**Economics 1 Lesson 3: Supply and Demand**

**Laws of Supply and Demand**

We have established that economics is about the allocation of resources, which are scarce, but on a day to day basis, at the microeconomic level, the way that this system works is through the use of money. You have known for a long time that things cost money, be it a bar of chocolate, an Xbox or a car, but that they don’t all cost the same, and that everything has a value, or price. For most of us, the money that we have comes from the wages for the work that we do, but we don’t think of our wages as a percentage of a house, or in how many bars of chocolate it will buy us, partly because our wages will change over time, and so will the price of goods.

Price is an interesting concept, and is subject to one of the most important laws of economics, the Laws of Supply and Demand. If you’re clearing out your wardrobe and come across jeans that you no longer wear, you might put them on ebay, but at what price? If you are only going to make a few pence after postage and charges, you will conclude that this is not worth your time, whilst on the other hand if you make them very expensive you stand to make a fortune, but nobody will actually buy them. That’s a very basic idea of establishing a price, but companies with a regular market for goods have to take a lot more than that into account.

The Laws of Supply and Demand tell us that at some prices companies will have too much of their product and be unable to sell it, whilst at other prices they will sell out quickly but not make the profit that they could have. **Supply** refers to the amount of the product that is available, for example the company can make 100 units per week, **demand** is about how many people want to buy a product. Supply and demand are themselves impacted by price; if the price is too low, there will be huge demand – everyone loves a bargain, whilst if it is too high then the demand will be low, and there will too much of the product. When a company has too much supply, they will need to lower the price to get rid of the product, which is often why clothes companies have sales at the end of a season, to make room for the new supply of goods.

Supply and demand can be impacted by other things though, factors outwith the control of the business, which are known in economics as **externalities**. It might be that a fire at the biscuit factory impacts their supply, leading to a shortage, whilst you may remember the images of people hoarding huge packets of toilet roll as the Cornavirus Crisis began and a sudden, unexpected and significant increase in demand for toilet roll led to a **shortage** which is a common term for a lack of supply.

**Equilibrium:**

In economics we talk often about the market, which is an invisible force, but a powerful one. The market usually sorts things out (we will see that this is not always the case) and the different forces eventually settle down. Buyers want products at a price they can afford to pay, and sellers want to make money for their product – eventually the market will settle on a price that satisfies both, because products that are too expensive will not sell and companies will either lower prices or go out of business, whilst prices can never stay too low for too long as companies need to make a profit to pay their staff. The theory is that the market will find a clearing price, where supply and demand are equal, and the technical name for this is the **equilibrium**.

One complication to what we have learned so far is that there is not only one company making chocolate biscuits, but several, and the potential for new ones at any time. The equilibrium does not just refer to one company but to the whole market, but this is where we see the power of the market (that invisible but powerful force) because as companies compete for business, those who go too low will not survive, whilst those who are too high will find that demand falls. Customers will be able to switch brands, or even to replace chocolate biscuits with custard creams, if the prices are not acceptable to them, so the market works to find prices for goods which ensure that supply and demand are close to equal and the equilibrium is achieved.

**Elasticity and Inelasticity of Demand:**

One issue with this is that not every product has an alternative, for example, if the price of petrol goes up, drivers still need it to run their car. Over time people might switch to cycling for some journeys, or to public transport where it is available, but if you want to run a petrol car, you still need to buy it. This is also the case with other goods such as cigarettes for smokers, drugs for drug addicts, oil, gas and so on. These goods often retain their demand, or suffer only a very small drop in demand, even when the price changes, due to a lack of alternatives or the necessity of that product to the customer. This is described as **inelasticity** because demand for the product is inelastic, or not sensitive to changes in the price.

The opposite of this is obviously **elasticity**, when demand for a good is elastic and changes based on the price. Most products are like this, chocolate biscuits, fizzy drinks, sports cars – the price goes up, demand comes down and vice versa. Some goods are more elastic than others, and even a tiny change in price will impact demand, whilst others can move slightly without too much impact.

**Economics 1 Task 3: Supply and Demand**

Please complete this week’s task as a word document and return it as an attachment on teams. The document title should be PUPIL NAME Economics week 3.

**Part A:**

One area in which supply and demand is often overlooked, but plays a crucial role, is the stock market. The price of shares, also known as stocks, changes daily even though the value of the business hasn’t changed. This is partly because stocks are an investment which people want to sell later, so they are gambling on that company doing well and may sell if they think the company won’t do well. Ultimately though, like most things, the price is based on supply and demand. Read this article <https://www.thebalance.com/how-stock-prices-are-set-3141289> and summarise how supply and demand impacts the stock market in one paragraph.

**Part B:**

You learned about the concept of elastic and inelastic demand, read the following article about the high cost of medicines in the US <https://www.theatlantic.com/health/archive/2019/03/drug-prices-high-cost-research-and-development/585253/> and then do the following:

“The market for medicine is mostly inelastic” In less than 300 words (100 – 300) discuss this statement, using the article to help, and giving your own opinion. You can compare the US to other countries if you wish, but are not required to.

**Part C:**

Finally, if you wish to maintain a glossary of economic terms, then the words in bold from the lesson would be a good addition to that. Once again this part of the task is voluntary.

**Next Time:**

In the next lesson we will look closer at the idea of the market, which has shaped economic history, and we will look at what happens when the market doesn’t function the way that it should.

**Further Reading:**

If you want to learn about how airlines price their tickets, which involves not only supply and demand, but a lot of other economic phenomenon, then this video is highly interesting:

<https://www.youtube.com/watch?v=72hlr-E7KA0>

This website: <https://econlife.com/> is aimed at very short articles about the economics all around us. In the Economic Ideas tab there is a section on Demand and Supply, which will give you short articles about this lesson’s topic, but you are free to explore other articles and it is an excellent website.