

Price mechanism		Demand (cont)		Shifts in demand (cont)	
Price machanism	Higher prices indicate higher demand and vice versa Rising prices indicate to producers to allocate their resources into that product		market D curve shows the relationship between the total QD by consumers each period and the price of that product	Changes in D	other factors like changes in people's income (normal or inferial Gs, changes in income tax, changes in the population, changes in the prices of other Gs (complementary GS - complements/substitutes), changes in tastes and fashion, advertising, etc.
Demand		Change in price		Supply	
Demand	for consumers is the want or willingness of consumers to buy Gs or Ss for demand to be effective consumers must have enough money to buy what they want and need	Utility	the satisfaction consumers have after buying and using Gs&Ss the wanted, they assume it is rational	Supply	the willingness of producers to make and sell Gs&Ss at different prices
Effective demand	real intention of consumers to purchase and to pay with the means available	Marginal utility	the extra unit gained from the consumption of one more product, usually goes down at some point	Quantity supplied	the amount of Gs&Ss producers are willing and able to make and sell to consumers in a market
Quantity dimanded	the amount of a good or service consumers are willing and able to buy	The law of dimini-shing returns	the more of a commodity consumers have, the less utility they get from consuming one more unit of it	Market supply	the sum of all the individual supply curves of producers vompeting to supply that product
Individual demand	D of just one consumer	Shifts in demand		Supply curve	expresses the amount of a good or service firms or producers are willing to make and sell at a given price opposit of DC
Market demand	the total D for that product from all its consumers willing and able to buy it	Ceteris paribus	all other things remaining unchanged, so no other factor that affects consumer's D changes	Change in price	movement along the curve and extension/contraction of supply
Aggregate demand	the total demand for all Gs&Ss in the economy	Increase/rise in D	consumers D more of a product at every price than they did before the DC moves outwards (to the right)	Other factors	increase/fall in supply
Demand curve	displays the D of all the consumers of that commodity given a set of possible prices following mostly applies: as price rises QD falls and vice versa, roughly downward sloping, P and QD move in opposite directions	Fall in the D	consumers now demand less of a product at every price than they did before the DC moves inwards (to the left)	Changes in supply	
				Changes in the cost of factors of production	fall in costs will increase profits and the SC will shift outwards and vice versa
				Changes in the price and profitability of other Gs & SS	may cause different ammount of S of different products



Changes in supply (cont)

Technical progress	new technology may be able to increase its production and vice versa
Business optimism and expectations	firms allocate resources based on what they think will be the most profitable
Other factors	natural disasters, sudden changes in weather, international trade sanctions, wars and political factors

Market price

Market price	QD and QS is the same
Equilibrium price	another name for market price
Excess supply	at higher prices firms supply more products above the D
Excess demand	at low prices low amount of products is supplied
Disequilibrium	D doesn't equal S

Changes in market prices

A shift in the market D	higher QD = higher P = higher S
A shift in the market S curve	higher S = lower P = higher D
Market price increases if	market D rises or market S falls

Price elasticity of demand

PED	the responsiveness of consumer D to changes in the price of a good or service
Elastic	change in price affects the QD (more shallow)
PED > 1	

Price elasticity of demand (cont)

Inelastic	change in price doesn't affect the QD, if so only in small amount (steeper)
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$$PED < 1$$

How to calculate PED?	$PED = \% \text{ change in QD} / \% \text{ change in P}$
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$$\% \text{ change in QD} = (\text{change in Q} / \text{original Q}) \times 100$$

$$\% \text{ change in P} = (\text{change in P} / \text{original P}) \times 100$$

Determinants of PED	factors that affect PED
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if the product is a necessity - inelastic

the number of close substitutes a product has - more = elastic, less = inelastic

the amount of time consumers have to search for substitutes - more time = inelastic, less time = elastic

the cost of switching to a different supplier - high = inelastic, low = elastic

the proportion of consumer's income spent on the product - higher = elastic, lower = inelastic

Why is knowledge of PED useful?	e. g. while government is placing taxes (cigarettes, alcohol, etc.)
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Special demand curves

Perfectly price inelastic	a straight vertical line, rise/fall in the P of commodity causes no change in S (insuline)
E = 0	
Infinitely price elastic	a straight horizontal line, any change in D will cause S to fall to zero, unrealistic
E = ∞	
Unitary elasticity	a % change in P will cause an equal change in the QD (looks like a DC)
E = 1	

Other measures of elasticity of demand

Income elasticity of D	by how much a change in income causes the QD of G/S to change
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$$IED = \% \text{ change in QD} / \% \text{ change in income}$$

positive number - rise in income = rise in D, normal Gs

negative number - rise in income = fall in QD, inferior Gs

Cross elasticity of D	by how much QD will rise/fall given the change in the price of another product
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$$CED = \% \text{ change in Q of good X} / \% \text{ change in P of good Y}$$

positive number - rise in P = rise in D, substitutes

negative number - rise in P = fall in D, complements

Price elasticity of supply	responsiveness of QS to a change in P
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$$PES = \% \text{ change in QS} / \% \text{ change in P}$$

Other measures of elasticity of demand (cont)

ES > 1 - price elastic - small increase in P = large extension in S

ES < 1 - price inelastic - rise in P = little extension in S

change in P > change in D = price inelastic

change in P < change in D = price elastic

Determinants of PES the availability of stock of finished goods and components - higher availability = elastic, low availability = inelastic

degree of unused or spare production capacity - higher = elastic, lower = inelastic

availability of resources - higher availability = elastic, lower availability = inelastic

time - momentary run (all FoP fixed - inelastic), short run (1 FoP variable, other 2 fixed), long run (all FoP variable - elastic)

Special supply curves

Perfectly price inelastic PES = 0 straight horizontal line, the QS remains the same whatever the P is

Infinitely price elastic PES = ∞ straight horizontal line, producers are willing to supply as much as they can at one particular price, theory

Unitary elasticity PES = 1 a % change in price will cause an equal % change in QS

Taxes and subsidies

Taxes imposed on goods and services are known as **indirect taxes** (VAT, excise duties placed on cigarettes and alcohol, etc.)

indirect taxes have an effect of increasing the market price and reducing the quantity traded in a market

Subsidy payment made to producers to help to reduce their costs of production

producers tend to increase their supply at every given price, higher supply = fall in market price = benefit to the consumers