

# The Market Forces of Supply and Demand


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**Economists use the model of supply and demand to analyse competitive market.**

 **There are many buyers and sellers, each of whom has little or no influence on the market price.**

**The demand curve shows how the quantity of a good demanded depends on the price.**

**According to the law of demand, as the price of a good falls, the quantity demanded rises.**

# Market

- *Actors*
- *Goods and services*
- *Nature of trade*
- *Regulation*

# Market Operators

- **Consumers:** *who want to purchase the goods.*
- **Companies:** *that produce and sell goods.*

# The Theory of consumer choice

The consumer theory analyzes consumer behavior aimed at obtaining the maximum utility in the presence of a budget constraint.

# Preferences

## Axioms of consumer theory.

### ■ **Completeness.**

**An ordering of preferences is complete if it allows the consumer to classify all possible baskets of goods and services, in order to still be able to make a choice between the baskets available.**

# Preferences

## Axioms of consumer theory.

### ■ Reflexivity.

**Each basket is desirable as much as himself.**



# Preferences

## Axioms of consumer theory.

### ■ **Transitivity.**

**Given three baskets of goods (X, Y and Z), if the consumer prefers X to Y and Y to Z, then he also prefers X to Z. This is also true in the case of "indifference" between baskets (if the consumer is indifferent between X and Y and is also indifferent between Y and Z, it will also be between X and Z).**

# Utility



The essential element of the behavior of consumer choice is whether a basket has been considered more useful than another (no matter how much).

# Utility

Classical Economists used the term Utility to refer to the satisfaction derived from consumption.

**Utility:** the Satisfaction Derived from the Consumption of a certain quantity of a Product.

# Utility

Utility is an ordinal concept, what this means is that it can be used as a way of ranking but cannot have any meaningful arithmetic operations performed on it.

# Utility

A utility function is a way of describing the consumer's preferences.

# Utility

A utility function assigns a numerical value to every possible consumption bundle: the favorite baskets receive greater numbers. A highest curve is assigned a higher value.

# Utility

- Diminishing marginal utility.
- Marginal utility of a good:

If the consumer consumes the good  $X$ , as does its utility if there is a small increase ( $\Delta x$ ) of the quantity of the good?

$$UM_x = \Delta U / \Delta x = u(x + \Delta x) - u(x) / \Delta x$$

# Indifference curves

Set of baskets that are indifferent to the consumer, equally desirable.

Are the graphic representation of the preferences of the consumer.



# Indifference curves

## Properties

- More are moved upwards and to the right, the greater the satisfaction level corresponding to these.

# Indifference curves

## Properties

- They have a negative slope.
- Never intersect.
- Are convex to the origin of the axes.

**The analysis of consumer choice looks at how consumers make decisions.**

**There are a number of assumptions underpinning the model which include that people behave rationally to maximize their utility from their given resources.**

**A consumer's budget constraint shows the possible combinations of different goods he can buy given his income and the prices of the goods.**

**The slope of the budget constraint equals the relative price of the goods.**

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