

Economics Theory of Supply and Demand Outdated

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Abstract

This paper shows that the traditional supply demand model that is the basis of all the modern day economic theories, models and fundamental inferences is wrong. The real supply curve complements, accentuates and follows the demand curve as the supply is always demand driven and not profit driven. This old model, predated to pre-industrialization that has been used for centuries has to be replaced by the corrected new model that accurately reflects the modern day markets and in not in conflict with them.

Keywords: Economic theories • Accurately • Demand curve

Introduction

The law of supply and demand combines two essential economic principles that explain how changes in the price of a resource, commodity, or product impact its supply and demand. When the price increases, the supply also rises, but demand decreases. Conversely, when the price drops, the supply contracts while demand grows. Supply and demand levels for different prices can be visualized on a graph as curves. The point where these curves intersect represents the equilibrium or market-clearing price, where demand equals supply. This intersection is crucial for price discovery in the marketplace.

Methodology

The key takeaways from this theory include:

- Law of demand:** Demand for a product or resource tends to decline as its price rises and increase as the price falls.
- Law of supply:** Higher prices encourage greater supply of an economic good, while lower prices lead to reduced supply.
- The market-clearing price balances supply and demand and can be graphically shown as the point where the supply and demand curves intersect.

The law of demand

The law of demand asserts that, in most cases, the price and the quantity demanded in a specific market exhibit an inverse relationship. In simpler terms, when the price of a product rises, people become less willing to purchase it. Conversely, as the price of a commodity decreases, consumers tend to shift their preference from relatively more expensive goods to the more affordable one, as depicted in Figure 1. It's important to note that factors beyond price can also influence demand. For instance, an increase in income can lead to an outward shift of the demand curve for a normal good, as illustrated in the Figure. These determinants are typically treated as constant factors affecting both demand and supply [1].

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Received: 07 February, 2024, Manuscript No. economics-24-127133; **Editor Assigned:** 09 February, 2024, PreQC No. P-127133; **Reviewed:** 23 February, 2024, QC No. Q-127133; **Revised:** 28 February, 2024, Manuscript No. R-127133; **Published:** 07 March, 2024, DOI: 10.37421/2375-4389.2024.12.451

The law of supply

The "Law of Supply" outlines that, in general, when the price of a good rises, its supply expands, and when the price falls, its supply contracts. Supply represents the relationship between the price of a product and the quantity available for sale at that price. This relationship can be depicted through tables or graphs that show how price influences the quantity supplied. When the price at which a good can be sold increases, producers are motivated to supply more of it, as illustrated in Figure 1. Higher prices create profitability incentives for increased production. Similar to the demand side, supply can also shift due to factors like changes in the price of productive inputs or technological advancements. The determinants of supply, including the price of substitutes, production costs, technology utilization, and other input factors, are assumed to remain constant during a specific evaluation period of supply [1].

Equilibrium price

Market equilibrium occurs at the point where the quantity supplied equals the quantity demanded, which corresponds to the intersection of the supply and demand curves shown in Figure 1. When an upward-sloping supply curve meets a downward-sloping demand curve, the supply and demand for the goods are perfectly balanced, resulting in no surplus or unmet demand.

Below equilibrium price: If the price falls below this equilibrium point, there is a shortage of quantity supplied compared to the quantity demanded. This scarcity tends to drive the price upward.

Above equilibrium price: Conversely, when the price rises above

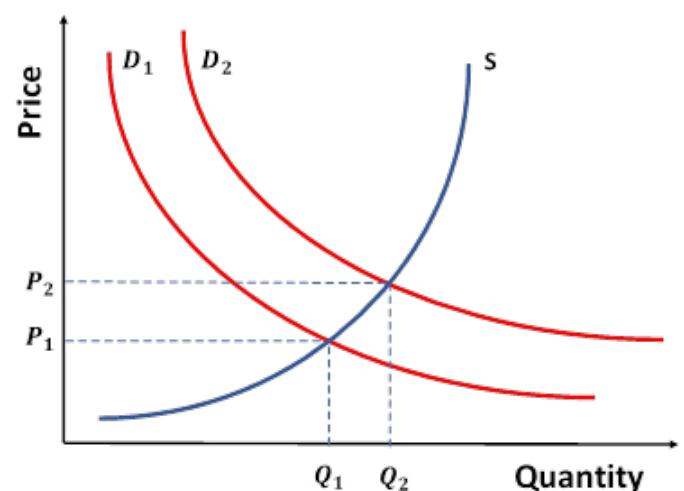


Figure 1. The supply and demand model describes how prices varies with product supply and demand. The increase, right-shift in demand from D1 to D2 can be seen along with the consequent increase in price and quantity required to reach a new equilibrium point on the supply curve (S).

equilibrium, there is a surplus of quantity supplied relative to the quantity demanded. This excess supply puts downward pressure on the price.

The supply and demand model predicts that, given specific supply and demand curves, the price and quantity will stabilize at a level where quantity supplied equals quantity demanded. The law of supply and demand encompasses two central economic principles:

Law of demand: As prices rise for a given resource, product or commodity, demand declines. Conversely, as prices fall, demand increases.

Law of supply: Higher prices encourage producers to supply more of a resource, product or commodity. Conversely, lower prices lead to reduced supply.

The equilibrium price is where demand matches supply, resulting in a balanced market. Understanding these principles helps all market participants anticipate and navigate future conditions.

Results and Discussion

The supply curve represents the manufacturers or producers, to be profit maxi misers, meaning that they attempt to produce and supply the amount of goods that will bring them the highest profit. The law of supply is thus not direct as the law of demand, but inverse. The higher the price, the higher the quantity supplied. Lower prices mean reduced supply, all else held equal. But in reality, a manufacturer or a business entity always tries to meet the demand in the market or in other terms, the profit maximization is not the driver but the market is. A company always tries to forecast the supply to match the demand in the market with the end goal always being to meet the demand exactly, or in term terms meet the market demand 100%. Although it is never practically possible but the end-goal, the driver and the target is always the consumer demand. The scenario of the law of supply is thus impractical and can be a feasible situation where there is a complete monopoly, which was possible during the start or pre industrial revolution but in modern day world is not relevant at all [2,3].

It can be seen in Figure 1 that there is a real huge imbalance in the supply and demand quantities, especially flagrant at the middle of the demand curve. For a increasing price per unit, the supply is exponentially decreasing for moderate increase in demand and the opposite is true for a decreasing price per unit towards the other end of the demand curve. This mismatch is impractical in real life as a manufacturer will have to carry a very high or very low inventory most of the time thus increasing the operating costs, lower the margins that ultimately affect the bottom line profits, customer service and the feasibility of the enterprise as a whole. Except for the equilibrium point where the supply is equal to the demand which is impractical and most of the time very difficult to achieve, the overall system is very inefficient with the old supply theory model.

With the new "corrected" supply and demand model as shown in Figure 2, the supply curve always follows the demand which is a more realistic, practical and real-world scenario, the inventory chase is thus kept to the target of zero. This is the target that every company wants to achieve of minimum inventory of 0, the scenario of supply meeting the demand and the price point of maximum profit versus the equilibrium point from the old model that is the point of supply matching demand. With the new model the supply curve always matches the demand. Gone are the days when the old supply model was more relevant, for example the Ford Model T that where build to push the supply into the market irrespective of the demand, just to maximise the profit as the only objective [4]. Today's market is more pull driven where the demand drives the supply and not the supply dictating the demand. We need to base all our modern economic theories based on today's world markets and not the markets of yester years which is infeasible at the present day. The old model also becomes infeasible if there is a drastic price reduction or increase as the equilibrium point becomes irrelevant. Also the model only functions for one supply demand matching but the new model always works irrespective of the price as the demand and supply is also consistent and not competing against each other. The demand and supply never competes but complements, accentuates and follows each

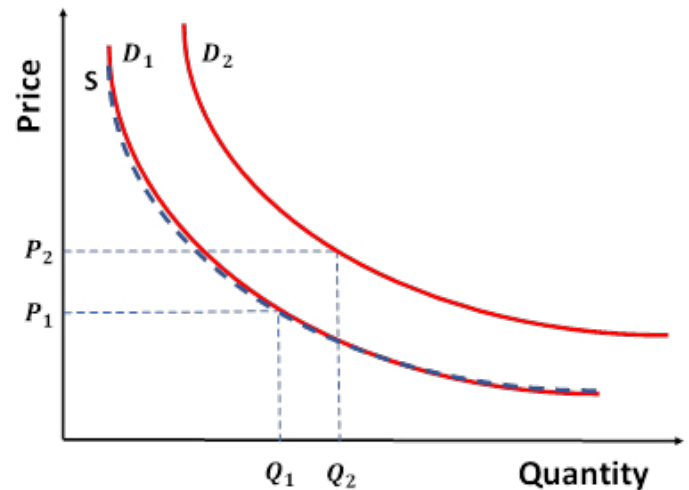


Figure 2. The "corrected" supply and demand model describes how prices vary with product supply and demand. The increase, right-shift in demand from D1 to D2 moves along with the supply curve that complements it, overlaps it and determines the best price point vs. the equilibrium point on the basis of profit maximization.

other with the demand being the primary driver of all. The real supply curve is one that is valid for all scenarios and not just at the equilibrium point [5].

What is the supply curve? A real supply curve is one where the supply always follows the demand and not the opposite. The old model will create too much inventory, inefficiencies and make companies inoperable. The new model on the other hand will always target for net zero inventories by the supply always following the demand [6]. This is the correct supply curve in this competitive modern world where a company is always playing a catching game to match the supply to demand and not create a debacle by focusing on maximizing profits by producing even more supply when the demand is decreasing and decreasing supply even more when the demand is going up. The new supply curve does not have to worry about the supply demand matching at the equilibrium point as it is already prebuilt but it does even better, taking the point to next level by defining the point of maximum profit versus the point of supply/demand matching in the old model.

Conclusion

It can be easily seen from the above inferences that the old model of supply and demand that has traditionally been used for centuries is wrong and was supply or profit driven and not market of demand, customer driven to accurately reflect the modern day markets and economics. This change has to be made to the fundamental economic theory to stay current with the present day situation and reflect, correct what is right, the truth.

Acknowledgement

None.

Conflict of Interest

None.

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How to cite this article: Jaiswal, Sandeep S. "Economics Theory of Supply and Demand Outdated." *J Glob Econ* 12 (2024): 451.