

DEMAND

Demand: the quantity of a product that consumers are able and willing to purchase at various prices over a period of time

Market: where or when buyers and sellers meet to trade or exchange products.

It is important to remember that a want and demand are entirely different what consumer's want they may not actually purchase.

Notional Demand: The desire for a product

Effective Demand: The willingness and ability to buy a product

The definition of demand assumes that the only factor affecting demand is price, economists refer to this as ceteris paribus

Ceteris Paribus: Assuming other variables remain unchanged

The relationship between demand and quantity is INVERSE

CONSUMER SURPLUS:

In every market there are always people who are willing to pay above what they actually pay.

Consumer Surplus: the extra amount that a consumer is willing to pay for a product above the price that is actually paid!

Diagram:

The determinants of Demand ☺

Consumer Income

Real disposable Income: income after taxes on income have been deducted, state benefits have been added AND the result is adjusted to account for changes in prices!

For Example:

If the money I receive from my job increases by 5% but prices also increase by 3% then my real income only increases by 2%

Therefore if consumer income increases then so does demand but if it falls demand falls because they lose the ability to pay for the good.

Normal Goods: goods for which an increase in income leads to an increase in demand, they also have a positive income elasticity of demand.

Inferior Goods: goods for which an increase in income leads to a fall in demand

It is difficult to generalise with inferior goods because it is different for different people.

The Price of other products:

The demand for a product can be affected by a change in price for another different product

Substitutes: competing goods

If the price of one substitute increases then the demand for the other substitute will increase because the other substitute's prices are no longer competitive

Complements: goods for which there is joint demand.

Tastes & Fashions:

Over time these are constantly changing, If something is fashionable then it will be in high demand.

Tastes are more personal; vegetarians would never buy beef or chicken

An increase in consumer income	A shift to the RIGHT
A rise in price of substitutes	
A fall in price of complements	
A positive change in tastes and fashion	A shift to the LEFT
A fall in consumer income	
A fall in the price of substitutes	
A rise in the price of complements	
A negative change in tastes and fashion	

Total Revenue/Expenditure = Price X Quantity

SUPPLY:

Supply: The quantity of a product that producers are willing and able to provide at different market prices over a period of time

Economists assume that the motives of a producer are governed by profit

Relationship between Price and Quantity Supplied

Suppliers always want to supply at a high price!

There is a normal positive relationship between the two, if price rises, supply rises

Producer Surplus:

Producer Surplus: The difference between the price a producer is willing to accept and what is actually paid.

Diagram:

Determinants of Supply:

Costs of Production:

These would increase if a company had to pay more for labour or for certain natural resources. Banks cut cost by replacing labour with machines 😊

Size & nature of the industry:

In a competitive industry minor increases in costs can have a big effect on supply. In a more inelastic market, the cost can be passed onto the consumer without it having a great effect.

Government Policy:

VAT for example, this increases the price for the consumer which affects the ability of the producer to supply. Regulations can lead to higher costs of productions but Subsidy's can lower them 😊

Factors Suppliers cannot control:

Weather! Hugely important in the agricultural industry

Summary:

A fall in raw material costs	A shift to the RIGHT
An improvement in labour efficiency	
A reduction in the rate of indirect taxation	
A positive technological advance	
Any other positive factor	
An increase in raw material costs	A shift to the LEFT
An increase in labour costs	
An increase in the rate of indirect taxation	
Any other negative factor	

Equilibrium Price: The price where demand and supply are equal

Disequilibrium Price: Any position in the market where demand and supply aren't equal

In practice markets are very unstable and operate in disequilibrium, this is when we get excess demand/ supply

Surplus: an excess of supply over demand

For example the supplier feels that their product can be sold at £400 and at this price they will supply 1140 holidays but then consumers only buy 650 of those because the price is high, there is too much SUPPLY therefore the operator has to decrease the price. Sales!!! 😊

When supply is greater than demand price will fall!

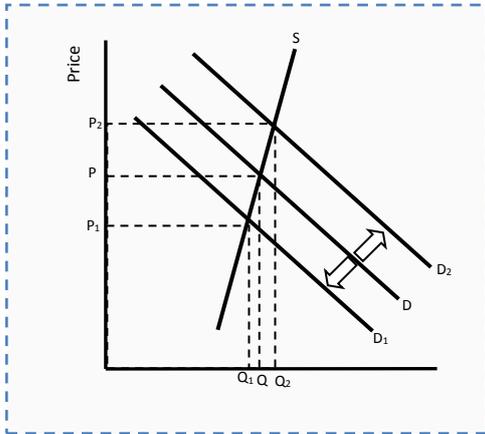
Shortage: an excess of demand over supply

When the producer sets the price at £200 and people would be willing to buy 1300 holidays, the problem arises when the producer says they can only supply 900 holidays. To fix this the operator increases their prices to provide more holidays but this is sometimes difficult

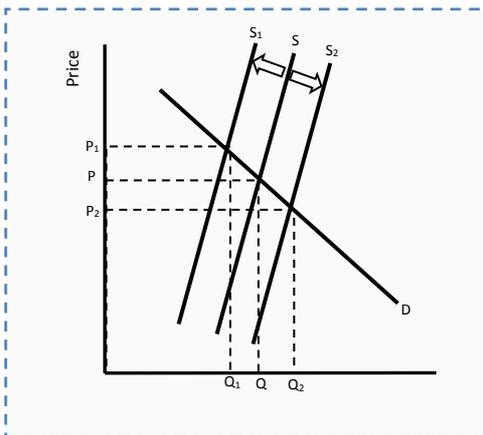
When demand is greater than supply, price will rise!

Demand & Supply Graphs:

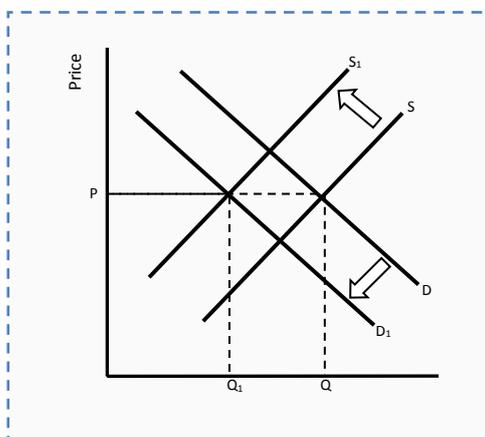
The demand curve could shift left or right ☺



The supply curve could shift left or right



Both curves could shift which could lead to the equilibrium price not changing



Elasticity's!

Elasticity: the extent to which buyers and sellers respond to a change in market conditions

They basically measure how much demand and supply changes when the factors affecting them are involved ☺

Price Elasticity of Demand: the responsiveness of a change in the quantity demanded to a change in the price of a product

$PED = \% \text{ change in QD} / \% \text{ change in price}$

Price Elastic: where the percentage change in quantity demanded is highly sensitive to a change in price

Price Inelastic: where the percentage change in the quantity demanded is insensitive to a change in price

The Determinants of PED:

The availability of Substitutes:

The more substitutes there are the more elastic a product is whereas things like petrol with not many substitutes is very inelastic

The relative expense of the product with respect to income

If a product takes up a very small proportion of a person's income e.g a banana then a double in price will not result in much change in QD these things are quite inelastic however when a product takes up loads of income e.g. a car/holiday it is far more price elastic

Time

At first it is difficult for consumer to alter spending habits so things appear to be price inelastic however over time as more substitutes are made aware to consumer the product becomes far more elastic.

INCOME ELASTICITY

The responsiveness of demand to a change in income

$YED = \% \text{ change in QD} / \% \text{ change in Income}$

The sign is extremely important!

+ means that it is a normal good and as incomes increase as does demand

- Means inferior good!

Income elastic: goods for which a change in income produces a less than proportionate change in demand

Income Inelastic: goods for which a change in income produces a greater than proportionate change in demand

Inferior goods: goods for which an increase in income leads to a fall in demand

These are your supermarket own brand goods ☺ as people get richer they want to buy less of them!

CROSS ELASTICITY:

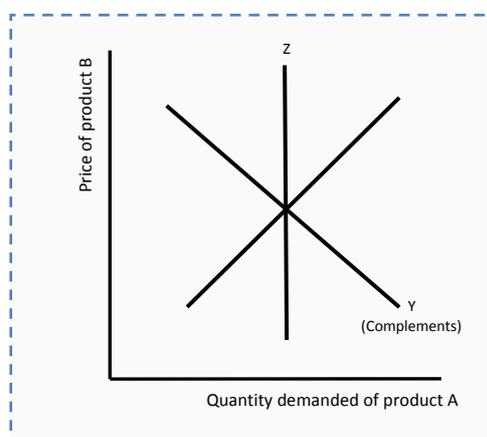
The responsiveness of demand for one product in relation to a change in the price of another product

$XED = \% \text{ change in QD of product A} / \% \text{ change in price of product B}$

+ is a Substitute!

- Is a Compliment!

0 means there isn't a particular relationship



Price Elasticity of Supply

The responsiveness of quantity supplied to a change in the price of the product

$PES = \% \text{ change in QS} / \% \text{ change in Price}$

If PES is elastic then a small change in price will have a big effect on the quantity supplied!

Determinants of PES:

Availability of Stocks of the product:

This is how quickly the producer can react to the change in demand, for example if there is a sudden fall in market prices and they cannot store their product because they're perishable it's going to have a big effect.

Asda, Tesco etc all have buffer stock which are released if market conditions change this aids their elasticity, however hotels cinemas and restaurants have supply that is infinitely inelastic since the product cannot be stored at all

Availability of Factors of Production:

For labour the supply is relatively elastic because workers can be used when needed (Christmas temps) For some business's the problem lies in not enough capital. If a firm needs to install machinery this takes time and the market may change.

Time Period:

Where it takes a lot of time for supply to be adjusted, supply will be price inelastic

BUSSINESS RELEVANCE OF ELASTICITY 😊

The Problems with Elasticity estimates:

Given that the nature data is collected (through surveys, past records and competitor analysis) it is important to remember the data are only estimates and inaccuracies may occur

Over time there might be other things affecting the estimate that haven't been thought of, prices may fall due to this and this would lead to an incorrect estimate

PED:

Used widely by business's to price their products, for example the transport industry has peak and off peak times

Peak time tends to be more inelastic because those purchasing tickets to London tend to have to be there before 10:30.

They use business to maximise revenue, elasticity estimates allow them to see how best to maximise their revenue.

YED:

In most economies real disposable incomes rise over time, this is good news for products that have a highly positive YED because demand rises as incomes do. This tends to mean that products with a negative YED will do badly. So the Positive Products have good long term business prospects ☺

However in the short term the highly positive elastic products demand will fall as people revert to inferior goods

XED:

This is particularly important to firms operating in a very competitive market. Increasing prices is risky unless subs all follow

PES:

Remember that over time products become far more price elastic so the producer can re allocate resources to respond to the increased price.

Allocative Efficiency:

Efficiency occurs in a market when the best use is made of available resources and the market works in a way that is most beneficial to consumers.

Efficiency: where the best use of resources is made for the benefit of consumers.

Allocative Efficiency: where consumer satisfaction is maximised.

This is where resources are used to produce goods and services that consumers actually demand, to do this the market must function at the **equilibrium position**.

The graph shows 2 points of allocative inefficiency because suppliers are not matching the quantity demanded.

