

Chapter 4

Demand

'It is not that pearls fetch a high price because men have dived for them; but on the contrary, men dive for them because they fetch a high price.'

—Richard Whately (1787-1863)

Effective Demand/ Demand: refers to the ability and willingness of individual consumers to purchase a good.

Desire: refers to the willingness of individual consumers to own that good.

Individual Demand And Market Demand:

An Individual Demand Schedule: is a list which shows the different quantities of a good that an individual consumer is prepared to buy at each price.

An Individual Demand Curve: is a graph which shows how much of a good an individual consumer is prepared to buy at each price. It is derived from that individual's demand schedule for that good.

A Market/Aggregate Demand Schedule: is a list which shows the total quantities of a good that all consumers in the market are prepared to buy at each price. It is derived by adding together all the individual demand schedules for that good.

A Market/Aggregate Demand Curve: is a graph which shows the total demand in the market for that good at each price. It is derived by adding together (horizontally) all the individual demand curves for that product.

schedule = list

curve = graph

4.1 The Law of Demand

The Law of Demand:



If the price of a good rises, the quantity demanded falls, while if the price falls, the quantity demanded rises.

If P rises, Q falls: $P \uparrow \Rightarrow Q \downarrow$

If P falls, Q rises: $P \downarrow \Rightarrow Q \uparrow$

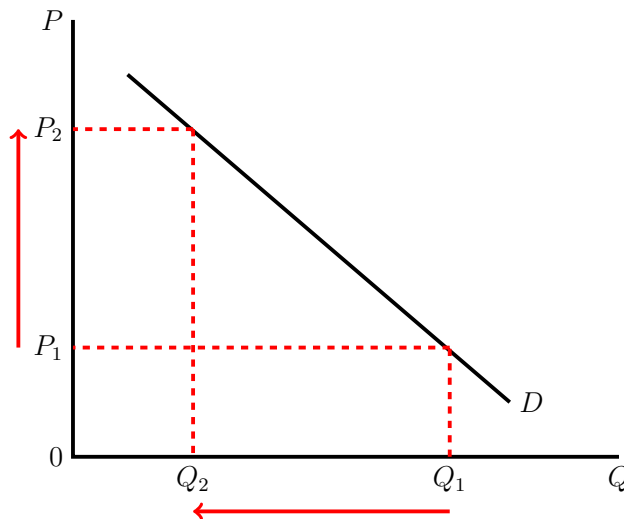
Thus, there is an **inverse** (or **negative**) relationship between price and quantity demanded.

If we graph P against Q , the slope is given by:

$$m = \frac{P}{Q} = \begin{cases} \uparrow \downarrow = \downarrow \\ \downarrow \uparrow = \downarrow \end{cases}$$

Therefore, the graph of P vs. Q will always have a negative slope (so long as the Law of Demand is followed). A negative slope means that the curve slopes down towards the right.

Figure 4.1: **The Normal Demand Curve**



Exceptions To The Law of Demand:

It is important to realise that there are many goods which do not obey the law of demand. These fall into three categories:

1. **Giffen Goods:** are goods in which a rise in the price causes an increase in demand, while a fall in the price causes a fall in demand.

- Named after Sir Robert Giffen, a Scottish economist.



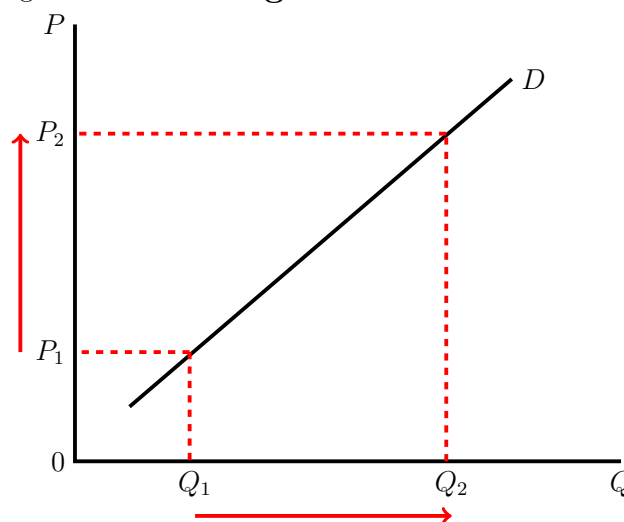
Chapter 4. Demand

- Observed in the case of necessities.
 - **E.G.** bread and rice in poor countries.
2. **Snob Goods:** are goods which are attractive to some consumers because they are expensive.
- The price is considered to be an indicator of their exclusive nature or their quality.
 - Also referred to as status symbols or goods of ostentatious value/consumption.
 - The purchase of such goods is often called **conspicuous consumption**.
 - **E.G.** expensive cars, wine, jewellery.
3. **Goods Affected By Consumer's Expectations:** expectations of a further price rise may cause people to increase their demand for a good following an initial price rise. Similarly, a fall in price may lead to a fall in demand if people think that the price of the good will fall further.

E.G. speculation in shares on the stock market; speculation in land and property values.

All such goods are said to have a perverse or regressive demand curve.

Figure 4.2: **The Regressive Demand Curve**



4.2 Factors Affecting Demand

Factors Affecting The Demand For A Good:



1. The Price Of The Good Itself

$$Q_x = f(P_x)$$

Goods which obey the law of demand	Goods which do not obey the law of demand
If P_x rises (\uparrow), Q_x falls (\downarrow)	If P_x rises (\uparrow) Q_x rises (\uparrow)
If P_x falls (\downarrow), Q_x rises (\uparrow)	If P_x falls (\downarrow) Q_x falls (\downarrow)

2. The Price Of Other Goods

Complementary Goods: are goods which are used jointly. The use of one involves the use of the other.

E.G. cars and petrol; cameras and film; gin and tonic; bread and butter.

- Complementary goods are said to be in **joint demand**.
- If two goods are complementary, then an increase in the price of one good causes a decrease in the demand for the other, and vice-versa.

Substitute Goods: are goods which satisfy the same need, and thus can be considered as alternatives of each other.

E.G. coffee and tea; butter and low-fat spreads.

- If two goods are substitutes, then an increase in the price of one good leads to an increase in the demand for the other, and vice-versa.

$$D_x = f(P_c, P_s)$$

3. The Level Of Income

Money Income: is a person's earnings expressed as euro per week/month/year.

Real Income: is the purchasing power of a person's money income.

Normal Good: is a good with a positive income effect. A rise in income causes more of it to be demanded, while a fall in income causes less of it to be demanded.

E.G.

Inferior Good: is a good with a negative income effect. A rise in income causes less of it to be demanded, while a fall in income causes more of it to be demanded.



Chapter 4. Demand

- Inferior in this sense does not refer to the quality of the good, but only to the reaction of consumers to the good as their incomes rise.

E.G. potatoes and white bread.

$$D_x = f(Y)$$

Normal goods	Inferior goods
If Y rises (\uparrow), D_x rises (\uparrow)	If Y rises (\uparrow) D_x falls (\downarrow)
If Y falls (\downarrow), D_x falls (\downarrow)	If Y falls (\downarrow) D_x rises (\uparrow)

4. Consumer Taste

$$D_x = f(t)$$

5. Consumer Expectations:

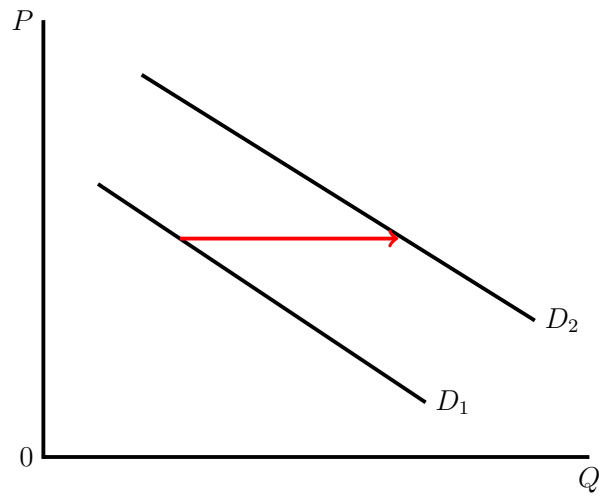
$$D_x = f(E)$$

Summary: The Demand Function

The demand function:

$$D_x = f(P_x, P_c, P_s, Y, t, E)$$

- If P_x changes, then there is said to be a **change in the quantity demanded** of the good X . This is a **movement** along the existing demand curve.
 - If any of the other variables change, then there is said to be a **change in demand**. This involves a **shift** to a new demand curve.
1. **The Substitution Effect:** is when the good becomes cheaper relative to other goods.
 2. **The Income Effect:** is when the income of the consumer is increased.

Figure 4.3: **Shift in Demand**Figure 4.4: **Shift in Demand**