**Topic 2: Supply**

**LVL 1: As you read, answer the following questions**

1. Who decides on the questions of production in a market economy?
2. Define demand.
3. Define supply.
4. What does the law of supply state?
5. What is the market equilibrium?
6. What is the difference between a change in supply versus a change in quantity supplied?

**SSEMI2 Explain how the law of supply, and prices work to determine distribution in a market economy.**

In a market economy, consumers decide what to produce, firms decide how to produce, and the price system decides who will get the items produced. Consumers of goods, services, and resources behave according to the law of demand. **Demand** is the quantity a consumer is willing and able to purchase at each price. The law of demand says that as the price of a good rises the quantity of the good consumers are willing and able to buy will decrease. **Supply** is the quantity a seller is willing and able to sell at each price. The law of supply says that as **price** rises the quantity a seller is willing and able to sell will increase. A market or equilibrium price is one where the quantity of a good that buyers are willing and able to buy matches the quantity of a good that producers are willing and able to sell. As the market/equilibrium price in the market changes, it sends signals to buyers and sellers about much they should be willing and able to buy and sell.

1. **Define the law of supply**

The **law of supply** says that as price rises the quantity a seller is willing and able to sell will increase. The graph below illustrates this law.



Supply



Quantity



Price



P1



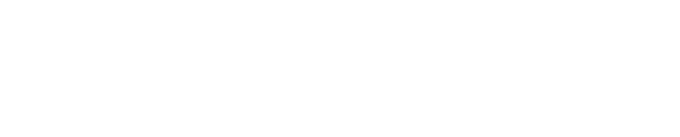
P2



Q2



Q1



As price rises from P1 to P2, the quantity of the

good sellers are willing and able to sell rises from

Q1 to Q2. This is the law of demand.

The **market supply curve** refers to all the quantities of a good, service, or resource sellers are willing and able to sell at each price. The **quantity supplied** is the amount of a good, service, or resource sellers are willing and able to sell at one specific price. In the graph below, the quantity supplied at a price of $1 is 100 units of the good. The market supply includes the quantities supplied at $1, $2, $3, and all other prices found along the curve. The table in the example below is the **Supply Schedule** and provides the data you use to create a supply curve.



150



Supply



Quantity



Price



$1



$3



200



100



$2

|  |  |
| --- | --- |
| **Price** | **Quantity Supplied** |
| $1 | 100 |
| $2 | 150 |
| $3 | 200 |