Name ______________________ Date ________________ Class ________________________

STUDY GUIDE Chapter 7, Section 3

For use with textbook pages 186–192

THE LAW OF SUPPLY AND THE SUPPLY CURVE

KEY TERMS

law of supply Economic rule that price and quantity supplied move in the same direction *(page 187)*

quantity supplied The amount of a good or service that a producer will supply at a specific price *(page 187)*

supply schedule Table showing quantities supplied at different possible prices *(page 188)*

supply curve Upward-sloping line on graph that shows the quantities supplied at each possible price *(page 189)*

technology Any use of land, labor, and capital that produces goods and services more efficiently *(page 190)*

law of diminishing returns Economic rule that says as more units of production (such as labor) are added, total output increases at a diminishing rate *(page 192)*

DRAWING FROM EXPERIENCE

How many apple pies could you produce in your kitchen in two hours? The answer depends on the size of your oven, among other things. If you had two ovens, you might double production, but that would require more cooks. Increasing production always requires additional inputs. Businesses increase production only when they foresee additional profits.

This section focuses on the law of supply and how it is affected by profits.

ORGANIZING YOUR THOUGHTS

Use the cause-and-effect diagram below to help you take notes as you read the summaries that follow. Think about how the supply curve is affected by the following determinants of supply.

Cause	Effect
Price of inputs goes down →	
Number of firms in the industry increases →	
Taxes go up →	
Technology improves →	

READ TO LEARN

■ Introduction *(page 186)*

While consumers demand products at the lowest possible prices, producers seek the highest possible profits.

STUDY GUIDE (continued) Chapter 7, Section 3

The Law of Supply (page 186)

The ***law of supply*** states the direct relationship between the ***quantity supplied*** and price: As the price of a good rises, the quantity supplied rises. As the price falls, the quantity supplied falls. A larger quantity of goods or services will be supplied at higher prices than at lower prices.

1. How does the relationship between price and quantity supplied differ from that between demand and quantity supplied?

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The Incentive of Greater Profits (page 187)

For a producer, being able to charge higher prices means higher profits. It also means the additional costs of increasing production will be covered. If a company wants to expand production, it must project the additional costs of such things as overtime pay, more machinery, repairs to machinery, etc. These costs must be met before profits are available.

2. What motivates suppliers in a market economy?

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The Supply Curve (page 188)

Like the demand curve, a supply curve can be built from a ***supply schedule,*** or table that lists the number of items supplied at each given price. On the ***supply curve*** the bottom axis shows the quantity supplied, while the side axis shows the price per item. The curve rises from the bottom left to the top right, showing that as prices rise, so does quantity supplied.

3. Is the relationship between price and quantity supplied direct or inverse?

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Quantity Supplied vs. Supply (page 189)

The supply curve shows that the *quantity supplied* will change when the price changes. Sometimes, however, other factors will enable producers to supply more goods or fewer goods at every price along the curve. In this case, the supply curve itself will shift to the left or right. This movement of the supply curve is called a *change in supply.* It is not the same as a *change in quantity supplied.*

4. What does a change in supply do to the supply curve?

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The Determinants of Supply (page 190)

Four major determinants of supply cause the entire supply curve to shift left or right.

A. Price of Inputs—If the price of raw materials, wages, or other inputs drops, a producer can supply more at a lower production cost. So, the supply curve shifts to the right. When the price of inputs rises, the curve shifts to the left.

B. Number of Firms in the Industry—If more firms enter the industry, greater quantities are supplied at every price, and the supply curve shifts right.

C. Taxes—Increases in taxes on business raise the cost of production, so the supply curve shifts left as fewer quantities are produced at every price.

D. Technology—An improvement in technology increases supply because it reduces the cost of production.

5. What would happen to the supply curve for computer chips if a firm found a more efficient way of producing them?

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The Law of Diminishing Returns *(page 192)*

The law of diminishing returns states that as more units of a factor of production are added, at some point the rate of increased production will diminish. For example, hiring one additional worker will increase production. Hiring 10 more workers may not increase production 10 times as much because too many workers may be crowded into too little space. Total output goes up with each additional worker added, but it does not continue to increase at the same rate.

6. What are the "returns" that diminish according to this law?

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