

## 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?

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## 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.

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### 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.

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### The New York Times

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February 1, 2009

## A Month Free? Rents Are Falling Fast

By ELIZABETH A. HARRIS

IN this painful economic climate of layoffs and shrinking investments, there is a sliver 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 of 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 Rental Market Report](#) produced by the Real Estate Group, a New York brokerage. The steepest drop was in one-bedrooms, down 5.7 percent in buildings with doormen and 6.53 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. Anecdotal evidence suggests that some people are negotiating rents as much as 20 percent lower than the original prices asked by landlords. These figures also leave out incentives, like a month of free rent or a landlord's paying the broker fee, which can 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.

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

Why does supply for pizza fall?

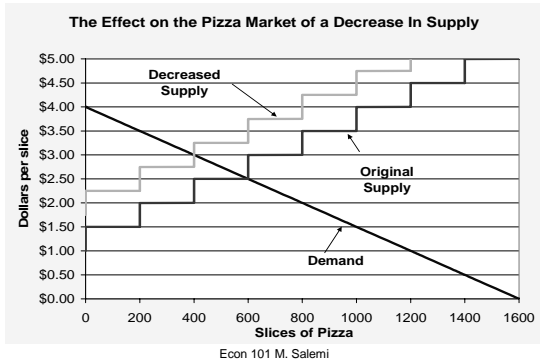
The higher cost of Mozzarella means pizza is  
more expensive to produce than before.

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.

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## The Effect on the Pizza Market Of an Increase in the Price of Cheese.



What is the effect on the pizza market?

What is the effect on equilibrium price?

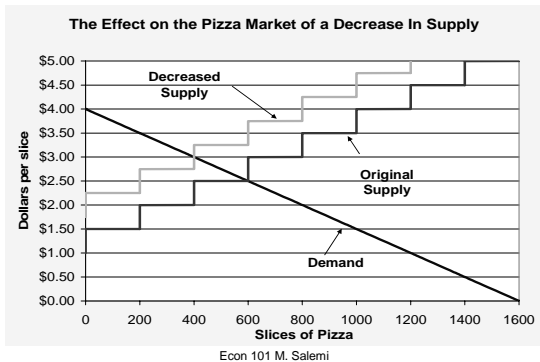
The equilibrium price increases from \$2.50 to \$3.00 per slice.

What is the effect on equilibrium quantity?

The equilibrium quantity falls from 600 slices per day to 400 slices per day.

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## The Effect on the Pizza Market Of an Increase in the Price of Cheese.



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.

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## 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 )

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Use Your Clickers To Answer  
The Following  
Non-Graded Question

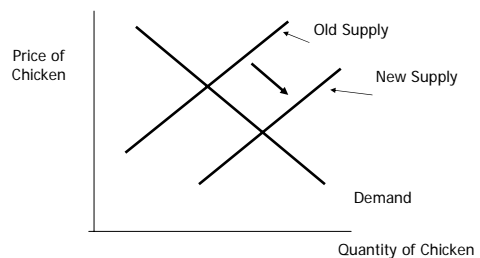
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If the price of chicken feed falls, the equilibrium price of **chicken** will \_\_\_\_\_ and the equilibrium price of **beef** will \_\_\_\_\_

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

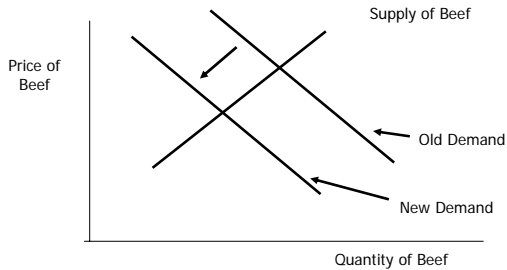
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How does a decrease in the price of chicken feed affect the chicken market?



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



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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.

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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.

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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.

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### Why does the rational spending rule make sense?

I like cookies and Snickers.

A snickers and a cookie pack each cost \$.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.

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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.

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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?

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Use Your Clickers To Answer  
The Following  
Graded Question

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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.

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The New York Times

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May 2, 2008

### As Gas Costs Soar, Buyers Flock to Small Cars

By BILL VLASIC

DETROIT — Soaring gas prices have turned the steady migration by Americans to smaller cars into a stampede.

In what industry analysts are calling a first, about one in five vehicles sold in the United States was a compact or subcompact car during April, based on monthly sales data released Thursday. Almost a decade ago, when sport utility vehicles were at their peak of popularity, only one in every eight vehicles sold was a small car.

The switch to smaller, more fuel-efficient vehicles has been building in recent years, but has accelerated recently with the advent of \$3.50-a-gallon gas. At the same time, sales of pickup trucks and large sport utility vehicles have dropped sharply.

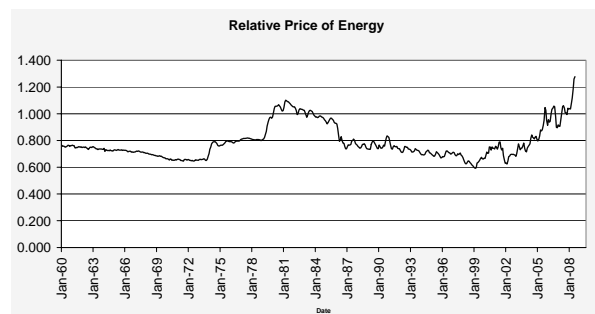
There are almost always substitutes for the goods and services we demand.

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.?

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



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Consumer surplus is the difference between our reservation price and what we pay.

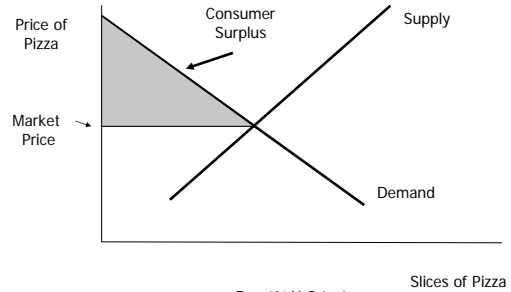
If all consumers pay the same price, as occurs in market equilibrium,

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).

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Consumer surplus is the difference between our reservation price and what we pay.



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Use Your Clickers To Answer  
The Following  
Graded Question

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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?

Potential Consumers	Reservation Price
Jean	\$50.00
Jerry	\$25.00
Pat	\$15.00
Ari	\$10.00
Sam	\$5.00

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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

Potential Consumers	Reservation Price
Jean	\$50.00
Jerry	\$25.00
Pat	\$15.00
Ari	\$10.00
Sam	\$5.00

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If the market price of the ticket is \$10.00, how much is the groups consumer surplus?

Potential Customers	Reservation Price	Surplus
Jean	\$50.00	\$40.00
Jerry	\$25.00	\$15.00
Pat	\$15.00	\$5.00
Ari	\$10.00	\$0.00
Sam	\$5.00	NA
Total Surplus		\$60.00

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What Have We Learned?

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