

Laws of Supply and Demand

The most basic concepts in **economics** are those of supply and demand. The law of supply and demand is not a law in the way we usually think of it. It was not voted in by Congress. In this case *law* means “the way things almost always work.”

The law of demand says that as the price of an item rises, demand for it falls. An example might be a luxury item such as a diamond ring. Many people would like to have a diamond ring, but if the cost of a ring is a thousand dollars or more, most people cannot afford it. Even if they do have the money, they will probably choose to pay rent or buy food rather than use it to buy a ring.

The law of demand also states that as the price of an item falls, the demand rises. That is, people will buy more if the price of an item is low. Take the diamond ring example. If it suddenly becomes possible to buy a top quality diamond ring for \$20, many people will want to buy.

The law of supply says that as the price of an item rises, the supply rises. Let’s take the diamond ring example again. When a diamond ring costs \$1,000 or more, fewer people want to buy. The supply, or amount of rings, that the seller possesses, will be greater

As the price falls, so does the supply. But if the diamond rings suddenly are priced at \$20, then the supply will decrease. More people will want to buy. The supply of diamond rings that the seller has will decrease.

The interaction of supply and demand determines prices.

Demand tends to push prices higher. Lots of people want diamond rings. If you are a seller of jewelry, and you know that many people want a diamond ring, you can raise the price because you know that people want the product so much they are willing to pay.

Decreasing demand tends to take prices lower. If fewer people want to buy something, then the seller may reduce the price to try to sell more of the product. If diamond rings aren’t selling well, you may reduce the price because getting a lower price is better than getting nothing at all.

Similarly, an increase in supply tends to push prices lower. Let’s say that there is a sudden increase in the amount of diamonds that are available because new mines have been found and it is cheaper to mine diamonds. The price of a diamond ring may become lower.