

MGT 104

Micro Economics

Supply

Supply is defined as the total amount of a specific good or service that firms are able to produce and offer for sale.

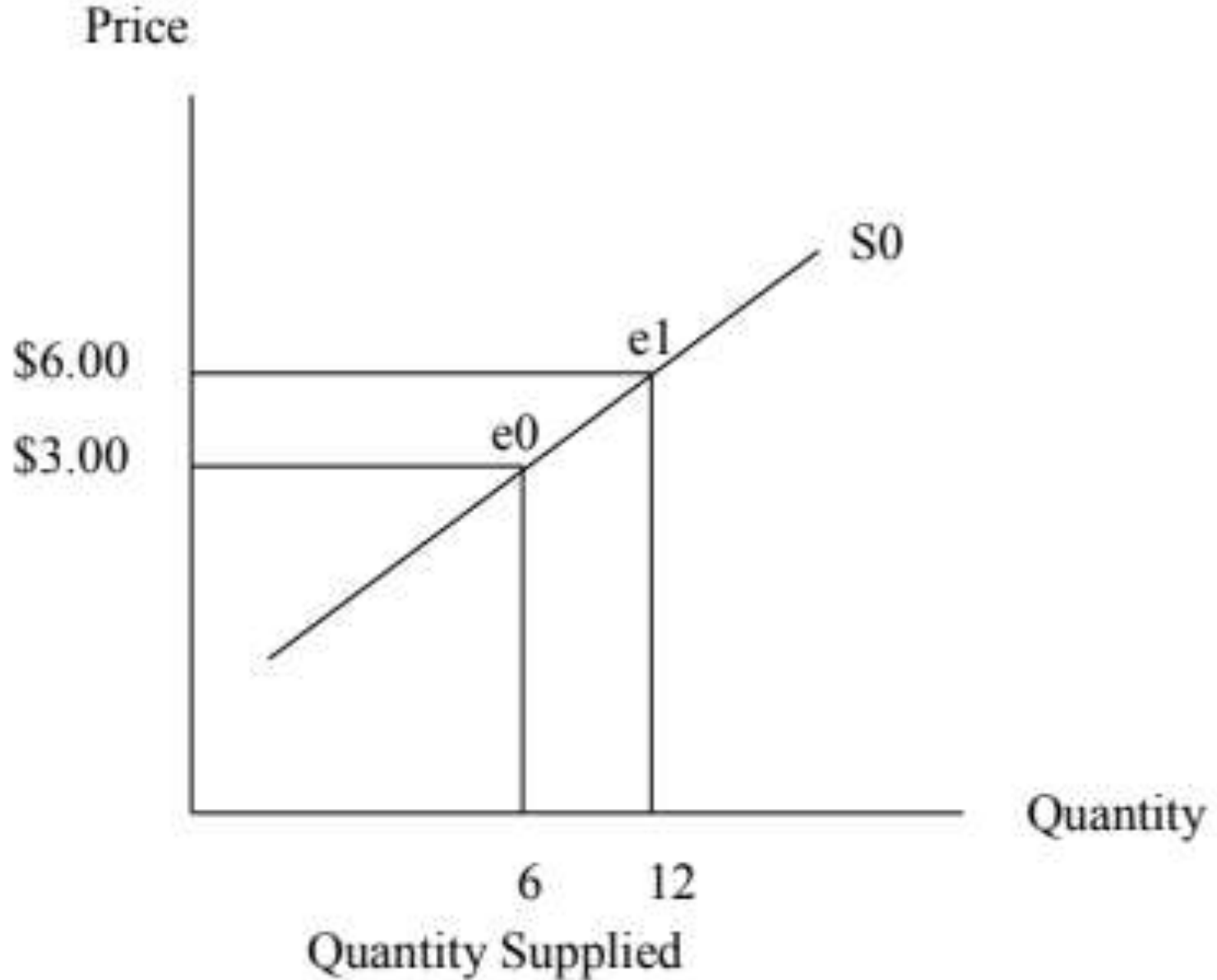
It is the total amount of a product (good or service) available for purchase at any specified price.

Law of Supply – Movement along the Supply Curve

Quantity supplied is that amount of goods that firms supply at a particular price level.

When the price of the product rises, for example, from \$3.00 to \$6.00, quantity supplied will increase from 6 units to 12 units which will be depicted as an upward movement along the supply curve from e_0 to e_1 as can be shown in the following graph.

Law of Supply – Movement along the Supply Curve



Law of Supply - Movement along the Supply Curve

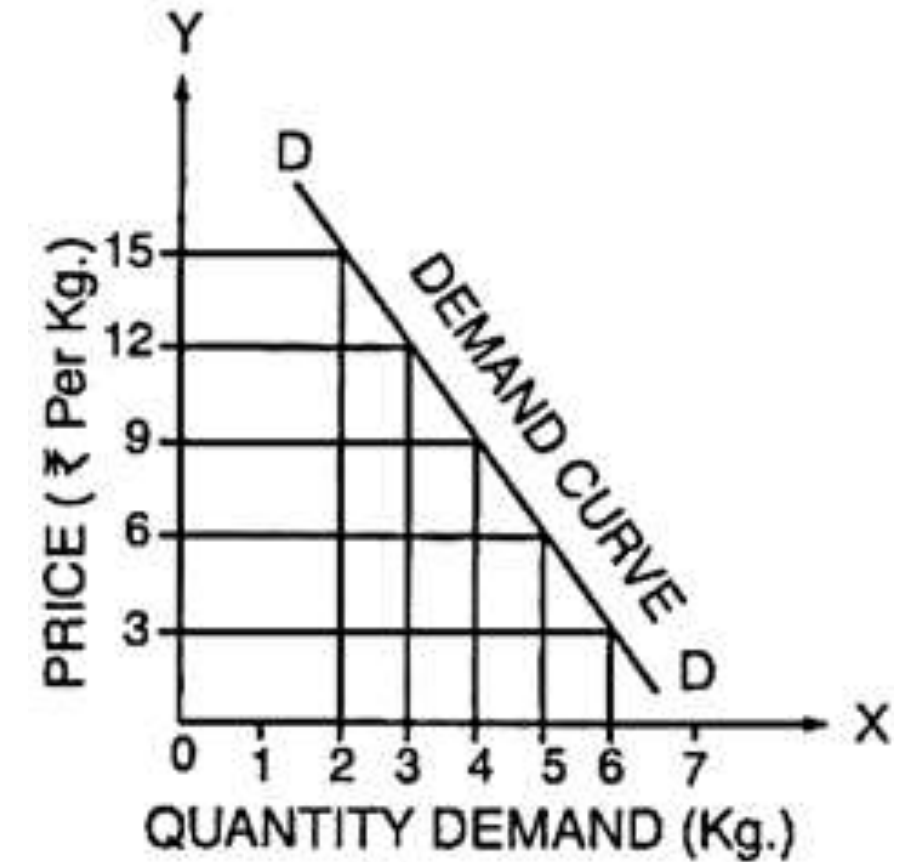
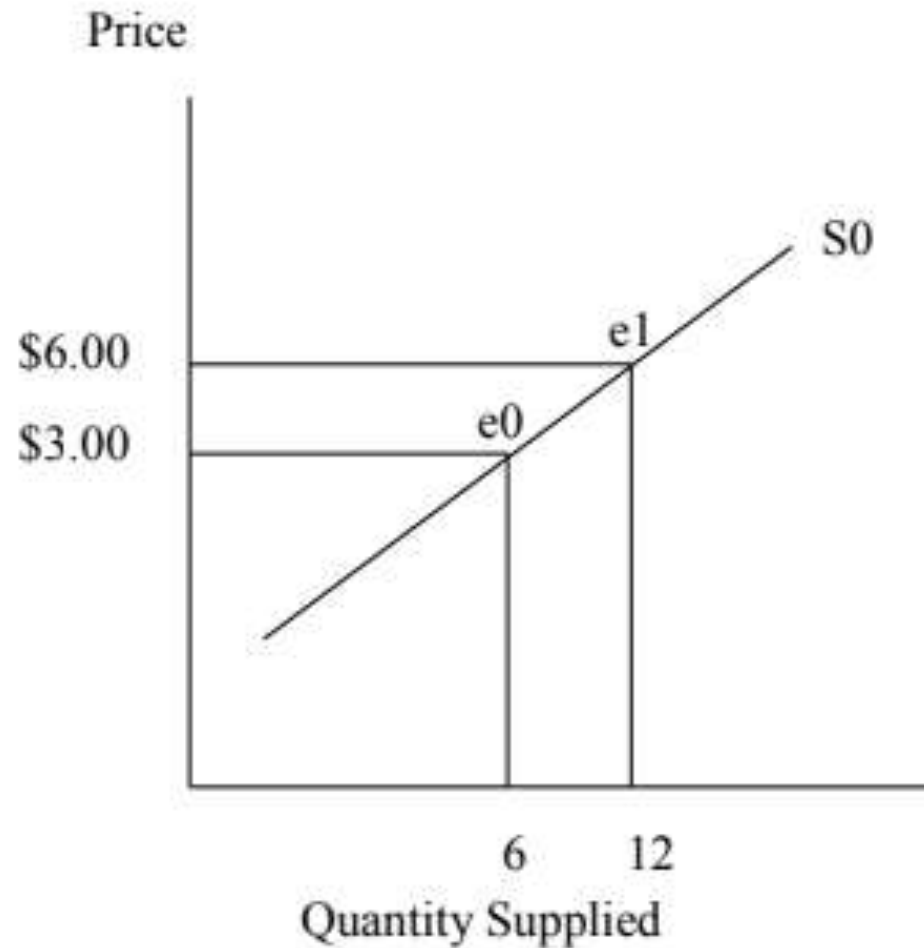


Fig. 7.1

Quantity

Law of Supply – Shifts in the Supply Curve

As stated above, quantity supplied is affected mainly by price and is shown as a movement along the supply curve.

On the other hand, supply is determined by other factors and these are represented by a shift of the entire supply curve.

These factors are cost of production, number of customer and state of technology.

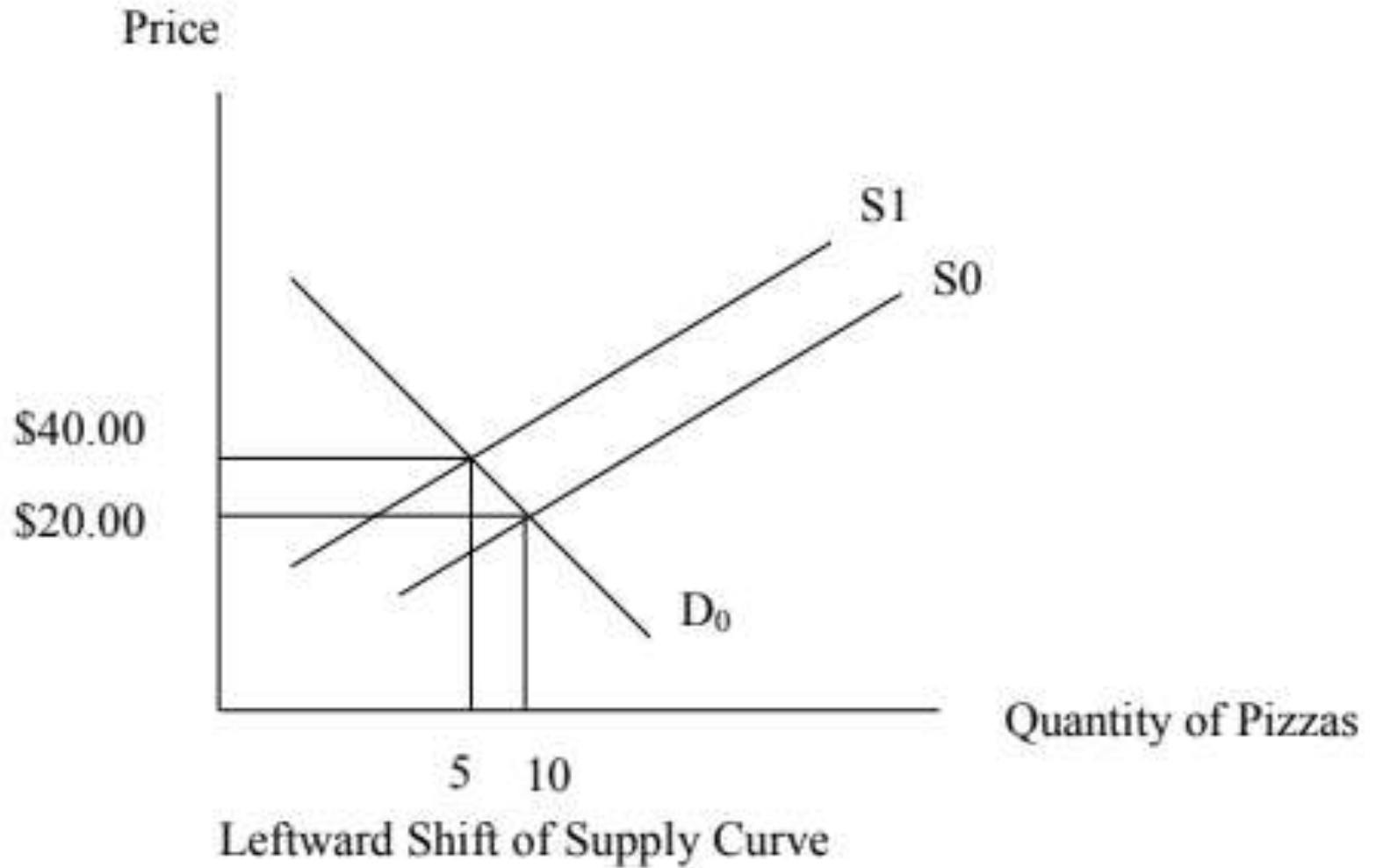
Law of Supply – Shifts in the Supply Curve

Cost of production – when costs of production for pizzas increase, this will make it expensive for producers to produce and so supply will fall.

This will cause the supply curve to shift to the left from S_0 to S_1 with the supply of pizzas falling from 10 pizzas to 5 pizzas as shown in the following graph.

Eventually price will increase from \$20.00 to \$40.00 due to the reduced supply of pizzas.

Law of Supply - Shifts in the Supply Curve



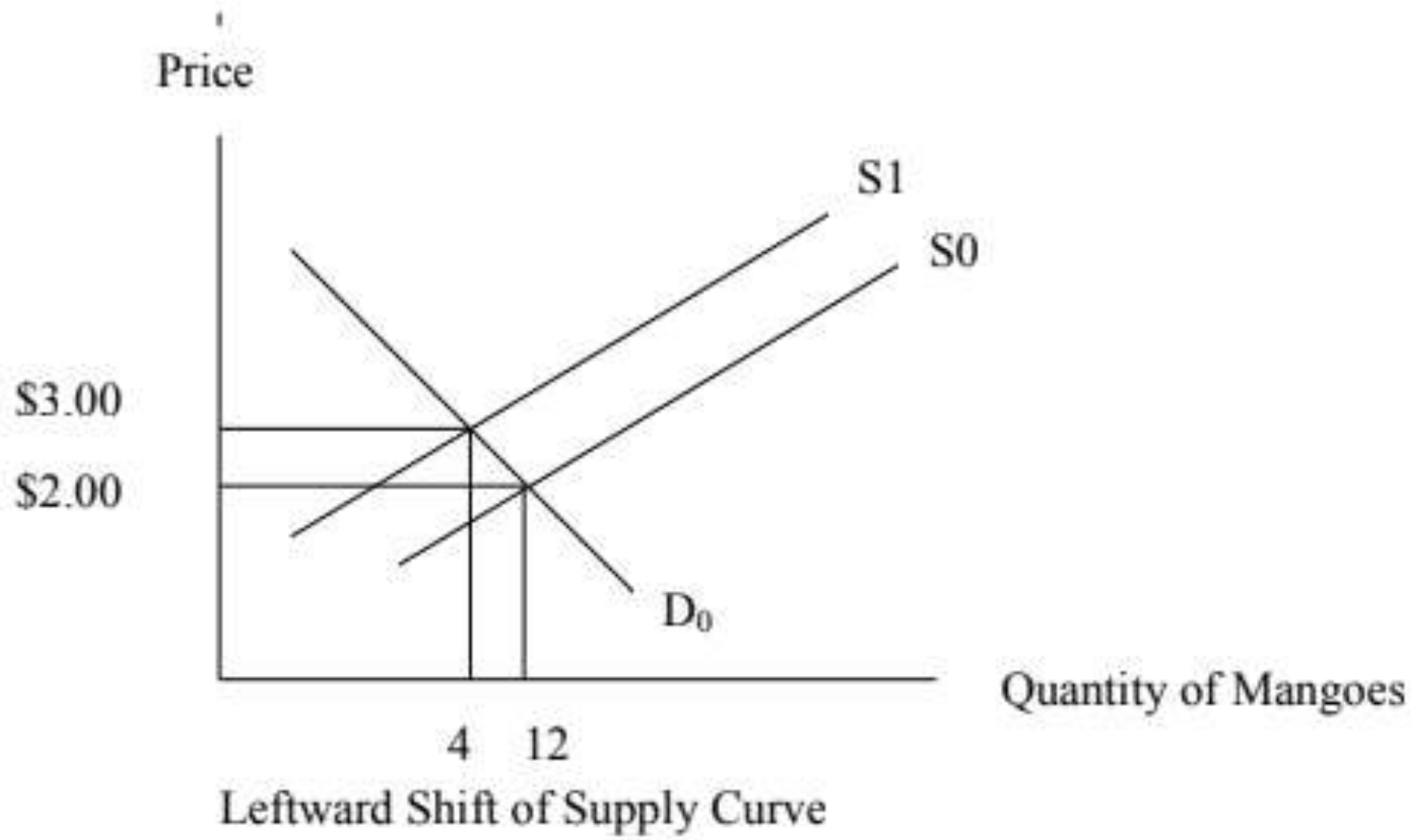
Law of Supply – Shifts in the Supply Curve

Number of Consumers – the smaller are the number of consumers for mangoes, the smaller will the market be for mangoes and so the less will be the supply of mangoes.

Assuming the supply curve for mangoes was at S_0 , the supply curve will now shift up to the left to S_1 with supply falling from 12 mangoes to 4 mangoes.

Because there is less mangoes on the market, the price of mangoes will now rise from \$2.00 to \$3.00 as shown in the following graph.

Law of Supply - Shifts in the Supply Curve



The Market

A market is defined as the interaction of all buyers and sellers in a particular sector or industry whose activities influence the price of the product or service in that industry.

There are two sides to a market: 1) demand and 2) supply. Demand is the willingness and ability of consumers to pay for their wants and needs.

The Market

On the other hand, supply is the willingness and ability of firms or businesses to make available goods and services to meet the wants and needs of consumers.

Determination of Equilibrium

Equilibrium price is also called market clearing price because at this price the exact quantity that producers take to market will be bought by consumers and there will be no surplus or shortage.

Equilibrium is where demand (D_1) equals supply (S_1) such as at point e_1 as in the following graph. At this point, there is no surplus or shortage and price will be P_1 and demand is Q_1 .

Determination of Equilibrium

There are times when the equilibrium position may change.

For example, demand may increase which may cause a rightward shift of the entire demand curve from D1 to D2.

Determination of Equilibrium

When demand rises from D_1 to D_2 , there will be a shortage (the difference between Q_1 and Q_2). Due to this shortage, there will be an upward pressure on price to increase and this will be at P_2 .

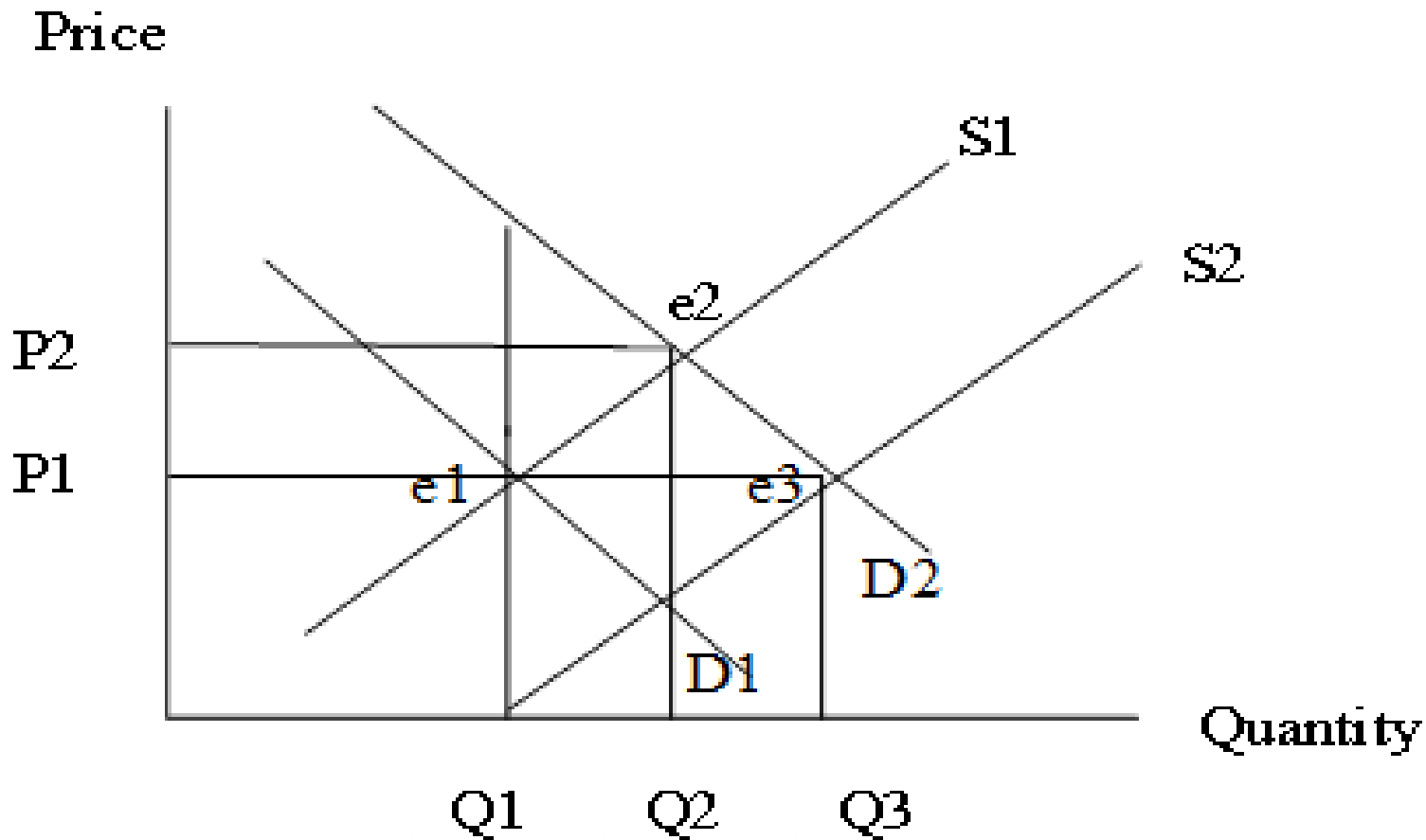
The new equilibrium is where D_2 equals S_1 at point e_2 . Because of this increased demand (distance between Q_1 and Q_2) and increased price (P_1 to P_2) along with the possibility of there being more suppliers entering the industry, manufacturers would want to increase their supply which will result in the supply curve shifting from S_1 to S_2 .

Determination of Equilibrium

This will result in quantity supplied being increased to Q_3 and price falling from P_2 back to P_1 . The end result of all these changes in the system for this particular product is the situation being settled where demand will be Q_3 and price falling back to P_1 because of the now increased number of suppliers in the industry.

New equilibrium will be where demand (D_2) and supply (S_2) such as at e_3 as can be seen in the following graph.

Determination of Equilibrium



Determination of Equilibrium when Demand Changes