Week 5: Demand and Supply theory

Demand Theory

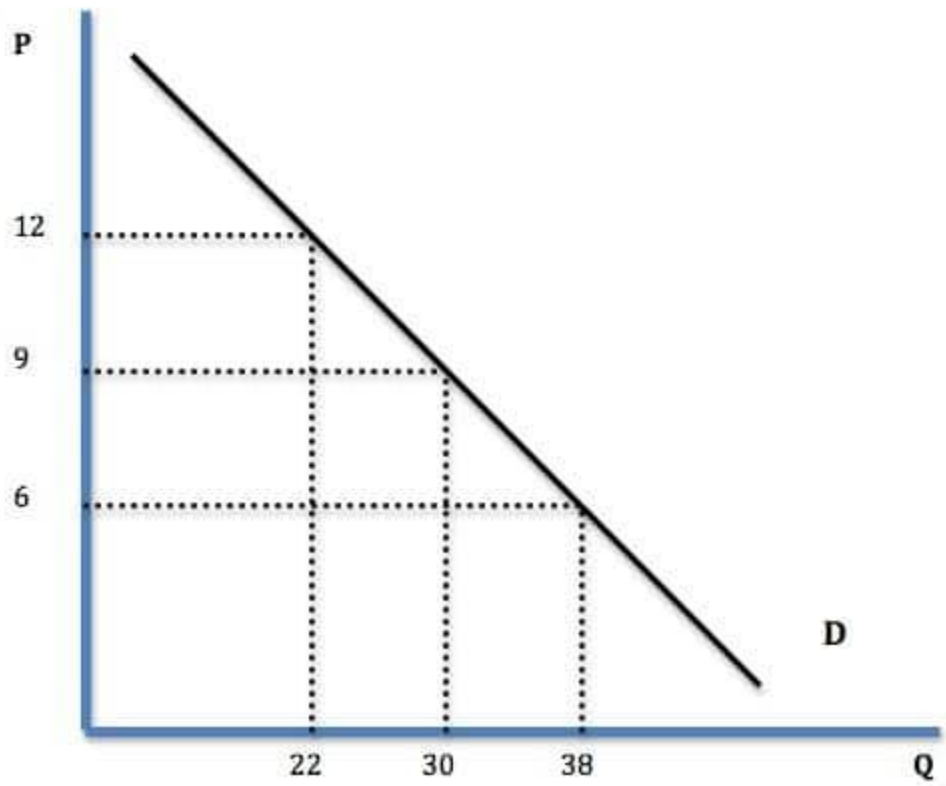
Use tutor2u and this video https://www.youtube.com/watch?v=YuV9RRqahVY to complete the following tasks.

Demand is the amount that consumers are .....

The demand curve shows the relationship between the .... at any given price over a period of time.

The law of demand states that as price increases....... and as price decreases......

This is represented as a line (or curve) on a diagram.

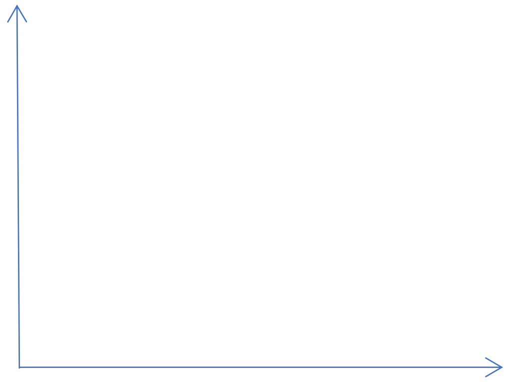


In the example above if the initial price was £9, demand is 30 units. Using this diagram, explain what is meant by a contraction and an extension in demand in the box below.

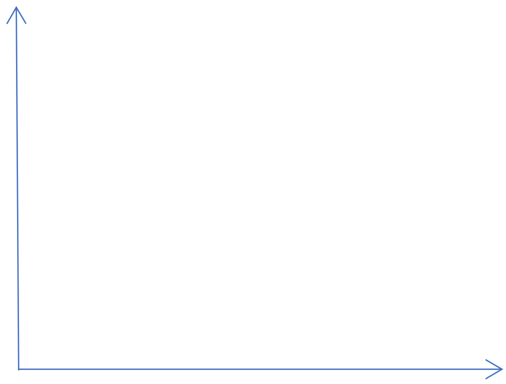
Changes in Demand

Factors other than price changing can shift the demand curve. The demand curve can move to the left, known as an increase in demand, or to the right, known as a decrease in demand.

1. Draw and label the impact on Price and Quantity demanded of a shift to the left, i.e. a decrease in demand at all prices



2. Draw and label the impact on Price and Quantity demanded of a shift to the right, i.e. a increase in demand at all prices



Causes of these changes, are usually factors outside the business's control. These are also referred to as **external factors**. This is a term you will come across a lot in your study of business.

3. What external factors could cause a shift in demand?
    - **Income** – a rise in income, can cause consumers to have more money to spend, therefore causing them to demand more of some goods
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    -

4. Sometimes demand for one product can affect the demand for another. Define and give examples of the following:

Type of demand	Definition	Example
Derived demand		
Joint demand		
Composite demand		

Elasticity of Demand

For your course you need to understand to *what degree* changes in price, consumer incomes and the price of other goods, affect the demand for a specific product. You will not need to be able to calculate the elasticity, just understand the theory. (Be grateful for this!)

The demand for some goods, is very responsive to price, whereas for other goods changes in price do not affect the demand. This is known as the **Price elasticity of demand**, or **PED**. This video here, will help you to understand the concept.

1. Complete the following table

PED	For a price increase, total revenue.....	For a price decrease, total revenue	Examples of goods that respond in this way
Elastic			
Inelastic			

Responsiveness to changes in consumer incomes is known as **Income elasticity of demand** or **YED.** This VIDEO can help to explain this topic.

2. Complete the following table

Type of good	Definition / type of elasticity	Impact of a RISE in consumer income	Examples of goods
Luxury			
Normal			
Inferior			

The final type of elasticity you need to understand is known as **Cross Elasticity of Demand** or **XED**. This is where a change in the price of one good, affects the quantity demanded of another. Watch this VIDEO and complete the table.

Type of good	Definition / type of elasticity	Impact of a RISE in the price of an alternative product	Examples of goods
Complementary			
Substitute			

Application Exercise

When answering these, there may not be a simple answer. At this level you will need to consider more than just one factor.

1. Read this article: https://www.bbc.co.uk/news/business-52508010. Clearly the demand for cars has fallen due to the pandemic. What other markets could be affected by this fall in demand?

2. Using your knowledge and understanding, explain what has happened to demand for online shopping services, such as Amazon during the pandemic and why.

3. Like myself ☹ many people have had or will have overseas holidays cancelled. Analyse how this could affect the demand for other goods and services.

4. Many staff have been furloughed or even lost their jobs. Analyse the impact of this on the demand for goods and services.

Supply Theory

Whilst demand is all about the impact of price and quantity from the consumers point of view, supply is about price and quantity from the business's point of view.

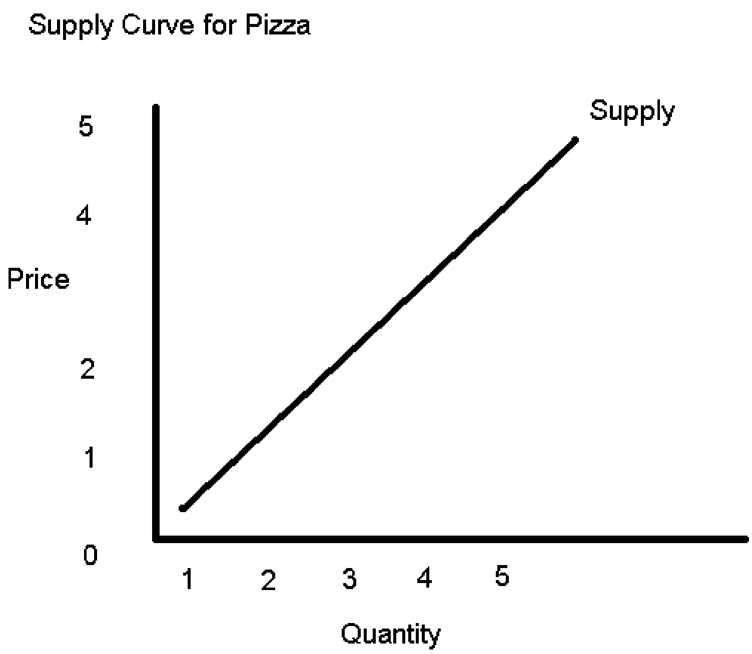
1. This [VIDEO] will introduce you to supply theory. Watch this and complete the gaps below:

Supply is the amount that producers are …..

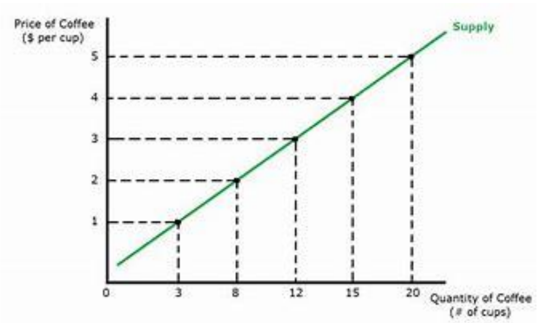
The supply curve shows the relationship between the ……………… at any given price over a period of time.

The law of supply states that as price increases……. and as price decreases……

This is represented as a line (or curve) on a diagram.



As in demand theory, a movement *along* the supply curve is caused by a change in price, and referred to as a contraction or expansion of supply.



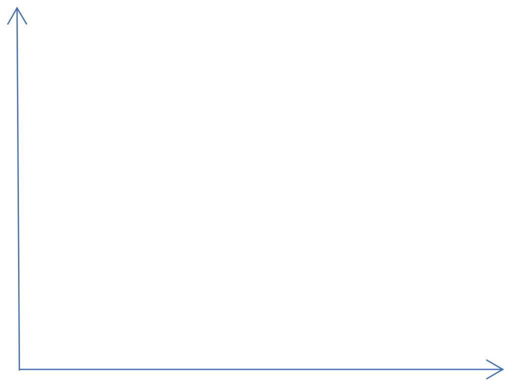
2. Using the diagram above, explain and give an example of a contraction and expansion of supply.

3. Why does this expansion and contraction happen?

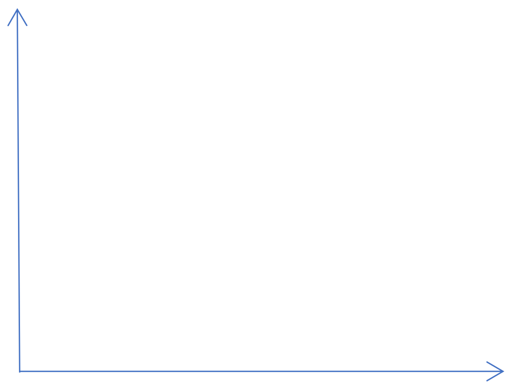
Changes in Supply

Factors other than price changing can shift the supply curve.

1. Draw and label the impact on Price and Quantity demanded of a shift to the left, i.e. a decrease in supply at all prices



2. Draw and label the impact on Price and Quantity demanded of a shift to the right, i.e. an increase in supply at all prices



3. What external factors could cause a shift in supply?
    - **Change in costs, e.g. of raw materials** – an increase in the costs of a business, for example the minimum wage increasing, can lead to an increase in the total costs. For some businesses this may mean that it is unprofitable to produce, and so they leave the market
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4. Define and provide examples of the following types of supply

Type of supply	Definition	Example
Joint supply		
Composite supply		
Competitive supply		

Price elasticity of supply

Price elasticity of supply, or **PES**, shows how responsive a business is in the levels of output to a change in the price of goods.

A good that has elastic PES is one where a change in the price will cause a large percentage change in the quantity supplied.

1. What is an inelastic PES?

2. What factors can affect the level of PES?

3. How can a business improve their PES, i.e. become more responsive to changes in the price of goods?

Application Questions

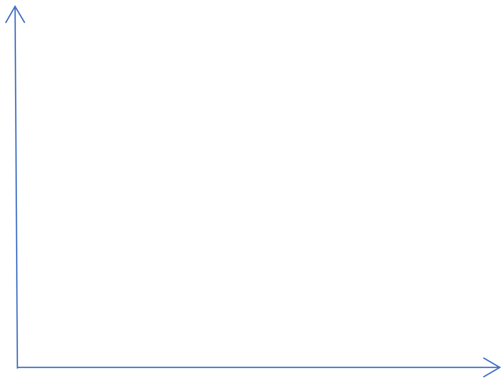
1. Read this news article from the BBC: https://www.bbc.co.uk/news/business-52543650. How does this illustrate the impact of changing price on supply?

2. Read this blog and the links. What factors are affecting the elasticity of supply in this case?

Price equilibrium

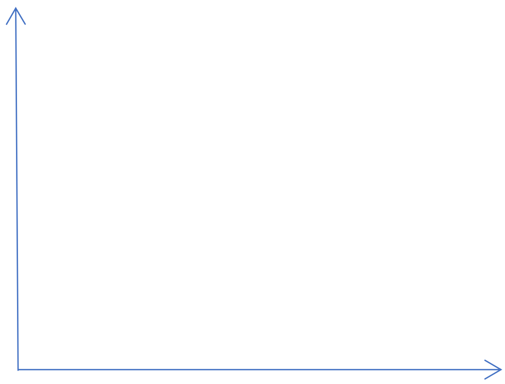
The equilibrium market price is when the amount a firm is willing to supply at a given price is the same as the amount consumers are willing to buy at the given price.

1. Draw a diagram to represent equilibrium price



Shifts in either the demand curve or the supply curve will affect equilibrium price

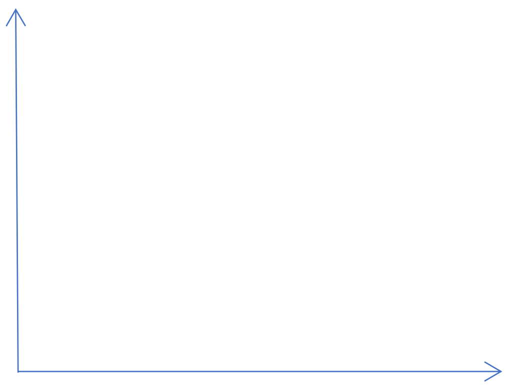
2. Draw the impact of a shift to the LEFT of the demand curve



What has happened to the Quantity sold in the market?

What has happened to the market price?

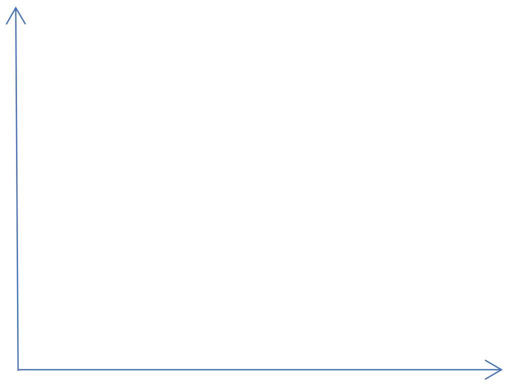
3. Draw the impact of a shift to the RIGHT of the demand curve



What has happened to the Quantity sold in the market?

What has happened to the market price?

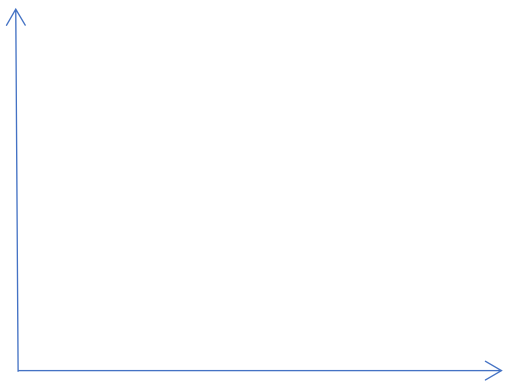
4. Draw the impact of a shift to the LEFT of the Supply curve



What has happened to the Quantity sold in the market?

What has happened to the market price?

5. Draw the impact of a shift to the RIGHT of the Supply curve



What has happened to the Quantity sold in the market?

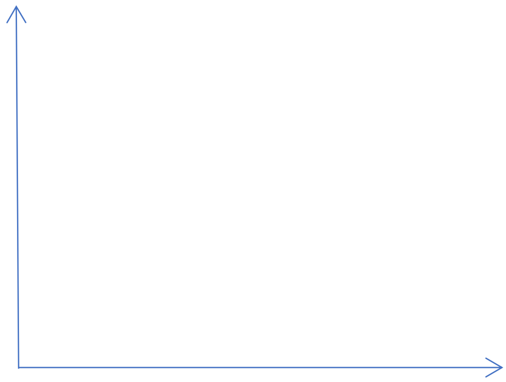
What has happened to the market price?

Market disequilibrium

This can be caused when the price is set above or below the market price. We therefore end up with a state of excess demand or excess supply. Economic theory states that market forces will eventually bring the market back into equilibrium.

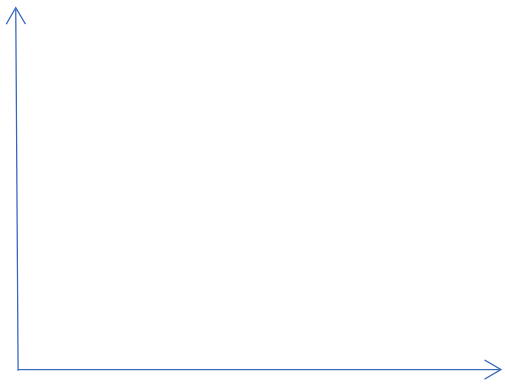
Excess demand – caused when there is greater demand than there is supply at a given price. This could be because a maximum price has been set on a product, which is below what the market price should be. Over time, prices will rise to the market price, as consumers will offer to pay more

1. Draw a diagram to illustrate this



Excess supply – caused when there is greater supply than there is demand at a given price. This could be because a minimum price has been set on a product, which is above what the market price should be. Over time, prices will fall to the market price, as producers will lower the price to get rid of stock

2. Draw a diagram to illustrate this



Application Questions

For these questions, try to think beyond the recent pandemic, and provide a newspaper article, images or quote to illustrate your example.

1. Explain an example of a market where there has been excess supply

2. Explain an example of a market where there has been excess demand