CHAPTER 3: BASIC ELEMENTS OF SUPPLY AND DEMAND

Many forces can operate to push the observed price of any given commodity higher or lower: changes in people's tastes, changes in their incomes, changes in the costs of production, changes in the prices of substitute products, changes in government policy, etc. In order to assess the impact of any of these single events, we need to divide these forces into two groups: those that have their initial impact on the demand side of the market and those that have their initial impact on the supply side of the market.

A. The Demand Schedule
1. When economists refer to the law of downward-sloping demand, they are speaking of a particular kind of behavior among buyers that is observed with so few exceptions that it can be designated as a “law” of behavior.

2. It is essential to keep in mind that a demand curve is a conditional schedule; it answers an “if this, then that” type of question. It shows, in particular, that if the price of some good were to stand at some specified level, then consumers would be willing to purchase the indicated quantity.

3. The quantity of a good or service that is read from a demand curve does not depend at all upon whether or not that quantity is feasible to supply at the given price. It reflects only the desires of consumers who worry only about their own preferences and what they can afford.

4. Remember that price is not the only factor that influences consumers’ decisions to buy. Average income, number of buyers, price and availability of related goods, and tastes and preferences all define the behavior of buyers in markets. Any changes in these factors will cause the demand curve to shift.

B. The Supply Curve
1. The supply schedule (and supply curve) for a commodity shows the relationship between its market price and the amount of that commodity that producers are willing to produce and sell, other things being held equal.

2. The quantity of a good or service that is read from a supply curve does not depend upon whether or not people want to buy that much. It reflects only the ambitions of suppliers who worry only about their costs and their anticipated profits (given the quoted price).

3. Technology, input prices, prices of related goods, and government policy all define the behavior of sellers. Thus, changes in any of these factors will cause the supply curve to shift.

C. Equilibrium of Supply and Demand
1. The division between buyers and sellers is nearly absolute. In all but a very few exceptional cases, economic forces directly influence either the demand side of a market or the supply side of a market, but not both.

2. Market-clearing equilibrium prices are achieved when the quantity supplied matches the quantity demanded.
3. When the quantity demanded exceeds the quantity supplied, the resulting shortage pushes the price up toward equilibrium. On the other hand, when the quantity demanded is less than the quantity supplied, the resulting surplus pushes the price down.

4. When we draw demand and supply schedules, we are defining a relationship between quantities demanded or supplied and the relative price of the product. When relative prices change, consumers or producers change their behavior along the demand and supply curves. Demand and supply curves shift only when a factor other than the own-price of the product has changed.

5. Whenever you are confronted with a supply and demand problem (even in a multiple choice or true/false problem), draw the appropriate diagram and use it to illustrate the changes that you anticipate in the market. The discipline of envisioning the graph will help you keep track of what is changing and what is staying the same, first on the demand side and second on the supply side. You will find it easier to avoid errors caused by confusing changes in quantities demanded and supplied (movement along curves) with changes in demand and supply (shifts of curves).

6. Excess demand means the same thing as shortage, while Excess supply means the same thing as surplus.