

2024 A/L | Econ-Hub 'Theory'

Supply Analysis

Market Economics (Price Theory)

Unit [2], Chapter [2]

Special Edition



Key Learning Outcomes

- Ability to define the concept of 'Supply' [outlining the implications and features of supply]
- Identifying 'Law of Supply' and being able to explain the principal reasons for the law of supply
- The ability to construct (derive) and interpret the supply curve and equation.
- The ability to technically analyze and represent Changes in supply and change in quantity supplied

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[3.4] Analysis: Other (Non-price) Factors and Supply

An important aspect of supply analysis is to **systematically evaluate** the relationship between non-price factors (i.e., factors other than the price of the own product or conditions of supply) affecting the supply of a given product and the supply of a given product.

[A] Price of Related Products [P_n]

In supply analysis the term price of related products refers to '**Production Substitutes or Goods Substitutable in Production**'. Production substitutes refer to two or goods which can be produced by employing similar resources and basic production technology (i.e., goods with high mobility of resources among them).

In addition, goods with perfect mobility of resources or production substitutes, the price of goods which are jointly or **mutually produced** (byproducts or **complementary goods**) can also be considered under price of related products [e.g., when the price and production of beef increases the supply or production of leather increases]

The relationship between a change in the price of a **production substitute** and the **supply** of the product under consideration tends to be **indirect or negative**.

Illustration:

[B] Cost of Production [C]

Cost of production is mainly subject to change when the price of production factors within factor markets tends to change. The supply curve of a profit-motivated producer represents the minimum expected price by the producer, while remaining profitable on the supply.

A change in the price of production factors (a change in cost of production), while the market price of the product is held constant leads to an **indirect or negative** effect on the producer's profitability and thus quantity supplied of the given product.

Illustration:

[C] Technology [T]

Technology broadly refers to the methodology which specifies how resources should be used within the process of producing a given product. Such production technology may change both **favorably** and **unfavorably**, affecting the level of efficiency causing an increasing or decreasing impact on cost of production, ultimately either increasing or decreasing supply (shifting the supply curve towards the left or right).

Illustration:

[D] Producer Expectations [Ex]

Changes in producer expectations for a broad range of factors such as future price, profits, sales volumes, market dynamics etc, tends to affect the present supply of a given product. Producer expectation on the future price of the product is a major influence on its present supply.

The reaction of producers or suppliers in terms of their current supply with response to an expected change in the future price shall depend on the nature of the product. In this respect products are mainly classified in to Basic or Nontechnical products and Industrial or Technology based products.

With regards to Basic products the relationship between a change in future price expected and the present supply to the market tends to indirect or negative, while with regards to industrial or technology-based products this relationship tends be positive or direct.