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Home Politics, Law & Government Economics & Economic Systems supply and demand, in economics, relationship between the quantity of a commodity that producers wish to sell at various prices and the quantity that consumers wish to buy. It is the main model of price determination used in economic theory. The price of a commodity is determined by the interaction of supply and demand in a market. The resulting price is referred to as the equilibrium price and represents an agreement between producers and consumers of the good. In equilibrium the quantity of a good supplied by producers equals the quantity demanded by consumers. The quantity of a commodity demanded depends on the price of that commodity and potentially on many other factors, such as the prices of other commodities, the incomes and preferences of consumers, and seasonal effects. In basic economic analysis, all factors except the price of the commodity are often held constant; the analysis then involves examining the relationship between various price levels and the maximum quantity that would potentially be purchased by consumers at each of those prices. The price-quantity combinations may be plotted on a curve, known as a demand curve, with price represented on the vertical axis and quantity represented on the horizontal axis. A demand curve is almost always downward-sloping, reflecting the willingness of consumers to purchase more of the commodity at lower price levels. Any change in non-price factors would cause a shift in the demand curve, whereas changes in the price of the commodity can be traced along a fixed demand curve.increase in demandIllustration of an increase in equilibrium price (p) and equilibrium quantity (q) due to a shift in demand (D). Encyclopædia Britannica, Inc. New from Britannica Treadmills were used in muscle-powered machinery since ancient times, and 19th-century English jails used them to punish prisoners. See All Good Facts The quantity of a commodity that is supplied in the market depends not only on the price obtainable for the commodity but also on potentially many other factors, such as the prices of substitute products, the production technology, and the availability and cost of labour and other factors of production. In basic economic analysis, analyzing supply involves looking at the relationship between various prices and the quantity potentially offered by producers at each price, again holding constant all other factors that could influence the price. Those price-quantity combinations may be plotted on a curve, known as a supply curve, with price represented on the vertical axis and quantity represented on the horizontal axis. A supply curve is usually upward-sloping, reflecting the willingness of producers to sell more of the commodity they produce in a market with higher prices. Any change in non-price factors would cause a shift in the supply curve, whereas changes in the price of the commodity can be traced along a fixed supply curve.decrease in supplyIllustration of an increase in equilibrium price (p) and a decrease in equilibrium quantity (q) due to a shift in supply (S).Encyclopædia Britannica, Inc. This reading addressed several important concepts that extend the basic market model of demand and supply to assist the analyst in assessing a firm's breakeven and shutdown points of production. Demand concepts covered include own-price elasticity of demand, cross-price elasticity of demand, and income elasticity of demand. Supply concepts covered include total, average, and marginal product of labor; total, variable, and marginal cost of labor; and total and marginal revenue. These concepts are used to calculate the breakeven and shutdown points of production. Elasticity of demand is a measure of how sensitive quantity demanded is to changes in various variables. Own-price elasticity of demand is the ratio of percentage change in quantity demanded to percentage change in a good or service's own price. If own-price elasticity of demand is greater than one in absolute terms, demand is elastic and a decline in price will result in higher total expenditure on that good. If own-price elasticity of demand is less than one in absolute terms, demand is inelastic and a decline in price will result in a lower total expenditure on that good. If own-price elasticity of demand is equal to negative one, demand is unit, or unitary, elastic and total expenditure on that good is independent of price. Own-price elasticity of demand will almost always be negative. Income elasticity of demand is the ratio of the percentage change in quantity demanded to the percentage change in consumer income. Demand is negatively sloped because of either the substitution effect or the income effect. The substitution effect is the phenomenon in which, as a good's price falls, more of this good is substituted for other, more expensive goods. The income effect is the phenomenon in which, as a good's price falls, real income rises and, if this good is normal, more of it will be purchased. If the good is inferior, the income effect will partially or fully offset the substitution effect. There are two exceptions to the law of demand: Giffen goods and Veblen goods. Giffen goods are highly inferior and make up a large portion of the consumer budget. As price falls, the substitution effect tends to cause more of the good to be consumed, but the highly negative income effect overwhelms the substitution effect. Demand curves for Giffen goods are positively sloped. Veblen goods are highly valued high-priced "status goods; consumers may tend to buy more of a good if its price rises. If income elasticity of demand is positive, the good is a normal good. If income elasticity of demand is negative, the good is an inferior good. Cross-price elasticity of demand is the ratio of the percentage change in quantity demanded of one good to the percentage change in the price of a related good. If cross-price elasticity between two goods is positive, they are substitutes, and if cross-price elasticity between two goods is negative, they are complements. The law of demand states that a decrease in price will cause an increase in quantity demanded. Total product of labor is a short-run concept that is the total quantity that is able to be produced for each level of labor input, holding all other inputs constant. Average product of labor (APL) is the total product of labor divided by number of labor hours. Marginal product of labor (MPL) is the change in total product divided by the change in labor hours. MPL might rise as more labor is added to a fixed amount of capital. The law of diminishing returns dictates that additional output must fall as more and more labor is added to a fixed amount of capital. Production costs increase as input prices rise and fall as inputs become more productive. Short-run total cost (STC) is the total expenditure on fixed capital plus the total expenditure on labor. Short-run marginal cost (SMC) equals the ratio of wage to marginal product of labor (MPL). Average variable cost (AVC) is the ratio of wage to average product of labor (APL). Average total cost (ATC) is total cost (TC) divided by the number of units produced. Revenue is price times quantity sold. Marginal revenue (MR) is the ratio of change in revenue to change in output. Firms under conditions of perfect competition have no pricing power and, therefore, face a perfectly horizontal demand curve at the market price. For firms under conditions of perfect competition, price is identical to marginal revenue (MR). Firms under conditions of imperfect competition face a negatively sloped demand curve and have pricing power. For firms under conditions of imperfect competition, marginal revenue (MR) is less than price. Economic profit equals total revenue (TR) minus total economic cost, whereas accounting profit equals TR minus total accounting cost. Economic cost takes into account the total opportunity cost of all factors of production. Opportunity cost is the next best alternative forgone in making a decision. Maximum economic profit requires that (1) marginal revenue (MR) equals marginal cost (MC) and (2) MC not be falling with output. The breakeven point occurs when total revenue (TR) equals total cost (TC), otherwise stated as the output quantity at which average total cost (ATC) equals price. Shutdown occurs when a firm is better off not operating than continuing to operate. If all fixed costs are sunk costs, then shutdown occurs when the market price falls below minimum average variable cost. After shutdown, the firm incurs only fixed costs and loses less money than it would operating at a price that does not cover variable costs. In the short run it may be rational for a firm to continue to operate while earning negative economic profit if some unavoidable fixed costs are covered. Economies of scale is defined as decreasing long-run cost per unit as output increases. Diseconomies of scale is defined as increasing long-run cost per unit as output increases. Long-run average total cost is the cost of production per unit of output under conditions in which all inputs are variable. Specialization efficiencies and bargaining power in input price can lead to economies of scale. Bureaucratic and communication breakdowns and bottlenecks that raise input prices can lead to diseconomies of scale. The minimum point on the long-run average total cost curve defines the minimum efficient scale for the firm.





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