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

www.mind-hub.lk



[3.1] Supply [What is mean by Effective Supply]:

Supply in the study of economics is essentially 'Effective Supply'.

Effective Supply is the different quantities of a given product producers have the ability to produce (resources and technology), willing (potential to earn profits) and are planning to produce and supply, under alternative market prices, when other factors affecting supply remain constant, during a given period of time.

Alternatively:

Supply of a good refers to the amount of goods that firms or producers are willing to make and sell at different sets of alternative prices in a given period of time.

[Source: P. Perera, p. 140]

Supply is always presented linked to **price** and **time** [Note: **Features** of **Supply**]. Three points are **implied** (**emphasized**) when a firm is supplying a good or service:

- The firm has the resources and technology needed to produce the good
- The firm can earn a profit by producing the good
- The firm has planned to produce and sell the good

[3.2]	Individual Firms' Supply Vs. Market Supply	▼ Key Definitio
		·

[3.3] **Determinants** [Factors Affecting...]:

[A] Determinants of Institutional Supply



product's own price and a range of factors other than the given product's own price (i.e., non-price factors/other factors/conditions of supply).				

[B] Determinants of Market Supply

All the standard or usual factors affecting individual firm's supply of a product shall also affect the market supply of the product, however in addition to these factors, market supply of a product is affected by a specific (or special) factor:

Number of sellers or firms in the market (Size of the industry)

[C] General Function of Supply [for Mkt Supply]

The General Function of Supply is a mathematical summary of the **Theory of Supply**, which is the broad relationship between supply and all the factors affecting supply

$$Qsx = f(Px,Pn,C,T,Ex,G,N,O)$$

Key Assumption: 'Ceteris Paribus' i.e., only one factor affecting supply is assumed to change when analyzing the functional relationships indicated through the supply function, while all other factors are held constant.

[E6] Application Exercise: Determinant of Supply Identify and state the factors which affect the supply of 'Fresh Milk' made by a given cattle or dairy farmer.				
	_			
	_			
	_			
	_			
	_			
	_			
	_			
	_			
	_			
	_			
	_			

Also Relevant: Supply Vs. Quantity supplied

Supply (S) refers to the <u>overall relationship</u> between the <u>quantity supplied</u> and a <u>range</u> of <u>prices</u> for a given product when all other factors affecting supply, apart from the price of the own product, is held constant, <u>during a given period of time</u>.

Quantity supplied essentially refers to the **amount of a good** that sellers are **able** and **willing** to **supply,** at a **specific price**.

Illustration:

[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 [Pn]

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 of negative, while with regards to industrial or technology-based products this relationship tends be positive or direct.