# *Economics review sheet Unit 2*

Key

Chapter 4—Demand

Demand: the desire and ability to purchase a good or service.

Law of demand: as price goes up, quantity demanded goes down. In other words: when a good's price is higher, people will buy less of it; when the price is lower, people will buy more.

- REMEMBER: if there is a change in PRICE there has to be a change in **QUANTITY DEMANDED**, not "demand."

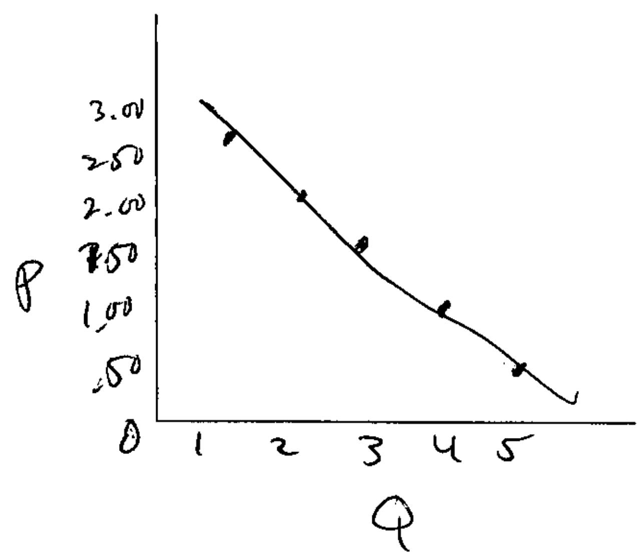
A demand schedule is a table that lists the quantity a person will buy at different prices. A market demand schedule lists the same information for all buyers in a certain market, instead of just one person.

Examples:

Individual demand schedule for slices of pizza:

| price ($) | quantity |
|---|---|
| .50 | 5 |
| 1.00 | 4 |
| 1.50 | 3 |
| 2.00 | 2 |
| 2.50 | 1 |

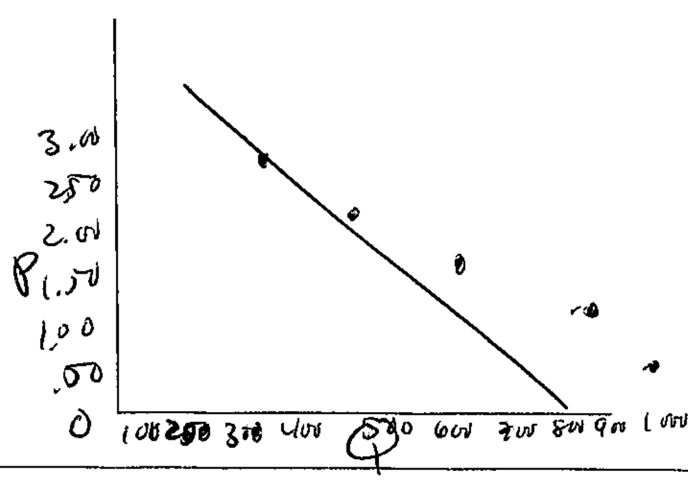
Practice graphing the demand curve:
Make sure you label!!!



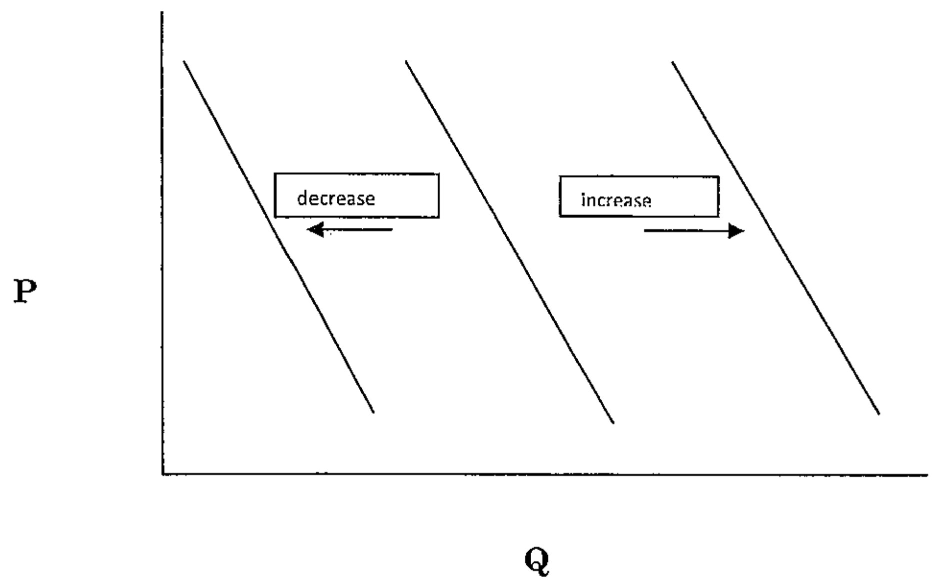

Market demand schedule for slices of pizza:

| price ($) | quantity |
|---|---|
| .50 | 1000 |
| 1.00 | 850 |
| 1.50 | 600 |
| 2.00 | 450 |
| 2.50 | 300 |

Practice graphing the demand curve:
Make sure you label!!!



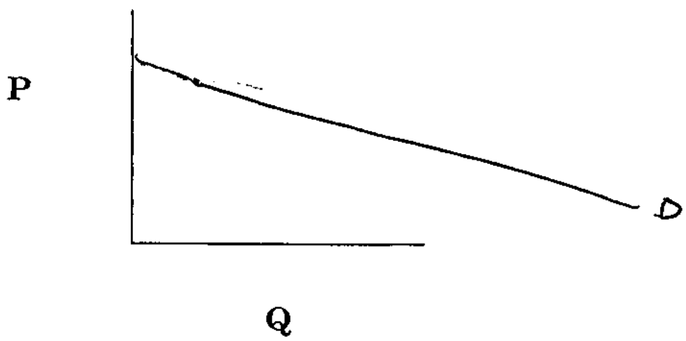
Sometimes consumers will buy different amounts of a product for a reason besides a change in price. When this happens, it is called a change in just "demand." This causes the whole demand curve to shift. If there is an **increase** in demand, the curve shifts **right.** If there is a **decrease** in demand, the curve shifts **left.**




- Change in income.
  - When people make more money, demand increases.
  - When people make less money, demand decreases.
- Change in #of buyers.
  - When there are more buyers in the market, demand increases.
  - When there are fewer buyers in the market, demand decreases.
- Change in tastes and preferencl
  - When something becomes more popular or trendy, demand increases.
  - When something is no longer popular or people think a new style is better, demand decreases.
- Change in future expectations
  - When buyers expect the price of a good to rise in the <u>future</u>, current demand increases (buy now before the price goes up).
  - When buyers expect the price of a good to go down in the <u>future</u>, current demand decreases (wait to buy until price goes down).
- Change in Substitutes (goods that can be used in place of each other).
  - When the price of a good's substitute increases, the demand for the original good increases (buy more of the original good).
  - When the price of a good's substitute decreases, the demand for the original good decreases (buy more of the substitute).
- Change in Complements (goods used together with each other).
  - When the price of a good's complement increases, the demand for the original good decreases (people don't buy the complement, and then don't buy the original good).
  - When the price of a good's complement decreases, the demand for the original good increases (people buy more of the complement, then buy more of the original good).

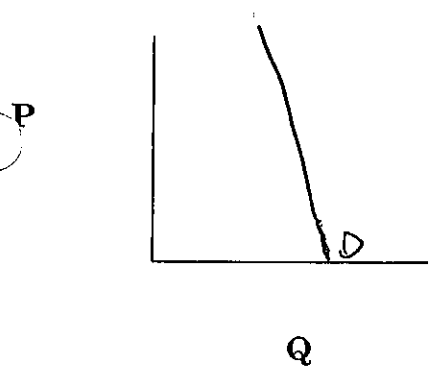
Elasticity of demand measure how responsive consumers are to price changes in the marketplace. If a good has **elastic** demand, then a change in price causes a relatively large change in quantity demanded. If a good has **inelastic demand**, then a change in price causes a relatively small change in quantity demanded.

Elastic demand curve




Elastic demand curves are relatively flat. The small change in price causes a large change in quantity demanded.

Inelastic demand curve




Inelastic demand curves are relatively steep. The large change in price causes only a small change in quantity demanded.

There are several factors that determine if a good's demand is elastic or inelastic.

- Availability of Substitutes.
  - No substitutes: inelastic. If the price changes, people still buy the good (prescription).
  - Many substitutes: elastic. If the price changes, people will buy the substitutes (chicken).

- Proportion of income (how much of your money the good takes up).
  - Small portion of income: inelastic. If the price changes, people still buy the good because it doesn't take up too much of their money (piece of candy).
  - Large portion of income: elastic. If the price changes, people won't buy the good anymore because it takes up a large part of their money (new camera).

- Necessity (need) or luxury?
  - Necessity: inelastic. If the price changes, people will still buy it because they need it.
  - Luxury: elastic. If the price changes, people won't buy it anymore because they don't really need it.

Chapter 5 – Supply

Supply: the ___desire___ and ability of a producer to offer goods and services for sale

Law of supply: producers will offer more for sale at a higher price, and less for sale at a lower price. **Price goes up, quantity supplied** ___increases___. **Price goes down, quantity supplied** ___decreases___.

REMEMBER: Ultimate goal of a producer is to make a profit!!!!!!

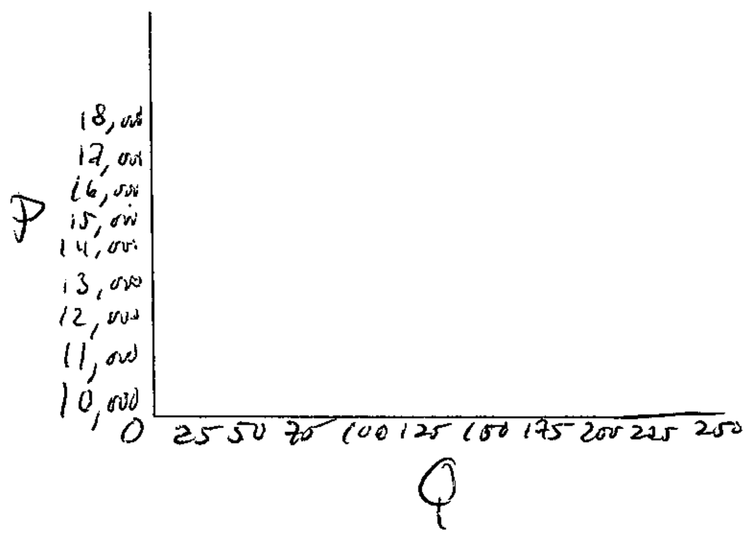
A supply schedule can be graphed to make a supply curve, just like a demand schedule and a demand curve.

Examples:

Market supply schedule for cars:

| price ($) | quantity |
|---|---|
| 10,000 | 50 |
| 12,000 | 100 |
| 14,000 | 150 |
| 16,000 | 200 |
| 18,000 | 250 |

Practice graphing the supply curve:
Make sure you label!!!



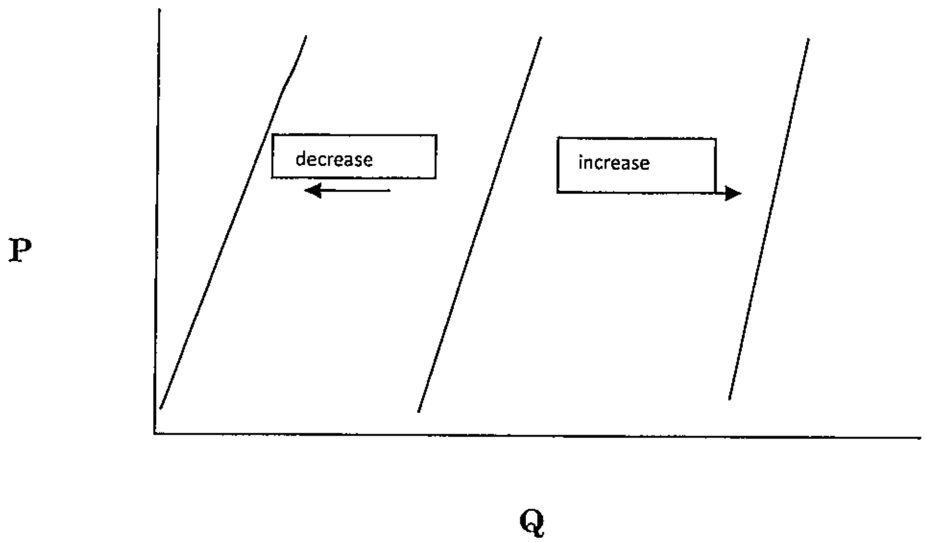

Producers don't want to offer many goods for sale when the price is low because of the **costs of production.** It costs a business every time they produce something. Because they want to maximize profit, producers want the greatest difference possible between **revenue** (the money made from selling their product) and **costs.**

**Costs** can be divided into two categories.

- ___fixed___ **costs**
  - Stay the same no matter how many products a business produces.
  - Examples: mortgage payments on a factory, salaries to managers, one-time equipment costs, insurance costs.
- ___variable___ **costs**
  - Change based on how many products a business produces.
  - Examples: Steel used to make cars, overtime payments to hourly workers, electricity to run the machines, shipping costs for finished products.

Sometimes producers will produce different amounts of a product for a reason besides a change in price. When this happens, it is called a change in just "supply." This causes the whole supply curve to shift. If there is an **increase** in supply, the curve shifts **right.** If there is a **decrease** in supply, the curve shifts **left.**

- **THINK:** is it cheaper and easier to make a product (increase), or more expensive and more difficult (decrease)?




- Change in the **costs of inputs** (the materials used to make a product).
  - Cost of inputs goes up: decrease in supply.
  - Cost of inputs goes down: decrease in supply.

- Change in **labor productivity** (how well your workers perform).
  - Labor productivity improves: increase in supply.
  - Labor productivity gets worse: decrease in supply.

- Change in **technology.**
  - Technology improves: increase in supply.
  - Technology gets worse: decrease in supply.

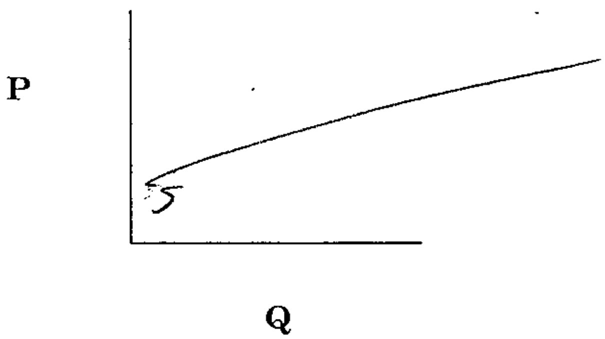
- **Government action.**
  - __Excise__: tax placed on the production of a certain good (alcohol, tobacco). Causes a decrease in supply.
  - __regulation__: controlling business behavior through rules or laws. Causes a decrease in supply.
  - __Subsidy__: government payment that partially covers the cost of production. Causes an increase in supply.

- Change in __Expectations__.
  - If a business expects its product to sell at a higher price in the future, it will wait to sell it then: decrease in supply.
  - If a business expects its product to sell at a lower price in the future, it will try and sell it now: increase in supply.

- Change in the __# of producers/sellers__.
  - More producers (new business starts up): increase in supply.
  - Fewer producers (a producer goes out of business): decrease in supply.

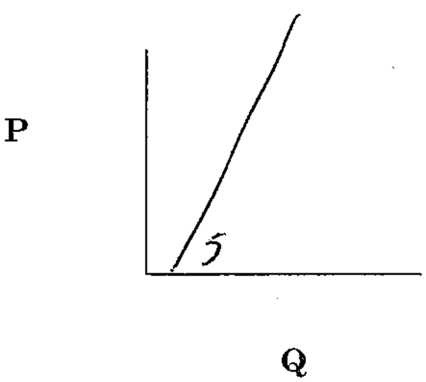
Similar to demand, supply can be **elastic** or **inelastic**—it depends how the producer **responds** to a change in price.

Elastic supply curve




Elastic supply curves are relatively flat. The small change in price causes a large change in quantity supplied.

Inelastic supply curve




Inelastic supply curves are relatively steep. The large change in price causes only a small change in quantity supplied.

The main factor that determines elasticity of supply is how easily prod. can adj. to Δ in P

- If a producer can adjust their quantity supplied quickly and easily in response to a change in price, then the product has elastic supply.
    - Simple products that **don't** require much skill or difficult-to-obtain resources to obtain, and services that can be performed quickly and easily.

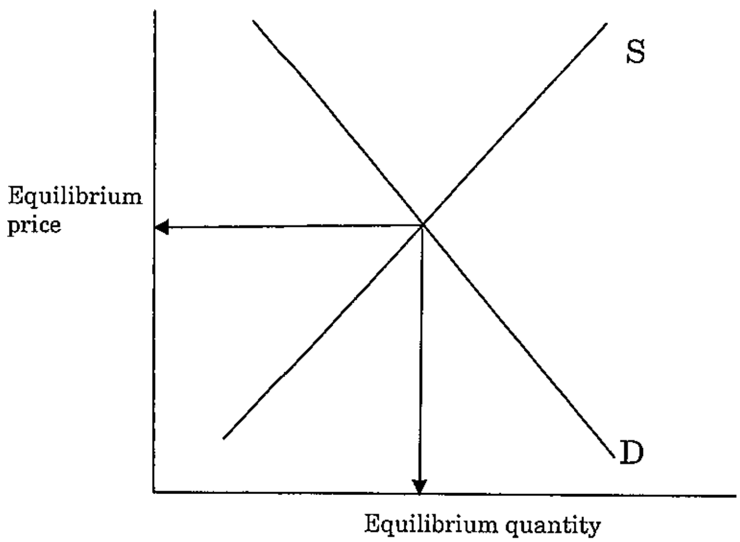
- If it is difficult and time-consuming for a producer to adjust their quantity supplied in response to a change in price, then the product has inelastic supply.
    - Complex products that require skilled labor and expensive or rare resources, and services that take much effort and time to be performed.

Chapter 6 – Demand, Supply, and Prices

In a free-market economy, consumers and producers <u>interact</u> to determine prices of goods and services. The price at which quantity demanded (what consumers want to and are able to purchase) and quantity supplied (what producers want to and are able to offer for sale) are equal is called the **equilibrium price.**

- This is the point where the demand and supply curves intersect.

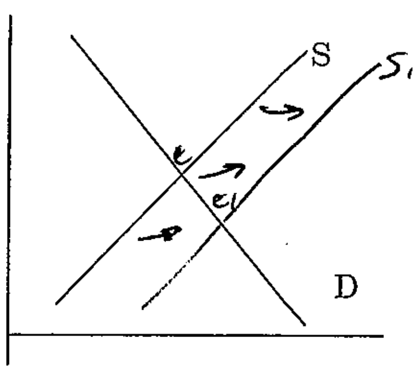
P




Q

Changes in supply and/or demand can change the equilibrium price and quantity. For example, the graph below shows an increase in supply. The point at which the new supply curve crosses the original demand curve is the new equilibrium point. In this case, the price decreased because of the change in supply.

P



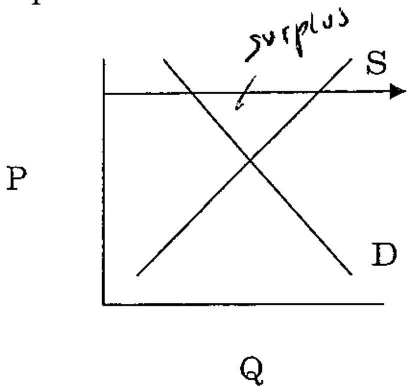

Q

Q↑ e↓

To figure out the change, first determine whether it is a change in supply or demand, and if it's an increase or a decrease. Then, draw the new curve. Find the new equilibrium point, and determine whether price increased or decreased, and whether quantity increased or decreased.

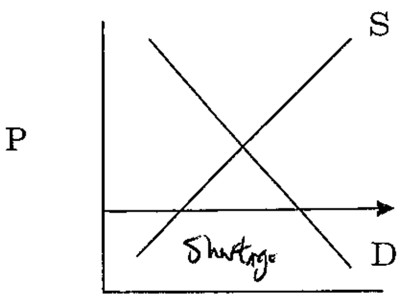
Markets usually do not arrive at equilibrium instantly; the process can involve some trial and error.

A **surplus** is a situation when the quantity supplied is greater than the quantity demanded. This usually occurs when the price is too high. Eventually the price will be forced down to reach equilibrium.




The arrow shows the price being too high, indicating a surplus, or many unsold goods. Follow the arrow from the high price across both curves. Notice how it crosses the supply curve at a much greater quantity than the demand curve.

A **shortage** is a situation when the quantity demanded is greater than the quantity supplied. This usually occurs when the price is too low. Eventually the price will be forced up to reach equilibrium.




The arrow shows the price being too low, indicating a shortage, or not enough goods to satisfy consumer demand. Follow the arrow from the low price across both curves. Notice how it crosses the demand curve at a much greater quantity than the supply curve.

There are several important characteristics of the pricing system in a free-market economy.

- It is neutral.
  - Does not favor either the producer or the consumer.
- It is market driven.
  - Prices are determined by market forces, not central planning. It requires no government oversight.
- It is flexible.
  - Prices can change very quickly when conditions change.
- It is efficient.
  - Prices will adjust until the maximum number of goods and services are sold.

Prices can also act as "signals," indicating important information to both consumers and producers.

- Producers
  - Rising prices: good time to enter a market (start supplying a certain good).
  - Falling prices: good time to leave a market (stop supplying a certain good).

- Consumers
  - High price: discourages them from buying a certain good.
  - Low price: encourages them to buy a certain good.

Because the United States has a mixed economy, and is not 100% free-market, the government does at times involve itself in the pricing system.

- price Ceiling: the maximum, or highest, price that sellers may charge for a good or service.

  - Established to keep some essential goods and services from becoming too expensive.
    - Example: rent control on some apartments and housing.
  - Pros: allows people to afford important goods and services.
  - Cons: creates an artificial shortage. Reduces incentives for producers, because it is more difficult for them to make a profit.

- price Floor: an established minimum price that buyers must pay for a good or service.

  - Designed to increase income to certain producers.
    - Example: minimum wage, established so people get paid at least a certain amount for the labor that they "produce;" agricultural (farm) price floors so farmers produce a large amount of food.
  - Pros: helps people get a decent pay for the work they do, encourages plentiful food production.
  - Cons: employers might hire fewer workers, as they have to pay each worker more.

- <u>Rationing:</u> a system in which the government allocates (gives out) goods and services using factors other than price.

  - Used during periods of national emergency.
    - World War II
  - Designed to conserve resources needed by the government for war or other emergencies.
  - Allows all people access to certain goods, not just the wealthy people who could afford them during shortages.