Economics of Firms and Markets (MS3) – Supervision 1

M.G. Pollitt
Cambridge Judge Business School

G. Dolphin

October 24, 2016

Demand and Supply

Determinants of demand (good X)

- Own price: p_x
- Income
- Price of a substitute or complement: p_y
- Taste (preferences)
- ...

Determinants of supply

- Own price: p_x
- Production technology
- Price of inputs: p_α
- ...

Elasticity

Elasticity is a percentage change. It is NOT constant along the (supply or demand) curve.

$$\epsilon \equiv \frac{\partial q}{\partial p}\frac{p}{q} \tag{1}$$

$\hookrightarrow$When is a curve elastic? What does elasticity mean?

- $\mid \epsilon \mid = 0$: inelastic
- $\mid \epsilon \mid > 0$: elastic

Price elasticity - illustrations

- The (own) price elasticity is not constant along a linear (demand) curve, i.e. the same percentage change in price will induce different percentage changes in quantities at two different points along the (demand) curve.

Midpoint formula

$$\text{Price elasticity of demand} = \frac{(Q_2 - Q_1)/[(Q_2 + Q_1)/2]}{(P_2 - P_1)/[(P_2 + P_1)/2]}$$

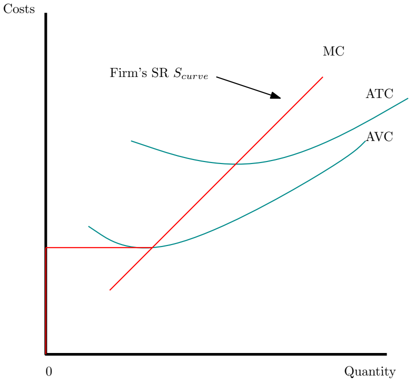
- The (own) price elasticity is greater in the LR than in the SR

Coal market - 0

Analysis

1. Distinguish between demand side and supply side "shocks"
2. Identify the sequence of events
3. Make a clear distinction between shifts of curves (i.e. changes in demand or supply at any given price) and changes in equilibrium prices.
4. Two sets of diagram are needed: market-level and firm-level
5. Distinguish SR and LR dynamics.

Coal market - I



Coal market - II