Demand

Assessment Objectives

Specific Expectations	
2.A	Define (using graphs as appropriate) the law of demand.
2.A	Explain (using graphs as appropriate) the relationship between the price of a good or service and the quantity demanded.
2.B	Explain (using graphs as appropriate) the determinants of demand.

Markets

- **Markets** include any kind of arrangement where buyers and sellers of goods, services or resources are linked together to carry out an exchange.
  - A market is a meeting place of buyers and sellers
  - Markets can be local, national or international
- Markets are characterized by their competitive structure. The degree of competition depends upon:
  - The number of buyers and sellers in the market
  - The type of product
  - Barriers to entry in the market
- A **competitive market** is a market composed of many buyers and sellers acting independently, none of whom has any ability to influence the price of the product.

Demand

- The **demand** of an individual consumer indicates the various quantities of a good (or service) the consumer is willing and able to buy at different possible prices during a particular time period, *ceteris paribus*.
  - Demand is concerned with the behaviour of buyers
  - Consumers (or households) are buyers of goods and services in product markets
  - Firms (or businesses) are buyers of the factors of production in resource markets
  - **Quantity demanded** is the amount of the good that consumers are willing to purchase at each price

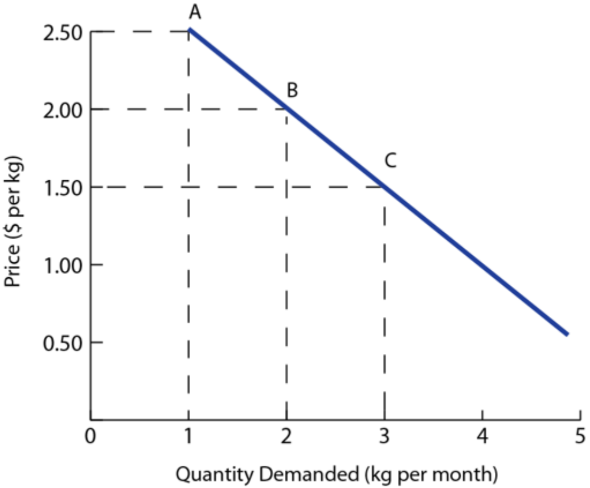
Demand curve

- **Demand schedule:** is a list of the quantities of a good or service demanded at different prices, holding everything else constant (all other factors that influence consumers planned purchases)

Price ($CAD per kg)	Quantity Demanded (kg per month)	Point on Graph
$2.50	1	A
$2.00	2	B
$1.50	3	C

- **Demand curve:** is a curve showing the relationship between the price of a good and the quantity of the good demanded, *ceteris paribus*.
  - A change in the quantity demanded means that there is a movement along the demand curve (for instance, from A to B).

Demand curve (Continued)

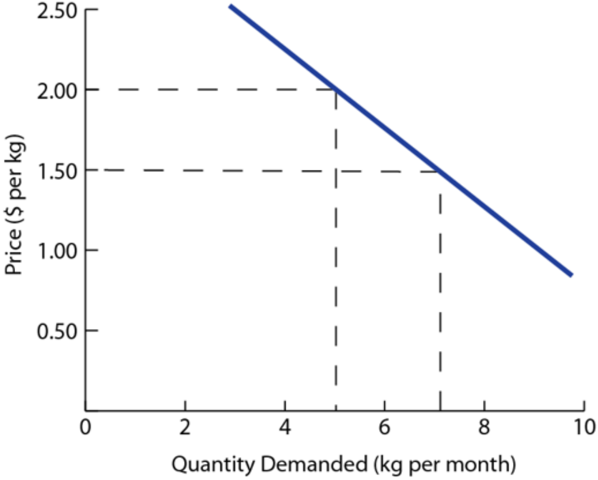


Market demand

- **Market demand:** is the sum of all individual demands for a good. The market demand curve illustrates the law of demand, shown by the negative relationship between the price and quantity demanded.

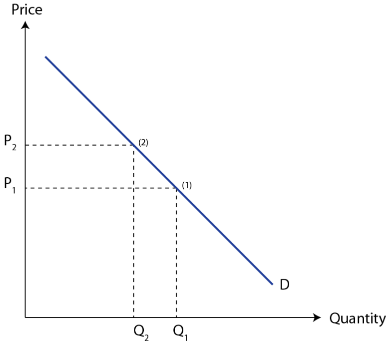
Price ($CAD per kg)	Quantity Demanded (Household A)	Quantity Demanded (Household B)	Market Demand
$2.50	1	2	3
$2.00	2	3	5
$1.50	3	4	7

Market demand (Continued)



Law of demand

- **Law of demand:** a law stating that there is a negative relationship between the price of a good and quantity of the good demanded, over a particular time period, *ceteris paribus*.
  - As the price of a good increases, the quantity of the good demanded falls (and vice versa).



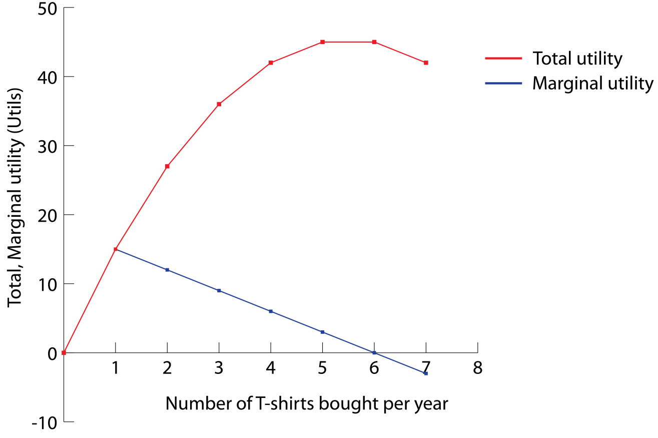
Law of diminishing marginal utility

- **Utility:** is the satisfaction that consumers gain from consuming something.
    - It is a subjective concept, because satisfaction is something that depends entirely on personal tastes and preferences.
    - **Total utility** is the total satisfaction that consumers get from consuming something.
    - **Marginal utility:** is the extra satisfaction that consumers receive from consuming one more unit of the good.
- According to the **law of diminishing marginal utility**, as consumption of a good increases, marginal utility, or the extra utility the consumer receives, decreases with each additional unit consumed.
    - This underlies the law of demand, as it shows that a consumer will be willing to buy an additional unit of a good only if its price falls.

Law of diminishing marginal utility (Continued)

Number of T shirts bought per year	Total utility (Utils)	Marginal utility (Utils)
0	0	–
1	15	15
2	27	12
3	36	9
4	42	6
5	45	3
6	45	0
7	42	–3

Law of diminishing marginal utility (Continued)



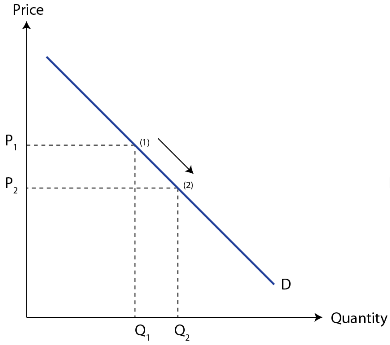
Income and substitution effects

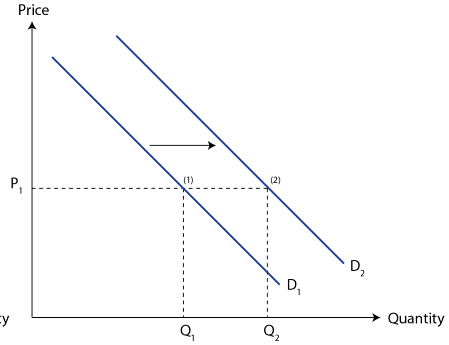
- The income and substitution effects are an alternative explanation of the law of demand and explain why the demand curve slopes downward.

  1. **Substitution effect:** there is an inverse relationship between price and quantity demanded because as price falls consumers substitute the now less expensive good for other products.
     - There is always a negative relationship between price and quantity demanded as a result of the substitution effect.
  2. **Income effect:** as price falls (increases) real income increases (falls) causing the consumer to buy more (less) of the good.
     - The substitution effect and the income effect reinforce each other; a fall in the price leads to an increase in quantity demanded, both because of the substitution effect and because of the income effect.

Changes in demand vs. Changes in quantity demanded

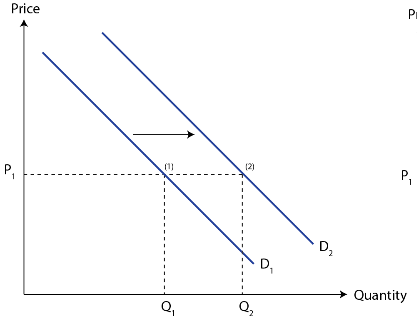
- Any change in price produces a **change in the quantity demanded**, shown as movement on the demand curve.
- Any change in a non-price determinant of demand leads to a **change in demand**, represented by a shift of the entire demand curve.

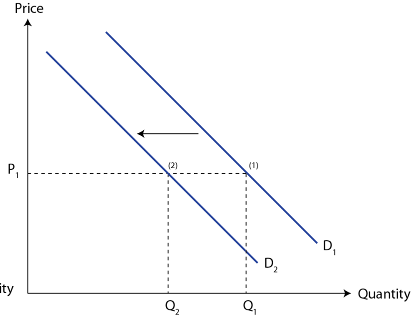




Changes in demand

- An increase (decrease) in demand shifts the demand curve upwards (downwards) and to the right (left). The quantity demanded increases (decreases) at every price.





Non-price determinants of demand

- The **non-price determinants of demand** are the variables other than price that can influence demand.
  - They are the variables assumed to be unchanging by use of the ceteris paribus assumption.
  - Changes in the non-price determinants of demand cause shifts in the demand curve where the entire demand curve moves to the right or to the left.
- The non-price determinant of market demand include:

1. **Consumer tastes and preferences**
   - If preferences and tastes change in favour of a product (the good become more popular), demand increases and the demand curve shifts to the right.

Non-price determinants of demand (Continued)

2. **Consumers' incomes**
   - A good is a **normal good** when demand for it increases in response to an increase in consumer income.
   - A good is an **inferior good** when demand for it decreases as consumer income increases.
3. **Price of related goods**
   - Two goods are **substitutes** if they satisfy a similar need. A fall (increase) in the price of one results in a fall (increase) in the demand for the other.
   - Two goods are **complements** if they tend to be used together. A fall (increase) in the price of one results in a increase (fall) in the demand for the other.

Non-price determinants of demand (Continued)

4. **Number of consumers (Size of the market)**
   - If there is an increase in the number of consumers, demand increases and therefore the market demand curve shifts to the right.
   - If the number of consumers decreases demand decreases and the curve shifts to the left.
5. **Expectations of future prices**
   - Expectations of higher (lower) future prices leads an an increase (decrease) in current demand.

Test your understanding

Question: Using diagrams, show the impact of each of the following

1. The number of consumers in the market for product A increases
2. Consumer income increases and product A is an inferior good
3. Consumer income decreases and product A is a normal good
4. A news report claims that use of product A has harmful effects on health
5. The price of substitute good B falls
6. The price of complementary good B increases

Summary

- **Enduring Understanding**
  - In a competitive market, demand for and supply of a good or service determine the equilibrium price.
- **Essential Knowledge**
  - The law of demand states there is an inverse relationship between price and quantity demanded, leading to a downward-sloping demand curve.
  - Factors that influence consumer demand, such as changes in consumer income, cause the market demand curve to shift.