Chapter 3: Demand and Supply

I. Demand and supply determine prices in a free market.

II. Demand side.
   A. The demand for a product shows the how the amount people are willing and able to buy depends upon the product’s price.
      1. individual demand curve
      2. market demand curve
   B. Quantity demanded of a good or service is the amount that consumers plan to buy during a given time period at a particular price.
   C. Law of Demand: other things remaining the same, the higher the price of a good, the smaller is the quantity demanded.
      1. substitution effect: as the price of a good rises, people purchase less of the good and replace it with substitutes.
      2. income effect: as the price of a good rises, people’s incomes purchase fewer goods than previously. The income effect of a price increase reduces purchases of all “normal goods”.
   D. Demand curve:
      1. example: demand for CDs
         i. quantity per period on horizontal axis
         ii. price per unit on vertical axis.
         iii. downward sloping (reflecting law of demand)
         iv. demand curve as a measure of “willingness to pay”, or marginal benefit.
      2. changes in demand
         i. price of other goods
            a. substitutes (+)
            b. complements (-)
         ii. income
            a. normal good (+)
            b. inferior good (-)
         iii. population (+)
         iv. preferences
v. expected future prices (+)
3. change in quantity demanded versus change in demand.

III. Supply side.
A. The supply of a product shows the relationship between the amount producers are willing to produce of a product and the product’s price.
   1. individual supply curve
   2. market supply curve.
B. Quantity supplied of a product refers to the amount sellers are willing to sell at a particular price.
C. Law of Supply: other things remaining the same, the higher the price of a good, the greater is the quantity supplied.
   1. the result of increasing marginal cost -- more on this later.
D. Supply curve.
   1. example: supply of CDs.
      i. same labels as with demand curve
      ii. downward sloping
      iii. supply curve is measure of cost of producing, or “marginal cost”.
   2. Change in supply
      i. prices of inputs (-)
      ii. technology (+)
      iii. number of suppliers (+)
      iv. prices of related goods produced
         a. substitutes in production (-)
         b. complements in production (+)

IV. Market equilibrium.
A. equilibrium price and quantity
B. shortage if price is too low
C. surplus if price is too high.

V. Consequences of changes in supply and demand
A. increase in demand
   1. equilibrium price and quantity increases
B. increase in supply
   1. equilibrium price decreases and quantity increases.

C. supply and demand move in same direction
   1. can predict quantity change, but not price change.

D. supply and demand move in opposite directions
   1. can predict price change, but not quantity change.