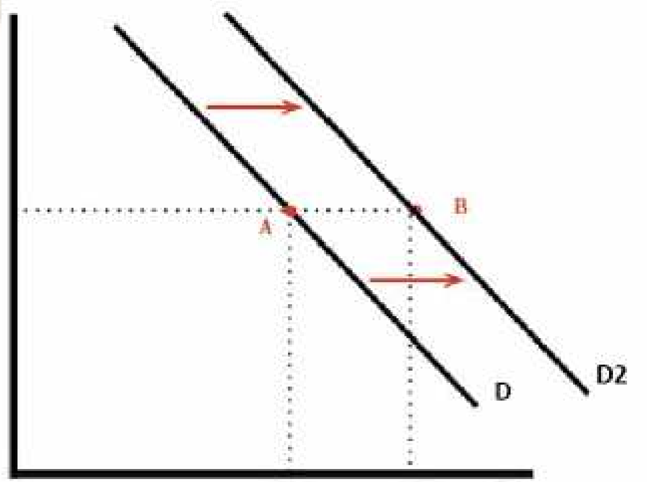
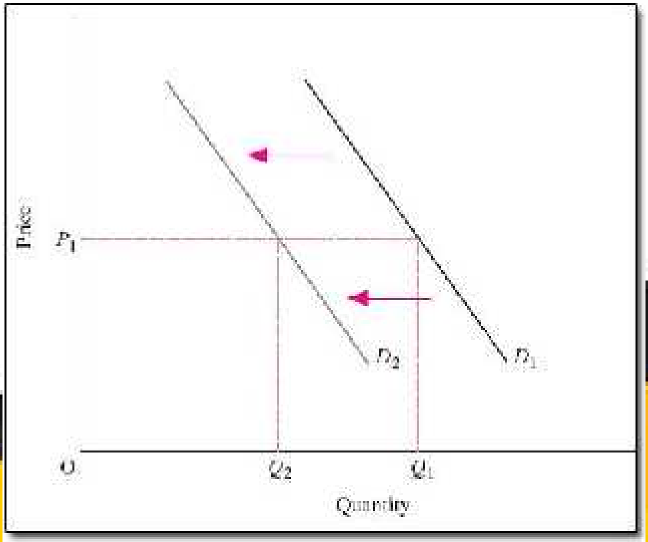
Interaction of demand and supply

Shifts in the demand curve

Change in demand: when there is a shift in the demand curve due to a change in factors other than the price of the particular product



A rightward shift indicates an increase in demand; a left ward shift indicates a decrease in demand.



- Consumers are now willing and able to buy more PCs at each and every price.
- Consumers previously were prepared to pay $1,600 for 3,000 PCs; now they are prepared to pay $1,800 each for that quantity.

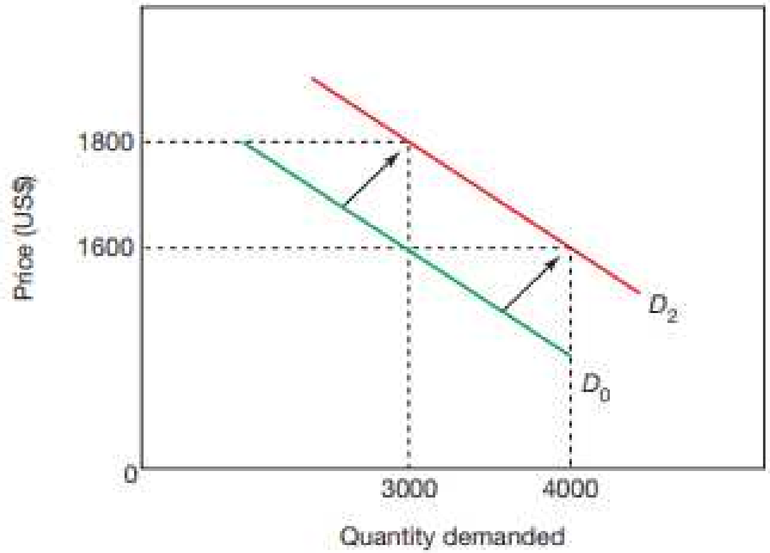


Figure 2.14 A shift to the right in the market demand curve for PCs

Causes of shifts in the demand curve

Economists have identified three key non-price categories that can be used to describe and analyse the factors that influence the demand for most products. They are:

1. the income/ability to pay for the product

2. the price and availability of related products

3. fashion, taste and attitudes.

Income/the ability to pay

What influences someone's ability to pay for a product? The key things are:

■ an individual's income or, more specifically, the purchasing power of their income after taxation

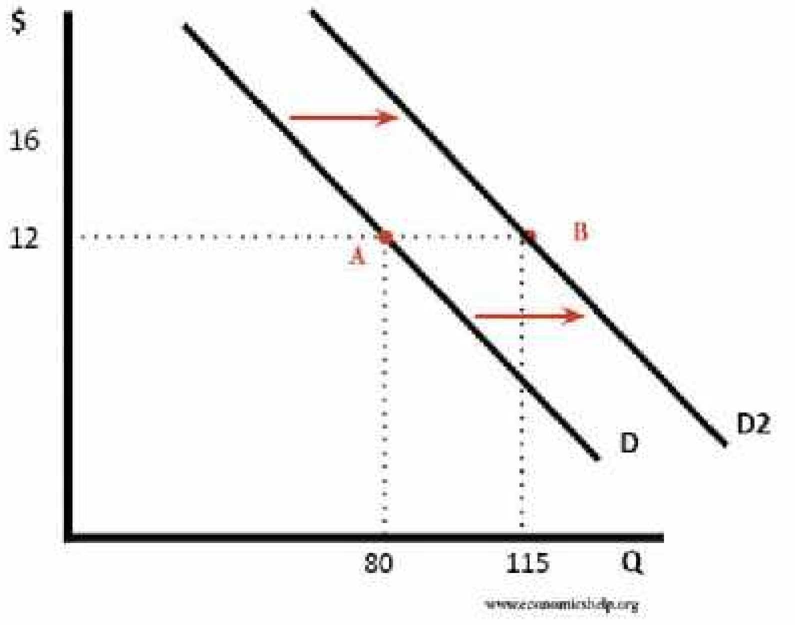
■ the availability of loans/credit and the interest rate that must be paid on loans or credit card balances.

The price and availability of related products

Normal goods

Positive relationship between the ability to pay and the demand for a product

- increase in the purchaser’s income generally leads to an increase in demand. D to D2



substitute goods

- If the price rises, then the demand for substitutes will increase as consumers switch their demand to the relatively cheaper products.

- It will shift to the right if the price of substitutes increases

Complements

- A rise in the price of one product will reduce the quantity demanded for it and its associated product.

- a fall in price will lead to an increase in the quantity demanded and will also lead to an increase in demand for its complement.

Fashion, taste and attitudes

- influenced by our own individual likes and dislikes, by peer pressure and by various forms of advertising and the marketing images that surround us.

Shifts in the market supply curve

- A rightward shift indicates an increase in supply; a left ward shift indicates a decrease in supply.

- Companies are now more willing and/or more able to supply PCs at each and every price.
- Companies previously wanted $1,200 per unit to persuade them to supply 3,000 units per week; now they are prepared to accept $1,000.

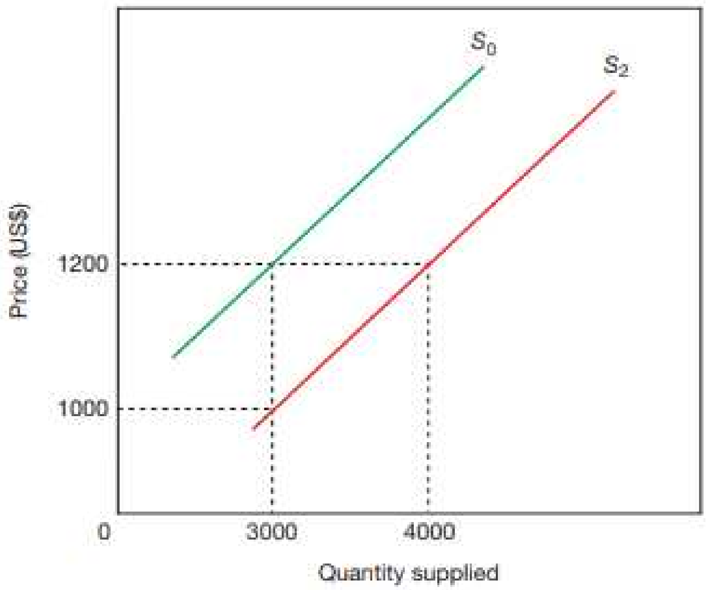


Figure 2.15 A shift to the right in the market supply curve for PCs

Causes of shifts in the supply curve

Possible factors other than price that will affect supply

1.The costs associated with supplying the product

2.the size, structure and nature of the industry

3. Government policy.

Costs

- Companies will make supply decisions on the basis of the price they can get for selling the product in relation to the cost of supplying it

Factors can cause an increase or a decrease in the costs of supplying each and every unit. If any factor pushes up costs, there is likely to be a left ward shift in the supply curve or a decrease in supply

- wage rates
- worker productivity (output per worker)
- raw material and component prices
- energy costs
- equipment maintenance costs
- transport costs
- the state of technology.

Size and nature of the industry

- If the size of the industry increases, because there are more firms or bigger firms, then it is likely that the supply of the industry will increase
- if firms in the industry start to compete more intensively on price, it is likely that the supply curve will shift to the right as the effects of this price competition start to affect the price that all companies are willing to accept for their products

Government policy

Specific tax: an indirect tax that is fixed per unit purchased.

Ad valorem tax: a tax that is charged as a given percentage of the price

- Governments may also impose *a specific tax* such as excise duties on the output of companies or an *ad valorem tax* such as a sales tax or value added tax on particular goods and services.

- Certain types of legislation or government subsidies can increase supply by encouraging firms to reduce prices for any given level of output

Legislation designed to protect consumers or workers may impose additional costs on companies and this may affect the supply curve

Other supply-influencing factors

Joint supply: when two items are produced together

For example, soya bean production, where part of the crop is used for human food products while what is left over is used to produce animal feed