

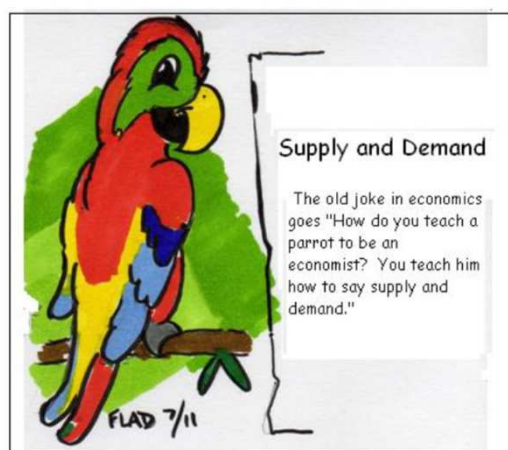
LEARNING UNIT 4

- **DATE:** March 2014
- **MODULE:** PMIC6111
- **TEXTBOOK REFERENCE:** CHAPTER 7 pgs 109 -132
- **THEME:** DEMAND, SUPPLY AND PRICES
- **OBJECTIVES:** BY END OF LEARNING UNIT 4 – YOU SHOULD KNOW THE FOLLOWING:
 - CONSTRUCT AND INTERPRET GRAPHS
 - EXPLAIN 'CETERIS PARIBUS' AND 'EQUILIBRIUM'
 - HOW DO HOUSEHOLDS & FIRMS REPRESENT DEMAND & SUPPLY
 - HOW HOUSEHOLDS AND FIRMS REPRESENT DEMAND AND SUPPLY
 - IDENTIFY IMPORTANT DETERMINANTS OF INDIVIDUAL DEMAND AND MARKET DEMAND
 - DEFINE LAW OF DEMAND
 - EXPLAIN DIFFERENCE BETWEEN DEMAND AND QUANTITY DEMANDED
 - DIFFERENTIATE BETWEEN MOVEMENT ALONG A DEMAND CURVE AND A SHIFT OF A DEMAND CURVE
 - EXPLAIN LAW OF DIMINISHING MARGINAL UTILITY

LEARNING UNIT 4

- EXPLAIN DOWNWARD SLOPING DEMAND CURVE IN TERMS OF LAW OF DIMINISHING MARGINAL UTILITY
- SHOW HOW SUPPLY CAN BE EXPRESSED IN WORDS, GRAPHS, NUMBERS AND EQUATIONS
- DEFINE LAW OF SUPPLY
- EXPLAIN DIFFERENCE BETWEEN SUPPLY AND QUANTITY SUPPLIED
- DIFFERENTIATE BETWEEN MOVEMENT ALONG SUPPLY CURVE AND A SHIFT OF SUPPLY CURVE
- IDENTIFY MOST IMPORTANT DETERMINANTS OF INDIVIDUAL SUPPLY AND MARKET SUPPLY
- EXPLAIN HOW EQUILIBRIUM PRICE AND QUANTITY ARE DETERMINED IN GOODS MARKET
- EXPLAIN FUNCTIONS OF PRICES IN MARKET ECONOMY
- DISTINGUISH BETWEEN CONSUMER AND PRODUCER SURPLUS

LEARNING UNIT 4



LEARNING UNIT 4

- **DEMAND**
 - REFERS TO QUANTITIES OF GOODS OR SERVICES THAT POTENTIAL BUYERS ARE **WILLING** AND **ABLE** TO BUY DURING A CERTAIN PERIOD
 - DEMAND IS **NOT** THE SAME AS WANTS OR NEEDS
 - DEMAND IS A FLOW CONCEPT (MEASURED OVER A PERIOD)
 - RELATES TO **PLANS** OF HOUSEHOLDS & FIRMS TO BUY PRODUCTS
 - THEREFORE QUANTITY DEMANDED MIGHT DIFFER FROM QUANTITY ACTUALLY BOUGHT
 - QUANTITY BOUGHT WILL DEPEND ON AVAILABILITY OF GOOD OR SERVICE
 - MAY BE LESS THAN, EQUAL TO OR GREATER THAN QUANTITY ACTUALLY BOUGHT

LEARNING UNIT 4

➤ INDIVIDUAL DEMAND

➤ WHAT DETERMINES DEMAND:

- PRICE OF PRODUCT (P_x)
- PRICES OF RELATED PRODUCTS (P_e)
 - COMPLEMENT – GOODS THAT ARE USED JOINTLY
 - SUBSTITUTES – GOODS THAT CAN BE USED INSTEAD OF ANOTHER GOOD
- INCOME OF CONSUMER (Y)
- TASTE (PREFERENCE) OF CONSUMER (T)
- SIZE OF HOUSEHOLD (N)
- THE SUPPLY OF PRODUCT DOES **NOT** DETERMINE A CONSUMER'S DEMAND

LEARNING UNIT 4

➤ LAW OF DEMAND STATES:

- OTHER THINGS BEING EQUAL (ie *ceteris paribus*) THE HIGHER THE PRICE OF A GOOD, THE LOWER THE QUANTITY DEMANDED
 - DEMAND CAN BE EXPRESSED VERBALLY:
 - QUANTITY OF A GOOD DEMANDED BY AN INDIVIDUAL IN A PARTICULAR PERIOD, DEPENDS ON THE PRICE, PRICE OF RELATED GOODS, INCOME, TASTE, SIZE OF HOUSEHOLD
 - CAN BE CUMBERSOME
 - DEMAND CAN BE EXPRESSED IN SYMBOLS:
 - $Q_d = f(P_x; P_e; Y; T; N; \dots)$
 - DEPENDENT VARIABLE IS Q
 - P_x, P_e, T, N, Y ARE INDEPENDENT VARIABLES
 - THE MOST IMPORTANT VARIABLE IS PRICE
 - THEREFORE LAW OF DEMAND IS DERIVED FROM RELATIONSHIP BETWEEN QUANTITY DEMANDED AND PRICE
 - DEMAND CAN BE EXPRESSED USING GRAPHS
 - DEMAND CAN BE EXPRESSED USING NUMBERS (DEMAND SCHEDULE) TABLE 7-1 pg 113

LEARNING UNIT 4

➤ MARKET DEMAND

- FIRMS INTERESTED IN **TOTAL** DEMAND FOR GOODS
- THEREFORE MARKET DEMAND IS THE **SUM** OF INDIVIDUAL DEMANDS
- REFER TO PG 115 OF TEXTBOOK – COMPLETE THE TABLE IN MODULE GUIDE PG 81
- GRAPH ON PG 115

➤ MOVEMENT ALONG DEMAND CURVE

- RELATES TO **SLOPE** OF THE CURVE
- IF PRICE OF PRODUCT CHANGES, WE OBTAIN THE CHANGE IN QUANTITY DEMANDED BY COMPARING RELEVANT POINTS ON FIXED DEMAND CURVE, THEREFORE WE MOVE **ALONG** THE CURVE
- NEGATIVELY SLOPED

LEARNING UNIT 4

➤ SHIFT IN DEMAND CURVE

- A CHANGE IN ANY OF THE DETERMINANTS OF DEMAND **OTHER** THAN THE **PRICE** WILL **SHIFT** THE DEMAND CURVE
- IT IS KNOWN AS A **CHANGE IN DEMAND**
- CHANGE IN PRICE OF RELATED GOOD
 - SUBSTITUTE GOOD eg page 117
 - COMPLEMENTARY GOOD eg page 118
- CHANGE IN INCOME OF CONSUMER
 - INCREASE IN INCOME WILL GENERALLY LEAD TO INCREASE IN DEMAND
 - WHERE DEMAND DECREASES WHEN INCOME INCREASES – GOOD IS REFERRED TO AS **INFERIOR GOODS**
- CHANGE IN TASTES OF CONSUMER
 - EG FASHION AND ADVERTISING COULD CAUSE CONSUMERS TASTES TO CHANGE
- CHANGE IN POPULATION
 - LARGER THE POPULATION GREATER WILL BE DEMAND FOR PRODUCT

LEARNING UNIT 4

- **THEORY OF CONSUMER CHOICE**
 - EXPLAINS WHY DEMAND CURVE IS DOWNWARD SLOPING
 - ASSUME CONSUMERS ATTEMPT TO MAXIMISE SATISFACTION, GIVEN AVAILABLE MEANS AND CHOICES
 - UTILITY IS TERM USED TO DESCRIBE CONSUMERS SATISFACTION
 - i.e. UTILITY IS DEFINED AS DEGREE OF SATISFACTION DERIVED FROM CONSUMPTION OF GOOD OR SERVICE
 - ASSUME CONSUMERS ASSIGN 'UTILS' (A SCORE) TO SUCCESSIVE UNITS OF A GOOD CONSUMED
 - e.g. on pg 90 OF MODULE GUIDE
 - EXTRA OR ADDITIONAL UTILITY IS CALLED **MARGINAL UTILITY**
 - MARGINAL UTILITY DECLINES UNTIL ZERO IS REACHED
 - TOTAL UTILITY INCREASES AS LONG AS MARGINAL UTILITY IS POSITIVE
 - LAW OF DIMINISHING MARGINAL UTILITY
 - MARGINAL UTILITY DECLINES AS MORE OF IT IS CONSUMED DURING ANY GIVEN PERIOD

LEARNING UNIT 4

- **SUPPLY**
 - DEFINED AS QUANTITIES OF GOODS OR SERVICES THAT PRODUCERS PLAN TO SELL AT EACH POSSIBLE PRICE DURING A CERTAIN PERIOD
 - PRODUCERS MUST BE WILLING & ABLE TO SUPPLY QUANTITIES OF A PRODUCT
 - NO GUARANTEE THAT QUANTITY SUPPLIED WILL ACTUALLY BE SOLD
 - QUANTITY SOLD WILL DEPEND ON DEMAND
 - QUANTITY SUPPLIED MAY BE GREATER THAN, EQUAL TO OR SMALLER THAN QUANTITY ACTUALLY SUPPLIED
 - SUPPLY IS A FLOW
 - CAN BE EXPRESSED IN WORDS, NUMBERS, GRAPHS AND SYMBOLS

LEARNING UNIT 4

- INDIVIDUAL SUPPLY
 - PRICE OF A PRODUCT (P_x)
 - PRICES OF ALTERNATIVE PRODUCTS (P_e)
 - PRICES OF FACTORS OF PRODUCTION (P_f)
 - EXPECTED FUTURE PRICES (P_e)
 - STATE OF TECHNOLOGY (T_y)
 - $Q_s = f(P_x; P_e; P_f; P_e; T_y, \dots)$

LEARNING UNIT 4



LEARNING UNIT 4

➤ MARKET SUPPLY

- INDIVIDUAL SUPPLY CURVES ARE ADDED TOGETHER
- MARKET SUPPLY CURVE SHOWS RELATIONSHIP BETWEEN PRICE OF PRODUCT AND QUANTITY SUPPLIED

➤ OTHER FACTORS THAT MAY INFLUENCE SUPPLY

- GOVERNMENT POLICY eg SUBSIDIES
- NATURAL DISASTERS
- JOINT PRODUCTS & BY-PRODUCTS
- PRODUCTIVITY – RELATED TO TECHNOLOGY

LEARNING UNIT 4

➤ MOVEMENTS ALONG THE SUPPLY CURVE

- AS PRICE INCREASES, SUPPLY WILL INCREASE
 - SLOPE IS A POSITIVE SLOPE
 - WHEN PRICE CHANGES, THERE WILL BE A MOVEMENT **ALONG** THE CURVE
 - A CHANGE IN QUANTITY SUPPLIED OCCURS

LEARNING UNIT 4

- **SHIFT IN SUPPLY CURVE**
 - A CHANGE IN DETERMINANTS, OTHER THAN PRICE, WILL CAUSE A **SHIFT** IN THE SUPPLY CURVE
 - CHANGE IS CALLED A CHANGE IN SUPPLY

LEARNING UNIT 4

- **MARKET EQUILIBRIUM**
 - EQUILIBRIUM REPRESENTS A SITUATION WHERE NONE OF THE PARTICIPANTS WANT TO CHANGE THEIR BEHAVIOUR
 - THEREFORE WHEN QUANTITY SUPPLIED = QUANTITY DEMANDED
 - PRICE AT WHICH THIS OCCURS IS CALLED **EQUILIBRIUM PRICE**
 - DISEQUILIBRIUM = WHEN QUANTITY SUPPLIED IS **NOT** EQUAL TO QUANTITY DEMANDED
 - IF QUANTITY DEMANDED IS MORE THAN QUANTITY SUPPLIED, WE HAVE A **SHORTAGE**
 - IF QUANTITY SUPPLIED IS GREATER THAN QUANTITY DEMANDED, WE HAVE AN **EXCESS**
 - MARKET FORCES WILL WORK, VIA PRICE MECHANISM TO BRING MARKET BACK INTO EQUILIBRIUM

LEARNING UNIT 4



LEARNING UNIT 4

- **FUNCTION OF PRICES**
 - SCARCE SUPPLIES WILL BE GIVEN TO THOSE WHO ARE WILLING TO PAY A HIGH PRICE FOR THEM
 - ARE SIGNALS AS TO HOW FACTORS OF PRODUCTION SHOULD BE USED IN PRODUCTION
- **CONSUMER SURPLUS**
 - DIFFERENCE BETWEEN WHAT CONSUMERS ACTUALLY PAY AND WHAT THEY WERE WILLING TO PAY
- **PRODUCER SURPLUS**
 - DIFFERENCE BETWEEN PRICE THAT SELLER WAS WILLING TO SELL PRODUCT FOR AND WHAT HE ACTUALLY RECEIVES

LEARNING UNIT 4

