Laws of market economy

- Theory of Demand
- Theory of Supply
- Market Equilibrium
- Government Intervention in the Market

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Demand of a Commodity

- Demand for a commodity
  - Depends on size of the market (Industry Demand for the commodity)
  - Summation of Individual level Demand
- Related to Consumer Choice Theory
- Consumer Demand Theory $Q_d = f\ (P_x, I, P_y, T)$

Individual Demand

- How are price and demand related for a good? (law of demand)
  - Normal Goods
  - Inferior Goods
- Example: Suzuki Mehran
- Effect of price of substitute and complementary goods
- Effect of Change in Income and Tastes
- Assuming everything else fixed................

Market Demand

- Horizontal Summation of Individual Demand Curves
- Negatively sloped, why?
- Inverse relation between price and quantity
- $Q_D = F(P_x, I, N, P_y, T)$
- Bandwagon Effect and Snob Effect

Market Demand

- Change in demand
- Change in quantity Demanded

Demand Faced by A Firm

- Monopolist
  - WAPDA
- Perfect Competition
  - No true example exists (Small scale farmers producing homogeneous wheat in USA)
  - Horizontal demand curve, why?

Demand Faced by A Firm

- Oligopoly
  - Few firms with standardized or differentiated product
- Monopolistic Competition
  - Heterogeneous and differentiated products

- Factors effecting Demand
  - Advertising, Promotional Policies, Price expectations

Demand Faced by A Firm

- Firms selling durable goods face more volatile & unstable demand
  - Like automobiles, washing machines, water geezers
- Why?
  - Consumers can wait for Availability of credit, or growth in economy

Demand Faced by A Firm

- Demand function faced by a firm

  $Q_D = a_0 + a_1 P_x + a_2 I + a_3 N + a_4 P_y + a_5 T$……………

- "a" is coefficient to be estimated with regression analysis

- Implications of estimated demand:
  - Types of inputs
  - Quantity of Inputs

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Supply of a Commodity

- The quantity sellers are willing to sell at a given price level
- Depends on:
  - Price of the commodity
  - Prices of inputs
  - Technology
  - Opportunity cost
  - Future expectations
  - Number of sellers

Individual Supply

- The higher the price, greater is the quantity sellers are willing to sell in the market (law of supply)
- Effect of prices of inputs and changes in technology
- Effect of prices of goods which can be produced with same inputs
- Effect of changes in expectations of future
- Assuming everything else is fixed………

Market Supply

- Horizontal Summation of Individual Supply Curves

- Positively sloped, why?

- Positive relation between price and quantity

Market Supply

- Change in supply
- Change in quantity supplied

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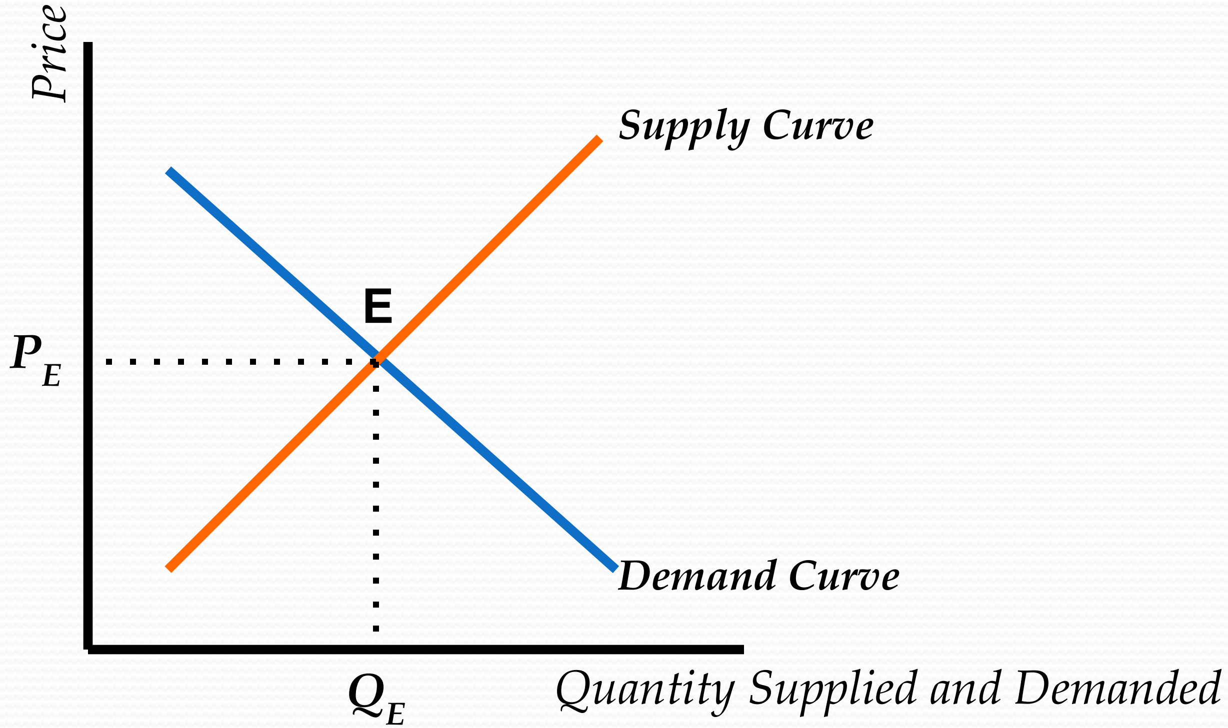
Market Equilibrium

- Equilibrium exists when quantity sellers are willing to sell is equal to the quantity buyers are willing to buy at a given price.



Market Equilibrium

- Surplus - Results in downward pressure on the price
- Shortage - Results in upward pressure on the price

- Impact of Changes in Demand on Market Equilibrium
- Impact of Changes in Supply on Market Equilibrium

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Role of the Government

- Public Sector Services
- Monopolies
- Restrictions and Barriers to Entry
- Reducing Trade Barriers Vs Import Tariffs
- Taxation
- Subsidies and Welfare payments
- Laws and Regulations

Case Study

- What would be the equilibrium price and quantity in presence of insurance?
- What would happen to the demand curve of health care facilities in absence of medical insurance?
- Explain the role of government in influencing the market of health care facilities?
- Explain a few scenarios in which the supply curve might shift?