

Market forces of demand and supply essay sample

[Economics](#), [Consumer](#)



DEMAND SCHEDULE

A table that shows the relationship between the price of a good and the quantity demanded represents the amount of some good that a buyer is willing and able to purchase at various prices. In economics, it is a table of the quantity demanded of a good at different price levels. Thus, given the price level, it is easy to determine the expected quantity demanded. This demand schedule can be graphed as a continuous demand curve on a chart having the Y-axis representing price and the X-axis representing quantity. Is typically used in conjunction with a supply schedule showing the quantity of a good that would be supplied to the market at given price levels. Then, graphing both schedules on a chart with the axes described above, it is possible to obtain a graphical representation of the supply and demand dynamics of a particular market. Ceteris paribus, the market will reach equilibrium where the supply and demand schedules intersect. At this point, the corresponding price will be the equilibrium market price, and the corresponding quantity will be the equilibrium quantity exchanged in the market.

DEMAND CURVE

A graph of the relationship between the price of a good and the quantity demanded a graphic representation of the relationship between product price and the quantity of the product demanded. It is drawn with price on the vertical axis of the graph and quantity demanded on the horizontal axis. With few exceptions, the demand curve is delineated as sloping downward from left to right because price and quantity demanded are inversely related (i. e., the lower the price of a product, the higher the demand or number of sales).

This relationship is contingent on certain *ceteris paribus* (other things equal) conditions remaining constant. Such conditions include the number of consumers in the market, consumer tastes or preferences, prices of substitute goods, consumer price expectations, and personal income.

A change in one or more of these conditions causes a change in demand, which is reflected by a shift in the location of the demand curve. A shift to the left indicates a decrease in demand, while a movement to the right indicates an increase. A graphic representation of the relationship between product price and the quantity of the product demanded. It is drawn with price on the vertical axis of the graph and quantity demanded on the horizontal axis. With few exceptions, the demand curve is delineated as sloping downward from left to right because price and quantity demanded are inversely related (i. e., the lower the price of a product, the higher the demand or number of sales).

LAW OF DEMAND

A microeconomic law that states, all other factors being equal, as the price of a good or service increases, consumer demand for the good or service will decrease, and vice versa. The law of demand says that the higher the price, the lower the quantity demanded, because consumers' opportunity cost to acquire that good or service increases, and they must make more tradeoffs to acquire the more expensive product. The law of demand states that other factors being constant (*ceteris paribus*), price and quantity demand of any good and service are inversely related to each other. When the price of a product increases, the demand for the same product will fall.

Description: Law of demand explains consumer choice behavior when the price changes. In the market, assuming other factors affecting demand being constant, when the price of a good rises, it leads to a fall in the demand of that good. This is the natural consumer choice behavior. This happens because a consumer hesitates to spend more for the good with the fear of going out of cash.

DEMAND SHIFTERS

Variables other than the price of a good that influence demand

1. Number of Buyers (Population): increase or decrease in people wanting to buy things in the market. 2. Tastes (advertising and consumer tastes): what is in fashion at the time, fads, or stores stop selling things because of the change in season 3. Income: A rise or fall in income that causes consumers to buy either normal goods or inferior goods. Normal goods are any name brand good and inferior goods are any off-brand goods 4. Expectations of Buyers (consumer expectations): what consumers think will happen to goods because of outside services 5. Price of Related Goods: Prices of substitutes and compliments cause changes in demand. A substitute is a similar good to the product that is being produced. It competes for more consumers with the product. A compliment is something you buy along with the product. They come hand-in-hand normally, like peanut butter and jelly.

NON-PRICE DETERMINANTS OF DEMAND

1. Change in the number of consumers in the market for a product [If the number of consumers in the market for a product increases, the demand for

the product will increase. If a new high school is built in the same block as a fast food restaurant, the demand for the fast-food restaurant's products will increase. When the school closes for summer vacation, the demand for the fast-food restaurant's products will decrease.] 2. Change in consumer tastes and preferences for a product [If consumer tastes and preferences for a product change, the demand for the product will change. If fashion magazines are showing short skirts, the demand for short skirts will increase. If fashion magazines show few pictures of short skirts, the demand for these skirts will decrease.] 3. Change in consumer income [If consumer income increases, demand for most goods and services will increase.

The reverse is also true. If consumer income decreases, demand for most goods and services will decrease. For example, if workers at a manufacturing facility sign a new contract that provides a 5% raise, these workers will have more income and their demand for goods and services will increase. If Social Security taxes increase for employees, consumers will have less take-home pay, and as a result, their demand for goods and services will decrease.] 4. Change in the price of related goods—complements [A change in the price of one good can change the demand for another good. One type of related goods is complements—goods that are purchased together.

A decrease in the price of strawberries will cause an increase in the demand for whipped cream. An increase in the price of hamburger will cause a decrease in the demand for hamburger buns.] 5. Change in the price of related goods—substitutes [A change in the price of one good can change the demand for another good. One type of related goods is substitutes—goods

that are bought in place of other goods. If the price of movie tickets increases, the demand for video rentals may increase. If the price of Hamburger Heaven's hamburgers decreases, the demand for Big Burger's hamburgers may decrease.]

DEMAN FUNCTION

A function that describes how much of a good will be purchased at alternative prices of that good and related goods, alternative income levels, and alternative values of other variables affecting demand.

CONSUMER SURPLUS

An economic measure of consumer satisfaction, which is calculated by analyzing the difference between what consumers are willing to pay for a good or service relative to its market price. A consumer surplus occurs when the consumer is willing to pay more for a given product than the current market price.

SUPPLY SCHEDULE

A table which contains values for the price of a good and the quantity that would be supplied at that price. A table or listing showing the exact quantities of a single type of good (or service) that potential sellers would offer to sell at each of a number of varying prices during some particular time period. Supply schedules may be drawn up to reflect the behavioral propensities of a single unique individual, household, or firm — or, more frequently encountered in microeconomic analysis, composite supply schedules for the particular good may be derived by adding up all the supply

schedules of the large number of individuals, households or firms that are active or potentially active as sellers in the market under consideration.

SUPPLY CURVE

graphic representation of the relationship between product price and quantity of product that a seller is willing and able to supply. Product price is measured on the vertical axis of the graph and quantity of product supplied on the horizontal axis. A graph showing the hypothetical supply of a product or service that would be available at different price points. The supply curve usually slopes upward, since higher prices give producers an incentive to supply more in the hope of making greater revenue. In the short run the price-supply tradeoff is greater than in the long run. In the short run, an increase in price will usually cause an increase in supply, but the leading producers can only manage a limited increase. However, in the longer term, new producers enter the market attracted by higher prices, and the supply at each price increases more significantly. In theory, in the most extreme cases, supply can be totally unreactive to price (special cases of very uncompetitive markets), or supply can be infinite at a particular price (e. g. a highly competitive market).

LAW OF SUPPLY

A microeconomic law that states, all other factors being equal, as the price of a good or service increases, the quantity of goods or services that suppliers offer will increase, and vice versa. The law of supply says that as the price of an item goes up, suppliers will attempt to maximize their profits by increasing the quantity offered for sale. An economic theory which states

that a company faced with constant demand will be able to raise prices inversely to shrinking available supply; conversely, the company may lower prices inversely to increased supply. If demand fluctuates, the corresponding price of supply will move in the opposite direction to the demand.

SUPPLY SHIFTERS

Variables other than the price of a good, such as input prices or technological advances that affects the supply

1. cost of inputs
2. available technology
3. profitability of other goods
4. number of sellers in the market
5. producer expectations
6. taxes and subsidies

SUPPLY FUNCTION

A supply function models the relationship between price and quantity with respect to the manufacturer. The mathematical function explaining the quantity supplied in terms of its various determinants, including price; thus the algebraic representation of the supply curve. A function that describes how much of a good will be produced at alternative prices of that good, alternative input prices, and alternative values of other variables affecting supply.

PRODUCER SURPLUS

producer surplus for an individual producer (or retailer) selling a single good

is the difference between the lowest amount the producer would be willing to sell the good and the price the producer actually sold it for. An economic measure of the difference between the amount that a producer of a good receives and the minimum amount that he or she would be willing to accept for the good. The difference, or surplus amount, is the benefit that the producer receives for selling the good in the market.

This is shown graphically above as the area (Producer Surplus) above the producer's supply curve that it receives at the price point ($P(i)$). The size of this area increases as the price for the good increases. Elasticity

A measure of the responsiveness of one variable to changes in another variable; the percentage change in one variable that arises due to a given percentage change in another variable.

ELASTICITY OF DEMAND

– The degree to which demand for a good or service varies with its price. Normally, sales increase with drop in prices and decrease with rise in prices. As a general rule, appliances, cars, confectionary and other non-essentials show elasticity of demand whereas most necessities (food, medicine, basic clothing) show inelasticity of demand (do not sell significantly more or less with changes in price). Also called price demand elasticity.

TYPES OF ELASTICITY OF DEMAND

1. Price elasticity of demand – Price elasticity of demand is the degree of responsiveness of quantity demanded of a good to a change in its price.

Different kinds of price elasticity of demand:

a. Elastic Demand

When the percent change in quantity of a good is greater than the percent change in its price, the demand is said to be elastic. Demand is elastic if the absolute value of the own price elasticity is greater than 1.

b. Inelastic Demand

When the percent change in quantity of a good demanded is less than the percentage change in its price, the demand is called inelastic. Demand is inelastic if the absolute value of the own price elasticity is less than 1.

c. Unitary Elastic Demand

When the percentage change in the quantity of a good demanded equals percentage in its price. Demand is unitary elastic if the absolute value of the own price elasticity is equal to 1.

d. Perfectly Elastic

A consumer will buy all the quantity of the commodity at this price and nothing else at some other price

e. Perfectly Inelastic

Demand remains unchanged whatever be the change in price

Numerical Value

Terminology

Description

Shape of the Demand Curve

Examples

1. Price Elasticity = ∞

Perfectly elastic

A consumer will buy all the quantity of the commodity at this price and nothing else at some other price. Horizontal

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2. Price Elasticity = 0

Perfectly inelastic

Demand remains unchanged whatever be the change in price

Vertical

Medicines

3. Price Elasticity = 1

Unitary elastic

$$\% \Delta Q = \% \Delta P$$

Rectangular hyperbola

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4. $0 < \text{Price Elasticity} < 1$

Inelastic

$$\% \Delta Q < \% \Delta P$$

Flatter

Essential goods

5. $\infty > \text{Price Elasticity} > 1$

Elastic

$\% \Delta Q > \% \Delta P$

Steeper

Luxuries and comforts

Total Revenue Test

If demand is elastic, an increase (decrease) in price will lead to a decrease (increase) in total revenue. If demand is inelastic, an increase (decrease) in price will lead to an increase (decrease) in total revenue. Finally, total revenue is maximized at the point where demand is unitary elastic.

2. Cross Elasticity of Demand – A measure of the responsiveness of the demand for a good to changes in the price of a related good; the percentage change in the quantity demanded of one good divided by the percentage change in the price of a related good. 3 diff. goods affecting cross elasticity

1. Substitute goods – When two goods are substitute of each other, such as coke and Pepsi, an increase in the price of one good will lead to an increase in demand for the other good. 2. Complementary goods – a rise in the price of one good will bring a fall in the demand 3. Unrelated goods – The two goods which are unrelated to each other; if the price of one good rises in the market, it is unlikely to result in a change in quantity demanded of the other good

3. Income Elasticity of Demand – A measure of the responsiveness of the demand for a good to changes in consumer income; the percentage change in quantity demanded divided by the percentage change in income. 2 diff. goods affecting income elasticity

1. Normal goods
2. Inferior goods

DETERMINANTS OF DEMAND ELASTICITY

1. the availability of substitutes: the more substitutes there are for a product, the more elastic its demand. 2. the importance of being unimportant (expenditure's share): if an item represents a small part of the consumer's budget, then less attention is paid to its price (demand is more inelastic). 3. time: the more time consumers have, the more responsive they are to price changes (and demand is more elastic).

ELASTICITY OF SUPPLY

Responsiveness of producers to changes in the price of their goods or services. As a general rule, if prices rise so does the supply. Elasticity of supply is measured as the ratio of proportionate change in the quantity supplied to the proportionate change in price. High elasticity indicates the supply is sensitive to changes in prices, low elasticity indicates little sensitivity to price changes, and no elasticity means no relationship with price. Also called price elasticity of supply.

TYPES OF ELASTICITY OF SUPPLY

1. Price Elasticity of supply – is a measure used in economics to show the responsiveness, or elasticity, of the quantity supplied of a good or service to a change in its price. a. Perfectly elastic supply – It is a case where a very slight change in price causes an Infinite change in supply. A slight fall in prices brings quantity supplied to zero. b. Perfectly inelastic supply – The

supply of a commodity is said to be perfectly inelastic when the supply of commodity is completely non-responsive to changes in price. It is a case where quantity supplied remains the same despite the change in price. c. Relatively elastic supply – The supply is relatively elastic when a given change in price produces more than proportionate change in quantity supplied. A doubling in price will result in more than double the quantity supplied. d. Relatively inelastic supply – When a certain change in price causes a smaller proportionate change in quantity supplied of a Commodity, the supply is said to be relatively less elastic. The percentage change in price is more than the percentage change in quantity supplied. e. Unitary elastic supply – In such a situation the proportionate change in supply equals the proportionate change in price.

DETERMINANTS OF ELASTICITY OF SUPPLY

1. Availability of raw materials
2. Length and complexity of production
3. Mobility factors – If the factors of production are easily available and if a producer producing one good can switch their resources and put it towards the creation of a product in demand, then it can be said that the PES is relatively elastic. The inverse applies to this, to make it relatively inelastic.
4. Time to respond – The more time a producer has to respond to price changes the more elastic the supply. Supply is normally more elastic in the long run than in the short run for produced goods, since it is generally assumed that in the long run all factors of production can be utilised to increase supply, whereas in the short run only labor can be increased, and

even then, changes may be prohibitively costly.

5. Inventories – A producer who has a supply of goods or available storage capacity can quickly increase supply to market.

6. Spare/Excess Production Capacity – A producer who has unused capacity can (and will) quickly respond to price changes in his market assuming that variable factors are readily available.[1] The existence of spare capacity within a firm, would be indicative of more proportionate response in quantity supplied to changes in price (hence suggesting price elasticity). It indicates that the producer would be able to utilise spare factor markets (factors of production) at its disposal and hence respond to changes in demand to match with supply. The greater the extent of spare production capacity, the quicker suppliers can respond to price changes and hence the more price elastic the good/service would be.

> Movement along the curve

-Demand is the relationship between various prices and the quantities consumers are willing and able to buy, holding all other things constant. Consumers, in general, are willing to buy more of a product at lower prices and less at higher prices. This is movement along the curve.

A shifted curve means the entire curve is redrawn and shifts to the right or left. A shift in the D curve results from: 1-Change in the number of consumers in the market for a product, 2-Change in consumer tastes and preferences for a product, 3-Change in consumer income, 4-Change in the price of related goods—complements or substitutes of a product.

A movement in a supply curve is a change in supply as a result of a change in price. A shift in a supply curve is a change in supply for a reason other than a change in price. Factors that caused more supply at every price:

1. Reduction in average costs of production
2. Subsidy on raw materials
3. Subsidy on labour
4. Improvements in technology

Factors that caused less supply at every price

1. Increase in average cost of production
2. Taxation of raw materials
3. A switch in production to a more lucrative option
4. A decline in demand for the product

> arc elasticity – is the elasticity of one variable with respect to another between two given points. It is the ratio of the percentage change of one of the variables between the two points to the percentage change of the other variable. It contrasts with the point elasticity, which is the limit of the arc elasticity as the distance between the two points approaches zero and which hence is defined at a single point rather than for a pair of points