ECN 1 A
Discussion Section 2

Week of April 16th

Demand and Supply

- **Competitive Market:**
  - the framework under which we will study and learn about demand and supply

  - When is a market considered competitive?
    - Many buyers and sellers
    - No single buyer or seller can influence the price

Law of Demand

- Law of demand: assuming everything else does not change,
  - if the price of a good rises, the quantity demanded falls
  - If the price of a good falls, the quantity demanded rises
  - Thus there is an inverse relationship between quantity demanded and price

Question 1

1) The law of demand implies that if nothing else changes, there is

A) a positive relationship between the price of a good and the quantity demanded.
B) a negative relationship between the price of a good and the quantity demanded.
C) a linear relationship between price of a good and the quantity demanded.
D) an exponential relationship between price of a good and the quantity demanded.

B, a ***negative*** relationship is the same as an ***inverse*** relationship.

The effect of price changes on quantity demanded

- What happens when the price of apples goes up?
  - By the law of demand we know that quantity demanded should go down, but why?
    - **Substitution effect**: price of apples rises relative to prices of **other** goods. Therefore the opportunity cost of one apple is higher! Thus, we consume less apples and **substitute** into “cheaper” goods.
    - **Income effect**: price of apples rises relative to our **income**. It makes us feely “poorer”. Thus, we cut our consumption of apples.

Question 2

2) A substitute is a good
  A) that can be used in place of another good.
  B) that is not used in place of another good.
  C) of lower quality than another good.
  D) of higher quality than another good.

- A. You can “substitute” it for what you really wanted to consume.
- A substitute teacher is a substitute for your teacher

Question 3

3) People buy more of good 1 when the price of good 2 rises. These goods are
   A) complements.
   B) substitutes.
   C) normal goods.
   D) inferior goods.

- B. If a good gets more expensive, from the substitution effect we will buy more of the substitute.
- A **complement** is a good that you buy together with the main good e.g. hot dog buns are a complement to hot dogs. If the price of the complement decreases you will increase your quantity of the good.

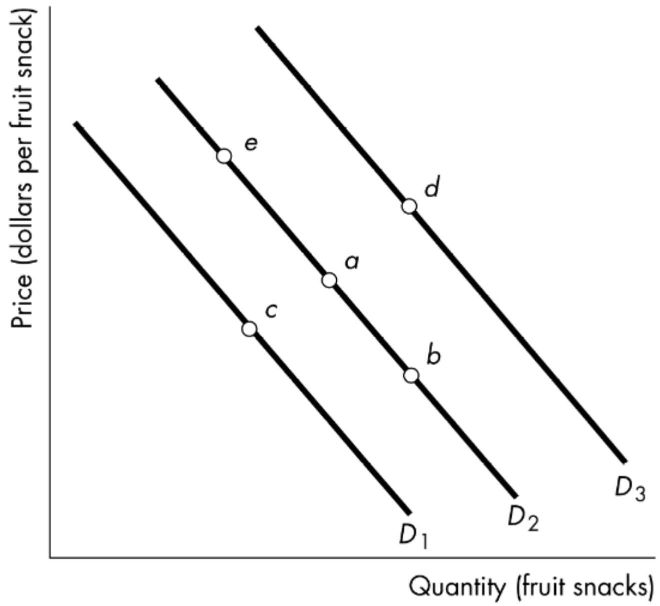
Question 4

4) The demand for a good increases when the price of a substitute ____ and also increases when the price of a complement ____.

A) rises; rises
B) rises; falls
C) falls; rises
D) falls; falls

- B

Question 5



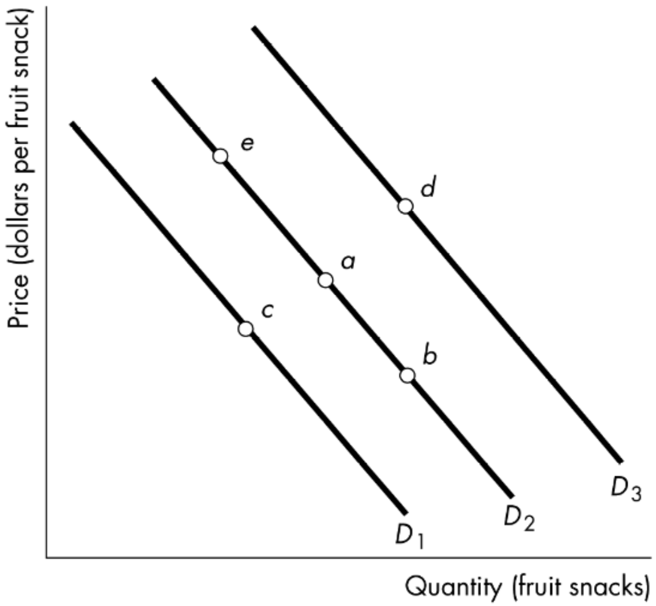
5) In the figure above, which movement reflects an increase in demand?

A) From point *a* to point *e*.
B) From point *a* to point *b*.
C) From point *a* to point *c*.
D) From point *a* to point *d*.

D, note importantly it asks about an increase in **demand**, not the *quantity demanded.* This means they are talking about the entire demand curve!

Increasing demand = shifting out the demand curve.

Question 6

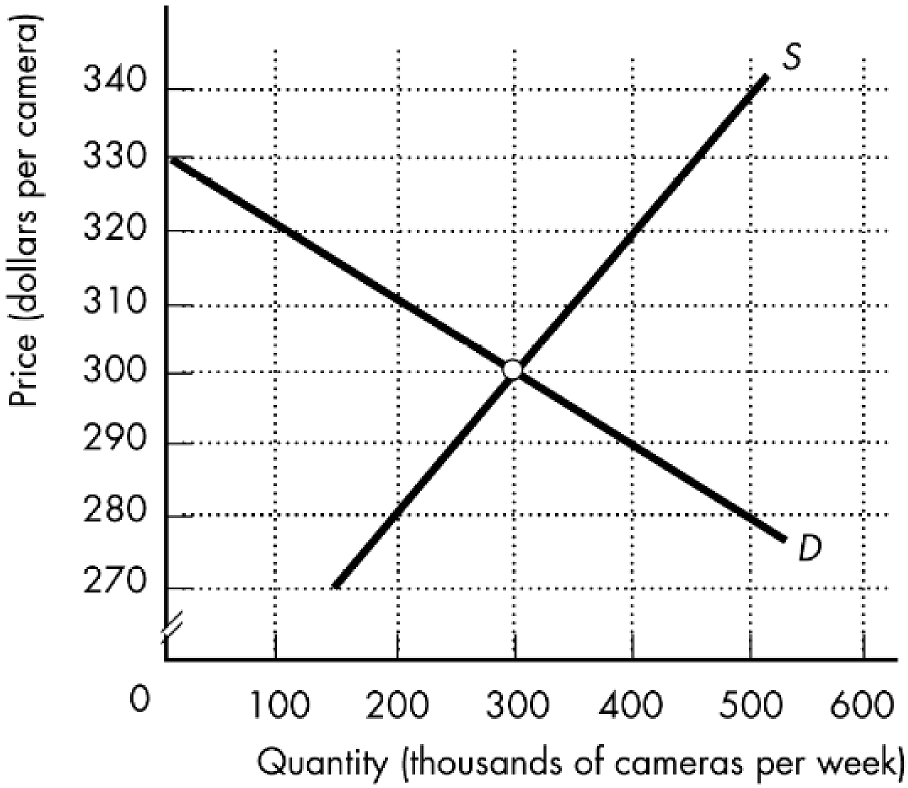


- A, decreasing quantity demanded is equivalent to **moving to the left** on a demand curve

6) In the figure above, which movement reflects a decrease in quantity demanded but NOT a decrease in demand?

A) From point *a* to point *e*.
B) From point *a* to point *b*.
C) From point *a* to point *c*.
D) From point *a* to point *d*.

Question 7



7) The figure above shows the market for digital cameras. If the price of film cameras falls, the efficient quantity of digital cameras will be ____ thousand cameras and the price of a digital camera will be ____.

A) less than 300; less than $300
B) greater than 300; less than $300
C) 300; greater than $300
D) greater than 400; greater than $310

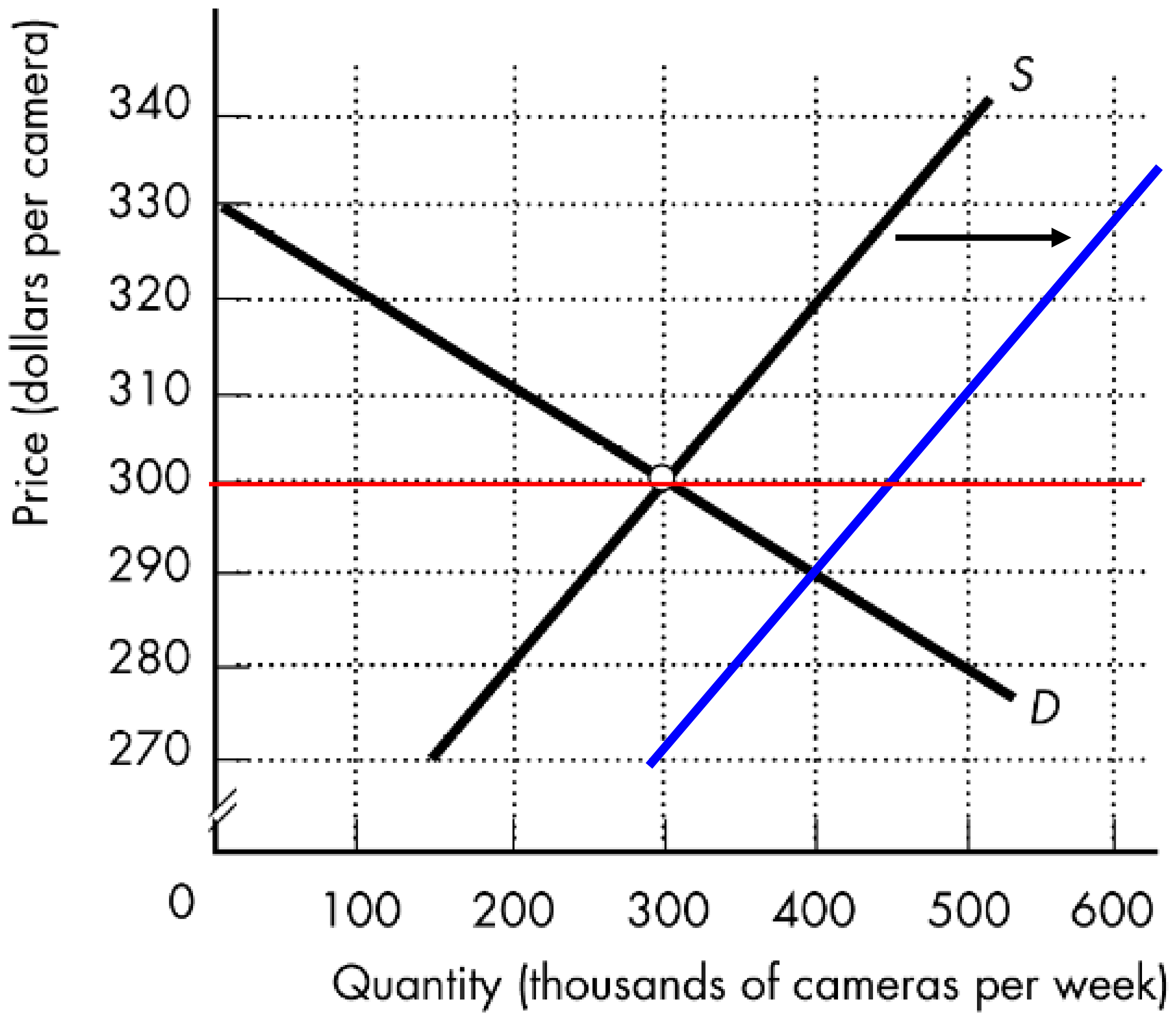
For the price to fall below $300…

- Two things can happen in a **competitive market:**

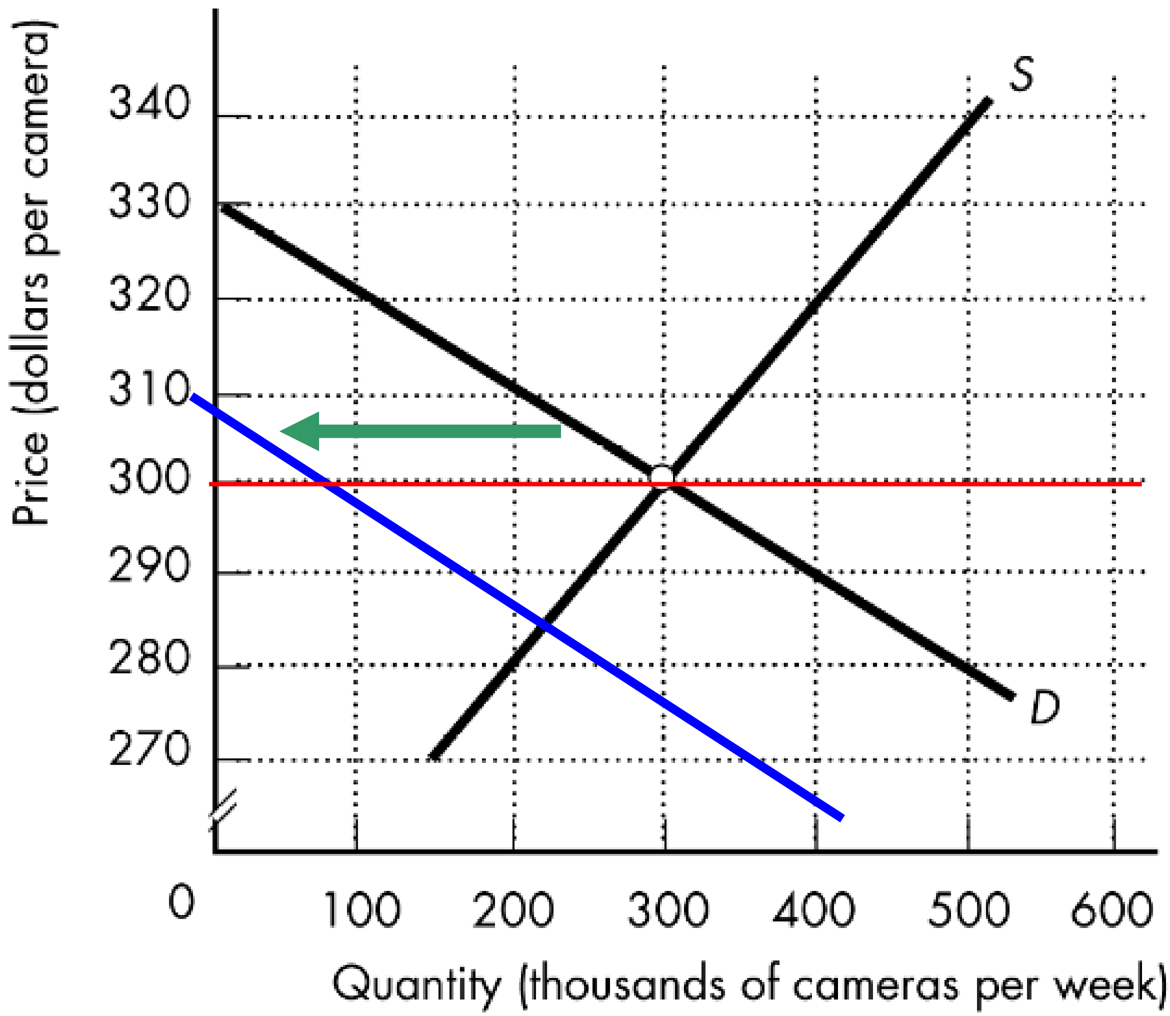
1. Supply curve shifts right

2. Demand curve shifts left

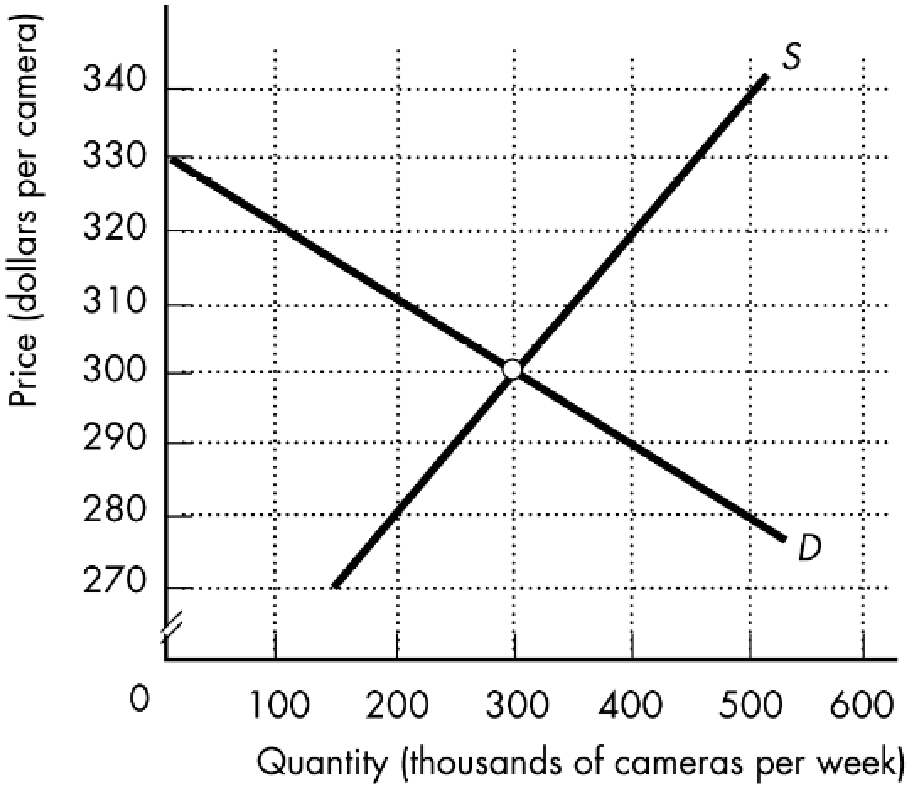
Supply curve shifts right (out)



Demand shifts left (in)



Question 7



- So it must be that the price is below $300, but which quantity are we talking about (quantity supplied or demanded)?
- Here's an example of a question that is a bit vague. If on an exam something is vague please raise your hand and ask!

7) The figure above shows the market for digital cameras. If the price of film cameras falls, the efficient quantity of digital cameras will be ____ thousand cameras and the price of a digital camera will be ____.

A) less than 300; less than $300
B) greater than 300; less than $300
C) 300; greater than $300
D) greater than 400; greater than $310

Question 8

8) The figure above shows the market for digital cameras. If consumers' incomes rise and a digital camera is a normal good, the efficient quantity of digital cameras to produce will be ____ thousand cameras and the price of a digital camera will be ____.

A) less than 300; less than $300
B) greater than 300; less than $300
C) 300; greater than $300
D) greater than 300; greater than $300

- Aha, now we have sufficient information – the question asks about the quantity to produce (quantity supplied)
- Hence D is the answer

Short Answer Question 1

- Will each of the following tend to shift the demand curve for toasters to the right, left, or not at all? Explain
  a) Consumer income rises by 20%
  b) The cost of producing a toaster falls by 10%
  c) Medical reports indicate that toast prevents heart attacks
  d) The price of electricity increases by 5%
  e) The price of bread falls by 10%

Short Question 2

- Will each of the following shift supply curve for toasters to the right, left, or not at all? Explain
  a) Consumer incomes rise by 20%
  b) The wage of workers producing toasters increases by 5%
  c) The price of metal used to make toasters falls by 10%
  d) The price of bread falls by 10%