Demand Theory

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Meaning

- Just desiring or wanting things is not enough to create a demand. Suppose, a mill worker desires or wants to have a car but does not have the necessary means to buy it. This desire is ineffective and will not become a demand. Similarly, a miser may desire to have the car, has means to purchase it, but will not spend the money. His desire would also not constitute a demand. Thus, we define demand for a commodity or service as an effective desire, i.e., a desire backed by means as well as willingness to pay for it.
- **The demand arises out of the following three things:**

  i. Desire or want of the commodity.

  ii. Ability to pay,

  iii. Willingness to pay.
- Only when all these three things are present then the consumer presents his demand in the market.

Definitions

- “Demand for a commodity is the quantity which a consumer is willing to buy at a particular price at a particular time.”
- “The demand for anything, at a given price, is the amount of it which will be bought per unit of time at that price.” -PROF. BENHAM
- “By demand, we mean the quantity of a commodity that will be purchased at a particular price and not merely the desire of a thing.”-HANSEN

Demand Schedule

- The demand schedule in the table represents different quantities of commodities that are purchased at different prices during a certain specified period
- **The demand schedule can be classified into two categories:**

1. Individual demand schedule;
2. Market demand schedule.

- **Individual Demand Schedule:** It represents the demand of an individual for a commodity at different prices at a particular time period.

Individual Demand Schedule

Price of Oranges (₹ per kg.)	Quantity of Oranges Demanded (kg.)
15	2
12	3
9	4
6	5
3	6

- **Market Demand Schedule:** Market Demand Schedule is defined as the quantities of a given commodity which all consumers will buy at all possible prices at given moment of time. The market

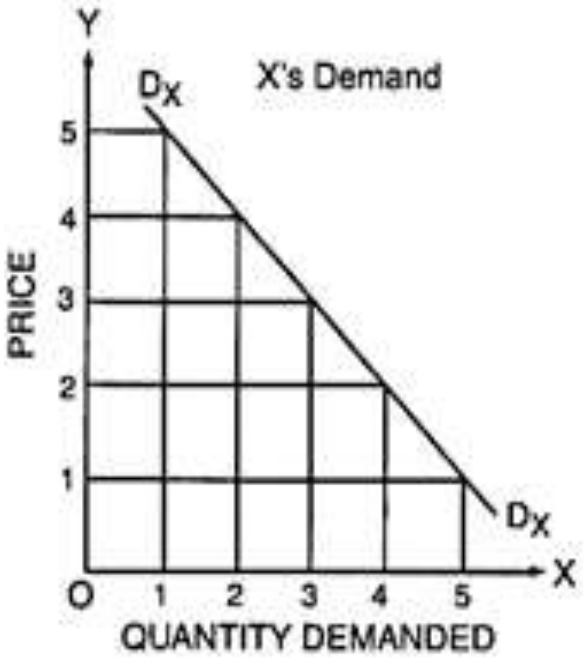
Market Demand Schedule

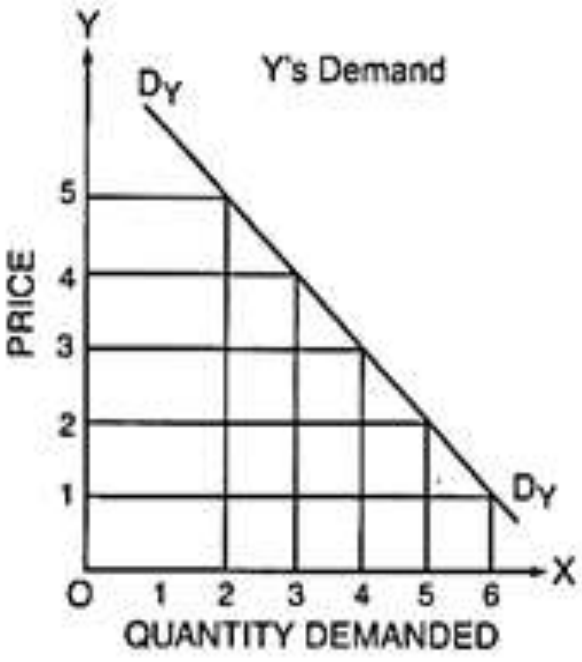
Price of Milk per litre (in ₹)	Demand of Mr. X. (in Litres)	Demand of Mr. Y. (in Litres)	Market Demand (in Litres)
5	1	2	1 + 2 = 3
4	2	3	2 + 3 = 5
3	3	4	3 + 4 = 7
2	4	5	4 + 5 = 9
1	5	6	5 + 6 = 11

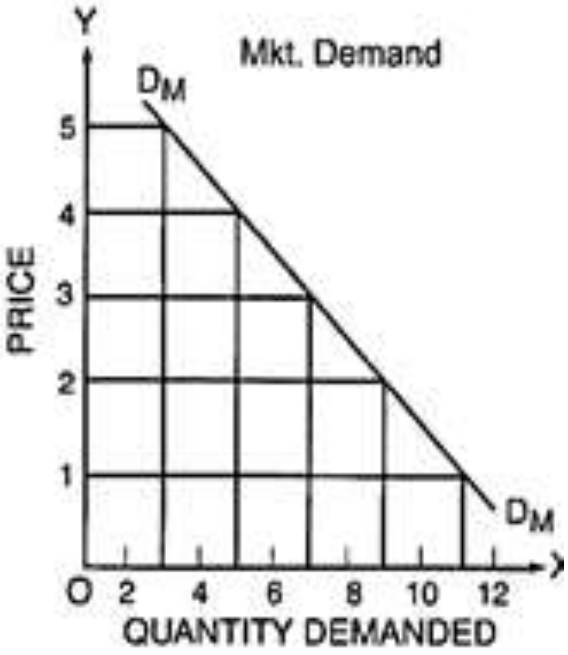
Demand Curves

- The demand curve is a graphic statement or presentation of the relationship between product price and the quantity of the product demanded. It is drawn with price on the vertical axis of the graph and quantity demanded on the horizontal axis. It only tells us how much quantity of goods would be purchased by the consumer at various possible prices.
- **The demand curve can be as follows:**
  1. Individual Demand Curve
  2. Market Demand Curve
- **Individual Demand Curve:** An Individual Demand Curve is a graphical representation of the quantities of a commodity that an individual (a particular consumer) stands ready t
  of time against different prices.

- **Market Demand Curve:** A Market Demand Curve is a graphical representation of the quantities of a commodity which all the buyers in the market stand ready to take off at all possible prices at a given moment of time.







Law of Demand

- ***Definition:*** The law of demand states that other factors being constant (cetris peribus), price and quantity demand of any good and service are inversely related to each other. When the price of a product increases, the demand for the same product will fall.

Description: Law of demand explains consumer choice behavior when the price changes. In the market, assuming other factors affecting demand being constant, when the price of a good rises, it leads to a fall in the demand of that good. This is the natural consumer choice behavior. This happens because a consumer hesitates to spend more for the good with the fear of going out of cash.

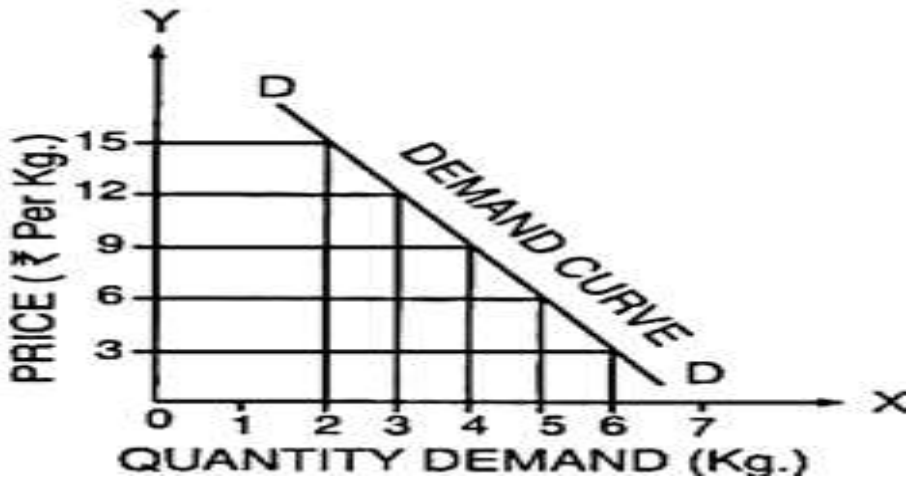
Assumptions

- Habits, tastes and fashions remain constant
- Money, income of the consumer does not change.
- Prices of other goods remain constant
- The commodity in question has no substitute
- The commodity is a normal good and has no prestige or status value.
- People do not expect changes in the prices.

Table 7-1 : Individual Demand Schedule

Price of Oranges (₹ per kg.)	Quantity of Oranges Demanded (kg.)
15	2
12	3
9	4
6	5
3	6

- When price of oranges is 15 per unit, a consumer purchases 2 Kgs of oranges. When the price falls to 12, he purchases 3 Kgs of oranges. Similarly, when the price further falls, quantity demanded by him goes on rising until at price Rs 3, the quantity demanded by him rises to 6 Kgs of oranges. The above table depicts an inverse relationship between price and quantity demanded as the price of the oranges goes on falling, its demand goes on increasing.



We can now plot the data from Table on a graph with price on the vertical axis and quantity on the horizontal axis. The graph depicts that when price of oranges is 15 per unit, a consumer purchases 2 Kgs of oranges. When the price falls to 12, he purchases 3 Kgs of oranges. Similarly, when the price further falls, quantity demanded by him goes on rising until at price Rs 3, the quantity demanded by him rises to 6 Kgs of oranges. The above graph depicts an inverse relationship between price and quantity demanded as the price of the oranges goes on falling, its demand goes on increasing.

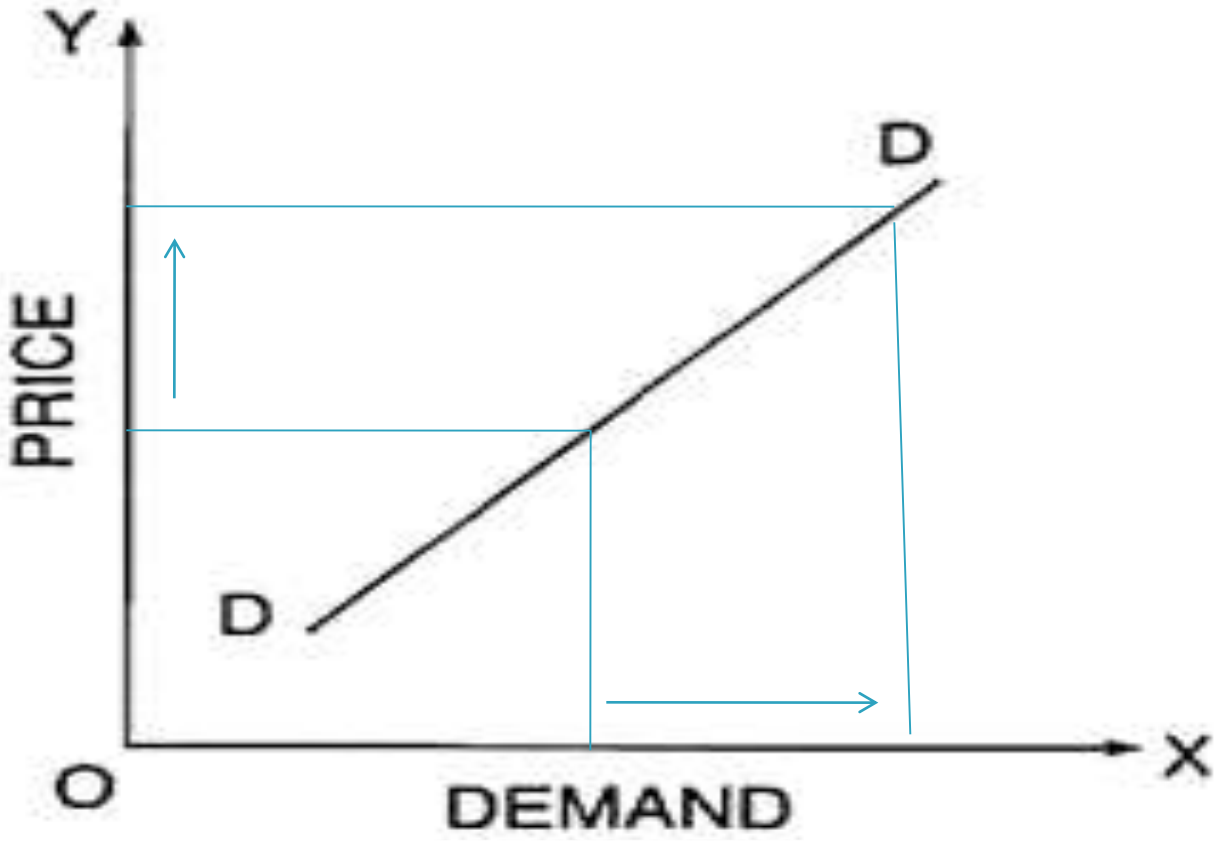
Exceptions to law of demand

- **Giffen goods**: these are those inferior goods on which the consumer spends a large part of his income and the demand for which falls with a fall in their price. The demand curve for these has a positive slope. The consumers of such goods are mostly the poor. a rise in their price drains their resources and the poor have to shift their consumption from the more expensive goods to the giffen goods, while a fall in the price would spare the household some money for more expensive goods. which still remain cheaper.

- **Articles of Distinction\ Commodities which are used as status symbols**: Some expensive commodities like diamonds, air conditioned cars, etc., are used as status symbols to display one's wealth. The more expensive these commodities become, the higher their value as a status symbol and hence, the greater the demand for them. As their prices go up and become costlier, rich people think it is more prestigious to have them. So they purchase more. On the other hand, when their prices fall sharply, they buy less, as they are no more prestigious goods.

- **Expectations regarding future prices**: If the price of a commodity is rising and is expected to rise in future the demand for the commodity will increase.

- **Emergency**: At times of war, famine etc. consumers have an abnormal behavior. If they expect shortage in goods they would buy and hoard goods even at higher prices. In depression they will buy less at even low prices.
- **Ignorance\ Quality-price relationship**: some people assume that expensive goods are of a higher quality then the low priced goods. They are fascinated with the high priced goods from the idea of getting a superior quality. However, this may not be always true.



Exceptional Demand Curve

Types of Demand

- **Price demand**- It refers to various types of quantities of goods or services which a customer will buy at a coated price and given time, considering other things remain constant.
- **Income demand**- It refers to various types of quantities of goods or services which a customer will buy at different stages of income, considering other things remain constant.
- **Cross demand**- This means that the product's demand doesn't depend on its own cost but depends on the cost of the other related commodities.
- **Direct demand**- When goods or services satisfy an individual's wants directly is known as direct demand.
- **Derived demand or Indirect demand**- The goods or services demanded or needed for manufacturing goods and satisfy the consumer directly is known as derived demand.
- **Joint demand**-To produce a product there are many things that are related to each other, for example, to produce bread, we need services like an oven, fuel, flour mill, etc. So, the demand for other additional things to produce a product is known as joint demand.
- **Composite demand**-A composite demand can be described when goods and services are utilised for more than one cause. Example- milk.

Determinants of Demand

- **Price of the Product**: People use price as a parameter to make decisions if all other factors remain constant or equal. According to the law of demand, this implies an increase in demand follows a reduction in price and a decrease in demand follows an increase in the price of similar goods.

  P ↑ D ↓

- **Income of the Consumers**:

  Normal goods: Rising incomes lead to a rise in the number of goods demanded by consumers. Similarly, a drop in income is accompanied by reduced consumption levels.

  Y ↑ D ↑

  Inferior goods: Rising incomes lead to a fall in the number of goods demanded by consumers. Similarly, a drop in income is accompanied by increased consumption levels.

  Y ↑ D ↓

  Necessities: Demand remains almost constant irrespective of the level of income. Eg Salt.

  Y ↑ D unchanged

- **Prices of related goods or services:**

  Complementary products – An increase in the price of one product will cause a decrease in the quantity demanded of a complementary product. Example: Rise in the price of bread will reduce the demand for butter. This arises because the products are complementary in nature.

  $P_x \uparrow \; D_y \downarrow$

  Substitute Product – An increase in the price of one product will cause an increase in the demand for a substitute product. Example: Rise in price of tea will increase the demand for coffee and decrease the demand for tea.

  $P_x \uparrow \; D_y \uparrow$

- **Expectation of future**:

  a. Future price: consumers' current demand will increase if they expect higher future prices; their demand will decrease if they expect lower future prices.

  b. Future income: consumers' current demand will increase if they expect higher future income; their demand will decrease if they expect lower future income.

- **Size and Composition of Population:** If the number of buyers for a commodity is huge or less than there be a shift in demand. If the size of the market increases, like if a country's population increases or there is an increase in the number of people in a certain age group, then the demand for products would increase. Simply put, the higher the number of buyers, the higher the quantity demanded. For example, if the birth rate suddenly skyrocketed, then there would be an increase in demand for baby products.

- **Tastes & Preferences**: Favorable change leads to an increase in demand, unfavorable change lead to a decrease.

Favourable change → **D** ↑

Unfavourable Change → **D** ↓

Movement of the Demand Curve

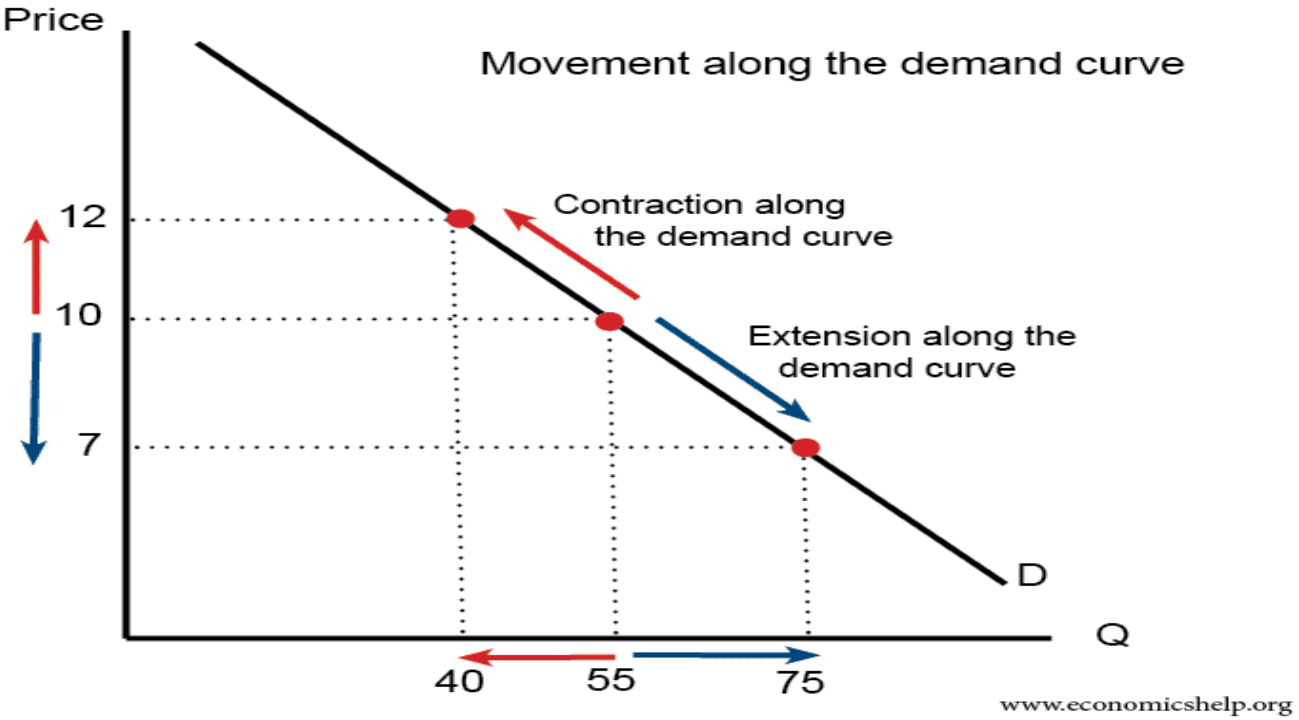
- Keeping all other factors the same, when there is a change in demand of a commodity due to change in price, it is referred to as the change in quantity demanded. It is shown as a movement along the demand curve when expressed graphically.

UPWARD MOVEMENT OF DEMAND CURVE

- When the price of the commodity rises, the quantity demanded falls. It leads to the upward movement of the demand curve.
- It is also known as contraction of demand.

DOWNWARD MOVEMENT OF DEMAND CURVE

- When the price of the commodity falls, the quantity demanded rises. It leads to the downward movement of the demand curve.
- It is also known as expansion of demand.



When price rises from 10 to 12 demand falls from 55 to 40. This is known as contraction of demand.

When price falls from 10 to 7 demand rises from 55 to 75. This is known as expansion of demand.

Shift in the Demand Curve

- A shift in the demand curve occurs when the whole demand curve moves to the right or left. For example, an increase in income would mean people can afford to buy more widgets even at the same price.

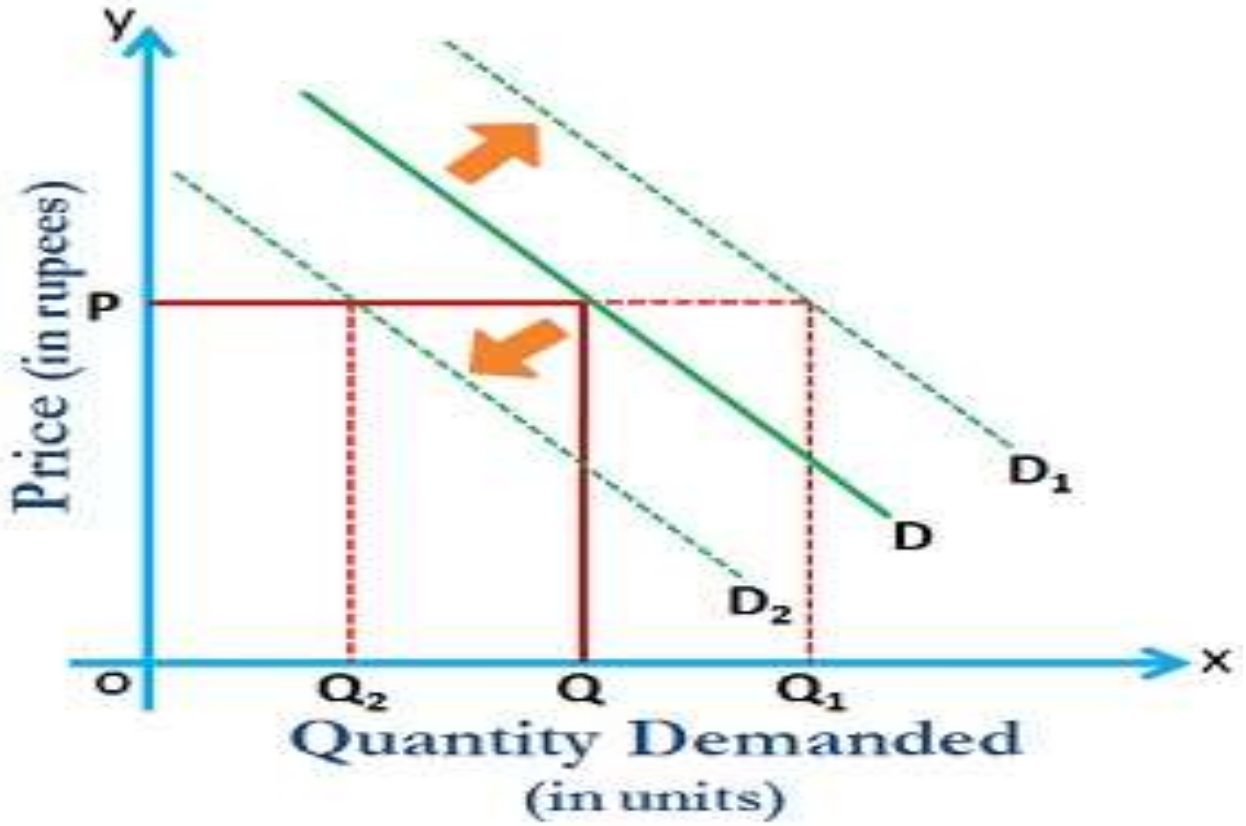
The demand curve could shift to the right for the following reasons:

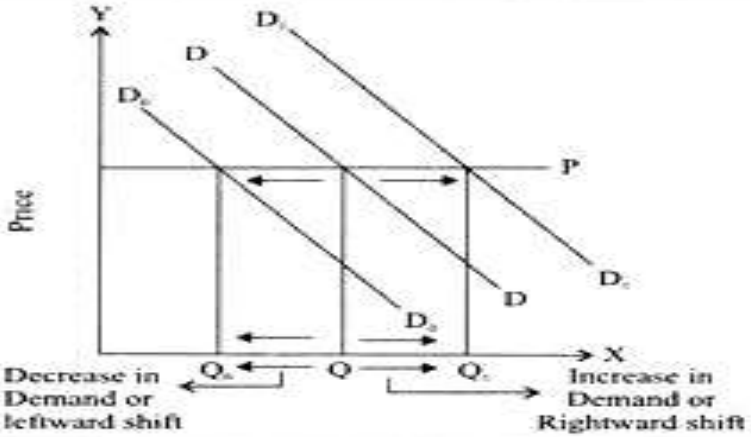
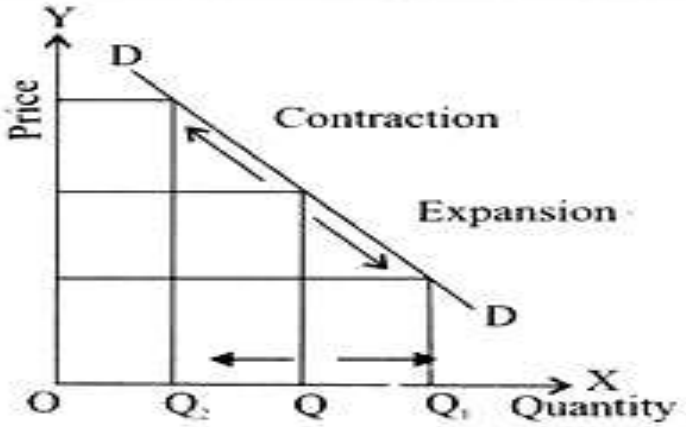
- The good became more popular (e.g. fashion changes or successful advertising campaign)
- The price of a substitute good increased.
- The price of a complement good decreased.
- A rise in incomes
- Seasonal factors.

The demand curve could shift to the left for the following reasons:

- The price of a substitute good decreased.
- The price of a complementary good increased.
- A fall in incomes
- Seasonal factors
- Unfavourable change in preference

- When price remains constant but demand falls from Q to Q2. This is known as decrease in demand.
- When price remains constant but demand rises from Q to Q1. This is known as increase in demand.



Basis	Change in Demand (Shift of demand curve)	Change in Quantity Demanded (Movement along the demand curves)
1. Factors responsible for rise or fall	It is increase or decrease in demand of a commodity due to the factors other than price of the commodity.	It is increase or decrease in quantity demanded due to price of the commodity while keeping other factors constant.
2. Price effect	No price effect i.e., At the same price demand is more	Price effect is negative i.e., At a lower price demand is more.
3. Shift of Demand curve	No price effect i.e., In case of increase in demand, demand curve shifts to the right and in case of decrease in demand, demand curve shift to the left.	Demand curve remains the same. However, in case of increase in quantity demanded there is a downward movement and in case of decrease in quantity demanded there is upward movement.
4. Diagram		
5. Demand Schedule	Price 10 10 10 — Quantity demanded 100 50 200	Price 10 15 20 — Quantity demanded 120 100 80

Thank You