

Outline for lecture 4

ECON 1a, Fall 2008, Warren Gibson

More about supply and demand

- Supply curves always slope up, demand curves down.
- A change in P or Q implies movement along the curves. A change in anything else implies a shift of the whole curve.
- Working with factors that shift curves:
 - Draw a S/D diagram
 - Decide which of the following is implied by the words:
 $D \uparrow, D \downarrow, S \uparrow, S \downarrow$.
 - On your diagram, draw a new demand or supply curve with a dashed line.
 - See what happened to the equilibrium price and quantity, P^* and Q^* . Did they rise or fall?
 - Does the result make sense?
- Examples:
 - What happens to the market for *domestic* cotton in these circumstances?
 - * Nylon is invented.
 - * The cotton gin is invented.
 - * The boll weevil becomes extinct.
 - * Foreign cotton growers bring in an exceptionally large harvest.

- Suppose this discovery were announced: eating soybeans prevents cancer and heart disease.
 - * What happens to the price of soybeans?
 - * What happens to the price of feed corn (which can usually be grown on land suitable for growing soybeans)?
- Suppose all states adopt a no-fault rule to cover auto accidents so it becomes impossible to sue for damages after an accident.
 - * What happens to the fee lawyers charge to draft a will?
 - * If only one state adopts the no-fault rule, what happens to the charge for drafting a will in that state?
- New technology increases the gas mileage of gasoline engines substantially. What happens to the price of gasoline?
- Dental hygienists persuade everyone to floss their teeth three times a day. What happens to the price of dental floss?
- What happens to the price of acoustic guitars if
 - * Lots of people lose interest in guitars and start playing accordions instead?
 - * The price of electric guitars falls substantially?
 - * A major guitar maker exits the market and decides to make violins instead?
- What has actually happened in the markets for crude oil and gasoline recently?
 - * Summer 2006 gasoline consumption was about 6% below that for summer 2005.

- * Increased production from tar sands and shale oil, which was formerly uneconomical.

- Shortages

- Shortages occur when the price is below the equilibrium price (where the supply and demand curves cross). Some willing demanders (buyers) cannot find suppliers (producers) at the current price. As a result the price rises and the market adjusts:

- * Some marginal demanders leave the market.
- * Some marginal suppliers enter the market.
- * The shortage disappears.

- Sometimes government agents prevent market adjustment by imposing price *ceilings*. The market cannot adjust because the government forbids it. Then other rationing methods must be used to decide who gets the goods.

- * Example: SJ City government forbids the sale of coffee for more than \$1 per cup.
- * During the 1970's government would not allow sales of crude oil above a certain. There were long lines at gas stations which frequently ran out. Odd/even license plates.
- * WW2 ration cards for gasoline, tires, sugar.
- * Price ceilings may be non-binding, e.g. no one allowed to sell coffee for more than \$25 per cup.

- Surplus

- Surpluses occur when the price is above the equilibrium price

(where the supply and demand curves cross). Some willing suppliers (sellers) cannot find buyers and are stuck with unsold inventories. As a result the price falls and the market adjusts:

- * Some marginal suppliers leave the market.
 - * Some marginal demanders enter the market.
 - * The surplus disappears.
- Sometimes government agents prevent market adjustment by imposing price *floors*. The market cannot adjust because the government forbids it.
- * Congress likes to fix the price of cotton above the equilibrium price so politicians in cotton-growing states can get re-elected.
 - * Workers are not allowed to sell their labor services for less than \$7 per hour. The result is a surplus of labor (unemployment).
 - * Price floors may be non-binding. Example: workers not allowed to sell their labor for less than 50 cents per hour. The equilibrium price is much more than 50 cents.