

CHAPTER-5

Theory of Supply

Q.1 Explain the law of supply?

Ans:-Normally we believe that the term supply means the commodities actually sold in the market or the total production of the commodity. But this is a loose interpretation of the term. In economics supply at a given point of time means the quantities which are offered for sale at particular prices.

In other words, the term supply may be defined as the actual amount of the commodity which is brought to the market for sale at a given price.

In short, stock (Total Production) is potential supply while supply refers to that part of stock which is offered for sale in the market at a given price.

Supply is always at a price. It is not possible to speak unless we mention the price.

The Law of Supply:-

Seller always sell their product for profit, Here we assume that the production cost is given. Thus, Profit are likely to be high at high prices. Therefore, more quantity of commodity supplied at higher price and less quantity at a lower price. This is the well-known law of supply which states that other thing being equal the amount of commodity supplied increases with every increase in its price and decrease with every fall in its price. The law of supply thus express the supply function which as under:-

$$S=f(p)$$

This function implies that the supply of commodity is the increasing function of its price.

Assumption:-

The law state that the supply varies directly with the price. It is based on various assumptions which are as under-

1. There is no change in the price of substitution.
2. There is no change in the cost of factors of production.
3. There is no expectation of any change in price in future.
4. The seller should not be in any sudden need of cash.

Supply Schedule:-

Supply schedule is tabular statement showing the different quantities of a commodity supplied at different prices. It represents a functional relationship between the price and quantity supplied. We can represent the supply schedule in two different ways-

- (1) Individual supply schedule
- (2) Market supply schedule

For, Example:-

1. Individual Supply Schedule

Price	Supply
1	100
2	200
3	300
4	400
5	500

2. Market Supply Schedule

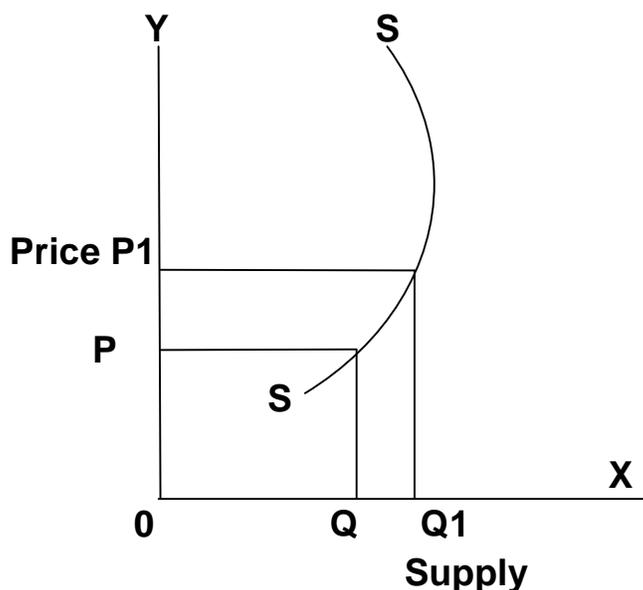
Price	Quantity supply by			Market supply
	Seller "A"	seller "B"	seller "C"	
1	25	30	35	90
2	30	35	40	105
3	35	40	45	120
4	40	45	50	135
5	45	50	55	150

An individual supply schedule represents the quantities supplied by a single seller. While the market supply schedule represents the sum of the quantity supplied by various seller.

Whatever it is an individual supply schedule or market supply schedule, it normally conforms to the law of supply.

Supply curve:-

It is a graphical presentation of the law of supply. The slope of supply curve is always upward because there is a positive relationship between price and quantity supplied.



S.S is the supply curve. It slopes upgrade from left to right because when the price of commodity increases the new sells enters in the market and the existing sellers offer more at a higher price and vice-versa.

Exceptions to the law of supply:-

There are certain exceptions to the law of supply. In certain case the slope of supply curve is backward.

For Example:- In the case of labour,as wages increase the worker might work for a less a number of hours than before.

An exception to the law is also seen in the case of person who wants to have a fixed income from their investment. As interest rate rise the amount of investment required to earn the same amount of interest is obviously less. In this case the slope of supply curve is backward.

Q2. Write a short note on determinants of supply.

Ans:- The law of supply express the positive relationship between price quantity supplied. It is on the assumption that the condition of supply remains constant. The

supply of commodity depends not only on the price of commodity but also on the several other factors collectively called the conditions of supply. Which are known as determinants of supply. They are as under:-

1.The price of factors of production:-

The cost of production of a commodity depends on the prices of the various factors of production. If the price of factors of production rise. The production cost would be the higher and profit margin would be declined. Therefore, supply will be decreased. Conversely, a fall in price of factors of production. The production cost would be the low, therefore supply will be affected.

2.State of Technology:-

The supply of a commodity depends upon the methods of production .When advanced technology is adopted the productivity increase and cost of production reduced. Both the change will affect to the profit margin and ultimately supply will be affected.

3. Non-economic factors:-

Weather-condition,Flood,drought,cyclone,etc.can be the cause for the fluctuation in the supply of agriculture goods.Fire,war and earthquakes may destroy productive assets of society and curtail future supply.

4. Tax and Subsidy:-

When the tax on a commodity increase or decreases it will affect to the production cost therefore supply will be affected. A subsidy on the other hand provides an incentive to production and therefore supply will be increased.

5. Political Stability:-

Political stability in the country maintain law and order, security of life and property, creates a favorable atmosphere for the industrialist to set up new industry. It will increase production and ultimate the supply will rise.

6. Improvement in the means of transport and communication:-

Adequate, quick and cheap means of transport and communication will make easy the movement of commodities from areas of plenty to areas of scarcity. Therefore the supply will increase.