

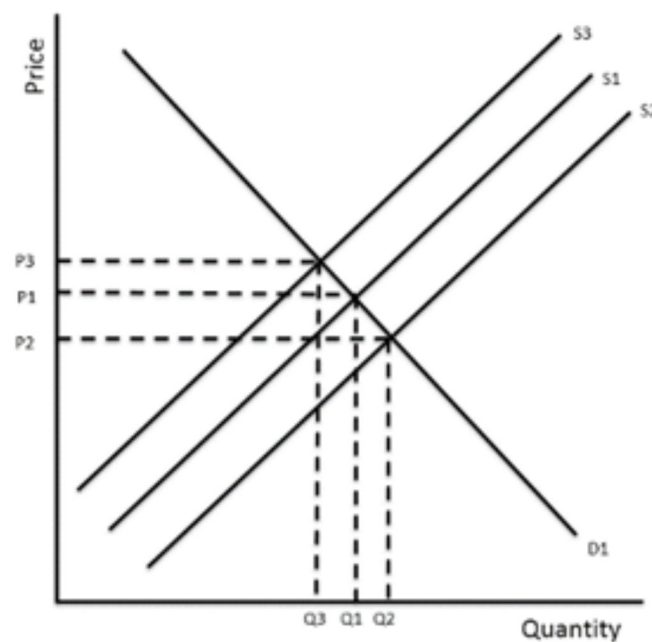
Topic 3—The Nature of Supply

Key Terms	
Supply	The quantity of a good or service that firms choose to sell at any possible price in a given period of time
Firm	An organisation that brings together factors of production in order to produce output
Competitive Market	A market in which individual firms cannot influence the price of the good or service they are selling, because of competition from other
Supply Curve	A graph showing the quantity supplied at any given price
Cartel	An agreement between firms in a market on price and output with the intention of maximising their joint profits

Supply
Supply is linked to firms, they make the decisions about what to supply and are always interested in making a maximum amount of profit
A change in the price of the product will result in a movement along the supply curve
A change in one of the other factors mentioned above will result in a shift of the supply curve

Factors that Influence Supply

- Production costs
- The technology of production
- Taxes and subsidies
- The price of related goods
- Firms expectations about future prices



Specification Link

1.2.4 Supply

Costs and Technology

If there are high costs of production, this will mean that producing the product is now more expensive so the firm chooses to supply less of the product (shift left)

Whereas if new technology exists, this is likely to make the production process more efficient or potentially cheaper which will encourage an increase in supply (shift right)

Taxes and Subsidies

Businesses are required to pay the government VAT on any good and service sold. This they usually pass onto firms in the form of higher prices. If VAT increases, this will lead to less willingness to supply that product so supply shifts left

On the other hand, subsidies provide free money for businesses to spend on improving their production, leading to lower costs and more supply (shift right).

Expected Prices

Producing products can take time, this means that future prices need to be considered when choosing which products to sell.

Some markets can influence future prices by forming a cartel such as OPEC. This can restrict the supply in the market which increases the prices of the product

Prices of Other Goods

If there are multiple uses for the factors of production this can lead to a change in the amount that is supplied. E.g. farmland can be used to grow crops or raise cattle, if the price of beef increases, this will increase the supply of cattle.

This depends on how high the switching cost is.



Topic 3—The Nature of Supply

Key Terms

Price Elasticity of Supply (PES)	A measure of the sensitivity of quantity supplied of a good or service to a change in the price of that good or service
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Price Elasticity of Supply

$$\frac{\% \text{ Change in Quantity Supplied}}{\% \text{ Change in Price}}$$

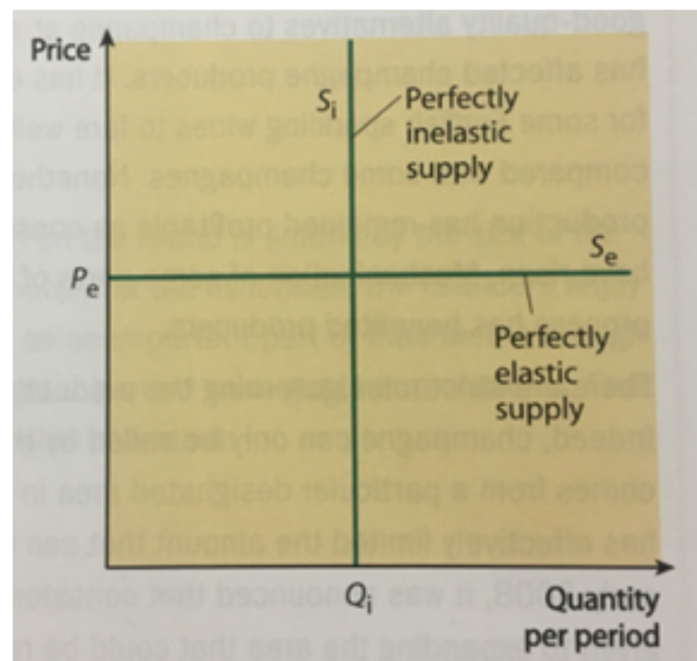
- If PES is above 1 than it is said to be relatively elastic
- If PES is between 0 and 1 than it is said to be relatively inelastic
- If PES equal to 1 than it is said to be unit elastic

The PES answer will always be a positive figure

Two Special Cases

In some cases, supply may be fixed so that no matter how much the price increases, firms will not be able to supply any more meaning it is perfectly inelastic. E.g. there may only be a certain amount of fish in the market due to quotas.

In other cases, firms may be willing to supply any amount of the good at the going price leading to a perfectly elastic curve.



Specification Link

1.2.4 Supply

Short Run and Long Run

Supply takes time to change which means that the price elasticity of supply of goods will depend on how quickly they can be made.

In the short term PES is relatively inelastic due to how hard it is to change supply, whereas in the long term PES is much more elastic.

