

Demand curve= consumers will buy more when prices fall (inverse proportional)

Law of demand: other things equal, as price falls, quantity demanded rises

Diminishing marginal utility – as consumer increases consumption of G+S, utility obtained from each additional unit decreases

Income effect –change in price of product changes consumer's real income (purchasing power) and therefore quantity of G+S purchased

Substitution effect –at lower price, buyers would buy ONE product over a similar one just because the price has fallen

Determinants of demand:

- consumers' taste (preferences)
- number of consumers in market
- consumer income
- prices of related goods
- consumer expectations

normal goods = products where demand varies directly with income

inferior goods = demand varies INVERSELY with income

substitute good= one can be used in place of another good

complementary good = one used together with another good

increase in demand can be caused by:

- favourable change in consumer taste
- increase in buyers
- increase in income (if normal good)
- falling in income (if inferior good)
- increase in price of substitute
- decrease in price of complementary
- new expectation that price and income will be higher in future

change in demand = change in entire curve (curve move R/L)

vs.

change in quantity demanded = MOVEMENT FROM ONE POINT TO ANOTHER ON DEMAND CURVE (on same curve, just diff point)

Law of supply: price rises, quantity supplied rises (PROPORTIONAL)

Marginal cost= cost of producing one more unit of output

Determinants of supply:

- factor prices
- technology
- taxes and subsidies
- prices of other goods
- prices expectations
- # of sellers in market

change in supply vs. change in quantity supplied

equilibrium price (“market clearing price”) = price where intentions of buyers and sellers match (price demanded = quantity supplied)

surplus = amt supplied exceed demanded at specific (above-equilibrium) price

shortage = amount by which quantity demanded exceeds supplied (below-equilib)

rationing function of prices – ability of competitive forces of supply and demand to establish a price which selling and buying decisions are consistent (at equilibrium)

productive efficiency= production of G+S is in least costly way possible

allocative efficiency = mix of G+S most valued by society (distribution of resources among firms and industries to produce G+S most wanted by society) “giving ppl what they most want in the most effective way”= (MB = MC)

*complex cases of DEMAND AND SUPPLY

price ceiling = max legal price a seller can charge (eg. Rent control)

-ceiling price must be below equilibrium price (anything more would produce a shortage - demand starts falling after POINT)

interest rate ceiling on credit cards: may result in many effects (in book)

price floor –min price fixed by gov (eg. Wages)

-anything more would be surplus