Quadrant II – Notes

Programme: Bachelor of Arts (First Year)

Subject: Economics

Paper Code: ECC101

Paper Title: DSC Microeconomics-I

Unit: I

Module Name: Law of Supply

Module No: 13

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Understanding Supply

Ideally, in economics, consumers influence the supply of a product by indicating they need more units of a product, which drives prices higher. To the supplier, the market movements are a positive indication to increase the volume of supplies. However, the pattern may vary across products. At the point when the supply is equal to the demand, the price is said to be at equilibrium, i.e., there is no surplus supply or shortages.

However, as far as supply is at equilibrium, the consumer maximizes utility, and the suppliers enjoy optimal profits. Any more push of supplies in the market will disproportionately lead to suppliers incurring losses. Such an effect will reduce supply, which will tend to decrease prices until equilibrium is regained again.

What is the Law of Supply?

The law of supply is a basic principle in economics that asserts that, assuming all else being constant, an increase in the price of goods will result in a corresponding direct increase in the supply thereof. The law works similarly with a decrease in prices.

The law of supply depicts the producer's behavior when the price of a good rises or falls. With a rise in price, the tendency is to increase supply because there is now more profit to be earned. On the other hand, when prices fall, producers tend to decrease production due to the reduced economic opportunity for profit.

Types of Supply:

Short-term supply explains that the ability of a purchaser to buy goods is constrained by the available supplies. Buyers cannot purchase beyond the supplied products.

Long-term supply explains the factor of time availability whenever the demand changes – meaning, the availability of time gives the supplier a leeway to adjust to a sudden shift in demand.

Joint supply explains the consequential supply. For example, lamb production affects meat and wool supply. In case farmers reduce farming lambs, meat and wool supply will go down, too. Similarly, an increase will result in the opposite effect.

Market supply explains the overall willingness and ability of all suppliers to supply the market a particular product on a day-to-day basis. For example, wheat suppliers A, B, and C may be willing to supply 5, 0, 6 kilos in the market at $1 per kilo for a total of 11 kilos. If prices rise to $2.50, the suppliers may increase to 10, 8, and 15 kilos, respectively. In total, the market supply amounts to 33 kilos.

Composite supply is used to explain the supply of products that serves more than one purpose. A perfect illustration is the mining of crude oil. The production of oil affects the manufacturing of petrol, gas, kerosene, diesel, etc.