

Demand & Supply other determinant beyond price

Other determinants of demand beyond price (Which shift a market demand curve to the right or left)

Price is not the only factor that determines how much of a good people will buy. Demand is also affected by the following.

Tastes. The more desirable people find the good, the more they will demand. Tastes are affected by factor such as advertising, fashion, observations of other consumers, considerations of health and experiences from consuming the good on previous occasions.

The number and price of substitute goods (i.e. competitive goods). The higher the price of substitute goods, the higher will be the demand for this good as people switch from the substitutes. For example, the demand for coffee will depend on the price of tea. If tea goes up in price, the demand for coffee will rise.

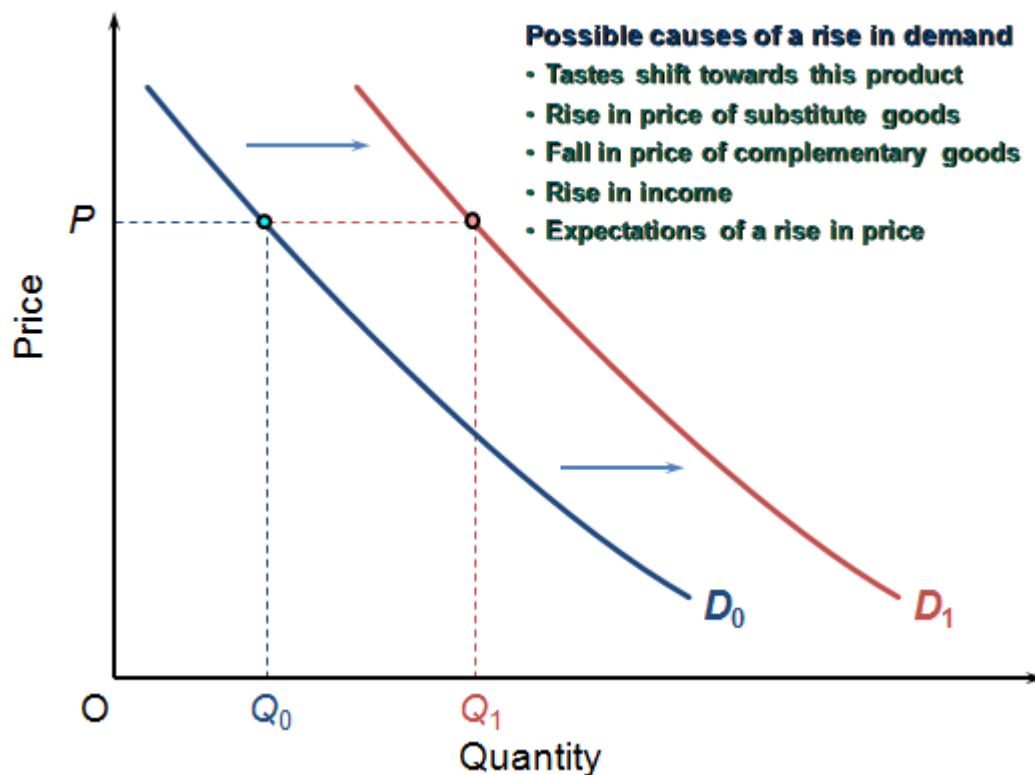
The number and price of complementary goods. Complementary goods are those that are consumed together: cars and petrol, shoes and polish, bread and butter. The higher the price of complementary goods, the fewer of them will be bought and hence the less the demand for this good. For example, the demand for compact discs will depend on the price of CD players. If the price of CD players goes up, so that fewer are bought, the demand for CDs will fall.

Income. As people's incomes rise, their demand for most goods will rise. Such goods are called normal goods. There are exceptions to this general rule, however. As people get richer, they spend less on inferior goods, such as cheap margarine, and switch to better-quality goods.

Distribution of income. If, for example, national income were redistributed from the poor to the rich, the demand for luxury goods would rise. At the same time, as the poor got poorer, they might have to turn to buying inferior goods, whose demand would thus rise too.

Expectations of future price changes. If people think that prices are going to rise in the future, they are likely to buy more now before the price does go up.

An Increase in demand



Other determinants of supply beyond price (Which shift a market supply curve to the right or left)

Like demand, supply is not determined simply by price, The other determinants of supply are as follows.

The costs of production. The higher the costs of production, the less profit will be made at any price. As costs rise, firms will cut back on production, probably switching to alternative products whose costs have not risen so much.

The profitability of alternative products (substitutes in supply). If some alternative product (a substitute in supply) becomes more profitable to supply than before, producers are likely to switch from the first good to this alternative. Supply of the first good falls. Other goods are likely to become more profitable if their prices rise or their costs of production fall. For example, if the price of carrots goes up, or the cost of producing carrots comes down, farmers may decide to produce more carrots. The supply of potatoes is therefore likely to fall.

The profitability of goods in joint supply. Sometimes when one good is produced, another good is also produced at

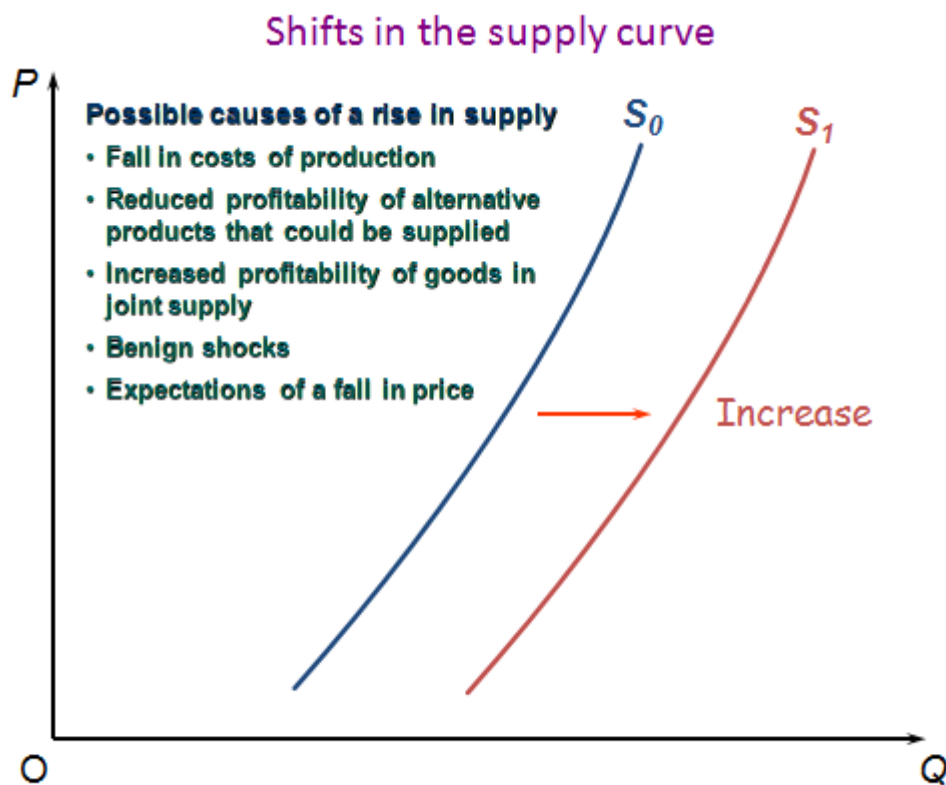
the same time. These are said to be goods in joint supply. An example is the refining of crude oil to produce petrol. Other grade fuels will be produced as well, such as diesel and paraffin. If more petrol is produced, due to a rise in demand, then the supply of these other fuels will rise too.

Nature, 'random shocks' and other unpredictable events. In this category we would include the weather and diseases affecting farm output, wars affecting the supply of imported raw materials, the breakdown of machinery, industrial disputes, earthquakes, floods and fire, etc.

The aims of producers. A profit-maximising firm will supply a different quantity from a firm that has a different aim, such as maximising sales.

Expectations of future price changes. If price is expected to rise, producers may temporarily reduce the amount they sell. Instead they are likely to build up their stocks and only release them on to the market when the price does rise. At the same time they may plan to produce more, by installing new machines, or taking on more labour, so that they can be ready to supply more when the price has risen.

The number of suppliers. If new firms enter the market, supply is likely to rise.



Note. In examples above we have only seen the supply and demand curves shift to the right but obviously they can shift in the other direction based on the determinants as well which affect them.