Demand and Supply

Demand and supply refer to *desired* amounts.

If the demand is 5, then the buyer wants to buy 5 units at the market price.

If the supply is 10, then the seller wants to sell 10 units at the market price.

Money as the Medium of Exchange

People use money to buy goods and services.

The demander is the one who pays the money.

The supplier is the one who provides the goods and services.

Labor Market

One speaks of the demand and supply of labor.

The employer pays for the labor, and the worker supplies the labor.

An economist does *not* speak of the demand and supply of jobs. This terminology would have the supplier providing the money, which is backwards.

Market Equilibrium

Market equilibrium means that demand equals supply.

Given the market price, each demander buys whatever quantity he chooses, at the market price. Each supplier sells whatever quantity he chooses, at the market price.

General Equilibrium

General equilibrium refers to market equilibrium simultaneously in all markets.

Standard microeconomic theory has the context of general equilibrium.

Notional Demand and Supply

One analyzes demand and supply under the assumption that in every market one can buy or sell any desired amount at the market price, subject to the budget constraint.

For example, a consumer decides on his demand for goods, under the assumption that he can work however much he chooses at the market wage.

One refers to this demand and supply as *notional*. The consumer has a notion that he wants to buy and sell in a certain way, and he assumes that he can do so.

Disequilibrium

Disequilibrium refers to a situation in which demand does not equal supply.

For example, the demand for a good might be 6, and the supply might be 10. The excess supply is 4.

One possibility is that the excess supply causes the price of the good to fall, raising demand and reducing supply, and equilibrium results.

Excess Supply

Alternatively, perhaps the price does not fall, and the excess supply endures.

Demanders buy 6 from the suppliers, and the excess supply is still 4.

Terminology

Since demand and supply refer to desired amounts, one must not say that the supply is 6. The suppliers sell 6, but the supply is 10.

Recession as Disequilibrium

According to Keynes, in recession the economy is not in general equilibrium. Instead there is excess supply of goods and labor.

Excess Supply of Goods

Firms reduce production because there is deficient aggregate demand for goods. There is no reason to produce what cannot be sold.

Production is less than supply. At the market price, firms would like to sell more, but the demand is lacking.

Excess Supply of Labor

In recession there is also excess supply of labor, because the demand for labor is weak.

There is involuntary unemployment in the following sense. Qualified workers who would like to work at the market wage cannot get a job, because the demand for labor is low.

Spillovers

Disequilibrium in one market has a spillover effect on another market.

For example, the excess supply of goods reduces the demand for labor. Firms will not hire workers if the output cannot be sold.

The excess supply of labor reduces the demand for goods. If workers are unemployed, they lack the income needed to buy goods.

Effective Demand and Supply

With disequilibrium, one refers to the *effective* demand and supply. The effective demand and supply take into account how disequilibrium in one market spills over into other markets.

Recession

For an economy in recession, the effective demand and supply govern the behavior of firms and consumers.

Given the market prices, perhaps notional demand equals notional supply, so potentially the economy could have been at general equilibrium. Production would be at capacity, and there would be full employment of labor.

However the notional demand and supply is not the effective demand and supply. The low production in recession reduces the effective demand for labor. National income is low, which reduces the effective demand for goods. Low effective demand for goods and labor characterize recession.