Levelling Up Grades Through Skills

H2 Economics

Microeconomics | Theme 2.1

<u>Chapter 3A:</u>
Supply Analysis and its Applications - Market, Curve, Determinants

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Chapter Checklist

By the end of this chapter, you should have mastered the following.

Content / Skill Required	Questions?
Able to explain the Law of Supply.	
Able to list out the determinants of Supply.	
Able to differentiate between a shift in Supply and movement along the Supply curve.	

1. Introduction to Supply

- Supply refers to the quantity of a good or service that producers are willing and able to sell at each given price over a given period of time, ceteris paribus.

Law of Supply

The law of supply states that there is a **positive relationship** between the price and quantity supplied of a good, ceteris paribus.

- This direct relationship occurs because at higher output levels, the marginal cost of producing a good rises, the producer would only be willing to produce more of the good if they are compensated with a higher price → Quantity supplied rises only if price increases.
- As a result of the Law of Supply, the supply curve is always sloping **upwards**.

Figure: *Change in Quantity Supplied (Qss): Movement along the supply curve*

2. Determinants of Supply

- Supply is affected/determined by non-price factors. You can memorise these factors with the acronym, **WETPIGS**.

Factor	Explanation
Weather	• Weather conditions that are unfavourable to certain goods such as crops would cause a drop in yield and hence fall in supply.
Expectation of Future Price Changes	• If the market price of a good is expected to rise, producers may temporarily hold back or reduce the supply sold in the market, build up stock, and sell them at a higher price in the future. This allows them to reap a greater amount of profit.
Technological Advancements	• With improvements in technology, producers can produce faster and in greater quantities with each factor of production. This helps to increase the supply.
Price of Related Goods	• Goods can be produced in joint supply or competitive supply. • ***Joint supply*** of goods refers to the production of goods that are derived from a single product/resource. The increase in supply of one will lead to the increase in supply of another good even if the price remains unchanged for the other good. ○ Example: ______________________________ • ***Competitive supply*** of goods refers to goods that compete for the same resources that are mutually exclusive. If the price of a good increases, its quantity supply will increase, diminishing the resources available or the other good, causing the supply of the other good to fall. ○ Example: ______________________________
Input Price Changes	• Changes in the price of factor inputs (raw materials, energy, labour cost, etc.) will change the cost of production.

	• An increase in the cost of production would reduce profits, hence firms are less willing and able to supply at the same price → Fall in supply. • An increase in worker productivity would mean that more goods can be produced with the same amount of labour (reduces unit labour cost) → Increase in supply.
Government Policies	• Government policies here mainly refer to indirect taxes and subsidies. • Subsidies help to reduce the cost of production, hence reducing total cost and increasing profits. This enhances the producers' willingness and ability to supply → Increase in supply. • Indirect taxes imposed on goods and services will increase the cost of production of firms, lowering their willingness to produce → Fall in supply.
Supplier Number Changes	• Supernormal profits made by existing producers may attract new firms into the industry, increasing total market supply.

Figure: *A change in a non-price determinant of supply will SHIFT the entire supply curve.*

Increase in supply = Rightward shift (SS_0 to SS_1)
Decrease in supply = Leftward shift (SS_0 to SS_2)

Causal Links

When there is an increase in supply...   When there is a decrease in supply...

Exam Requirements

- Understand how a movement along the curve differs from a shift of the curve for supply.
- Be able to draw the various supply diagrams and individual changes in supply.
- Be able to explain and discuss the various supply non-price factors/determinants.
- Be able to apply to real world case studies and examples, and craft strong arguments in essays.

Practice Questions

Q1. Recent advancements in artificial intelligence and automation has allowed Tinmen Co. to streamline production processes of heavy crude oil. Tinmen Co. is a producer of heavy crude oil, while its sister company, Tinwomen Co. is a producer of petroleum, which has been known to be a by-product of heavy crude oil.

Explain the effects that the oil market faces as a result of what companies like Tinmen Co. and Tinwomen Co. are facing, as well as the potential effect on consumers. [10]