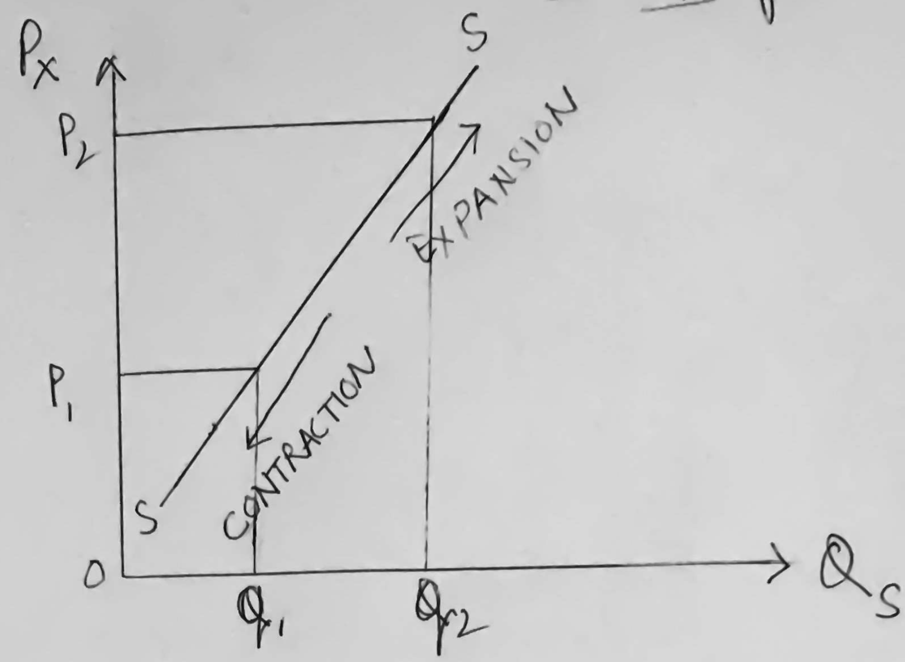
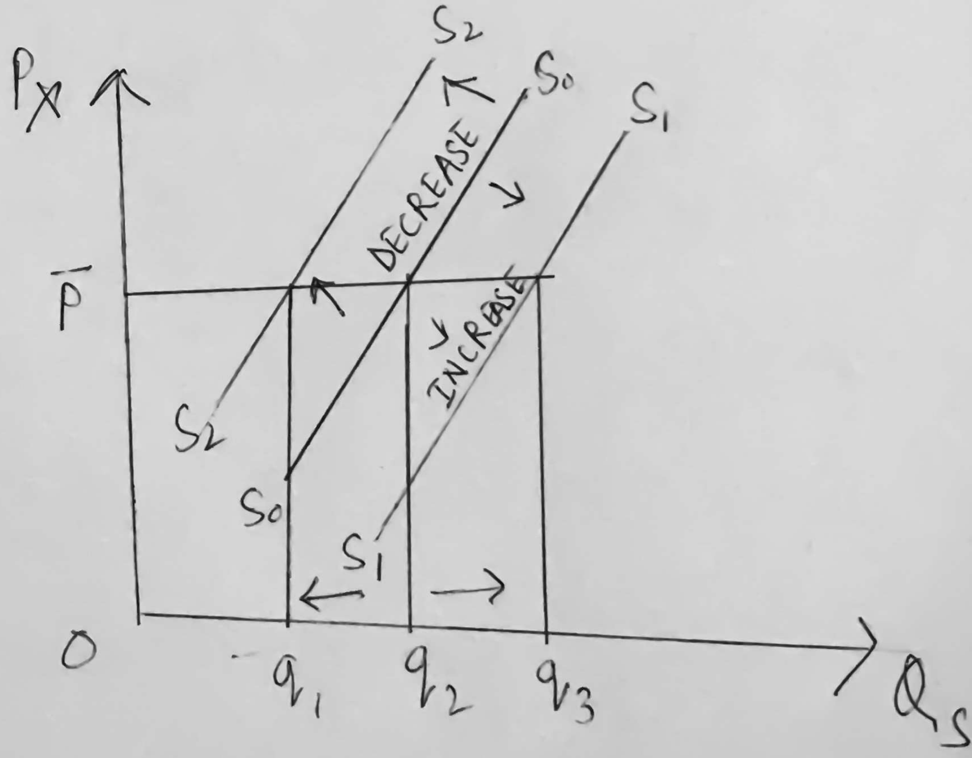
CONTRACTION AND EXPANSION OF SUPPLY

SS = Supply Curve





INCREASE AND DECREASE OF SUPPLY

LAW OF SUPPLY

Law of supply establishes the relation between the price of the commodity and its supply. Other things remain the same the supply of a commodity increases with an increase in its price and decreases with a fall in price. The relationship between price and supply is direct and positive.

Assumptions of the law of supply : The law of supply like the law of demand assumes other things remaining the same. It considers the following factors remaining constant to establish, direct and positive relationship between price and quantity supplied.

(1) No change in the prices of factors of production.

(2) No change in the prices of related goods.

(3) No change in the state of technology.

(4) No change in Government Policy about taxation and subsides.

(5) Producers do not expect any change in the price of the commodity in near future.

Explanation of the Law :

The direct relation between price and quantity supplied, summarised in the table form is known as supply schedule. It has two aspects

(1) Individual supply schedule

(2) Market supply schedule

Individual supply schedule presents the quantities of a commodity offered for sale in the market at various price levels by an individual firm/producer. Table 1 shows a firm's supply schedule.

Price per unit (₹)	Supply of Firm A (Quintals)	Supply of Firm B (Quintals)
20	100	120
40	150	200
60	200	280

Table 1. Individual Supply Schedule

Market supply schedule shows the market supply of a commodity at different price levels. It is the sum of all individual supply schedules in the market producing the commodity. Table 2 depicts the aggregate supply of the market.

Price per unit (₹)	Supply of Firm A (in Quintals)	Supply of Firm B (in Quintals)	Market supply (in Quintals)
20	100	120	220
40	150	200	350
60	200	280	480

Table 2. Market Supply Schedule

Supply curve : The graphic representation of supply schedule is known as supply curve. Like the supply schedules, there can be an Individual supply curve and Market supply curve.

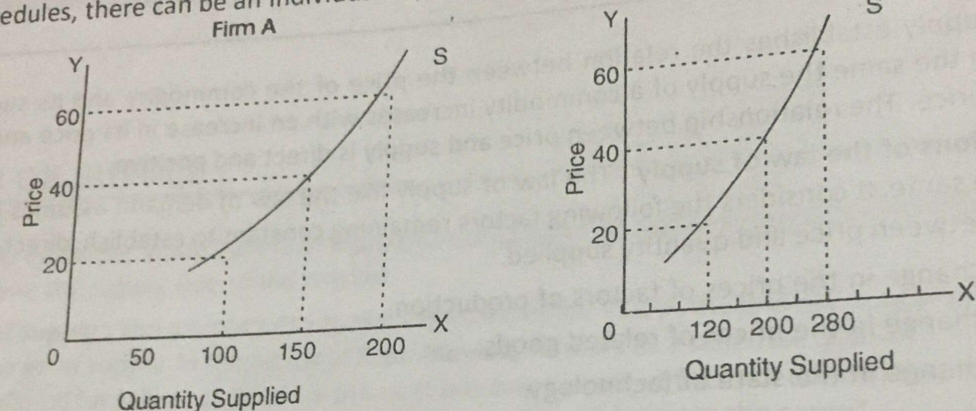


Fig. 1 : Individual Supply Curve

Individual supply curve is depicted with the help of data given in individual supply schedule. Diagram 1 shows the individual supply curve based on the data given in individual supply schedule.

Market supply curve is the horizontal summation of individual supply curves of firm A and B. It is based on the market supply schedule given in the table 2.

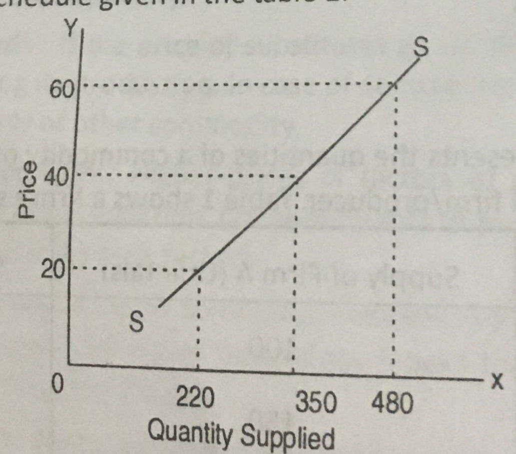


Fig. 2 : Market Supply Curve

Both the supply curves have a positive slope since there is a positive relationship between price and supply made by firms in the market. Comparing to the individual supply curves the market supply curve is quite elastic. This is because of two reasons. Firstly, firms already present in the market sell more and more as price rises. Secondly, with the rise in price, more firm are attracted to the market to sell. But the ultimate thing which affects the supply of a commodity, is the cost of production. Because the firms supply more commodity at higher prices just to get more profit and it depends upon the cost of production and price.

Change in Supply : There are two aspects of change in supply.

(1) Extension and contraction in supply.

(2) Increase and decrease in supply.

(1) Extension and contraction in supply : The most important factor for bringing about change in supply is change in price. Rise in price increases the supply of the commodity and a fall in price decreases the quantity supplied of the commodity.

(2) Increase and decrease in supply : When the amount supplied rises without any change in prices, or the same amount is supplied at lower price, it is called increase in supply. On the other hand, if same amount is supplied at higher price or lower quantity is offered at same price, it is called decrease in supply. As shown in the following figure the original supply curve is *SS* and at *OP* price, *OM* quantity of the commodity is supplied. If the supply curve shifts from *SS* to *S′S′* position, the quantity supplied increases from *OM* to *OM′* at the same price *OP*. At this *S′S′* supply curve the previously supplied quantity *OM* can be obtained at a lower price *OP′*. This shift in supply curve shows the increase in supply. On the other hand, if the supply curve shift from *SS* to *S′′S′′* position the same quantity *OM* can be obtained at higher

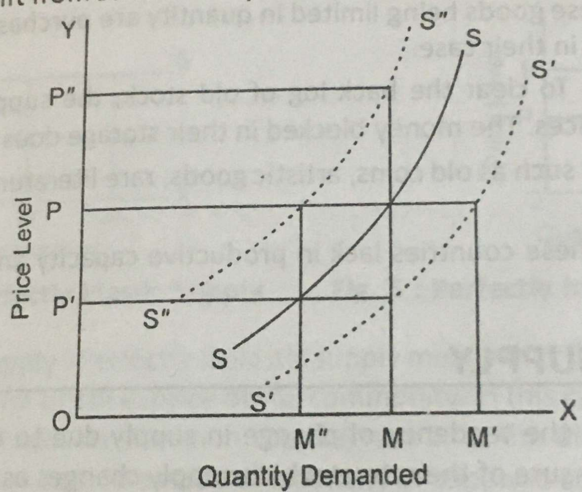


Fig. 3 : Increase and Decrease in Supply

price *OP′′* or at the same price *OP* the quantity supplied is reduced to *OM′′*. This shift in supply curve from *SS* to *S′′S′′* position explains decrease in supply.

REASONS FOR THE LAW OF SUPPLY

The main reasons are as follows :

(1) Change in stock : With price rise more quantity is supplied out of the old stock while lesser supply is made with the fall in price. There is increase in the present stock. The inventories are released with price rise.

(2) Profit and loss : Rising prices generally result in higher profits and increased production. On the other hand, lower prices resulting in losses, decrease the supply. This discourages producers who decide to produce smaller quantities. Therefore, production is suppressed at lower price.