

- *In this chapter, look for the answers to these questions:*
- What factors affect buyers' demand for goods?
- What factors affect sellers' supply of goods?
- How do supply and demand determine the price of a good and the quantity sold?
- How do changes in the factors that affect demand or supply affect the market price and quantity of a good?
- How do markets allocate resources?
- Markets and Competition

- A **market** is a group of buyers and sellers of a particular product.
- A **competitive market** is one with many buyers and sellers, each has a negligible effect on price.
- In a **perfectly competitive** market:
  - All goods exactly the same
  - Buyers & sellers so numerous that no one can affect market price—each is a “**price taker**”
- In this chapter, we assume markets are perfectly competitive.
- Demand
- The **quantity demanded** of any good is the amount of the good that buyers are willing and able to purchase.
- **Law of demand:** the claim that the quantity demanded of a good falls

when the price of the good rises,  
other things equal

- **The Demand Schedule**

- **Demand schedule:**

a table that shows the relationship  
between the price of a good and  
the quantity demanded

- **Example:**

Helen's demand for lattes.

- Notice that Helen's preferences  
obey the  
law of demand.

- **Market Demand versus  
Individual Demand**

- The quantity demanded in the market  
is the sum of the quantities demanded  
by all buyers at each price.

- Suppose Helen and Ken are the only  
two buyers in the Latte market. ( $Q^d$   
= quantity demanded)

- The Market Demand Curve for Lattes
- Demand Curve Shifters
- The demand curve shows how price affects quantity demanded, *other things being equal*.
- These “other things” are non-price determinants of demand (i.e., things that determine buyers’ demand for a good, other than the good’s price).
- Changes in them shift the ***D*** curve...
- Demand Curve Shifters: # of Buyers
- Increase in # of buyers increases quantity demanded at each price, shifts ***D*** curve to the right.

- Demand Curve Shifters:  
Income
- Demand for a **normal good** is positively related to income.
  - Increase in income causes increase in quantity demanded at each price, shifts **D** curve to the right.(Demand for an **inferior good** is negatively related to income. An increase in income shifts **D** curves for inferior goods to the left.)
- Demand Curve Shifters:  
Prices of Related Goods
- Two goods are **substitutes** if an increase in the price of one causes an increase in demand for the other.

- Example: pizza and hamburgers. An increase in the price of pizza increases demand for hamburgers, shifting hamburger demand curve to the right.
- Other examples: Coke and Pepsi, laptops and desktop computers, CDs and music downloads
- **Demand Curve Shifters:**  
**Prices of Related Goods**
- Two goods are **complements** if an increase in the price of one causes a fall in demand for the other.
- Example: computers and software. If price of computers rises, people buy fewer computers, and therefore less software. Software demand curve shifts left.

- Other examples: college tuition and textbooks, bagels and cream cheese, eggs and bacon
- Demand Curve Shifters:  
Tastes
- Anything that causes a shift in tastes *toward* a good will increase demand for that good and shift its **D** curve to the right.
- Example:  
The Atkins diet became popular in the '90s, caused an increase in demand for eggs, shifted the egg demand curve to the right.
- Demand Curve Shifters:  
Expectations

- Expectations affect consumers' buying decisions.
- Examples:
  - If people expect their incomes to rise, their demand for meals at expensive restaurants may increase now.
  - If the economy sours and people worry about their future job security, demand for new autos may fall now.

- **Summary: Variables That Influence Buyers**

**Variable A change in this variable...**

- ACTIVE LEARNING 1

## **Demand Curve**

- Supply

- The **quantity supplied** of any good is the amount that sellers are willing and able to sell.
- **Law of supply:** the claim that the quantity supplied of a good rises when the price of the good rises, other things equal
- **The Supply Schedule**
- **Supply schedule:**  
A table that shows the relationship between the price of a good and the quantity supplied.
- **Example:**  
Starbucks' supply of lattes.
- **Starbucks' Supply Schedule & Curve**
- **Market Supply versus Individual Supply**

- The quantity supplied in the market is the sum of the quantities supplied by all sellers at each price.
- Suppose Starbucks and Jitters are the only two sellers in this market. ( $Q^s$  = quantity supplied)
- Supply Curve Shifters
- The supply curve shows how price affects quantity supplied, *other things being equal*.
- These “other things” are non-price determinants of supply.
- Changes in them shift the **S** curve...
- Supply Curve Shifters: Input Prices
- Examples of input prices: wages, prices of raw materials.

- A fall in input prices makes production more profitable at each output price, so firms supply a larger quantity at each price, and the **S** curve shifts to the right.
- Supply Curve Shifters:  
Technology
  - Technology determines how much inputs are required to produce a unit of output.
  - A cost-saving technological improvement has the same effect as a fall in input prices, shifts **S** curve to the right.
- Supply Curve Shifters: # of Sellers

- An increase in the number of sellers increases the quantity supplied at each price, shifts **S** curve to the right.
- Supply Curve Shifters:  
Expectations
- Example:
  - Events in the Middle East lead to expectations of higher oil prices.
  - In response, owners of Texas oilfields reduce supply now, save some inventory to sell later at the higher price.
  - **S** curve shifts left.
- In general, sellers may adjust supply\* when their expectations of future prices change.

*(\* If good not perishable)*

- Summary: Variables that  
Influence Sellers

## Variable A change in this variable...

- ACTIVE LEARNING 2

### Supply Curve

- Three Steps to Analyzing Changes in Eq'm

To determine the effects of any event,

1. Decide whether event shifts **S** curve,  
**D** curve, or both.
2. Decide in which direction curve shifts.
3. Use supply—demand diagram to see how the shift changes eq'm **P** and **Q**.

- Terms for Shift vs. Movement Along Curve

- **Change in supply:** a shift in the **S** curve  
occurs when a non-price determinant of supply changes (like technology or costs)
- **Change in the quantity supplied:** a movement along a fixed **S** curve occurs when **P** changes
- **Change in demand:** a shift in the **D** curve  
occurs when a non-price determinant of demand changes (like income or # of buyers)
- **Change in the quantity demanded:** a movement along a fixed **D** curve occurs when **P** changes

- ACTIVE LEARNING 3

Shifts in supply and demand

- CONCLUSION:  
How Prices Allocate Resources

- One of the Ten Principles from Chapter 1:

***Markets are usually a good way***

***to organize economic activity.***

- In market economies, prices adjust to balance supply and demand. These equilibrium prices are the signals that guide economic

decisions and thereby allocate scarce resources.

## ■ SUMMARY

- A competitive market has many buyers and sellers, each of whom has little or no influence on the market price.
  - Economists use the supply and demand model to analyze competitive markets.
  - The downward-sloping demand curve reflects the law of demand, which states that the quantity buyers demand of a good depends negatively on the good's price.
- ## ■ SUMMARY
- Besides price, demand depends on buyers' incomes, tastes, expectations, the prices of

substitutes and complements, and number of buyers.

If one of these factors changes, the **D** curve shifts.

- The upward-sloping supply curve reflects the Law of Supply, which states that the quantity sellers supply depends positively on the good's price.
- Other determinants of supply include input prices, technology, expectations, and the # of sellers. Changes in these factors shift the **S** curve.
- SUMMARY
- The intersection of **S** and **D** curves determines the market equilibrium. At the equilibrium price, quantity

supplied equals quantity demanded.

- If the market price is above equilibrium, a surplus results, which causes the price to fall.

If the market price is below equilibrium, a shortage results, causing the price to rise.

- **SUMMARY**

- We can use the supply-demand diagram to analyze the effects of any event on a market:

First, determine whether the event shifts one or both curves. Second, determine the direction of the shifts. Third, compare the new equilibrium to the initial one.

- In market economies, prices are the signals that guide economic decisions and allocate scarce resources.