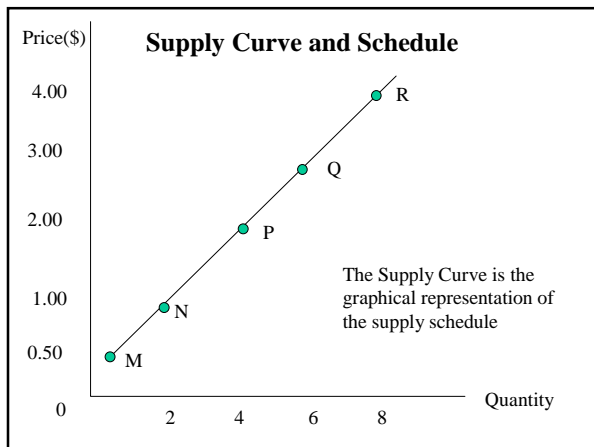
DEFINITION: The **quantity supplied** is the amount of a good sellers are willing and able to make available in the market over a given period of time, ceteris paribus.

- 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

	<u>Price(\$)</u>	<u>Supplied per week</u>
M	\$0.50	1
N	\$1.00	2
P	\$2.00	4
Q	\$3.00	6
R	\$4.00	8



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.
