Think About It 7.1

The prices of most goods in the shops do not change every day. Does this mean that the price mechanism does not work in reality?

*Answers might include:*  
In a typical retail outlet it may not be realistic to change prices so regularly - e.g. cost of time and admin changing systems. Will take a view of the demand for a given period and price on this. However online it may be possible to change prices at different times and even depending on where someone is searching from.

Data Analysis 7.1

1. **What is the equilibrium market price in the market shown in table 7.1?**  
   Equilibrium price is £8

2. **What is the difference between the quantity demanded and the quantity supplied at a price of £6? What will happen to the price in this case to bring about equilibrium? Explain how this brings about equilibrium?**  
   At £6 there is excess demand of 110 units and the price will rise to return to equilibrium

3. **What is the difference between the quantity demanded and the quantity supplied at a price of £10? What will happen to the price in this case to bring about equilibrium? Explain how this brings about equilibrium?**  
   At £10 there is excess supply of 100 units and the price will fall.

Think About It 7.2

1. Can you think of anything that would prevent the price from moving up or down to achieve equilibrium in any market instantaneously?

*Answers might include:*  
- Lack of information of demand conditions  
- Costs of changing the prices e.g. changing system information  
- Fixed agreements e.g. set prices in a contract

2. Can you think of any market in which the price does not move up or down? Why not?

*Answers might include:*  
- May have prices fixed for a period of time e.g. an annual wage agreement  
- May be a price fixed by the government e.g. a fixed exchange rate

3. When do you think the following occurred?

Google was launched. 1998  
The first iPod was sold. 2001  
The first PlayStation was sold. 1994  
Apple was set up. 1976  
Facebook was set up. 2004
Twitter was set up. 2006

p185. Think About It 7.3

Which of the following might explain an increase in demand?

A: An increase in the price of a substitute: True; consumers switch to demand this product.

B: An increase in the price of a complement: False; consumers would buy less of the complement and less of this product.

C: An increase in income for an inferior good: False; with more income consumers would buy less of an inferior product.

D: A decrease in the costs of production: False; Lower costs of production would increase supply and not shift the demand curve.

p186. Business Analysis 7.1

Do you think that the government should interfere with market forces?

Answers might include:
Depends on why they are intervening, how they intervene and the extent to which there is a market failure and imperfection. Intervention can create problems of its own e.g. raising the funding for intervention this can create distortions elsewhere.

Think About It 7.4

2. What items do you think should be added next to the basket of goods?

Up to you! How are consumption patterns changing do you think? What are we buying now that we weren’t buying a few years ago?

p187. Data Analysis 7.2

1. Would the effect of an increase in demand on the equilibrium price relative to the equilibrium quantity be greater if the price elasticity of supply were +1.2 or +0.2? Explain your answer.

The effect would be greater the more price inelastic supply is i.e. 0.2 rather than 1.2

2. Given an increase in income of 10 per cent, would the shift in demand be greater or smaller if the income elasticity were +2 or +0.2? Explain your answer.

It would be greater if the income elasticity were 2- it would be 2* 10% rather than 0.2 * 10%
Business Analysis 7.2

Using a supply and demand diagram, explain why the price of orange juice has increased.

With disease this has affected the crops and shifted supply to the left. This should lead to an increase in prices.

Think About It 7.5

1. Which of the following will increase supply?
   A: An increase in income; Increases demand
   B: An improvement in technology; Increases supply
   C: An increase in production costs; Reduces supply
   D: An increase in the price of a complement; Reduces demand for the complement and this reduces demand for this product.

2. What will happen to the price of wheat in a year during which crops are poor?
   Should increase as supply has shifted inwards.

3. Why might farmers welcome a poor year?
   If demand is price inelastic then an increase in price can increase revenue (and farmers’ incomes); farmers may be better off in a bad year than a good one in terms of earnings.

4. Would a shift in supply have a greater effect on equilibrium price than on quantity if the price elasticity of demand were −0.1 or −1.1? Explain your answer using a supply and demand diagram.
   The effect on price is greater the more price inelastic demand is i.e. the effect will be bigger when the price elasticity of demand is -0.1 rather than -1.1.

Think About It 7.6

1. As a result of changes in demand or supply conditions, the equilibrium price and quantity have increased in your market. What change in market conditions might have caused this? Illustrate your answer with a supply and demand diagram.
   An increase in demand.
2. As a result of changes in demand or supply conditions, the equilibrium price has increased and the quantity has decreased in your market. What change in market conditions might have caused this? Illustrate your answer with a supply and demand diagram.

A decrease in supply.

3. As a result of changes in demand or supply conditions, the equilibrium price and the quantity have decreased in your market. What change in market conditions might have caused this? Illustrate your answer with a supply and demand diagram.

A fall in demand.

Think About It 7.7

1. Identify four influences on the demand for housing.

* Answers might include:
  - Mortgage rates
  - Income levels
  - Availability of credit
  - Population size

2. Explain two reasons why demand for housing may have fallen between 2011 and 2012.

* Answers might include:
  - Lower incomes
  - Worries about future incomes
  - More difficult to raise finance
  - Lower mortgages available

3. What do you think determines the supply of housing?

* Answers might include:
  - Prices
  - Costs of materials and other resources
  - Technology
  - Planning permission

4. Do you think that the supply of housing is price elastic or price inelastic. Why? Does this mean that price or quantity is affected more by a fall in demand?

Probably price inelastic- takes time to build, may be difficult to get planning permission, limited availability of land.
5. Why do you think changes in the price of housing are so significant in the UK?

Because such a high proportion of people in the UK are homeowners; changes in price have a significant effect on their wealth. The home is the major asset for most households.

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Think About It 7.8

Which of the following statements are true and which are false?

A: If there is excess demand in a market, the price is likely to increase: True.
B: An increase in demand will usually lead to a higher equilibrium price and lower quantity: False; higher price and higher quantity.
C: An increase in supply will usually lead to a lower equilibrium price and lower equilibrium quantity: False; a lower price and higher quantity.
D: If there is excess supply in a market, the equilibrium price is likely to rise; False; the price is likely to fall.

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Think About It 7.9

1. Using supply and demand analysis, explain why a painting by Rembrandt is expensive, whereas the price of a newspaper is relatively cheap. Illustrate your answer with diagrams.

Rembrandt painting: limited supply and high demand = high price
Newspaper: high supply relative to demand = low price

Business Analysis 7.3

What do you think will happen in this industry in the long term?

May lead to fewer firms in the industry as there is such excess capacity at present. Some may exit the industry.

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Business Analysis 7.4

1. Discuss the factors that determine how much of the tax bakers would have been able to pass on to consumers if the pasty tax had been introduced.

Answers might include:
- Would depend on the price elasticity of demand
- The more price inelastic demand is the more that the effects of an indirect tax will be passed on to consumers rather than absorbed by producers.
Data Analysis 7.3

1. **What is the original equilibrium, price and quantity in the market shown in Table 7.3?**
2. **As a result of a fall of production costs, supply rises by 50 per cent at all prices. What would be the new equilibrium price and quantity?**
3. **What would the government want to subsidise? Why would it need to?**

**Answers might include:**
- Equilibrium price is £1.50
- New equilibrium price will be £1.30 with an output of 240 units demanded and supplied
- Might want to subsidise industries that it wants to support or protect; may want to subsidise if it wants to encourage production and consumption e.g. if it feels products are socially desirable and underprovided in the free market.

**Suggested Answers to Short Answer Questions**

1. A change in price leads to a movement along the demand curve all other factors unchanged; a change in factors other than price lead to a shift in the demand curve.
2. Number of consumers, price of substitutes, price of complements, income levels.
3. Costs, technology and number of producers.
4. If there is a shortage the price increases reducing the quantity demanded and increasing the quantity supplied; if there is a surplus the price falls reducing the quantity supplied and increasing the quantity demanded.
5. If supply is upward sloping an increase in demand increases the equilibrium price and quantity.
6. If demand is downward sloping a decrease in supply leads to a higher price and lower equilibrium quantity.
7. The effect of a fall in demand on the equilibrium price depends on the price elasticity of supply.
8. The difference between the price consumers are willing and able to pay for a unit and the price actually paid.
9. Community surplus = consumer surplus + producer surplus.
10. This occurs when there is allocative inefficiency i.e. there are units which are not produced but where the social marginal benefit is greater than the social marginal cost.