Chapter 3 introduces you to the most fundamental tools of economic analysis: demand and supply. Demand and supply are simply "boxes" or categories into which all the forces and factors that affect the price and quantity of a good bought and sold in a competitive market are placed. Demand and supply determine price and quantity exchanged. It is necessary to understand why and how they do this.

Many students never learn to define demand and supply. They never learn (1) what an increase or decrease in demand or supply means, (2) the important distinctions between "demand" and "quantity demanded" and between "supply" and "quantity supplied," and (3) the equally important distinctions between a change in demand and a change in quantity demanded and between a change in supply and a change in quantity supplied.

Once students learn these things, however, it is no great trick to comprehend the so-called laws of demand and supply. The equilibrium price—that is, the price that will tend to prevail in the market as long as demand and supply do not change—is simply the price at which quantity demanded and quantity supplied are equal. The quantity bought and sold in the market (the equilibrium quantity) is the quantity demanded and supplied at the equilibrium price. If you can determine the equilibrium price and quantity under one set of demand and supply conditions, you can determine them under any other set.

This chapter includes a brief examination of the factors that determine demand and supply and the ways in which changes in those determinants affect and cause changes in demand and supply. A graphic method is used in this analysis to illustrate demand and supply, equilibrium price and quantity, changes in demand and supply, and the resulting changes in equilibrium price and quantity. The demand curve and the supply curve are graphic representations of the same data contained in the schedules of demand and supply.

The application section at the end of the chapter explains government-set prices. When the government sets a legal price in a competitive market, it creates a price ceiling or price floor. This prevents supply and demand from determining the equilibrium price and quantity of a product that will be provided by a competitive market. As you will learn, the economic consequence of a price ceiling is a persistent shortage of the product. An example of a price ceiling would be price controls on apartment rents. A price floor will result in a persistent surplus of a product, and the example given is price supports for an agricultural product.

You will use demand and supply over and over. It will turn out to be as important to you in economics as jet propulsion is to the pilot of an airplane: You can't get off the ground without it.

**CHECKLIST**

When you have studied this chapter you should be able to:

- Define demand and state the law of demand.
- Give three explanations for the inverse relationship between price and quantity demanded.
- Graph the demand curve when you are given a demand schedule.
- Explain the difference between individual demand and market demand.
- List the five major determinants of demand and explain how each one shifts the demand curve.
- Define normal goods, inferior goods, substitute goods, and complementary goods.
- Distinguish between change in demand and change in the quantity demanded.
- Define supply and state the law of supply.
- Graph the supply curve when you are given a supply schedule.
- List the major determinants of supply and explain how each one shifts the supply curve.
- Distinguish between change in supply and change in the quantity supplied.
- Describe how the equilibrium price and quantity are determined in a competitive market.
- Define surplus and shortage.
- Determine, when you are given the demand for and the supply of a good, the equilibrium price and the equilibrium quantity.
- Explain the meaning of the rationing function of prices.
- Distinguish between productive efficiency and allocative efficiency.
- Predict the effects of changes in demand on equilibrium price and quantity.
- Predict the effects of changes in supply on equilibrium price and quantity.
- Predict the effects of changes in both demand and supply on equilibrium price and quantity.
- Explain the economic effects of a government-set price ceiling on product price and quantity in a competitive market.
Describe the economic consequences of a government-set price floor on product price and quantity.

CHAPTER OUTLINE

1. A market is any institution or mechanism that brings together buyers ("demanders") and sellers ("suppliers") of a particular good or service. This chapter assumes that markets are highly competitive.

2. Demand is a schedule of prices and the quantities that buyers would purchase at each of those prices during a selected period.

   a. The law of demand states that there is an inverse or negative relationship between price and quantity demanded. Other things equal, as price increases, buyers will purchase smaller quantities, and as price decreases, they will purchase larger quantities. There are three explanations for the law of demand:
      (1) Diminishing marginal utility. After a point, consumers get less satisfaction or benefit from consuming more and more units.
      (2) Income effect. A higher price for a good decreases the purchasing power of consumers' incomes so that they can't buy as much of the good.
      (3) Substitution effect. A higher price for a good encourages consumers to search for cheaper substitutes and thus buy less of it.

   b. The demand curve has a downward slope and is a graphic representation of the law of demand.

   c. Market demand for a good is a summation of all the demands of all consumers of that good at each price. Although price has the most important influence on quantity demanded, other factors can influence demand. These factors, called determinants of demand, are consumer tastes (preferences), the number of buyers in the market, consumers' income, the prices of related goods, and consumer expectations.

   d. An increase or decrease in the entire demand schedule and the demand curve (a change in demand) results from a change in one or more of the determinants of demand. For a particular good,
      (1) an increase in consumer tastes or preferences increases its demand;
      (2) an increase in the number of buyers increases its demand;
      (3) consumers' income increases its demand if it is a normal good (one where income and demand are positively related), but an increase in consumers' income decreases its demand if it is an inferior good (one where income and demand are negatively related);
      (4) an increase in the price of a related good will increase its demand if the related good is a substitute good (one that can be used in place of another), but an increase in the price of a related good will decrease its demand if the related good is a complementary good (one that is used with another good);
      (5) an increase in consumer expectations of a future price increase or a future rise in income will increase its current demand.

   e. A change in demand means that the entire demand curve or schedule has changed because of a change in one of these determinants of demand, but a change in the quantity demanded means that there has been a movement along an existing demand curve or schedule because of a change in price.

3. Supply is a schedule of prices and the quantities that sellers will sell at each of those prices during some period of time.

   a. The law of supply shows a positive relationship between price and quantity supplied. Other things equal, as the price of the good increases, larger quantities will be offered for sale, and as the price of the good decreases, smaller quantities will be offered for sale.

   b. The supply curve is a graphic representation of supply and the law of supply; it has an upward slope, indicating the positive relationship between price and quantity supplied.

   c. The market supply of a good is the sum of the supplies of all sellers or producers of the good at each price.

   d. Although price has the most important influence on the quantity supplied, other factors can influence supply. Those factors, called determinants of supply, are changes in (1) resource prices; (2) technology; (3) taxes and subsidies; (4) prices of other goods; (5) price expectation; and (6) the number of sellers in a market.

   e. A change in supply is an increase or decrease in the entire supply schedule and the supply curve. It is the result of a change in one or more of the determinants of supply that affect the cost of production. For a particular good,
      (1) a decrease in resource prices increases its supply;
      (2) an improvement in technology increases its supply;
      (3) a decrease in taxes or an increase in subsidies increases its supply;
      (4) a decrease in the price of another good that could be produced leads to an increase in the supply of the particular good;
      (5) an increase in producer expectations of higher prices for the good may increase or decrease its supply.

   f. A change in supply means that the entire supply curve or schedule has changed because of a change in one of these determinants of supply, but a change in the quantity supplied means that there has been a movement along an existing supply curve or schedule because of a change in price.

4. The market or equilibrium price of a product is that price at which quantity demanded and quantity supplied are equal; the quantity exchanged in the market (the equilibrium quantity) is equal to the quantity demanded and supplied at the equilibrium price.

   a. If the price of a product is above the market equilibrium price, there will be a surplus or excess supply. In this case, the quantity demanded is less than the quantity supplied at that price.
b. If the price of a product is below the market equilibrium price, there will be a shortage or excess demand. In this case, the quantity demanded is greater than the quantity supplied at that price.

c. The rationing function of prices is the elimination of surpluses and shortages of a product.

d. Competitive markets produce productive efficiency, in which the goods and services society desires are being produced in the least costly way. They also create allocative efficiency, in which resources are devoted to the production of the goods and services society values most highly.

e. Changes in supply and demand result in changes in the equilibrium price and quantity. The simplest cases are ones where demand changes and supply remains constant or where supply changes and demand remains constant. More complex cases involve simultaneous changes in supply and demand.

(1) Demand changes. An increase in demand, with supply remaining the same, will increase the equilibrium price and quantity; a decrease in demand, with supply remaining the same, will decrease the equilibrium price and quantity.

(2) Supply changes. An increase in supply, with demand staying the same, will decrease the equilibrium price and increase the equilibrium quantity; a decrease in supply, with demand staying the same, will increase the equilibrium price and decrease the equilibrium quantity.

(3) Complex cases. These four cases involve changes in demand and supply: Both increase; both decrease; one increases and one decreases; and one decreases and one increases. For the possible effects on the equilibrium price and quantity in the four complex cases, see #4 in the "Hints and Tips" section.

5. Supply and demand analysis has many important applications to government-set prices.

a. A price ceiling set by government prevents price from performing its rationing function in a market system. It creates a shortage (quantity demanded is greater than quantity supplied) at the government-set price.

(1) Another rationing method must be found, and so government often steps in and establishes one. But all rationing systems have problems because they exclude someone.

(2) A government-set price creates an illegal black market for those who want to buy and sell above the government-set price.

(3) One example of a legal price ceiling that creates a shortage would be the rent control established in some cities to restrain the rental price of apartments.

b. A price floor is a minimum price set by government for the sale of a product or resource. It creates a surplus (quantity supplied is greater than quantity demanded) at the fixed price. The surplus may induce the government to increase demand or decrease supply to eliminate the surplus. The use of price floors has often been applied to agricultural products such as wheat.

6. (Last Word). Supply and demand analysis can be used to understand the shortage of organs for transplants. The demand curve for such organs is downsloping, and the supply is fixed (vertical) and to the left of the zero price on the demand curve. Transplanted organs have a zero price. At that price the quantity demanded is much greater than the quantity supplied, creating a shortage that is rationed with a waiting list. A competitive market for organs would increase the price of organs and make them more available for transplantation (make the supply curve upsloping), but there are moral and cost objections to this change.

HINTS AND TIPS

1. This chapter is the most important one in the book. Make sure you spend extra time on it and master the material. If you do, your long-term payoff will be a much better understanding of the applications in later chapters.

2. One mistake students often make is to confuse change in demand with change in quantity demanded. A change in demand causes the entire demand curve to shift, whereas a change in quantity demanded is simply a movement along an existing demand curve.

3. It is strongly recommended that you draw supply and demand graphs as you work on supply and demand problems so that you can see a picture of what happens when demand shifts, supply shifts, or both demand and supply shift.

4. Make a chart and related graphs that show the eight possible outcomes from changes in demand and supply. Figure 3.7 in the text illustrates the four single shift outcomes:

(1) \( D \uparrow, P \uparrow, Q \uparrow \)

(2) \( D \downarrow, P \downarrow, Q \downarrow \)

(3) \( S \uparrow, P \downarrow, Q \uparrow \)

(4) \( S \downarrow, P \uparrow, Q \downarrow \)

Four shift combinations are described in Table 3.7 of the text. Make a figure to illustrate each combination.

(1) \( S \uparrow, D \downarrow, P \downarrow, Q ? \)

(2) \( S \downarrow, D \uparrow, P \uparrow, Q ? \)

5. Make sure you understand the "other-things-equal" assumption described in the Consider This box on salsa and coffee beans. It will help you understand why the law of demand is not violated even if the price and quantity of a product increase over time.

6. Practice always helps in understanding graphs. Without looking at the textbook, draw a supply and demand graph with a price ceiling below the equilibrium price and show the resulting shortage in the market for a product. Then draw a supply and demand graph with a price floor above the equilibrium price and show the resulting surplus. Explain to yourself what the graphs show. Check your graphs and your explanations by referring to textbook Figures 3.8 and 3.9 and the related explanations.

IMPORTANT TERMS

demand

demand schedule

law of demand

diminishing marginal utility
income effect
substitution effect
demand curve
determinants of demand
normal goods
inferior goods
substitute good
complementary good
change in demand
change in quantity demanded
supply
supply schedule

law of supply
supply curve
determinants of supply
change in supply
change in quantity supplied
equilibrium price
equilibrium quantity
surplus
shortage
price ceiling
price floor

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SELF-TEST

■ FILL-IN QUESTIONS

1. A market is the institution or mechanism that brings together buyers or (demanders, suppliers) and sellers or __________ of a particular good or service.

2. The relationship between price and quantity in the demand schedule is (a direct, an inverse) __________ relationship; in the supply schedule the relationship is __________ one.

3. The added satisfaction or pleasure a consumer obtains from additional units of a product decreases as the consumer’s consumption of that product increases. This phenomenon is called diminishing marginal (equilibrium, utility) __________.

4. A consumer tends to buy more of a product as its price falls because
a. The purchasing power of the consumer is increased and the consumer tends to buy more of this product (and of other products); this is called the (income, substitution) __________ effect;
b. The product becomes less expensive relative to similar products and the consumer tends to buy more of the original product and less of the similar products, which is called the __________ effect.

5. When demand or supply is graphed, price is placed on the (horizontal, vertical) __________ axis and quantity on the __________ axis.

6. The change from an individual to a market demand schedule involves (adding, multiplying) __________ the quantities demanded by each consumer at the various possible (incomes, prices) __________.

7. When the price of one product and the demand for another product are directly related, the two products are called (substitutes, complements) __________.

8. When a consumer demand schedule or curve is drawn, it is assumed that five factors that determine demand are fixed and constant. These five determinants of consumer demand are
a. __________
b. __________
c. __________
d. __________
e. __________

9. A decrease in demand means that consumers will buy (larger, smaller) __________ quantities at every price or will pay (more, less) __________ for the same quantities.

10. A change in income or in the price of another product will result in a change in the (demand for, quantity demanded of) __________ the given product, and a change in the price of the given product will result in a change in the __________ the given product.

11. An increase in supply means that producers will make and be willing to sell (larger, smaller) __________ quantities at every price or will accept (more, less) __________ for the same quantities.

12. A change in resource prices or the prices of other goods that could be produced will result in a change in the (supply, quantity supplied) __________ of the given product, but a change in the price of the given product will result in a change in the __________

13. The fundamental factors that determine the supply of any commodity in the product market are
a. __________
b. __________
c. __________
d. __________
e. __________
f. __________

14. The equilibrium price of a product is the price at which quantity demanded is (greater than, equal to, less than) __________ quantity supplied, and there (is, is not) __________ a surplus or a shortage at that price.

15. If quantity demanded is greater than quantity supplied, price is (above, below) __________ the equilibrium
price, and the (shortage, surplus) ______ will cause the price to (rise, fall) _______. If quantity demanded is less than the quantity supplied, price is (above, below) ______ the equilibrium price, and the (shortage, surplus) ______ will cause the price to (rise, fall) _______.

16. In the space next to a–h, indicate the effect [increase (+), decrease (−), or indeterminate (?)] on equilibrium price (P) and equilibrium quantity (Q) of each of these changes in demand and/or supply.

   a. Increase in demand, supply constant
   b. Increase in supply, demand constant
   c. Decrease in demand, supply constant
   d. Decrease in supply, demand constant
   e. Increase in demand, increase in supply
   f. Increase in demand, decrease in supply
   g. Decrease in demand, decrease in supply
   h. Decrease in demand, increase in supply

17. If supply and demand establish a price for a good so that there is no shortage or surplus of the product, then price is successfully performing its (utility, rationing) ______ function. The price that is set is a (market-changing, clearing) ______ price.

18. A competitive market produces two types of efficiency: Goods and services will be produced in the least costly way, and so there will be (allocative, productive) ______ efficiency, and resources will be devoted to the production of the mix of goods and services society most wants, or there will be ______ efficiency.

19. A price ceiling is the (minimum, maximum) ______ legal price a seller may charge for a product or service, whereas a price floor is the (minimum, maximum) ______ legal price set by government.

20. If a price ceiling is below the market equilibrium price, a (surplus, shortage) ______ will arise in a competitive market, and if a price floor is above the market equilibrium price, a (surplus, shortage) ______ will arise in a competitive market.

■ TRUE–FALSE QUESTIONS

Circle T if the statement is true, F if it is false.

1. A market is any arrangement that brings together the buyers and sellers of a particular good or service. T F

2. Demand is the amount of a good or service that a buyer will purchase at a particular price. T F

3. The law of demand states that as price increases, other things being equal, the quantity of the product demanded increases. T F

4. The law of diminishing marginal utility is one explanation of why there is an inverse relationship between price and quantity demanded. T F

5. The substitution effect suggests that, at a lower price, you have the incentive to substitute the more expensive product for similar products which are relatively less expensive. T F

6. There is no difference between individual demand schedules and the market demand schedule for a product. T F

7. In graphing supply and demand schedules, supply is put on the horizontal axis and demand on the vertical axis. T F

8. If price falls, there will be an increase in demand. T F

9. If consumer tastes or preferences for a product decrease, the demand for the product will tend to decrease. T F

10. An increase in income will tend to increase the demand for a product. T F

11. When two products are substitute goods, the price of one and the demand for the other tend to move in the same direction. T F

12. If two goods are complementary, an increase in the price of one will tend to increase the demand for the other. T F

13. A change in the quantity demanded means that there has been a change in demand. T F

14. Supply is a schedule that shows the amounts of a product a producer can make in a limited period. T F

15. An increase in resource prices will tend to decrease supply. T F

16. A government subsidy for the production of a product will tend to decrease supply. T F

17. An increase in the prices of other goods that could be made by producers will tend to decrease the supply of the current good that the producer is making. T F

18. A change in supply means that there is a movement along an existing supply curve. T F

19. A surplus indicates that the quantity demanded is less than the quantity supplied at that price. T F

20. If the market price of a product is below its equilibrium price, the market price will tend to rise because demand will decrease and supply will increase. T F

21. The rationing function of prices is the elimination of shortages and surpluses. T F
22. Allocative efficiency means that goods and services are being produced by society in the least costly way. T F

23. If the supply of a product increases and demand decreases, the equilibrium price and quantity will increase. T F

24. If the demand for a product increases and the supply of the product decreases, the equilibrium price will increase and the equilibrium quantity will be indeterminate. T F

25. A price ceiling set by government below the competitive market price of a product will result in a surplus. T F

**MULTIPLE-CHOICE QUESTIONS**

Circle the letter that corresponds to the best answer.

1. A schedule that shows the various amounts of a product consumers are willing and able to purchase at each price in a series of possible prices during a specified period of time is called
(a) supply
(b) demand
(c) quantity supplied
(d) quantity demanded

2. The reason for the law of demand can best be explained in terms of
(a) supply
(b) complementary goods
(c) the rationing function of prices
(d) diminishing marginal utility

3. Assume that the price of video game players falls. What most likely will happen to the equilibrium price and quantity of video games, assuming this market is competitive?
(a) Price will increase; quantity will decrease.
(b) Price will decrease; quantity will increase.
(c) Price will decrease; quantity will decrease.
(d) Price will increase; quantity will increase.

4. Given the following individuals' demand schedules for product X, and assuming these are the only three consumers of X, which set of prices and output levels below will be on the market demand curve for this product?

<table>
<thead>
<tr>
<th>Price X</th>
<th>Consumer 1</th>
<th>Consumer 2</th>
<th>Consumer 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5</td>
<td>1</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>4</td>
<td>2</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>4</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>1</td>
<td>5</td>
<td>10</td>
<td>3</td>
</tr>
</tbody>
</table>

(a) ($5, 2); ($1, 10)
(b) ($5, 3); ($1, 18)

5. Which change will decrease the demand for a product?
(a) a favorable change in consumer tastes
(b) an increase in the price of a substitute good
(c) a decrease in the price of a complementary good
(d) a decrease in the number of buyers

6. The income of a consumer decreases, and the consumer's demand for a particular good increases. It can be concluded that the good is
(a) normal
(b) inferior
(c) a substitute
(d) a complement

7. Which of the following could cause a decrease in consumer demand for product X?
(a) a decrease in consumer income
(b) an increase in the prices of goods that are good substitutes for product X
(c) an increase in the price that consumers expect will prevail for product X in the future
(d) a decrease in the supply of product X

8. If two goods are substitutes for each other, an increase in the price of one will necessarily
(a) decrease the demand for the other
(b) increase the demand for the other
(c) decrease the quantity demanded of the other
(d) increase the quantity demanded of the other

9. If two products, A and B, are complements, then
(a) an increase in the price of A will decrease the demand for B
(b) an increase in the price of A will increase the demand for B
(c) an increase in the price of A will have no significant effect on the price of B
(d) a decrease in the price of A will decrease the demand for B

10. If two products, X and Y, are independent goods, then
(a) an increase in the price of X will significantly increase the demand for Y
(b) an increase in the price of Y will significantly increase the demand for X
(c) an increase in the price of Y will have no significant effect on the demand for X
(d) a decrease in the price of X will significantly increase the demand for Y

11. The law of supply states that, other things being constant, as price increases,
(a) supply increases
(b) supply decreases
(c) quantity supplied increases
(d) quantity supplied decreases
12. If the supply curve moves from $S_1$ to $S_2$ on the graph below, there has been
   (a) an increase in supply
   (b) a decrease in supply
   (c) an increase in quantity supplied
   (d) a decrease in quantity supplied

13. A decrease in the supply of a product most likely would be caused by
   (a) an increase in business taxes
   (b) an increase in consumer incomes
   (c) a decrease in resource costs for production
   (d) a decrease in the price of a complementary good

14. If the quantity supplied of a product is greater than the quantity demanded for that product, then
   (a) there is a shortage of the product
   (b) there is a surplus of the product
   (c) the product is a normal good
   (d) the product is an inferior good

15. If the price of a product is below the equilibrium price, the result will be
   (a) a surplus of the good
   (b) a shortage of the good
   (c) a decrease in the supply of the good
   (d) an increase in the demand for the good

16. Which would be the best example of allocative efficiency? When society devoted resources to the production of
   (a) slide rules instead of handheld calculators
   (b) horse-drawn carriages instead of automobiles
   (c) computers with word processors instead of typewriters
   (d) long-playing records instead of compact discs

Answer Questions 17, 18, and 19 on the basis of the data in the following table. Consider the following supply and demand schedules for bushels of corn.

<table>
<thead>
<tr>
<th>Price</th>
<th>Quantity demanded</th>
<th>Quantity supplied</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20</td>
<td>395</td>
<td>200</td>
</tr>
<tr>
<td>22</td>
<td>375</td>
<td>250</td>
</tr>
<tr>
<td>24</td>
<td>350</td>
<td>290</td>
</tr>
<tr>
<td>26</td>
<td>320</td>
<td>320</td>
</tr>
<tr>
<td>28</td>
<td>280</td>
<td>345</td>
</tr>
<tr>
<td>30</td>
<td>235</td>
<td>365</td>
</tr>
</tbody>
</table>

17. The equilibrium price in this market is
   (a) $22
   (b) $24

18. An increase in the cost of labor lowers the quantity supplied by 65 bushels at each price. The new equilibrium price would be
   (a) $22
   (b) $24
   (c) $26
   (d) $28

19. If the quantity demanded at each price increases by 130 bushels, then the new equilibrium quantity will be
   (a) 290
   (b) 320
   (c) 345
   (d) 365

20. A decrease in supply and a decrease in demand will
   (a) increase price and decrease the quantity exchanged
   (b) decrease price and increase the quantity exchanged
   (c) increase price and affect the quantity exchanged in an indeterminate way
   (d) affect price in an indeterminate way and decrease the quantity exchanged

21. An increase in demand and a decrease in supply will
   (a) increase price and increase the quantity exchanged
   (b) decrease price and decrease the quantity exchanged
   (c) increase price and affect the quantity exchanged will be indeterminate
   (d) decrease price and the effect on quantity exchanged will be indeterminate

22. An increase in supply and an increase in demand will
   (a) increase price and increase the quantity exchanged
   (b) decrease price and increase the quantity exchanged
   (c) affect price in an indeterminate way and decrease the quantity exchanged
   (d) affect price in an indeterminate way and increase the quantity exchanged

23. A cold spell in Florida devastates the orange crop. As a result, California oranges command a higher price. Which of the following statements best explains the situation?
   (a) The supply of Florida oranges decreases, causing the supply of California oranges to increase and their price to increase.
   (b) The supply of Florida oranges decreases, causing their price to increase and the demand for California oranges to increase.
   (c) The supply of Florida oranges decreases, causing the supply of California oranges to decrease and their price to increase.
   (d) The demand for Florida oranges decreases, causing a greater demand for California oranges and an increase in their price.
Answer Questions 24, 25, 26, and 27 based on the following graph showing the market supply and demand for a product.

24. Assume that the market is initially in equilibrium where \( D_1 \) and \( S_1 \) intersect. If there is an increase in the number of buyers, then the new equilibrium most likely would be at point:
(a) \( W \)
(b) \( X \)
(c) \( Y \)
(d) \( Z \)

25. Assume that the equilibrium price and quantity in the market are \( P_2 \) and \( Q_2 \). Which factor would cause the equilibrium price and quantity to shift to \( P_1 \) and \( Q_3 \)?
(a) an increase in product price
(b) an increase in demand
(c) an increase in supply
(d) a decrease in quantity

26. What would cause a shift in the equilibrium price and quantity from point \( Z \) to point \( X \)?
(a) a decrease in production costs and more favorable consumer tastes for the product
(b) an increase in the number of suppliers and an increase in consumer incomes
(c) an increase in production costs and a decrease in consumer incomes
(d) an improvement in production technology and a decrease in the price of a substitute good

27. Assume that the market is initially in equilibrium where \( D_1 \) and \( S_1 \) intersect. If consumer incomes increased and the technology for making the product improved, the new equilibrium most likely would be at
(a) \( P_1 \) and \( Q_1 \)
(b) \( P_2 \) and \( Q_2 \)
(c) \( P_1 \) and \( Q_3 \)
(d) \( P_3 \) and \( Q_1 \)

28. The demand curve with its inverse relationship between price and quantity demanded is based on the assumption of
(a) other-things-equal
(b) complementary goods
(c) increasing marginal utility
(d) changing consumer expectations

Questions 29 and 30 relate to the following table, which shows a hypothetical supply and demand schedule for a product.

<table>
<thead>
<tr>
<th>Quantity demanded (pounds)</th>
<th>Price (per pound)</th>
<th>Quantity supplied (pounds)</th>
</tr>
</thead>
<tbody>
<tr>
<td>200</td>
<td>$4.40</td>
<td>800</td>
</tr>
<tr>
<td>250</td>
<td>4.20</td>
<td>700</td>
</tr>
<tr>
<td>300</td>
<td>4.00</td>
<td>600</td>
</tr>
<tr>
<td>350</td>
<td>3.80</td>
<td>500</td>
</tr>
<tr>
<td>400</td>
<td>3.60</td>
<td>400</td>
</tr>
<tr>
<td>450</td>
<td>3.40</td>
<td>300</td>
</tr>
<tr>
<td>500</td>
<td>3.20</td>
<td>200</td>
</tr>
</tbody>
</table>

29. A shortage of 150 pounds of the product will occur if a government-set price is established at
(a) $3.20
(b) $3.40
(c) $3.80
(d) $4.00

30. If a price floor set by the government is established at $4.20, there will be a
(a) surplus of 300 pounds
(b) shortage of 300 pounds
(c) surplus of 450 pounds
(d) shortage of 450 pounds

PROBLEMS

1. Using the demand schedule at the top of the next column, plot the demand curve on the graph below the schedule. Label the axes and indicate for each axis the units being used to measure price and quantity.

<table>
<thead>
<tr>
<th>Price</th>
<th>Quantity demanded (1000 bushels of soybeans)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$7.20</td>
<td>10</td>
</tr>
<tr>
<td>7.00</td>
<td>15</td>
</tr>
<tr>
<td>6.80</td>
<td>20</td>
</tr>
<tr>
<td>6.60</td>
<td>25</td>
</tr>
<tr>
<td>6.40</td>
<td>30</td>
</tr>
<tr>
<td>6.20</td>
<td>35</td>
</tr>
</tbody>
</table>
a. Plot the following supply schedule on the same graph.

<table>
<thead>
<tr>
<th>Price</th>
<th>Quantity demanded 1000 bushels of soybeans</th>
</tr>
</thead>
<tbody>
<tr>
<td>$7.20</td>
<td>40</td>
</tr>
<tr>
<td>7.00</td>
<td>35</td>
</tr>
<tr>
<td>6.80</td>
<td>30</td>
</tr>
<tr>
<td>6.60</td>
<td>25</td>
</tr>
<tr>
<td>6.40</td>
<td>20</td>
</tr>
<tr>
<td>6.20</td>
<td>15</td>
</tr>
</tbody>
</table>

b. The equilibrium price of soybeans will be $. . .

c. How many thousand bushels of soybeans will be exchanged at this price?

d. Indicate clearly on the graph the equilibrium price and quantity by drawing lines from the intersection of the supply and demand curves to the price and quantity axes.

e. If the Federal government supported a price of $7.00 per bushel, there would be a (shortage, surplus) of _______ bushels of soybeans.

2. The demand schedules of three individuals (Ellie, Sam, and Lynn) for loaves of bread are shown in the following table. Assuming there are only three buyers of bread, determine and graph the total or market demand schedule for bread.

<table>
<thead>
<tr>
<th>Price</th>
<th>Quantity demanded, loaves of bread</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Ellie</td>
</tr>
<tr>
<td>$1.50</td>
<td>1</td>
</tr>
<tr>
<td>1.40</td>
<td>3</td>
</tr>
<tr>
<td>1.30</td>
<td>6</td>
</tr>
<tr>
<td>1.20</td>
<td>10</td>
</tr>
<tr>
<td>1.10</td>
<td>15</td>
</tr>
</tbody>
</table>

3. Following is a demand schedule for bushels of apples. In columns 3 and 4 insert any new figures for quantity that represent in column 3 an increase in demand and in column 4 a decrease in demand.

<table>
<thead>
<tr>
<th>(1) Price</th>
<th>(2) Quantity demanded</th>
<th>(3) Demand increases</th>
<th>(4) Demand decreases</th>
</tr>
</thead>
<tbody>
<tr>
<td>$6.00</td>
<td>400</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.90</td>
<td>500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.80</td>
<td>600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.70</td>
<td>700</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.60</td>
<td>800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5.50</td>
<td>900</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. Assume that O'Rourke has, when his income is $100 per week, the demand schedule for good A shown in columns 1 and 2 of the following table and the demand schedule for good B shown in columns 4 and 5. Assume that the prices of A and B are $.80 and $5, respectively.

<table>
<thead>
<tr>
<th>Demand for A (per week)</th>
<th>Demand for B (per week)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Price</td>
<td>(2) Quantity demanded</td>
</tr>
<tr>
<td>$9.00</td>
<td>10</td>
</tr>
<tr>
<td>8.50</td>
<td>20</td>
</tr>
<tr>
<td>8.00</td>
<td>30</td>
</tr>
<tr>
<td>7.50</td>
<td>40</td>
</tr>
<tr>
<td>7.00</td>
<td>50</td>
</tr>
<tr>
<td>6.50</td>
<td>60</td>
</tr>
<tr>
<td>6.00</td>
<td>70</td>
</tr>
</tbody>
</table>

a. How much A will O'Rourke buy?

b. Suppose that as a consequence of a $10 increase in O'Rourke's weekly income, the quantities demanded of A become those shown in column 3 and the quantities demanded of B become those shown in column 6.

(1) How much A will he now buy?

(2) Good A is (normal, inferior)

(3) Good B is

5. The market demand for good X is shown in columns 1 and 2 of the following table. Assume the price of X to be $2 and constant.

<table>
<thead>
<tr>
<th>(1) Price</th>
<th>(2) Quantity demanded</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2.40</td>
<td>1600</td>
</tr>
<tr>
<td>2.30</td>
<td>1650</td>
</tr>
<tr>
<td>2.20</td>
<td>1750</td>
</tr>
<tr>
<td>2.10</td>
<td>1900</td>
</tr>
<tr>
<td>2.00</td>
<td>2100</td>
</tr>
<tr>
<td>1.90</td>
<td>2350</td>
</tr>
<tr>
<td>1.80</td>
<td>2650</td>
</tr>
</tbody>
</table>

a. If as the price of good Y rises from $1.25 to $1.35, the quantities demanded of good X become those shown in column 3, it can be concluded that X and Y are (substitute, complementary) goods.

b. If as the price of good Y rises from $1.25 to $1.35, the quantities demanded of good X become those shown in column 4, it can be concluded that X and Y are (substitute, complementary) goods.

6. The existing demand and supply schedules are given in columns 1, 2, and 3 of the following table.

<table>
<thead>
<tr>
<th>Demand and Supply Schedules</th>
<th>New Demand and Supply Schedules</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Price</td>
<td>(2) Quantity demanded</td>
</tr>
<tr>
<td>$5.00</td>
<td>10</td>
</tr>
<tr>
<td>4.00</td>
<td>20</td>
</tr>
<tr>
<td>3.00</td>
<td>30</td>
</tr>
<tr>
<td>2.00</td>
<td>40</td>
</tr>
<tr>
<td>1.00</td>
<td>50</td>
</tr>
</tbody>
</table>
a. Now the demand increases by 10 units at each price and supply decreases by 10 units. Enter the new amounts for quantity demanded and quantity supplied in columns 5 and 6.

b. What was the old equilibrium price? 
   
   What will be the new equilibrium price? 

b. What was the old equilibrium price? 
   
   What will be the new equilibrium price? 

7. In a local market for hamburger on a given date, each of 300 identical sellers of hamburger has the following supply schedule.

<table>
<thead>
<tr>
<th>Price (Price)</th>
<th>Quantity supplied—one seller, lbs</th>
<th>Quantity supplied—all sellers, lbs</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2.00</td>
<td>150</td>
<td></td>
</tr>
<tr>
<td>2.00</td>
<td>110</td>
<td></td>
</tr>
<tr>
<td>1.95</td>
<td>75</td>
<td></td>
</tr>
<tr>
<td>1.90</td>
<td>45</td>
<td></td>
</tr>
<tr>
<td>1.85</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>1.80</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

a. In column 3 construct the market supply schedule for hamburger.

b. Following is the market demand schedule for hamburger on the same date and in the same local market as that given above.

<table>
<thead>
<tr>
<th>Price</th>
<th>Quantity demanded, lbs</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2.05</td>
<td>28,000</td>
</tr>
<tr>
<td>2.00</td>
<td>31,000</td>
</tr>
<tr>
<td>1.95</td>
<td>36,000</td>
</tr>
<tr>
<td>1.90</td>
<td>42,000</td>
</tr>
<tr>
<td>1.85</td>
<td>49,000</td>
</tr>
<tr>
<td>1.80</td>
<td>57,000</td>
</tr>
</tbody>
</table>

If the Federal government set a price on hamburger of $1.90 a pound, the result would be a (shortage, surplus) of ___________ pounds of hamburger in this market.

8. Each of the following events would tend to increase or decrease either the demand for or the supply of computer games and, as a result, would increase or decrease the price of these games. In the first blank, indicate the effect on demand or supply (increase, decrease); in the second blank, indicate the effect on price (increase, decrease). Assume that the market for computer games is a competitive one.

a. It becomes known that an electronics store is going to have a sale on these games 3 months from now. 

b. The workers who produce the games go on strike for over 2 months. 

c. The workers in the industry receive a $2 an hour wage increase. 

d. The average price of movie tickets (a substitute for games) increases. 

e. The price of business software, a product also supplied by the computer software producers, rises. 

f. It is announced by a private research institute that children who play computer games also improve their grades in school. 

g. Because of the use of mass-production techniques, the amount of labor necessary to produce a game decreases. 

h. The price of computers decreases. 

i. The average consumer believes that a shortage of games is developing in the economy. 

j. The Federal government imposes a $5 tax per game on the manufacturers of computer games.

b. SHORT ANSWER AND ESSAY QUESTIONS

1. Define demand and the law of demand.

2. Use the concept of diminishing marginal utility to explain why the quantity demanded of a product will tend to rise when the price of the product falls.

3. In past decades, the price of coffee in the United States rose significantly as a result of bad weather in coffee-producing regions. Use the concepts of the income effect and the substitution effect to explain why the quantity of coffee demanded in the United States significantly decreased.

4. What is the difference between individual demand and market demand? What is the relationship between these two types of demand?

5. Explain the difference between an increase in demand and an increase in the quantity demanded.

6. What are the factors that cause a change in demand? Use supply and demand graphs to illustrate what happens to price and quantity when demand increases.

7. How are inferior and normal (or superior) goods defined? What is the relationship between these goods and changes in income?

8. Why does the effect of a change in the price of related goods depend on whether a good is a substitute or a complement? What are substitutes and complements?

9. A newspaper reports that "blue jeans have become even more popular and are now the standard clothing that people wear for both play and work." How will this change affect the demand for blue jeans? What will happen to
the price and quantity of blue jeans sold in the market? Explain and use a supply and demand graph to illustrate your answer.

10. Compare and contrast the supply schedule with the demand schedule.

11. Supply does not remain constant for long because the factors that determine supply change. What are those factors? How do changes in them affect supply?

12. Explain the difference between an increase in supply and an increase in the quantity supplied.

13. Describe and illustrate with a supply and demand graph the effect of an increase in supply on price and quantity. Do the same for a decrease in supply.

14. The U.S. Congress passes a law that raises the excise tax on gasoline by $1 per gallon. What effect will this change have on the demand and supply of gasoline? What will happen to gasoline prices and quantity? Explain and use a supply and demand graph to illustrate your answer.

15. Given the demand for and the supply of a commodity, what price will be the equilibrium price of this commodity? Explain why this price will tend to prevail in the market and why higher (lower) prices, if they do exist temporarily, will tend to fall (rise).

16. What is the relationship between the price of a product and a shortage of that product? What is the relationship between the price of a product and a surplus of that product?

17. Explain why competition implies both productive efficiency and allocative efficiency.

18. Analyze the following quotation and explain the fallacies contained in it: "An increase in demand will cause price to rise; with a rise in price, supply will increase and the increase in supply will push price down. Therefore, an increase in demand results in little change in price because supply will increase also."

19. What are the consequences of a price ceiling for a product if it is set below the equilibrium price? Illustrate your answer with a graph.

20. What are the economic problems with price floors? How have they been used by government?

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**TRUE-FALSE QUESTIONS**

8. F. pp. 46, 49–50 17. T. p. 52
9. T. p. 48 18. F. pp. 52–53

**MULTIPLE-CHOICE QUESTIONS**


**PROBLEMS**

1. a. graph; b. 6.60; c. 25,000; d. graph; e. surplus, 20,000
2. Total: 5, 9, 17, 27, 39
3. Each quantity in column 3 is greater than in column 2, and each quantity in column 4 is less than in column 2.
4. a. 30; 4; b. (1) 20; (2) inferior; (3) normal (superior)
5. a. complementary; b. substitute
6. a. column 5 (quantity demanded): 20, 30, 40, 50, 60; column 6 (quantity supplied): 40, 30, 20, 10, 0; b. $3.00, $4.00; c. 50, 30
7. a. 45,000; 33,000; 22,500; 13,500; 6,000; 0; b. shortage, 28,500
8. a. decrease demand, decrease price; b. decrease supply, increase price; c. decrease supply, increase price; d. increase demand, increase price; e. decrease supply, increase price; f. increase demand, increase price; g. increase supply, decrease price; h. increase demand, increase price; i. increase demand, increase price; j. decrease supply, increase price

---

**ANSWERS**

**FILL-IN QUESTIONS**

1. demanders, suppliers
2. an inverse, a direct utility
3. income; substitution
4. vertical, horizontal
5. adding, prices
6. substitutes, complements
7. a. the tastes or preferences of consumers; b. the number of consumers in the market; c. the money income of consumers; d. the prices of related goods; e. consumer expectations with respect to future prices and income (any order for a–e)
9. smaller, less
10. demand for, quantity demanded of
11. larger, less
12. supply, quantity supplied
13. a. the technology of production; b. resource prices; c. taxes and subsidies; d. prices of other goods; e. producer expectations of price; f. the number of sellers in the market (any order for a–f)
14. equal to, is not
15. below, shortage, rise, above, surplus, fall
16. a. +; b. –; c. –; d. +, –; e. +, –; f. +, ?; g. ?, –; h. –, ?
17. rationing, clearing
18. productive, allocative
19. maximum, minimum
20. shortage, surplus
<table>
<thead>
<tr>
<th>SHORT ANSWER AND ESSAY QUESTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. pp. 45–46</td>
</tr>
<tr>
<td>2. p. 46</td>
</tr>
<tr>
<td>3. p. 46</td>
</tr>
<tr>
<td>5. pp. 49–50</td>
</tr>
<tr>
<td>7. p. 48</td>
</tr>
</tbody>
</table>