

Introduction to Demand and Supply

Review

Reservation prices are the building blocks of demand and supply.

In a market economy, price acts as a rationing mechanism.

Demand Schedule summarizes buyer behavior.

Supply Schedule summarizes seller behavior.

The market equilibrium is the price and quantity such that demand equals supply.

What have we learned?

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Students protest UNC's sweatshop involvement

Online Exclusive
 April 11, 2008
 David Gilmore, Staff Writer
 0 comments

Students passing through Polk Place on Thursday were confronted with grim details about the working conditions of the factories that make their UNC shirts and caps.

Several students representing Student Action with Workers, a chapter of United Students Against Sweatshops, set up a table and read stories of workers who labor under hard and sometimes illegal conditions to create University apparel.

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To Take Advantage of the Benefits of Specialization, People Must Trade.

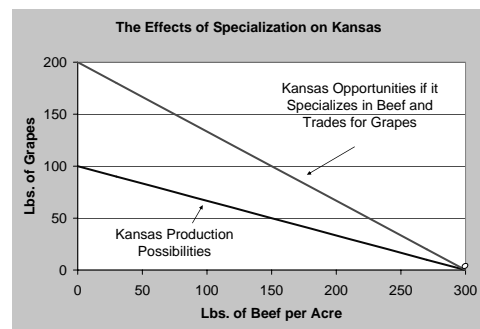
Both Kansas and California can produce beef cattle and grapes. Assume the value of labor and other needed inputs is the same per acre in each state and for each product.

In Kansas an acre of land can be used to produce 300 pounds of beef or 100 pounds of grapes.

In California, an acre of land can be used to produce 150 pounds of beef or 200 pounds of grapes.

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Suppose the price of a lb. of grapes is 1.5 lbs. of beef...



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Despite the benefits, Free Trade is Controversial.

Reducing barriers to international trade increases the total value of goods and services produced in each nation.

But

It does not guarantee that each individual citizen does better when the barriers are reduced.

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Who wins and who loses when the U.S. Imports T Shirts from Vietnam?

Importing T Shirts from Vietnam will likely lower the price of T Shirts in the U.S.

Consumers win!

U.S. producers of T Shirts now receive a lower price for their product.

The lower T Shirt price can translate into a lower wage for T Shirt workers.

US Companies and their workers lose!

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Reservation Prices

A buyer's reservation price is the largest dollar amount that the buyer would be willing and able to pay for a unit of a well-defined good.

A seller's reservation price is the smallest dollar amount for which the seller would be willing able to provide a unit of a well-defined good.

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What is a well-defined good?

To define a good properly and completely, we must specify:

Quantity (Pound, Kilogram, Slice, etc.)

Quality

Time Frame (Per Week, Per Month, etc.)

Locale (The size of a market)

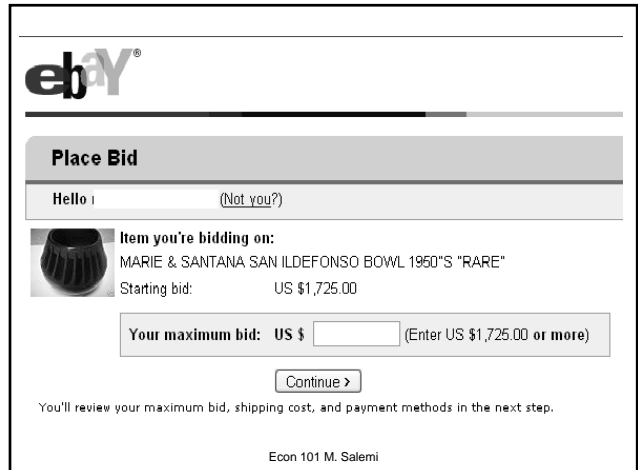
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Reservation Prices on EBay

EBay allows prospective buyers to enter a maximum bid. EBay keeps a prospective buyer in the auction until the current bid exceeds his maximum.

EBay allows prospective sellers to enter a minimum bid. Although the bidding may start below the minimum, the seller is not obliged to sell unless the final bid exceeds her minimum.

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The screenshot shows the eBay 'Place Bid' page. At the top is the eBay logo. Below it is a grey bar with the text 'Place Bid'. Underneath is a 'Hello' greeting with a '(Not you?)' link. A small image of a dark bowl is shown next to the text 'Item you're bidding on: MARIE & SANTANA SAN ILDEFONSO BOWL 1950'S 'RARE''. Below this, it says 'Starting bid: US \$1,725.00'. There is a text input field for 'Your maximum bid: US \$' with a placeholder '(Enter US \$1,725.00 or more)'. A 'Continue >' button is located below the input field. At the bottom, a note states: 'You'll review your maximum bid, shipping cost, and payment methods in the next step.'

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UC-Santa Cruz T Shirt Auction



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UC-Santa Cruz T Shirt Auction

Use clickers to bid.

All bids are binding.

Bid only in multiples of ten cents.

The winner is the highest bidder. In case of ties, the winner will be chosen by random draw.

The winner will pay the second highest bid.

You should bid your reservation price.

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What Do You Bid For The UC-SD T Shirt?

Enter your Bid with Your Clicker

.....

And the Winning Bid Is.....

Reservation Prices and Demand

Next Class, I will use your bids to derive the class demand schedule for a UCSD T Shirt

For now, I will use some made up data to illustrate the concept of demand.

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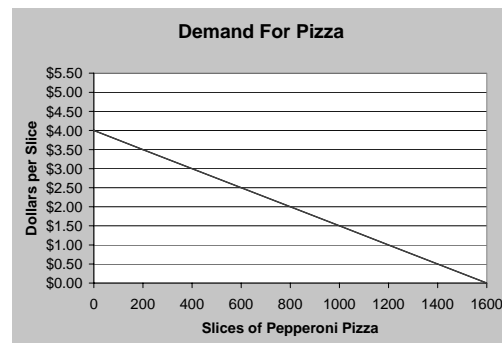
Demand Schedule

A Demand Schedule shows the quantity of a well-defined good that buyers are willing and able to purchase at each possible price.

Consider the following demand schedule for slices of Pepperoni Pizza on Franklin Street on a typical weekday when UNC is in session.

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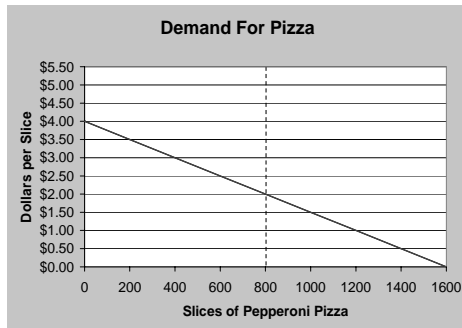
Demand Schedule for a 10 ounce slice of pepperoni pizza on a September weekday in Chapel Hill



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Demand Schedule for Pizza

Suppose 800 slices are available. What price rations the available slices?



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Use Your Clickers To Answer The Following Graded Question

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Which of the following best explains why the quantity demanded of a slice of pepperoni pizza falls as the price of the slice rises? It falls because...

- A. The opportunity cost of the slice grows smaller.
- B. The opportunity cost of the slice grows larger.
- C. Buyers have smaller effective incomes when the price of pizza rises.
- D. Sellers have larger effective incomes when the price of pizza rises.

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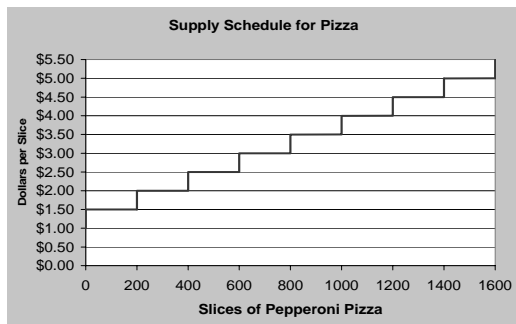
Supply Schedule

A Supply Schedule shows the quantity of a well-defined good that sellers are willing and able to sell at each possible price.

Consider the following supply schedule for slices of Pepperoni Pizza on Franklin Street on a typical weekday when UNC is in session.

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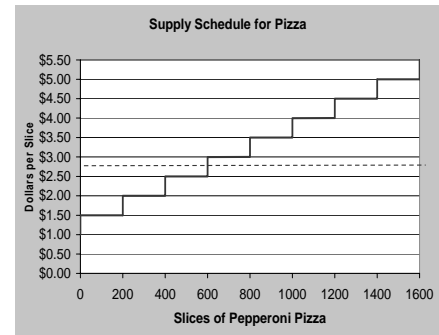
Supply Schedule for a 10 ounce slice of pepperoni pizza on a September weekday in Chapel Hill



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Supply Schedule for Pizza

How much pizza will suppliers supply at a price of \$2.75 per slice?



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Market Price is a Rationing Mechanism

A good is scarce when there is an insufficient supply of it relative to the desires of a group of prospective consumers.

Some mechanism is required to allocate scarce goods among prospective consumers.

In a market economy, price is the allocation mechanism.

Price separates prospective buyers into two groups: those who get the good and those who do not.

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Market Equilibrium

A system is in equilibrium when there is no tendency for it to change.

Can our pizza market be in equilibrium at a price per slice of \$2.00?

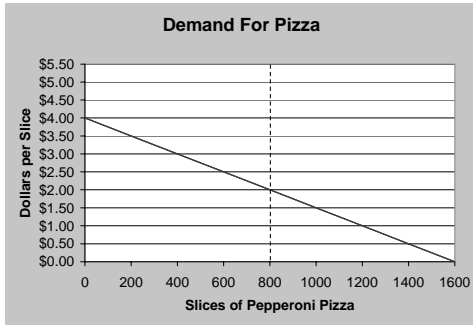
At a price of \$2.00, pizza buyers want 800 slices.

At a price of \$2.00, pizza sellers will sell only 400 slices.

What change do you predict will occur?

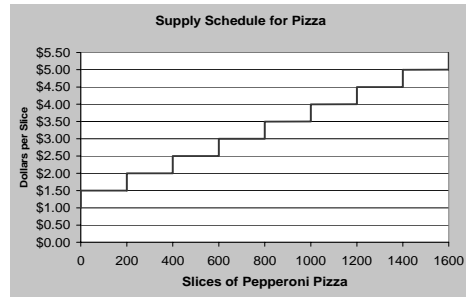
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At a price of \$2.00,
Consumers Want 800 slices.



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At a Price of \$2.00,
Suppliers will Supply 400 Slices.



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Market Equilibrium

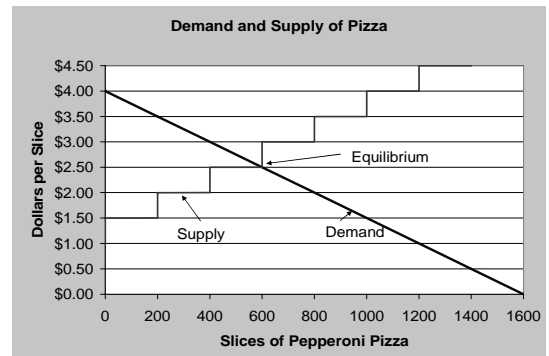
A system is in equilibrium when there is no tendency for it to change.

In a market, equilibrium price and quantity are the price and quantity for which the quantity demanded equals the quantity supplied.

Market equilibrium is modeled as the intersection of the demand and supply schedules.

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Market Equilibrium



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Use Your Clickers To Answer
The Following
Graded Question

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As the price of a slice of pizza rises
quantity demanded _____ and
quantity supplied _____.

- A. Rises, Rises
- B. Rises, Falls
- C. Falls, Rises
- D. Falls, Falls

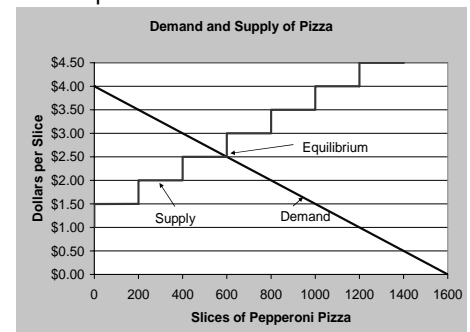
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Use Your Clickers To Answer
The Following
Non-Graded Question

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In equilibrium, the number of slices that will be
denied to consumers even though consumers have a
positive reservation price for those slices is ...

- A. 0
- B. 600
- C. 1000
- D. 1600



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Assignment for Week 3 Recitation

Students will participate in a simulation of a market. They will play the rolls of buyers and sellers of a product.

The top earning buyer and top earning seller from each recitation will be entered in a lottery that awards a prize of \$20.00. Two students will win a prize of \$20.00.

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What Have We Learned?

Reservation Prices are the building blocks of demand and supply schedules.

Market Prices ration goods.

Demand Schedule summarizes the buyer side of the market

Supply Schedule summarizes the supply side of the market.

Market Equilibrium occurs at a price where quantity demanded and supplied are equal.

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