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Supply and Demand at the Lemonade Stand

By Cindy Grigg

Have you ever wondered why certain things cost more than others? It's true that sellers decide on the prices of their products. But consumers also help determine prices. It depends on how much people want something (demand) and how much of that thing is available (supply).

Suppose you open a lemonade stand on a cloudy day. You begin selling your lemonade for 25 cents a glass. You get some customers, and you realize you are making a small profit. That is, you are able to pay for the costs of making the lemonade and have a little money left over.

Then the clouds disappear, the sun comes out, and it gets really hot. Now you have many, many customers. You decide to raise your price to 30 cents a glass. You will make more profit. A few people leave the line when they see the price increase, but there are still more people in line than you have lemonade.

Now there is a shortage of lemonade- there is not enough lemonade to fill the demand for it. You have to go to the supermarket to buy more ingredients. You'll have to close the lemonade stand, or maybe you could hire someone to help you. That will cost money and lower your profits. If you raise the price of lemonade again, you might be able to make enough money to hire some help. You decide to raise the price to 50 cents a glass. Several people leave the line, and several more just walk by without stopping. You get a friend to go to the store for you to buy more lemons and sugar.

Now your friend is back, you've made more lemonade, and people are still in line buying it. Business is good; profits are up! Your neighbor down the street decides to open his own lemonade stand. Some of your customers are overheard saying that your neighbor is selling a larger glass of lemonade for 35 cents. Some people leave your stand to go to your neighbor's. Competition for customers causes you to change your price again to 30 cents. You won't make as large a profit per glass, but you're selling more glasses of lemonade than you were at 50 cents each.

But wait! All of a sudden, rain clouds cover the sun. There's a loud clap of thunder, and within five minutes, it's pouring down rain. Suddenly, nobody wants lemonade. Now there's a surplus of lemonade. This means that there is more lemonade available than is needed for people who want to buy it. The supply is greater than the demand. You lower the price to 10 cents a glass, hoping to make enough to cover your costs. You hope the lower price will convince some people to stop running indoors and stop to buy some of your lemonade. You hope it won't rain tomorrow!

Prices drive our economy. Prices make things happen. If buyers want to own something badly enough, they will pay more for it. When sellers want to sell something badly enough, they will lower their prices. Prices play such an important role in the United States, our economy is often called a price-directed market economy.

One of the things that prices do is carry information to buyers and sellers. When prices are low, they send a "buy" signal to consumers who can now afford the things they want. When prices are high enough, they send a "sell" signal to sellers who can now earn a profit at the new price. If the demand is greater than the supply, the price goes up. If the supply is greater than the demand, the price goes down.

Prices encourage business people to make goods at the lowest possible cost. The less it costs to produce an item, the more likely it is that the producers will earn a profit. Profit is the incentive for people who start a business. Businesses that are efficient will produce more goods with fewer raw materials than businesses that are inefficient. While these efforts are in the best interest of the sellers, all of us may benefit because we are provided with the things we want at lower costs.

Finally, prices help to determine who will receive goods and services. Buyers who have more money to pay higher

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prices will always get what they want. Buyers with less money will have to wait until prices go down before they can afford to buy what they want. The price that a worker receives for doing a job is called a wage. The amount of his wage determines how much the worker has to spend. What the worker can buy with those wages will depend upon the prices of the goods and services the worker would like to own.

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Questions

_____ 1. It's better for consumers when there is a ______ of the goods they want to buy.

A. surplus
B. shortage

_____ 2. It's better for sellers when there is ______ of the goods they sell.

A. shortage
B. surplus

_____ 3. What does it mean to have a shortage of goods?

A. The price is too low for the sellers to make a profit.
B. The price is too high on the goods people want to buy.
C. There's more of the goods than people want to buy.
D. There's not enough of the goods that people want to buy.

_____ 4. What happens when there is a surplus of goods?

A. There's too little supply of goods so prices go up.
B. There's too much of the goods so prices go down.
C. There's too little supply of goods so prices go down.
D. There's too much of the goods so prices go up.

_____ 5. What happens when there is a shortage of goods?

A. There's too little supply of goods so prices go up.
B. There's too little supply of goods so prices go down.
C. There's too much of the goods so prices go up.
D. There's too much of the goods so prices go down.

6. The economy of the United States is often called ______.

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7. What happens when supply is greater than demand?

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_____ 8. Prices encourage business people to make goods:

A. at the highest possible cost
B. at the lowest possible cost
C. at the highest efficiency possible
D. both b and c are correct
E. none of the above

Explain why efficiency is important to business owners.

Explain how prices "drive" the U.S. economy.