Cheatography

How prices are decided Cheat Sheet

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Price mechanism

Price machanism	Higher prices indicate higher demand and vice versa
	Rising prices indicate to producers to allocate their resources into that product

Demand

Demand	**for consumers** is the want or willingness of consumers to buy Gs or Ss
	for demand to be effective consumers must have enough money to buy what they want and need
Effective demand	real intention of consumers to purchase and to pay with the means available
Quantity dimanded	the amount of a good or service consumers are willing and able to buy
Individual demand	D of just one consumer
Market demand	the total D for that product from all its consumers willing and able to buy it
Aggregate demand	the total demand for all Gs&Ss in the economy
Demand curve	displays the D of all the consumers of that commodity given a set of possible prices
	following mostly applies: as price rises QD falls and vice versa, roughly downward sloping, P and QD move in opposite directions

Demand (cont)

	market D curve shows the relationship between the total QD by consumers each period and the price of that product
Change in price	**movement along the curve and extension/contraction of D**
Utility	the satisfaction consumers have after buying and using Gs&Ss the wanted, they assume it is rational
Marginal utility	the extra unit gained from the consumption of one more product, usually goes down at some point
The law of diminishing returns	the more of a commodity consumers have, the less utility they get from consuming one more unit of it

Shifts in demand

Ceteris paribus	all other things remaining unchanged, so no other factor that affects consumer's D changes
Increase/rise in D	consumers D more of a product at every price than they did before
	the DC moves outwards (to the right)
Fall in the D	consumers now demand less of a product at every price than they did before
	the DC moves inwards (to the left)

Shifts in demand (cont)

Changes in D	other factors like changes in people's income (normal or inferial Gs, changes in income tax, changes in the population, changes in the prices of other Gs (complementary GS - complements/substitutes), changes in tastes and fashion, advertising, etc.

Supply

Supply	the willingness of producers to make and sell Gs&Ss at different prices
Quantity supplied	the amount of Gs&Ss producers are willing and able to make and sell to consumers in a market
Market supply	the sum of all the individual supply curves of producers vompeting to supply that product
Supply curve	expresses the amount of a good or service firms or producers are willing to make and sell at a given price
	opposit of DC
Change in price	**movement along the curve**
	and extension/contraction of supply
Other factors	**increase/fall in supply**

Changes in supply

Changes in the cost of factors of production	fall in costs will increase profits and the SC will shift outwards and vice versa
Changes in the price and profitability of other Gs & SS	may cause different ammount of S of different products

Changes in supply (cont)

Technical progress	new technology may be able to increase its production and vice versa
Business optimism and expectations	firms allocate resources based on what they think will be the most profitable
Other factors	natural disasters, sudden changes in weather, international trade sanctions, wars and political factors

Market price

Market price	QD and QS is the same
Equilibrium price	another name for market price
Excess supply	at higher prices firms supply more products above the D
Excess demand	at low prices low amount of products is supplied
Disequilibrium	D doesn't equal S

Changes in market prices

A shift in the market D	higher QD = higher P = higher S
A shift in the market S curve	higher S = lower P = higher D
Market price increases if	market D rises or market S falls

Price elasticity of demand

PED	the responsivness of consumer D to changes in the price of a good or service
Elastic	change in price affects the QD (more shallow)
	PED > 1

Price elasticity of demand (cont)

Inelastic	change in price doesn't affet the QD, if so only in small amount (steeper)
	PED < 1
How to calculate PED?	PED = % change in QD/% change in P
	% change in QD = (change in Q/original Q) x 100
	% change in P = (change in P/original P) x 100
Determinants of PED	factors that affect PED
	if the product is a necessity - inelastic
	the number of close substitutes a product has - more = elastic, less = inelastic
	the amount of time consumers have to search for subsitutes - more time = inelastic, less time = elastic
	the cost of switching to a different supplier - high = inelastic, low = elastic
	the proportion of consumer's income spent on the product - higher = elastic, lower = inelastic
Why is knowleadge of PED useful?	e. g. while government is placing taxes (cigarettes, alcohol, etc.)

Special demand curves

Perfectly price inelastic E = 0	a straight vertical line, rise/fall in the P of commodity causes no change in S (insuline)
Infinitely price elastic E = ∞	a straight horizontal line, any change in D will cause S to fall to zero, unrealistic
Unitary elasticity E = 1	a % change in P will cause an equal change in the QD (looks line a DC)

Other measures of elasticity of demand

Income elasticity of D	by how much a change in income causes the QD of G/S to change
	IED = % change in QD/%i change n income
	positive number - rise in income = rise in D, normal Gs
	negative number - rise in income = fall in QD, inferior Gs
Cross elasticity of D	by how much QD will rise/fall given the change in the price of another product
	CED = % change in Q of good X/% change in P of good Y
	positive number - rise in P = rise in D, substitutes
	negative number - rise in P = fall in D, complements
Price elasticity of supply	responsivness of QS to a change in P
	PES = % change in QS/% change in P

Other measures of elasticity of demand (cont)

	ES > 1 - price elastic - small increase in P = large extension in S
	ES < 1 - price inelastic - rise in P = littel extention in S
	change in P>change in D = price inelastic
	change in P<change in D = price elastic
Determinants of PES	**the avaliability of stock of finished Gs and components** - higher availability = elastic, low availability = inelastic
	degree of unused or spare production capacity - higher = elastic, lower = inelastic
	availabbility of resources - higher availability = elastic, lower availability = inelastic
	time - momentary run (all FoP fixed - inelastic), short run (1 FoP variable, other 2 fixed), long run (all FoP variable - elastic)

Special supply curves

Perfectly price inelastic PES = 0	straight horizontal line, the QS remains the same whatever the P is
Infinitely price elastic PES = ∞	straight horizontal line, producers are willing to S as much as they can at one particular price, theory
Unitary elasticity PES = 1	a % change in price will cause an equal % change in QS

Taxes and subsidies

Taxes	imposed on Gs & Ss are known as **indirect taxes** (VAT, excise duties placed on cigarettes and alcohol, etc.)
	indirect taxes have an effect of increasing the market price and reducing the Q traded in a market
Subsidy	payment made to producers to help to reduce their costs of production
	producers tend to increase their S at every given P, higher S = fall in MP = benefit to the consumers