Supply and demand: markets, prices and price setting

Business

ECO 201 Module 2 - 1 Supply and Demand: Markets, Prices and Price Setting

For this Module 2 of the course, I reviewed the tutorials thoroughly. They were clear

and interesting, with practical and easy-to-follow examples. The basic cost concepts

were easy to understand, but I did try the exercises related to marginal costs and to

diminishing returns, which were harder to understand and apply. The exercises were

useful in clarifying and applying these concepts.

The core lessons of these tutorials include development of a thorough understanding

of the various types of costs, such as fixed, variable and marginal costs; the nature of

diminishing returns; the meaning of supply and demand, and how they interact to determine prices; and the differences between changes in supply and demand, and

changes in quantity supplied and quantity demanded. These are major concepts.

I tried as many of the tutorial exercises as I felt were helpful and useful, and within

the available time limits. When I understood a concept clearly, and could follow the

tutorial examples with no difficulties, I did not pursue the tutorial exercises as a rule.

The core lessons of these tutorials include the following:

COSTS AND DIMINISHING RETURNS

1) Business costs can be grouped into the following categories: total fixed costs,

total variable costs, overall total costs, average fixed costs, average variable costs, average total costs, and marginal costs. Firms need to understand each of these

types of costs, how they are determined, and how to control or reduce them.

2) Marginal costs are the basic determinant of business decisions, and are compared

to product prices at various levels of output in order to find the best profit point.

3) The forces of competition help to hold prices down, as each competitive firm has

to take account of the overall market price and cannot charge more than that.

4) Marginal and average costs may fall as output rises in the early stages of produc-

tion, but such costs must begin to rise beyond some point due to diminishing

returns, which come about because each additional unit of the variable resources

has less and less of the fixed resources to work with.

DEMAND, SUPPLY, MARKETS AND PRICES

5) The forces of supply and demand are perhaps the most fundamental to economics,

and these forces work together in a complex set of markets to determine all prices.

6) The law of demand states the people will buy more at lower prices and less at

higher prices. When the price of a product changes, that causes a change in

quantity demanded. If any other factor changes, that causes a change in demand.

7) The law of supply states the firms will produce more of a product at a higher

price and less at a lower price, because higher prices are more profitable. If the price of a product changes, that causes a change in quantity supplied. If any other

factor changes, that causes a change in supply.

8) Demand and supply interact to eliminate both shortages and surpluses, so that the

equilibrium price, which balances the market,, is determined in each competitive

market. Equilibrium prices and quantities will change whenever demand or

supply change in each market. When the quantity demanded exceeds the quantity

supplied, there will be a shortage and prices will rise; when the quantity supplied

exceeds the quantity demanded, there will be a surplus and prices will fall.

In summary, this unit and these tutorials provide the foundation for the remainder of the course. Costs, diminishing returns, competition, demand, supply, and markets are vital concepts which must be mastered in order to understand micro economics.

THIS REPORT WAS PREPARED WITHOUT ACCESS TO THE THIRD TUTORIAL ON SUPPLY, DEMAND, AND MARKETS.

References:

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McConnell and Brue, ECONOMICS, 15th Edition, McGraw-Hill Irwin, 2007, Chapter 3

McConnell and Brue, ECONOMICS, 15th Edition, McGraw-Hill Irwin, 2007, Chapter 4