Markets and prices are a little like the air you breathe—they are everywhere. Anytime you buy or sell something, you will buy or sell that something at a price, in a market. Supply and demand go together to determine price. What determines the price of the car you buy? Answer: supply and demand. What determines the price that you sell your labor services for? Answer: supply and demand. What determines the price of the house you buy? Answer: supply and demand.

We will learn about supply and demand together in this chapter by looking at several examples from everyday life. We will also learn about price, which is the outcome of demand and supply working at the same time.
The following events occurred one day in June.

**8:45 A.M.** Gordon is online checking the price of a stock he is thinking of buying. Ten minutes ago the price was $43.23. Right now, it is $42.18. Gordon wonders whether he should buy the stock now or wait another 10 minutes, or 20 minutes, or several hours.
- What causes the price of a share of stock to drop $1.05 in 10 minutes?

**8:47 A.M.** Jennifer is driving to work. With so many cars on the road, Jennifer is only moving 15 mph. She is listening to a song on the radio and wondering why traffic is so bad during the morning commute.
- What does traffic congestion have to do with supply and demand?

**2:17 P.M.** Malcolm is at home watching a baseball game on television. The announcer is talking about the player who is currently at bat. The player earns $7 million a year playing baseball. Malcolm wonders why some people earn so much just to play a game.
- Why do some baseball players earn millions of dollars to play baseball?

**8:13 P.M.** Alice and Parker are at home watching their favorite television show. Alice says, “You know, I read that the show has really high ratings.” “Good,” says Parker, “that means it won’t be canceled any time soon.”
- How are TV ratings like the economic concept of price?

**9:05 P.M.** After she hears a knock at her door, Evelyn walks to the door and opens it. It’s the pizza delivery guy. He takes a large pizza out of the hot case and says that she owes him $15.75. She gives him a $20 bill. After she receives her change, she gives the pizza delivery guy a $3 tip.
- Why was the price of the pizza $15.75? Why wasn’t it $12 or $18?
Moving to Equilibrium

Imagine a pair of scissors. Which blade does the cutting, the top blade or the bottom? It’s impossible to say, isn’t it? In much the same way, it is impossible to say whether demand or supply is responsible for the prices we pay for goods and services. The fact is, supply and demand work together to determine price.

To understand exactly how supply and demand work together, imagine that you are at an auction where 40,000 bushels of corn are being sold. All of the potential buyers of corn are sitting in front of computers. At any given price, the buyers simply key in the number of bushels they want to buy. The auction begins with the auctioneer calling out a price of $6. (Follow along in Exhibit 6-1 on the next page as you read about what is happening at the auction.)

- At $6 a bushel, the potential buyers think for a second, and then they all enter into their computers the number of bushels they want to buy at that price. The total that the buyers enter is 20,000 bushels, which is the quantity demanded of corn at $6 per bushel (see Exhibit 6-1). The quantity supplied, though, is 40,000. In economics, when quantity supplied is greater than quantity demanded, a surplus exists. At a price of $6 per bushel, the surplus equals 20,000 bushels (the difference between the quantity supplied and the quantity demanded). So, what do you think will happen next? The auctioneer, realizing that 20,000 bushels of corn will go unsold at $6, decides to lower the price per bushel to $5.
- At $5 a bushel, the buyers again key in the number of bushels they will buy, and the total increases to 30,000 bushels. This amount still leaves a surplus of corn—specifically, 10,000 bushels. So, what will the auctioneer do? Again, he lowers the price, this time to $2.
- At only $2 a bushel, the buyers want to buy a lot more corn, and the total quantity demanded jumps to 60,000 bushels. At first it sounds like a good thing, but do you see why it is a problem? (Look again at Exhibit 6-1.) Quantity...
demanded is now greater than quantity supplied, a condition that economists call a \textit{shortage}. The auctioneer, realizing that he can’t sell 60,000 bushels of corn when he only has 40,000, decides to raise the price to $3.

- As we would expect, when the price goes up, from $2 to $3 a bushel, the buyers want less corn. The quantity demanded falls to 50,000 bushels, but still there is a shortage. So the auctioneer again raises the price, this time to $4.

- At $4 a bushel, the buyers key in a total of 40,000 bushels, exactly the same amount as the auctioneer has to sell. Quantity demanded equals quantity supplied. The auction stops. At this point, but not until this point, economists would say that the corn market is in equilibrium. A market is said to be in \textit{equilibrium} when the quantity demanded of a good equals the quantity supplied. In this example, 40,000 bushels is referred to as the \textit{equilibrium quantity} (the quantity of a good bought and sold in a market that is in equilibrium). The price of $4 is referred to as the \textit{equilibrium price} (the price at which a good is bought and sold in a market that is in equilibrium).

\begin{center}
\begin{tabular}{|c|c|}
\hline
\textbf{Relationship of quantity supplied (Q$_s$) to quantity demanded (Q$_d$)} & \textbf{Market condition} \\
\hline
Q$_s$ > Q$_d$ & Surplus \\
Q$_d$ > Q$_s$ & Shortage \\
Q$_s$ = Q$_d$ & Equilibrium \\
\hline
\end{tabular}
\end{center}

When the price was $6 a bushel and there was a surplus of corn, the auctioneer lowered the price. When the price was $2, resulting in a shortage, he raised the price. The behavior of the auctioneer can be summarized this way: If a surplus exists, lower the price; if a shortage exists, raise the price. In this way, the auctioneer moved the corn market into equilibrium.

Not all markets have auctioneers. (When was the last time you saw an auctioneer in the grocery store?) Still, many markets act as if an auctioneer is calling out higher and lower prices until equilibrium price is reached. In many real-world markets, prices fall when a surplus occurs and rise when a shortage happens.

\section*{Why Does Price Fall When a Surplus Occurs?}

With a surplus, suppliers will not be able to sell all they had hoped to sell, so their \textit{inventories} (stock of goods on hand) grow beyond the normal level. Storing extra goods can be costly and inefficient; thus sellers want to reduce their inventories. Some will lower prices to do so; some will cut back on producing output; others will do a little of both. As shown in Exhibit 6-2, price and output tend to fall until equilibrium is achieved.

\section*{Why Does Price Rise When There Is a Shortage?}

With a shortage, buyers will not be able to buy all they had hoped to buy. Some buyers will offer to pay a higher price to get sellers to sell to them rather than other buyers. The higher prices will motivate suppliers to start producing more output. Thus, in a shortage, the tendency is for price and output to rise until equilibrium is achieved (see Exhibit 6-2 on the next page).
We know what a shortage and a surplus look like on a graph, but what do they look like in the real world? Suppose it’s Friday night and your school’s football team is playing at home. Your school stadium seats 2,000 people but only 500 people are in the stands (350 from your school and 150 from your opponents’ school), resulting in a surplus of seats. In other words, the people who wanted to be at the game was a smaller number than seats available in the stands. On the other hand, suppose at another game 2,500 people want to be at the game but the stadium still has only 2,000 seats. Here we see a shortage of seats. Maybe some people will have to stand, or some people will not be admitted to the game.

**EXHIBIT 6-2 Moving to Equilibrium**

- At $15, a surplus occurs. Quantity supplied (150) is greater than quantity demanded (50). Price falls.
- A price of $10 results in neither a surplus nor a shortage. Quantity supplied (100) is equal to quantity demanded (100). Equilibrium occurs.
- At $5, a shortage happens. Quantity demanded (150) is greater than quantity supplied (50). Price rises.

**Example:** We know what a shortage and a surplus look like on a graph, but what do they look like in the real world? Suppose it’s Friday night and your school’s football team is playing at home. Your school stadium seats 2,000 people but only 500 people are in the stands (350 from your school and 150 from your opponents’ school), resulting in a surplus of seats. In other words, the people who wanted to be at the game was a smaller number than seats available in the stands. On the other hand, suppose at another game 2,500 people want to be at the game but the stadium still has only 2,000 seats. Here we see a shortage of seats. Maybe some people will have to stand, or some people will not be admitted to the game.

**Example:** Back when the Soviet Union existed (pre-1989), you could walk around Moscow and find very few people in some shops, but long lines of people inside and outside of other shops. At the time, Soviet officials set the prices of the goods and services sold in the country. Often, the prices they set were not equilibrium prices—prices at which quantity demanded equaled quantity supplied. Where the Soviet officials set the price of a good higher than equilibrium price (say, 100 rubles is the equilibrium price and officials set the price at 30 rubles), there was a shortage of that good. You could “see” a shortage in the form of a long line of people waiting to buy a good that was likely to be “sold out” before they reached the front of the line.

**What Causes Equilibrium Prices to Change?**

You now know that equilibrium price is determined by both supply and demand. Can you guess what could cause an equilibrium price to change? You probably guessed right—for the equilibrium price to change, either supply or demand would have to change.

Before looking at changes to equilibrium prices, let’s review your ability to read graphs showing supply and demand curves. Practice reading these graphs will help you use graphs to determine shortages, surpluses, and ultimately, equilibrium prices.

Look at Exhibit 6-2. Start at a price of $15. To find the quantity demanded, follow the dotted horizontal line over to the demand curve (D). Then follow the dotted vertical line downward to the horizontal (or quantity) axis (50). In this way, you find that the quantity demanded at $15 is 50.
Once upon a time, a man bought a house. The house was built on a high cliff overlooking the Atlantic Ocean. The man would get up every morning and drink his coffee as he gazed out over the ocean.

One day a friend visited the man. The friend asked the man how much he thinks he paid for the ocean view he enjoyed daily. The man said, “I didn’t pay anything for the view. I bought the house. The view was just there.”

The friend asked the man if any houses in the neighborhood were similar to his house but without an ocean view. The man said a house right down the street was exactly like his house but without an ocean view. “Was the price of the house down the street the same as the price of your house?” the friend asked. “No,” said the man, “it was $200,000 cheaper.”

“Then that is what you paid for the ocean view,” the friend said. “If the only difference between your house and the house down the street is the ocean view, then the price difference between the houses is the price of the view.” Of course, another way of putting this relationship is to say that the demand for the man’s house was greater than the demand for the house down the street because the man’s house came with an ocean view and the house down the street didn’t. Higher demand for the house with the view means higher price paid for the house with the view.

The man knew that his friend was right. All this time he thought that he simply paid more for his house. Instead, he paid the same dollar price for his house as the person down the street paid for the identical house, and then he “purchased” the ocean view for $200,000.

Now ask yourself if there is anything for you that is similar to what the house was for the man. Do you buy and pay for things that you are unaware of? If you ever paid more for designer jeans than for the identical (and it must truly be “identical”) nondesigner jeans, then the price difference is what you paid for the name on the back of the jeans. If you ever paid more for Bayer aspirin than for generic aspirin, then the price difference is what you paid for the name “Bayer.” We are not urging you to stop buying designer jeans or Bayer aspirin. Similarly, we are not saying that it is somehow wrong to buy a house with an ocean view. We are simply pointing out what it is you are paying for.

**THINK ABOUT IT**

People who reside in good climate locales often talk about the good climate being “free.” Someone might say, “Aren’t we lucky to live here? And to think, we don’t have to pay a penny for all this good weather.” Is it true that they don’t pay for the “good weather”?  

To find the quantity supplied at $15, again start at the price of $15 on the vertical axis, and follow the dotted horizontal line over to the supply curve (S). Then follow the dotted vertical line downward to the horizontal axis. The number here is 150, so the quantity supplied at $15 is 150.

So, at $15, does a surplus or a shortage occur? Because the quantity supplied (150) is greater than the quantity demanded (50), the result is a surplus.

Now let’s look at some graphs to see what happens when either supply or demand changes.
Demand Changes Cause Changes to Equilibrium Price

Exhibit 6-3(a) below shows the demand for and supply of television sets. The original demand curve is $D_1$, the supply curve is $S_1$, equilibrium is at point 1, and the equilibrium price is $300. Now suppose the demand for television sets increases. (Recall from Chapter 4 the factors that can shift the demand curve for a good: income, preferences, prices of related goods, number of buyers, and future price.) The demand curve shifts to the right, from $D_1$ to $D_2$. $D_2$ is now the relevant demand curve. At $300 per television, the quantity demanded (using the new demand curve, $D_2$) is 300,000, and the quantity supplied (using the one and only supply curve, $S_1$) is 200,000.

Because the quantity demanded is greater than quantity supplied, a shortage exists in the television market. Price then begins to rise. As it does, the television market moves to point 2, where it is in equilibrium again. The new equilibrium price is $400. We conclude that an increase in the demand for a good will increase price, all other things remaining the same.

Now suppose the demand for television sets decreases as in Exhibit 6-3(b). The demand curve shifts to the left, from $D_1$ to $D_2$. At $300, the quantity demanded (using the new demand curve, $D_2$) is 100,000, and the quantity supplied (again using $S_1$) is 200,000. Because quantity supplied is greater than quantity demanded, a surplus exists. Price begins to fall. As it does, the television

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A change in equilibrium price can be brought about by (a) an increase in demand, (b) a decrease in demand, (c) an increase in supply, or (d) a decrease in supply.
Section 1 Supply and Demand Together

market moves to point 2, where it is in equilibrium again. The new equilibrium price is $200. A decrease in the demand for a good will decrease price, all other things remaining the same.

**EXAMPLE:** If you go to the Boston Red Sox Web site you will be able to buy tickets (that some ticket holders want to sell) for various games played at Fenway Park. On the day we checked, the price of a seat in Section 36, Row 19 was $105 if you wanted to see the game between the Boston Red Sox and the Atlanta Braves. If you wanted to see a game between the Boston Red Sox and the New York Yankees the price of a seat in the same section and row was $205. The number of seats in Fenway Park is the same for all games. In other words, the supply curve of seats at Fenway Park is vertical at a little more than 36,000 seats. The demand for games at Fenway differs from game to game,

**Economics**

The price to get an A in Mr. Johnson’s class is higher than the price to get an A in Mr. Meyer’s class.

**Economics**

The quantity demanded of seats in that class is greater than the quantity supplied, resulting in a shortage of seats in that class.

**Economics**

The quantity demanded of fast food at the school dropped to zero.
though. For example, the demand for a game with the Yankees is usually greater than the demand for a game with the Braves (in other words, the demand curve for a Yankees game lies to the right of the demand curve for a Braves game). As a result, the ticket price for a Red Sox–Yankees game is usually higher than the ticket price for a Red Sox–Braves game.

EXAMPLE: A hotel in Miami Beach charges $150 a night for a room in June but $250 a night in January. Why the difference? A room is a room is a room, isn’t it? Well, yes, a room is a room, but the demand for the room is different at different times of the year. Winter is the “high season” in Miami Beach, because people all over the United States want to escape the cold weather where they live and vacation for a few days in warm Miami Beach. Higher demand translates into higher price.

Supply Changes Cause Changes to Equilibrium Price

Now let's return to Exhibit 6–3. Suppose the supply of television sets increases. (Recall the discussion in Chapter 5 of the factors that can shift the supply curve for a good, including resource prices, technology, taxes, and so on.) The supply curve in Exhibit 6–3(c) shifts to the right, from $S_1$ to $S_2$. At $300, the quantity supplied (using the new supply curve, $S_2$) is 300,000, and the quantity demanded (using $D_1$) is 200,000. Quantity supplied is greater than quantity demanded, so a surplus exists in the television market. Price begins to fall, and the television market moves to point 2, where it is in equilibrium again. The new equilibrium price is $200. Thus, an increase in the supply of a good will decrease the price, all other things remaining the same.

Now suppose the supply of television sets decreases, as in Exhibit 6–3(d). The supply curve shifts leftward, from $S_1$ to $S_2$. At $300, the quantity supplied (using $S_2$) is 100,000, and the quantity demanded (using $D_1$) is 200,000. Because quantity demanded is greater than quantity supplied, a shortage exists in the television market. Price begins to rise, and the television market moves to point 2, where it is again in equilibrium at the new equilibrium price of $400. We conclude that a decrease in the supply of a good will increase the price, all other things remaining the same.

EXAMPLE: The supply of oranges in Florida and California is greater in year 2 than in year 1. As a result, the supply curve of oranges in year 2 lies to the right of the supply curve of oranges in year 1. If the demand curve for oranges in both years is the same, then the price of oranges will be lower in year 2 than in year 1.

Changes in Supply and in Demand at the Same Time

Until now, we have looked at cases in which either demand changed and supply remained constant, or supply changed and demand remained constant. In the real world, of course, both demand and supply can change at the same time. Let's look at one case and see how equilibrium price changes as a result.

Look at Exhibit 6–4. Suppose that $D_1$ and $S_1$ represent the initial situation in the market, and the resulting equilibrium price is $300. Then both demand and supply increase. Demand increases from $D_1$ to $D_2$, and supply increases from $S_1$ to $S_2$. Notice that the increase in demand is greater than the increase in supply. In other words, the
demand curve shifts further right (from $D_1$ to $D_2$) than the supply curve shifts right (from $S_1$ to $S_2$). As we can see in the exhibit, equilibrium price rises from $300 to $400. So, if both demand and supply increase and demand increases more than supply, the equilibrium price increases.

The change in equilibrium price will be determined by which changes more, supply or demand. If demand increases more than supply, the equilibrium price goes up. If supply increases more than demand, the equilibrium price will go down.

**Does It Matter if Price Is at Its Equilibrium Level?**

Think of two different worlds. World 1 has ten markets, each of which is in equilibrium. If all markets are in equilibrium, it means no shortages or surpluses of any good or service. In this world, buyers or sellers have no complaints. Everyone is happy.

World 2 also has ten markets, but in five of the ten markets price is below equilibrium price, and in five markets price is above equilibrium price. In other words, half the markets are in surplus, and half are in shortage. In this world, both buyers and sellers are complaining.

Which world would you rather live in? Can you see why economists think it is important to study and understand price and equilibrium?

**Price Is a Signal**

You are probably beginning to see that price has certain important jobs that it fulfills in the marketplace. One such job is to provide information, which it does in a kind of “market conversation.” For example, suppose for two goods—clocks and books—preferences one day shift against clocks and in favor of books. We know that a change in preferences affects the demand for both clocks and books. The demand for clocks will fall and the demand for books will rise.

What happens to price in each case? As a result of the decreased demand for clocks, the price of clocks falls. Because of the lower price for clocks, the quantity supplied of clocks falls. In other words, clock sellers will respond to the lower price for clocks by offering to sell fewer clocks. (The quantity supplied of clocks is lower at a lower price than at a higher price.)

As a result of the increased demand for books, the price of books rises. Because of the higher price for books, book sellers will offer to sell more books. In other words, book sellers will respond to the higher price of books by offering to sell more books. (The quantity supplied of books is higher at a higher price than at a lower price.)

Notice how buyers are communicating with sellers. Buyers aren’t saying “produce fewer clocks and produce more books,” but the result is the same. Instead, buyers are simply lowering the demand for clocks and raising the demand for books. As a result, price goes down for clocks and up for books. Sellers see these price changes and respond to them. They decrease the quantity supplied of clocks and increase the quantity supplied of books. Price, then, acts as a signal that is passed along by buyers to sellers. As price goes down, buyers are saying to sellers “produce less of this good.” As price goes up, buyers are saying to sellers “produce more of this good.”

In this example, price is a signal that directs the allocation of resources away from clocks and toward books.
What Are Price Controls?

Sometimes government prevents markets from reaching an equilibrium price. For example, suppose that the equilibrium price for a good is $10. It is possible for government officials to pass a law setting the price lower—say, $8. A legislated price that is below the equilibrium price is called a price ceiling. A price ceiling is like a ceiling in a room. Just as you cannot go higher than the ceiling in a room, buyers and sellers cannot legally buy and sell a good for a price higher than the price ceiling.

Government could, and sometimes does, legislate a higher (than equilibrium) price—say, $12. A legislated price that is above the equilibrium price is called a price floor. A price floor is like a floor in a room. Just as you cannot go lower than the floor in a room, buyers and sellers cannot legally buy and sell a good for a price lower than the price floor.

Let’s look at both a price ceiling and price floor graphically. In Exhibit 6-5(a) we show a price ceiling. In the exhibit, $10 is the equilibrium price of the good. You will also notice that the equilibrium quantity is 80. The price ceiling of $8 is below the equilibrium price. What is an effect of the price ceiling? One effect is that a price ceiling creates a shortage in the market. Notice that at $8, quantity demanded (100) is greater than quantity supplied (60), which is the definition of a shortage. Because suppliers only want to supply 60 units at $8, only 60 units are bought and sold. (Sure, buyers may want to buy 100 units at $8, but because suppliers only want to sell 60 units, they decide how much is bought and sold. You can’t make suppliers sell more of the good than they want to.)

Now look at Exhibit 6-5(b). Here you see a price floor of $12. What is an effect of the price floor? One effect is that a price floor creates a surplus in the market. Notice that at $12, quantity supplied (98) is greater than quantity demanded (65), which is the definition of a surplus. With the price floor, fewer units are bought and sold. Because buyers only want to buy 65 units at $12, only 65 units are bought and sold.

QUESTION: Why does government sometimes impose price controls (price ceilings and price floors)?

ANSWER: Sometimes government imposes a price ceiling on a good because it wants to make the good cheaper for...
consumers to buy. For example, suppose the price of a particular medicine is $200 for a month’s supply. Government could impose a price ceiling on this medicine of, say, $100, with the hope that more people will be able to afford the medicine now. Of course, the unintended effect of this lower-than-equilibrium price is that a shortage will result. In other words, some of the people who need the medicine might not be able to buy the medicine at $100 because it is not available.

Sometimes government imposes a price floor because it wants to assist a certain group of producers. For example, farmers sometimes argue that they need to receive a higher dollar price for what they sell. Suppose that the equilibrium price for a bushel of corn is $3. Farmers argue that they can’t make a decent living at $3 a bushel. In response, government imposes a price floor of $4 on corn. Government says that no one can buy or sell corn for less than $4 a bushel. The intended effect of the price floor is to help farmers. The unintended effect, though, is to hurt the buyers of corn (they have to pay a higher price). Also, the price floor leads to a surplus of corn.

**Price Controls and the Amount of Exchange**

Price controls (price ceilings and price floors) bring about less exchange (less trade) than would exist without them. In Figure 6-5(a) the equilibrium quantity traded was 80, but the price ceiling reduced this level to 60. In Figure 6-5(b) the equilibrium quantity traded was 80, but the price floor reduced it to 65.

With this relationship in mind, let’s go back to something that you learned about voluntary exchange (or trade) in Chapter 2 and Chapter 3. In those chapters, you learned that exchange is something that makes people better off. If John exchanges his $15 for Yvonne’s book, John is, through his actions, saying that he is better off with the book than the $15. At the same time Yvonne is saying that she is better off with the $15 than she is with the book. In other words, exchange is something that makes both parties (the buyer and the seller) better off. If price controls decrease the amount of exchange that occurs, we must conclude that price controls limit the opportunities people have to make themselves better off.

**Defining Terms**

1. Define:
   a. shortage
   b. surplus
   c. equilibrium (in a market)
   d. equilibrium quantity
   e. equilibrium price
   f. inventory
   g. price ceiling
   h. price floor

**Reviewing Facts and Concepts**

2. If demand increases and supply is constant, what happens to equilibrium price?

3. If supply decreases and demand is constant, what happens to equilibrium price?

4. If supply increases and demand is constant, what happens to equilibrium price?

5. If the shortage is 40 units and the quantity supplied is 533 units, then what does quantity demanded equal?

6. If supply decreases by more than demand decreases, what happens to equilibrium price?

**Critical Thinking**

7. A producer makes 100 units of good X at $40 each. Under no circumstances will he sell the good for less than $40. Do you agree or disagree? Explain your answer.

**Graphing Economics**

8. Graph the following:
   a. Demand increases in a market.
   b. Supply decreases in a market.
   c. Demand decreases in a market.
   d. Demand increases by more than supply increases in a market.
Why the Long Lines for Concert Tickets?

Suppose tickets for a rock concert go on sale at 8 a.m. on Saturday. A long line of people forms even before the ticket booth opens. The average person has to wait an hour to buy a ticket. Some people don’t get to buy tickets at all because the concert sells out before they get to the ticket booth.

Why do so many people wait in line to buy tickets to the rock concert, yet you don’t see a long line of people waiting to buy food at the grocery store or TVs at the electronics store? Also, why are some of the people waiting to buy tickets to the rock concert turned away, but no one who wants to buy bread is turned away at the grocery store, and no one who wants to buy a TV set is turned away at the electronics store? The market for the rock concert tickets (at least in this instance) must differ somehow, but how?

In economic terms, when some people go away without being able to buy what they came to buy, it means that quantity demanded exceeds quantity supplied, resulting in a shortage in the market.

You learned earlier that a market shortage causes price to rise. Eventually, it will rise to its equilibrium level. The problem in the rock concert example, though, is that the tickets were bought and sold before the seller realized a shortage of tickets would occur. In hindsight, the seller knows that the price charged for the tickets was too low, and this pricing caused a shortage. If the seller had charged the equilibrium price, he would have encountered no shortage, no long lines, and no one turned away without a ticket.

As shown in Exhibit 6-6, the seller charged $40 a ticket. At this price, quantity demanded (12,500) was greater than quantity supplied (10,000). If the price had been $60 a ticket, quantity supplied (10,000) would have equaled quantity demanded (10,000), and no shortage would have happened.

Why didn’t the seller charge the higher equilibrium price, instead of a price that was too low? The seller might have charged the equilibrium price had she known it. Think back to the auctioneer example. Note that the auctioneer did not call out the equilibrium price at the start of the auction. He called out $6, which was too high a price,
which created a surplus. Later, he called out $2, which was too low a price, causing a shortage. It was only through trial and error that the auctioneer finally hit upon the equilibrium price. Because people come to the grocery store and electronics store to buy goods every day, those stores have countless opportunities to learn by trial and error and adjust their prices to reach equilibrium. The seller of the rock concert tickets did not have the same opportunity.

**A Student Asks**

**QUESTION:** At a concert I attended last month, scalpers were selling tickets for at least $50 more than the original price of the ticket. Tickets that were initially sold for $60 were being sold by scalpers for $110. Aren’t the scalpers, in a way, like the auctioneer?

**ANSWER:** Yes. Look again at Exhibit 6-6. We can see that the equilibrium ticket price (for this particular concert) is $60, but the initial ticket seller sells tickets for only $40. What will happen in this case is that someone is likely to buy a ticket (or two, or three, or four) for $40 and then resell the ticket for $60, for a profit of $20 per ticket. Now ask yourself whether this buying and reselling of tickets would happen if all tickets were sold for $60 in the first place. The answer is no. Lesson learned: Scalpers (people who buy and resell tickets at higher prices) will only exist if the good in question was not originally sold at its equilibrium price.

Look around you. You don’t see scalpers when it comes to milk, computers, rugs, shirts, turkey sandwiches, or cups of coffee. No person stands outside a coffee shop and offers to sell you a cup of coffee for $2 more than you can pay for a cup of coffee inside the shop. The reason you don’t see any scalpers in these cases is because the prices of the goods are at equilibrium.

Still, you will see a scalper for a rock concert, or some sporting events, or even some plays. Why? Because in these cases, the price initially charged for these events was below the equilibrium price; that is, the price was below the price at which quantity demanded equals quantity supplied.

**The Difference in Prices for Candy Bars, Bread, and Houses**

In general, no matter where you go in the United States, the price of a candy bar (pick your favorite brand) is approximately the same. A candy bar in Toledo, Ohio, is approximately the same price as a candy bar in Miami, Florida. This consistency is true for the most part for many other goods, such as a loaf of bread, for example.

But is it true for all goods? What about real estate prices—in particular, the price of a house in San Francisco, California, and the price of a similar house in a similar neighborhood in Louisville, Kentucky? The house in San Francisco will sell for approximately three to four times the price of the house in Louisville. Why, when it comes to candy bars and bread, does a good sell for approximately the same price no matter where it is purchased in the United States, whereas a house purchased in San Francisco is so much more expensive than a similar house in Louisville? Supply and demand give us the answer.
Let’s imagine for a second that the price of a candy bar is not the same in Toledo as in Miami. At a particular point in time the price for candy bars is $2 in Toledo and $1 in Miami, because the demand for candy bars is higher in Toledo. Knowing what you know now about supply and demand, what do you think will happen?

Given the price difference, the suppliers of candy bars will prefer to sell more of their product in Toledo than in Miami, so the supply of candy bars will increase in Toledo and decrease in Miami. Then what will happen? The price of a candy bars will decrease (say, from $2 to $1.50) in Toledo and increase (say, from $1 to $1.50) in Miami. Only when the prices of candy bars are the same in Toledo and Miami will suppliers no longer have an incentive to rearrange the supply of candy bars in the two cities. The same type of activity would affect the price of bread in the two cities. When suppliers can shift supply from one location to another, price will tend to be uniform for products.

Now consider houses in different cities. Housing prices are much higher in San Francisco than in Louisville because the difference between demand and supply (more demand, less supply) in San Francisco is greater than it is in Louisville. If houses were candy bars or bread, suppliers would shift their supply from Louisville to San Francisco. However, houses are built on land, and the price of the land is part of the price of a house. Naturally, suppliers cannot pick up an acre of land in Louisville and move it to San Francisco.

So, what have we learned? When the supply of a good cannot be moved in response to a difference in price between cities, prices for this good are likely to remain different in these cities.

**A Student Asks**

**QUESTION:** I was in both Oklahoma and California this past summer and the price of gas was higher in California than in Oklahoma. Gas is something that can be moved from place to place (by trucks). So why wasn’t the price of gasoline the same in the two locations?

**ANSWER:** Good question. The major reason for the difference you noticed is that taxes on gasoline are different in different states. Many states (and counties too) place an excise tax on gasoline. An excise tax is a tax on the manufacture or sale of a particular good. For example, in Florida gasoline is subject not only to a state excise tax but a county excise tax in many cases as well. State and county excise taxes differ across the country. It so happens that excise taxes on gasoline are less in Oklahoma than in California. This difference in excise taxes often explains why you might pay more for a gallon of gasoline in one state than you pay in another.
Supply and Demand at the Movies

Have you noticed that the prices for movie tickets can vary? If you want to see a movie on Friday night, you may have to pay $8, but for the same movie at 11:00 a.m. on Tuesday, you may have to pay only $3.50. The difference depends on supply and demand. Certainly the supply of seats in the theater is the same Friday night as Tuesday morning. The demand, however, is different. The demand to see a movie on Friday night is higher than on Tuesday morning, and the higher demand makes for a higher price.

Supply and Demand on a Freeway

Supply and demand are easy to see at a rock concert, a movie theater, or the grocery store. But supply and demand also appear in places we wouldn’t initially think to look, such as on a freeway. Suppose a certain supply of freeway space consists of a certain number of lanes and miles. Also, the demand for freeway space is equal to the demand people have to drive on freeways.

The demand to drive on a freeway is not always the same, of course. The demand is higher at 8 a.m. on Monday, when people are driving to work, than at 11 p.m. You can see this demand represented in Exhibit 6-7(a). The supply curve, $S_1$, represents the

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Year | Price
---|---
1994 | 4.08
1995 | 4.35
1996 | 4.42
1997 | 4.59
1998 | 4.69
1999 | 5.06
2000 | 5.39
2001 | 5.65
2002 | 5.80
2003 | 6.03
2004 | 6.21

Source: Motion Picture Association of America.

Exhibit 6-7: Supply and Demand on a Freeway

Freeway congestion can be solved by (a) charging a toll, (b) increasing supply, or (c) reducing demand.

What was the ticket price for a movie in 1948? In 1962? In 1974?

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supply of freeway space (say, four lanes for 150 miles). The demand curve $D$ (11 p.m.) represents the demand for freeway space at 11 p.m. Monday, and the demand curve $D$ (8 a.m.) represents the demand for freeway space at 8 a.m. Monday. You will notice that the demand at 8 a.m. is greater than the demand at 11 p.m.

What do most people have to pay to drive on the freeway? For most freeways across the country, the price is zero; most freeways do not have tolls. In Exhibit 6-7(a), you will notice that zero price is the equilibrium price at 11 p.m. on Monday. The demand curve for freeway space and the supply curve of freeway space intersect at zero price at

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1 People do pay taxes to build freeways, but this fact is not relevant here. People are not paying a price to drive on freeways, at least not non-toll freeways.
11 p.m. on Monday. In other words, at this time neither a shortage nor a surplus of freeway space exists. People are using the freeway. Traffic is moving freely without congestion.

Now look at the situation at 8 a.m. At zero price—no toll—the quantity demanded of freeway space is greater than the quantity supplied, resulting in a shortage of freeway space. In everyday language, the freeway is congested. If you have ever been in a major traffic jam, you can probably understand that a congested freeway means a shortage of freeway space.

What is the solution to freeway congestion? Two common solutions are building more freeways and having people carpool. One solution deals with the supply side of the freeway market, and the other with the demand side. When people say that we ought to build more freeways, they want to push the supply curve (of freeway space) to the right, shown in Exhibit 6-7(b). If the supply of freeway space shifts from $S_1$ to $S_2$, freeway space is able to meet the quantity demanded at zero price at 8 a.m. The problem of freeway congestion is solved.

If more people carpool, then for all practical purposes the demand for freeway space falls as in Exhibit 6-7(c). In other words, if people carpool to such an extent that the demand for driving on the freeway drops by as much as shown in the exhibit, then freeway space is able to meet the quantity demanded at zero price at 8 a.m. The shortage of freeway space again is eliminated.

Of course, as is probably evident now, a third way can be used to get rid of freeway congestion. It has nothing to do with building more freeways or carpooling. Freeway congestion can be eliminated by charging tolls. The tolls bring the freeway market into equilibrium. In other words, as shown in Exhibit 6-7(a), a toll of $1.50 would eliminate freeway congestion at 8 a.m.

### Supply and Demand on the Gridiron

Suppose you want to try out for a high school sport, such as football, volleyball, or golf. How competitive do you have to be to get on the team? It depends on how many open positions are available on the team you want to try out for, as well as how many people are going to try out for those positions. How competitive you must be is a matter of the supply of positions and the demand for positions.

Suppose you want to try out for tight end on the high school football team. The team's coach has decided that he will have three tight ends on the team. In economic terms,
we can say that the quantity supplied of tight end positions is three. Suppose that 30 people want to try out for the position of tight end. The quantity demanded of tight end positions is then 30. Because quantity demanded is greater than quantity supplied, a shortage of tight end positions results.

When a shortage of anything occurs in a competitive market, the price of that thing rises. The team’s coach, of course, is not going to accept money from the students who want to try out for the team. What he will do is raise the “price” of being a tight end in a different way. People will have to “pay” to be a tight end with hard work and skill. The players who pay more—demonstrate more skill and work harder—will be the ones to make the team as tight ends.

Would these players have to be as good to get on the team if only five people wanted to be a tight end? Not at all. In that case, the shortage of tight end positions would be smaller, and the “price” of being a tight end would not rise as much to bring supply and demand into equilibrium.

Supply and Demand on the College Campus

As you probably know, you do not need the same grade point average (GPA) or standardized test score (SAT or ACT) to get into all colleges. One college may require a GPA of 3.0 and an SAT score of 1550, while another requires a GPA of 3.8 and an SAT score of 2100. Why the difference? Again, the answer is supply and demand. The higher the demand to get into a particular college, the higher its entrance requirements.

Take two colleges, college A and college B. Each college will admit 2,000 students to its entering freshman class next year. Each college charges $5,000 a semester in tuition. The quantity supplied of open spots and the tuition are the same at each college, but suppose the demand to go to college A is three times the demand to go to college B. At college B, 4,000 students apply for 2,000 spots, but 12,000 students apply for 2,000 spots at college A.

The shortage at college A is greater than the shortage at college B, so the “price” to get into college A will rise by more than it will rise at college B. The “price” of getting into college is usually measured in terms of high school academic performance (in other words, GPA and SAT or ACT scores.) The greater the demand to get into a college compared to supply, the higher the GPA and standardized test scores required to get into that college, or the higher the “price” a student must pay in terms of grades.

\textbf{Example:} Suppose a university charges tuition of $12,000 a year and requires a 3.0 GPA and an SAT score of 1900 or higher for admission. Currently, 7,000 students apply for admission each year and 2,000 are admitted. Time passes and the number of applicants rises to 10,000. We know that a rise in the number of applicants is just another way of saying that demand to attend the university increased.

Our study of supply and demand teaches us that if demand rises, tuition will rise too. In other words, tuition might rise to $16,000 a year. Suppose the university chooses not to raise tuition; it maintains tuition at $12,000 a year. Will the standards of admission rise instead? The answer is yes—the university might start requiring a 3.3 GPA and an SAT score of 2000 or higher.

\textbf{Necessary Conditions for a High Income: High Demand, Low Supply}

As consumers, we are used to paying prices. We pay a price to buy a computer, a soda, or a shirt. We sometimes receive prices, too. As a seller of a good, you receive the price that the buyer pays.

Many people do not sell goods; instead, they sell their labor services. The person who works at a fast-food restaurant after school or an attorney at a law firm is selling labor services. The “price” employees receive for what they sell is usually called a wage. A wage, over time, can be referred to as a salary or income. A person who earns a wage of $10 an hour receives a monthly income of $1,600 if he or she works 160 hours a month.

\footnote{The new SAT scores used here first went into effect in March of 2005.}
A wage is determined by supply and demand, just as the price of oranges, apples, or TV sets is. It follows, then, that for someone to receive a high wage, demand must be high and supply low. The higher the demand relative to supply, the higher the wage will be.

To earn a high wage, then, is to perform a job in great demand that not many other people can do. If few know how to do it, supply will be low. Low supply combined with high demand means you will receive a (relatively) high wage.

Consider the wage of a restaurant server versus a computer scientist. The demand is great for both servers and computer scientists. However, a large supply of servers and a not-so-large supply of computer scientists mean that computer scientists earn more than servers.

**Example:** In 2005, Randy Johnson was a pitcher for the New York Yankees. His salary that year was $15,419,815. Why was his salary so high? The answer: high demand, low supply. The demand to watch a good pitcher play in a baseball game is high. The number of people in the world who can pitch a baseball the way Randy Johnson pitches is small. High demand and low supply is the winning combination for a high salary.

### Reviewing Facts and Concepts

1. A freeway sometimes experiences traffic congestion (bumper-to-bumper traffic) and sometimes very little traffic. Explain why.
2. Housing prices are higher in city X than in city Y. Using the concepts of supply and demand, explain why.
3. Identify whether a shortage, a surplus, or equilibrium exists in the following settings:
   - Fewer students apply for the first-year class at college X than spaces available.
   - People who wanted to attend a baseball game were told that tickets had sold out the day before.
   - Houses for sale used to stay on the market for two months before they were sold. Now they are staying on the market for up to six months, and they still aren’t selling.

### Critical Thinking

4. Carmelo says, “A movie theater charges the same price for a popular movie as it does for an unpopular movie. Obviously, the movie theater doesn’t charge more when demand for the movie is higher than when it is lower.” Shelby counters by saying, “Movie theaters often call the more popular movies special engagements and do not accept any discount tickets for them.” If Shelby is correct, does her point negate Carmelo’s? Explain your answer.

### Applying Economic Concepts

5. This section stated that people will earn high incomes if they can supply labor services that not many other people can supply, and for which demand is great. If you choose to go to college, how will this information affect your supply position?
Information is something people will pay to have. We see it a hundred times a day. A person who wants to sell her house will pay a real estate agent to inform her of where the buyers are who want to buy her house. A person who wants to buy bonds and stocks might pay a financial analyst to inform him of the best stocks and bonds to buy. Just as people buy goods and services every day, they also buy information every day.

**The World Wide Web**

The introduction of the World Wide Web has made it cheaper and easier to acquire certain information. You just need to know where to look.

**Buying a Car** Let’s suppose that Jimmy wants to buy a Honda Accord. The list price of the car is $23,100. But Jimmy wants to know the invoice price; he wants to know what the dealer paid for the car. He can go to [www.emcp.net/autobytel](http://www.emcp.net/autobytel) and find that the invoice price is $20,788. Knowing the invoice price gives Jimmy information that he didn’t have before. It is information that is useful to him when he is negotiating the price he will pay for the car.

Suppose Jimmy just wants to know what cars are especially safe for teenagers. He can go to [www.emcp.net/consumerreports](http://www.emcp.net/consumerreports) and click on “cars for teen drivers.” He will then find a list of recommended cars that have advanced safety features and good crash-test results.

**Comparing Prices** Suppose Katherine wants to buy a television set. Instead of going from store to store to price sets, she can go to [www.emcp.net/consumerworld](http://www.emcp.net/consumerworld). There she can click on the “Price Checker” for TV sets and in two seconds, she can see a list of 12 or more stores (in her area) that are willing to sell her the TV she is looking at, each listing its price for the TV set.

Suppose Ivan wants to find where he can get gas for as little as possible. He can go to [www.emcp.net/firstgov](http://www.emcp.net/firstgov) and click on “Find Cheapest Gas Prices.” On his next screen he will see a map of the United States. He clicks on his state, New York, and then on his city, Buffalo. Up pops a list of gasoline stations with gas prices per gallon listed.

**Background Checks** Suppose Melissa is thinking about having a medical operation. She wants to know something about the surgeon who is planning to do the operation. What’s his education? Is he a good surgeon? Is he board certified? Have there been any disciplinary actions taken against him? All she needs to do is go to [www.emcp.net/healthgrades](http://www.emcp.net/healthgrades) and click on “Physician Quality Reports.” There she can purchase (for about $8) a full report on her surgeon.

**College Information** Suppose it is Oliver’s first year at college and he wants to know what students at his
college think about some of the professors whose courses he wants to take. He can go to www.emcp.net/ratemyprofessors and find out. Once at the site, all he has to do is choose the state, the college, and then the professor. Here’s what we found written about one professor: “All we did was watch videos. What a hack.” And here’s what we found written about another: “Best class I’ve ever had. Her lectures are clear and she is always there to help you.”

Caveat Emptor

When it comes to buying goods and services, it is sometimes good to remember the saying “caveat emptor,” which means “let the buyer beware.” It means that you, as a buyer, have the responsibility of watching out for yourself. Sellers will not always tell you everything they think you want to know. A car salesperson isn’t likely to tell you how poorly the car you’re looking at did in the national crash tests. The surgeon isn’t likely to tell you that he has two disciplinary actions pending. The gas station isn’t likely to advertise that it has some of the highest gas prices in the county.

Many companies will advertise that you can get a “free” credit report from them. An ad might read: “Want to know what your credit report says. Come to our Web site and you’ll get a free credit report in minutes.”

Fact is, many of the companies that advertise “free” credit reports don’t deliver free credit reports. Often once at their sites they will try to get you to sign up for subscription-based services sold by credit bureaus. As of this writing, only one congressionally mandated site, AnnualCreditReport.com, provides a free credit report. Oddly enough, though, if you do a search of “free credit report” on the search engine Google, AnnualCreditReport.com doesn’t even make the first page of Google results.

My Personal Economics Action Plan

Here are some points you may want to consider and some guidelines you might want to put into practice.

✔ 1. The World Wide Web makes it easier and less costly for you to become an informed consumer. Use the Web to learn about the products and services you are thinking about buying.

I will research ______ to determine ______ within the next six months.

✔ 2. Sellers will not always willingly provide you with the information you may want before you make a purchase. You have to watch out for yourself. Remember: caveat emptor—let the buyer beware.

Before I make my next major purchase, I will ______ to make sure that I am making a smart buying decision.
Chapter Summary

Be sure you know and remember the following key points from the chapter sections.

Section 1

- Supply and demand work together to determine price.
- A surplus exists when quantity supplied is greater than quantity demanded.
- A shortage exists when quantity demanded is greater than quantity supplied.
- A market reaches equilibrium when the quantity of a good that buyers are willing and able to buy is equal to the quantity of the good that sellers are willing and able to produce and offer for sale, and is shown as the intersection point of the supply and demand curves.
- The cost of storing inventories is part of the reason prices decrease when a surplus occurs.
- A shift in the demand curve will cause prices to increase or decrease.
- A shift in the supply curve will also cause a change in price.
- Governments sometimes legislate price controls: a price ceiling sets a level that a price for a good cannot go above legally, and a price floor is the lowest price at which a good can be sold legally.

Section 2

- A shortage in a market causes price to increase.
- A surplus in a market causes price to decrease.
- The laws of supply and demand affect many areas of our lives: the price of goods and services, the likelihood of getting into a certain university or on a certain sports team, how much traffic is on the roads, and how much money we earn in our jobs.
- All other factors being the same, prices and quantity will always move toward the equilibrium point.

Economics Vocabulary

To reinforce your knowledge of the key terms in this chapter, fill in the following blanks on a separate piece of paper with the appropriate word or phrase.

1. A(n) ______ exists when quantity supplied is greater than quantity demanded.
2. A(n) ______ exists when quantity demanded is greater than quantity supplied.
3. A market is in ______ when quantity demanded equals quantity supplied.
4. The price that exists in a market when quantity demanded equals quantity supplied is called the ______.
5. The quantity that exists in a market when quantity demanded equals quantity supplied is called the ______.
6. In a market, if quantity supplied is currently greater than quantity demanded, a firm’s ______ is/are above normal levels.
7. A(n) ______ is a legislated price below which legal trades cannot be made.
8. A(n) ______ is a legislated price above which legal trades cannot be made.

Understanding the Main Ideas

Write answers to the following questions to review the main ideas in this chapter.

1. Explain why price falls when a surplus occurs.
2. Look at the prices listed in Exhibit 6-1. At what prices does a surplus occur? What are the equilibrium price and the equilibrium quantity?
3. “All markets are necessarily in equilibrium at all points in time.” Agree or disagree? Explain.
4. What might we see when a market is experiencing a shortage? (Comment: It is not enough to say that quantity demanded is greater than quantity supplied because this answer is simply a definition of shortage. You must identify a tangible event of a shortage.)
5. Pens sell for about the same price in every city in the country, but houses do not. Why?
6. Alfred Marshall, the British economist, compared supply and demand to the two blades of a pair of scissors. Explain his thinking.
7. Identify what will happen to equilibrium price and equilibrium quantity in each of the following cases:
   a. Demand rises and supply is constant.
   b. Demand falls by more than supply rises.
   c. Supply rises by more than demand rises.
   d. Supply falls and demand is constant.

8. Suppose you are a manager of a grocery store. How would you know which goods were in shortage? In surplus?

9. Both the demand for and the supply of a good rise. Under what condition will the price of the good remain constant?

10. Some National Basketball Association (NBA) players receive annual incomes of several million dollars. Explain their high salaries in terms of supply and demand.

Doing the Math

Do the calculations necessary to solve the following problem.

1. Price is $10, quantity demanded is 100 units, and quantity supplied is 130 units. For each dollar decline in price, quantity demanded rises by 5 units, and quantity supplied falls by 5 units. What is the equilibrium price?

Working with Graphs and Tables

1. Identify the exhibit in the chapter that illustrates the following:
   a. an increase in demand, supply constant
   b. a decrease in supply, demand constant
2. Graphically represent the following:
   a. a decrease in demand, supply constant
   b. an increase in supply, demand constant
   c. a decrease in demand equal to a decrease in supply
3. Explain what is happening in each part, (a)–(d), of Exhibit 6-8.

Solving Economic Problems

Use your thinking skills and the information you learned in this chapter to find solutions to the following problems.

1. Analysis. Suppose that in 2005 the average price of a meal at a restaurant was $20, and 50,000 restaurant meals were bought and sold. In 2006 the average price was $22, and 60,000 meals were bought and sold. Which of the following events can explain a higher price and more meals purchased and sold? Explain.
   a. The supply of restaurant meals increased.
   b. The demand for restaurant meals decreased.
   c. The demand for restaurant meals increased.

2. Cause and Effect. Suppose the equilibrium price of bread is $2 a loaf. The federal government mandates that no bread can be sold for more than $1 a loaf. How will the market for bread be different from when bread could be purchased and sold for $2? Explain.
Should There Be Price Controls on Some Goods at Certain Times?

In the summer of 2005, gasoline prices were rising. It was common for people around the country to pay $3 or more per gallon for gasoline.

Then, in the early morning of August 29, 2005, Hurricane Katrina hit the United States and devastated much of the area of the Gulf Coast from New Orleans, Louisiana, to Mobile, Alabama. As a result of Hurricane Katrina, there were breaches in the levee system on the New Orleans side of Lake Pontchartrain, which led to massive flooding and an evacuation of New Orleans.

Just weeks later, Hurricane Rita hit the Gulf Coast area near Galveston, Texas. Hurricane Rita was not as devastating as Katrina, but many of the oil refineries along the coast were put out of commission by the hurricane, further reducing the supply of fuels such as gasoline.

People demanded that something be done. It became common to hear people arguing for price ceilings on gas, on certain food items, and on water. In response, some people argued against price ceilings. Here is what a few people had to say as they discussed the day’s news events at their local coffee shop one morning.

Gilberto Vasquez, marketing manager of a fast-food chain

Gasoline prices have risen nearly 70 cents in just the last week. This is getting ridiculous. It used to be that I paid about $25 to fill up and now I’m paying almost $10 more. For many people, this spike in gas prices is adding $100 to $200 a month to the amount of money they have to spend. That is a lot of money. What am I supposed to do? After all I have to do a lot of driving in my job. What do I do, buy less food for my family? My daughter needs braces badly. Does she go without braces? I think the federal government should impose a price ceiling for gas. Maybe the ceiling should be set at 20 cents or 30 cents more than the price used to be, so the oil companies can make some money. But there is no need to let the oil companies gouge us by tacking on 70 cents or $1 more in just one week’s time. Did you see the article in the paper this week about one of the oil company’s record profits? Don’t get me wrong. I don’t usually favor government controls. But sometimes I think they are necessary. Why should some people have so much when they are just taking from others?

Winifred Smith, Economics teacher at Jefferson High School

I’m not sure I agree with Gilberto’s assumption. He seems to assume that the oil companies can raise the price of gas to anything they want. But if they could do that, why weren’t they charging more when the price of gas at the pump was under $2 a gallon? They didn’t, I expect, because they couldn’t. Supply and demand determine gasoline prices—not the big oil companies. Supply and demand are impersonal forces, they don’t have an office anywhere in some building. But people always seem to want to blame someone for their predicament. It is just so easy to blame the oil companies.

Well, suppose, the federal government does slam a price ceiling on gas when it is
rising rapidly. If that price ceiling is below the equilibrium price, then simple economics tells us that we are going to have some problems. At a price below equilibrium price, shortages will arise. And with shortages, long lines. I can remember back to the late 1970s when the federal government did place a price ceiling on gas at the pump. Sometimes I had to wait for an hour in line to get gas. I don’t want to go back to that.

Patrick talks as if price is only there to take money away from some and give to others. Price is a rationing device; that is what all economists teach you. If the demand for water or motel rooms or gasoline is high, and there is only so much supply, then something is going to have to ration these goods. What should the motel owner do? Ration by brute force: if you are stronger than someone else, you get the motel room? By appearance: the prettier you are the more likely you will get a room? Patrick seems to forget that price has a job to do and if we don’t let it do its job—which is rationing—something else is going to have to do the job. Patrick didn’t suggest what should become the rationing device for water, or gas, or motel rooms. He simply points a finger at sellers and scolds them.

Maybe sometimes a long line is better than a high price. Take what happened after Hurricane Katrina or after any natural disaster. All of a sudden, the price of water rises. What the day before cost $2 to buy, now costs $5 or more to buy.

After Katrina hit, many people had to leave their homes. Some went to Houston, Baton Rouge, Atlanta, and other cities. In many of the cities near where cities were devastated, hotel and motel rooms went for higher daily rates. Some of these motel and hotel owners must have said to themselves, “Well, here come all the people leaving New Orleans, so our motel rooms are going to be in high demand, so now is the time to raise the daily rate.” It seems to me that these people who raise prices dramatically after a natural disaster are profiting on human misery. They see someone in trouble, they see someone who has no choice but to pay the prices they charge, and they sock it to them.

Maybe there should be a law that after natural disaster, no one can raise the price of anything for at least a month. I think I would be in favor of such a law. We shouldn’t allow some people to benefit because other people are in a miserable situation.

Doug Canterfield,
salesman

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Anabelle Roberts,
high school student

I think some good points have been made on both sides of the issue. I guess I would argue that if people can help one another during a natural disaster, they should. If that means holding prices down, they ought to. After all, presumably the motel owners made money on the day before Hurricane Katrina hit by charging a certain daily rate. Why can’t they make money after the hurricane if they charge the same rate?

What Do You Think?

1. Who do you most nearly agree with? Why?
2. What are the strong points of the debate here? The weak points?