MARKET ECONOMICS

DEMAND THEORY AND DEMAND ANALYSIS

UNIT [2] PART [2]

ECON-HUB

THEORY RE-CAP

Theory **R**ecap **Q**uestions **[TRQs]**
Practice **Q**uestions [**PQs**]

Essentials

‘LETS MASTER MARKET ECONOMICS’

[PQ: 04] **List** the **generic factors affecting (determinants of) market demand** **[04 marks]**

1. The product's own **price (P)**
2. **Non-price factors** (factors other than price)

- **Price** of **related** Products **(Pn)**
- consumers' **nominal** (Money) **income (Y)**
- Consumers' **taste** and preferences **(T)**
- Consumers' **expectations (Ex)**
- **Social** and **demographical** factors (**R**)
- **Number of consumers/Size of the market (N)**
- **Other relevant factors** such as **Natural, man**–made factors, **political** and **acts of state (O)**

[01 mark each, maximum 04 marks]

[TRQ: 05] What is meant by the term **'Theory of Demand'** **[03 marks]**

$$\mathbf{Qd} = f\,(\mathbf{P, Pn, Y, T, Ex, R,}\ \boldsymbol{N}\mathbf{, O})$$

Also Relevant [1]:

[A] **Quantity demanded (Qd):**
This is the amount (quantity or number of units) of a good that buyers are willing and able to purchase, **at a specific or given price.**

[B] **Non-price Factors Affecting Demand:**
These are the factors affecting the demand of a product **other than the given product's own price.** Any other factor or condition affecting demand, in addition to the price of the product under consideration.

[C] **'Constancy Assumption'** or **'Ceteris Paribus'**
Which says, that only one factor affecting demand is assumed to change when analyzing the functional relationships indicated through the demand function, while all other factors are held constant.

[PQ: 05] **Distinguish** between **'Demand'** and **'Quantity demanded'**

[04 marks]

Demand (D) refers to the **overall relationship between** the **quantity demanded** and **price** of a certain product when all other factors affecting demand, apart from price of the own product is held constant, **during a given period of time.**

[01 mark]

Quantity demanded (Qd) essentially refers to the **amount of a good** that buyers are willing and able to purchase, **at a specific price**.

[01 mark]

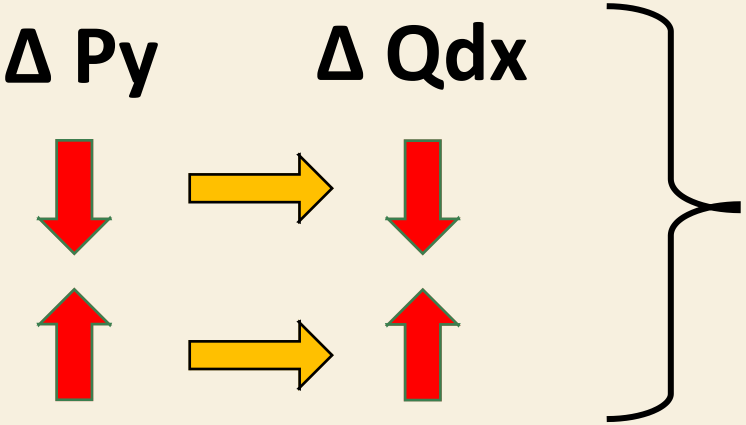
In a more technical sense Qd is a specific price: quantity combination, which indicates **one point** of a certain demand schedule or curve, i.e., the quantity demanded at a **given price**, while **demand** is represented by the **entire demand curve**.

[01 mark]

Quantity demanded is generally used to **measure** the demand for a certain product.

[01 mark] [Total 04 marks]

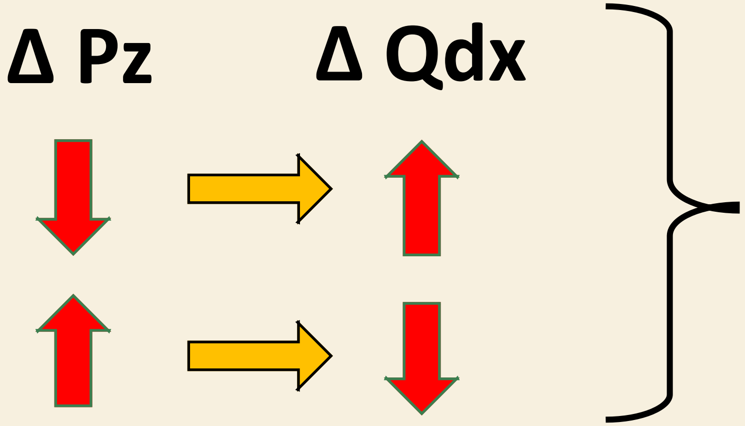
SUBSTITUTE GOODS



Change in price of product (Y) **ΔPy** and change in quantity demanded of product (X) **ΔQdx** has a **positive (direct) relationship**

Therefore (Y) and (X) are **‘Substitute Goods’**

COMPLEMENTARY GOODS



Change in price of product (Z) **ΔPz** and change in quantity demanded of product (X) **ΔQdx** has a **negative (indirect) relationship**

Therefore (Z) and (X) are **‘Complementary Goods’**

[PQ: 06] Distinguish with **relevant examples** the difference between **'Substitute Goods'** and **'Complementary Goods'** **[04 marks]**

Examples: Butter and margarine, Potatoes and sweet potatoes, Tea and coffee, Movie tickets and drama tickets, Bus travel and train travel.

Examples: Smart phone and mobile data (or Wi-Fi access), Tea and sugar, gun and bullets, Pen and ink, TV and Satellite Set-top (receiver) Box

[02 marks] [Total 04 marks]

NORMAL GOOD

Δ Y		Δ Qdx
↓	→	↓
↑	→	↑

Change in consumers’ income (Y) **ΔY** and change in quantity demanded of product (X) **ΔQdx** has a **positive (direct) relationship**

Therefore product (X) is a **‘Normal Goods’**

INFERIOR GOOD

Δ Y		Δ Qdx
↓	→	↑
↑	→	↓

Change in consumers’ income (Y) **ΔY** and change in quantity demanded of product (X) **ΔQdx** has a **negative (indirect) relationship**

Therefore product (X) is a **‘Inferior Goods’**

[PQ: 07] Distinguish between **'Normal Goods'** and **'Inferior Goods'** form an economic point of view

[04 marks]

The distinction between an inferior good and normal good is highly subjective. The same product can be perceived as an inferior good or normal good depending on (or subject to) the particular demanders income level (high or low income earners). Therefore a given product cannot be inferior at all income levels, of a given income earner.

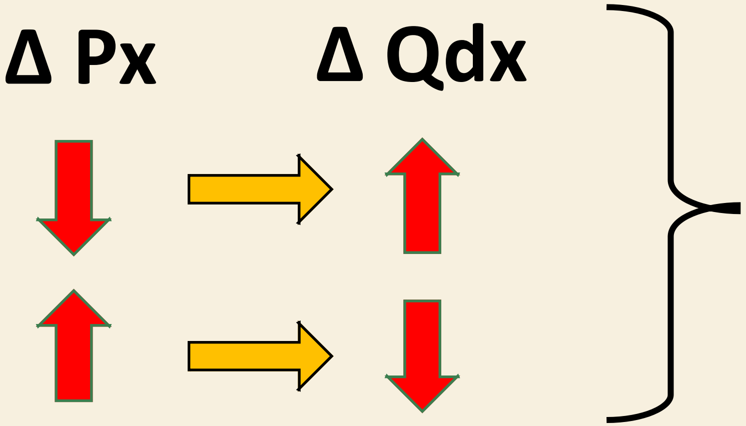
[01 mark] [Total 04 marks]

COMMON EXAMPLES …..

- **Bread** – consumers may shift from this relatively cheap, filling food to more expensive three or four course meals or other convenience foods as their incomes increase.
- **Margarine** – consumers shift from margarine to butter, if their income rises [this might not happen at a higher rate today, due to health concerns]
- **Bus transport** – consumers switch from buses to their own cars when they can afford to buy their own car.

Theory Re-cap

LAW OF DEMAND



Change in price of product (X) **ΔPx** and change in quantity demanded of product (X) **ΔQdx** has a negative **(indirect) relationship,** while factors other than price affecting the demand of product (X) remain constant.

Why Law of Demand:

The **main reasons** for this indirect relationship between price of a given product and quantity demand can be given as the '**Price Effect**', which is a combination of two sub-effects:

- '**Substitution Effect**' of a change in price
- **'Income Effect'** of a change in price

[PQ: 08] In the context of a normal good, **define 'Law of Demand'** and **state** the main methods of representing law of demand

[04 marks]

Alternatively:

Law of demand states that when the price of a given product increases or is at a higher level the quantity demanded of the product tend to fall or be at a lower level and when the price decreases or is at lower level the quantity demanded of the product will rise or be at a higher level.

The **main reasons** for the aforementioned law of demand can be given as the ‘**Price Effect**’, which is a combination of two sub-effects:

- **‘Substitution Effect**’ of a change in price
- **‘Income Effect’** of a change in price