What’s Behind the Demand Schedule?

Review
Rational individuals do less of an activity as its cost rises.
There are almost always substitutes for the goods and services we demand.
Consumer surplus is the difference between our reservation price and what we pay.
What have we learned?

Week 4 Recitation Assignment

Find and put in your journal a news article that concerns a market allocation issue. In your journal, write 200 words explaining how demand and supply can be used to interpret the article.
Review end-of-chapter problems. Raise your questions about these problems in recitation.

Review
What shifts the demand schedule?
The demand schedule gives the relationship between quantity demanded and price with other demand factors unchanged.
When other demand factors change, the demand schedule shifts.

The New York Times

February 9, 2009
A Month Free? Rents Are Falling Fast
By ELIZABETH L. HAIER

In this painful economic climate of layoffs and straitened investments, there is a silver of positive news: it’s a good time to be a renter in New York City. Prices are falling, primarily in Manhattan, and concessions like a month’s free rent are widespread.

Although it is notoriously difficult to quantify the state of the rental market, rents fell in almost every sector of the Manhattan market last year, according to the Manhattan Real Estate Market Report produced by the Real Estate Group at New York brokerage. The report covers one-bedroom rentals in buildings with doorways and 6.12 percent in buildings without. The only category that rose rents for two-bedroom apartments in doorman buildings, up just a bit, by 0.61 percent. But these numbers, like most available data, represent asking rents rather than the final price. Nevertheless, evidence suggests that some people are negotiating rents as much as 20 percent lower than the original price asked by landlords. These figures also leave out incentives, like a month of free rent or a landlord paying the broker fee, which add up to real savings.
Use Your Clickers To Answer The Following Graded Question

Which of the following could account for falling rents in Manhattan in 2009? Rents in Manhattan fell because...

A. Rent ceilings on Manhattan apartments were eliminated.
B. Rent floors on Manhattan apartments were raised.
C. Incomes of Manhattan consumers fell due to the recession.
D. Several large Manhattan apartment building were demolished to make a new subway line.

Shifts in the Supply schedule

The supply schedule gives the relationship between quantity supplied and price with other supply factors unchanged.

When other supply factors change, the supply schedule shifts.

What Happens in the Pizza Market if There is an Increase in the Price of Mozzarella Cheese?

Why does supply for pizza fall? The higher cost of Mozzarella means pizza is more expensive to produce than before.

By how much does the supply of pizza fall? The supply price rose by $0.75 for each quantity. The effect on quantity is different for different prices because of the stair-step shape of the supply schedule.
What is the effect on the pizza market?

If the supply price rose by $0.75 per slice why did the equilibrium price rise only by $0.50 per slice?

Consumers are not willing to buy 600 slices at a price $3.25 ($2.50 + $0.75). The quantity demanded falls because of the increase in price.
STONER: Factors that Shift Supply

- Subsidies and Taxes
- Technological Progress
- Other Goods (prices of goods that producers might produce)
- Number of Sellers
- Expectations (of relevant future prices)
- Resource Costs (prices of inputs)

Use Your Clickers To Answer
The Following
Non-Graded Question

If the price of chicken feed falls, the equilibrium price of chicken will _____ and the equilibrium price of beef will ______

A. Fall, Fall
B. Fall, Rise
C. Rise, Fall
D. Rise, Rise

How does a decrease in the price of chicken feed affect the chicken market?

A. Price of Chicken
B. Quantity of Chicken
C. New Supply
D. Demand
How does a decrease in the price of chicken affect the beef market?

Rational individuals do less of an activity in response to a rise in its cost.

An increase in market price of a good or service implies an increased opportunity cost for activities involving the good or service.

Why is the quantity demanded inversely related to price?

As price rises, it rises above the reservation price for some potential consumers (and they drop out).

As individuals increase consumption of a good or service, the marginal benefit of consuming more falls and so their reservation price for additional units falls.

The Rational Spending Rule

Spending should be allocated across goods and services so that the marginal benefit of the last “penny” spent on each good is the same.
Why does the rational spending rule make sense?

I like cookies and Snickers. A snickers and a cookie pack each cost $0.75. Each week, I consume 5 cookie packs and 5 snickers. I can always get one more snickers by giving up one cookie pack. Rational spending requires that I change my cookie-snickers mix until further changes will not improve my satisfaction.

There are almost always substitutes for the goods and services we demand.

The existence of substitutes is the most important reason why economists think it is more accurate to say that an individual “wants” something than to say that an individual “needs” something.

There are almost always substitutes for the goods and services we demand.

Why do the wealthy in Manhattan live in smaller houses than the wealthy in Seattle?

Use Your Clickers To Answer The Following Graded Question
Wealthy people in Manhattan live in smaller houses than wealthy people in Seattle because...

A. The opportunity cost of large houses is higher in Seattle.
B. The wealthy in Manhattan have different tastes than the wealthy in Seattle.
C. The wealthy in Manhattan are not as wealthy as the wealthy in Seattle.
D. It is necessary to give up less to live in a large home in Seattle than in Manhattan.

There are almost always substitutes for the goods and services we demand.

Why did American drivers turn to four cylinder engine cars in the 1970's only to shift back to larger engine cars in the 1990's?

What do you predict will happen in the next five years to the mix of small engine and large engine cars sold in the U.S.?

There are almost always substitutes for the goods and services we demand.

Why did consumers turn to small engine cars in the 1970's?

Why did consumers turn to small engine cars in the 1970's?
Consumer surplus is the difference between our reservation price and what we pay.

If all consumers pay the same price, as occurs in market equilibrium,
Then...
Consumer surplus is the area of the triangular shape formed by the price axis (height), the equilibrium price (base) and the demand schedule (hypotenuse).

Use Your Clickers To Answer The Following Graded Question

The following Table gives reservation prices for five potential consumers for a ticket to hear Doc Watson. If the market price of the ticket is $10.00, how much is the group’s consumer surplus?

<table>
<thead>
<tr>
<th>Potential Consumers</th>
<th>Reservation Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jean</td>
<td>$50.00</td>
</tr>
<tr>
<td>Jerry</td>
<td>$25.00</td>
</tr>
<tr>
<td>Pat</td>
<td>$15.00</td>
</tr>
<tr>
<td>Ari</td>
<td>$10.00</td>
</tr>
<tr>
<td>Sam</td>
<td>$5.00</td>
</tr>
</tbody>
</table>
If the market price of the ticket is $10.00, how much is the group’s consumer surplus?

A. $105.00  
B. $100.00  
C. $90.00  
D. $60.00  
E. $55.00

<table>
<thead>
<tr>
<th>Potential Consumers</th>
<th>Reservation Price</th>
<th>Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jean</td>
<td>$50.00</td>
<td>$40.00</td>
</tr>
<tr>
<td>Jerry</td>
<td>$25.00</td>
<td>$15.00</td>
</tr>
<tr>
<td>Pat</td>
<td>$15.00</td>
<td>$5.00</td>
</tr>
<tr>
<td>Ari</td>
<td>$10.00</td>
<td>$0.00</td>
</tr>
<tr>
<td>Sam</td>
<td>$5.00</td>
<td>NA</td>
</tr>
<tr>
<td>Total Surplus</td>
<td></td>
<td>$60.00</td>
</tr>
</tbody>
</table>

What Have We Learned?

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