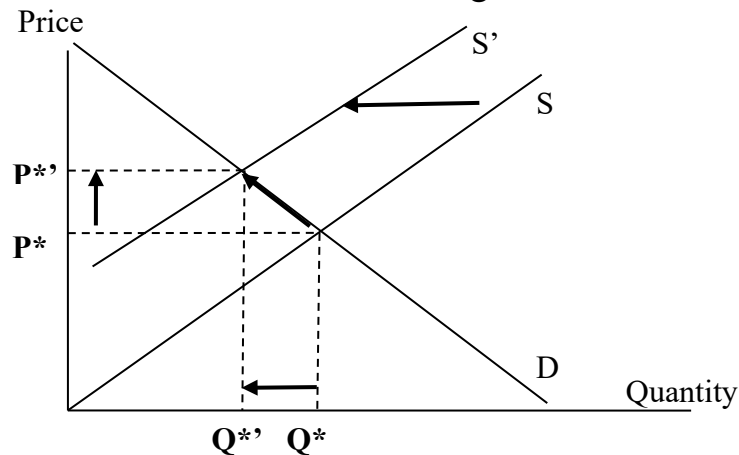


## TOPIC 04: SHIFTING SUPPLY AND DEMAND

### I. Shifting a Curve.

- a. Recall that the supply curve is a bunch of marginal costs and the demand curve is a bunch of marginal benefits.
- b. As the world changes, these costs and benefits change as well. A *curve* will shift, causing a movement along the *other* curve.
- c. This is perhaps the most interesting use of supply and demand analysis. While the diagram illustrates a simple world where the only things that matter are supply, demand, price, and quantity, we can simulate changes in the market by shifting the supply or the demand curve to the left or to the right. For example, suppose a hurricane came through and destroyed all the factories for making books. How does this affect the market for making books?



- i. The grounding assumption in this sort of analysis is *ceteris paribus*, Latin for “all other things being equal.” In other words, we do not consider how the market will react to this shock beyond the most immediate response. Because the economy is so complex, the analysis has to be done bit by bit. How does this *one change* affect this *one part* of the economy?
  - ii. Note that the supply of books shifted to the left and, to achieve the new equilibrium, there was an instantaneous movement *along* the demand curve.
- d. Another way to think about shifts is that *ceteris paribus* assumption:
- i. The same amount of books will cost more to produce.

- ii. The same price of books will result in fewer books produced.
- II. Common Demand shifters
  - a. Income
    - i. *Normal good or service*—a change in income result in demand shifting in the same direction (e.g. increase income increases demand).
    - ii. *Inferior good or service*— a change in income result in demand shifting in the opposite direction (e.g. increase income decreases demand).
  - b. Population of consumers
  - c. Price of *substitutes*—two goods or services consumed instead of one another
  - d. Price of *complements*—two goods or services consumed together
  - e. Tastes
- III. Common Supply shifters
  - a. Production (changes in productivity)
  - b. Input prices
  - c. Population of producers
  - d. Opportunity cost
  - e. Taxes