## 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 |



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## 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 |



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## 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 |



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