WELLAND GOULDSMITH SCHOOL
ECONOMIC APPLICATIONS
CLASS-10
CH- THE THEORY OF DEMAND
ANSWER KEY

Answer 1: There are different concepts of demand.these are as follows :

- Income demand : When the demand for any commodity depends only on the income of the consumer it is called income demand.in case of normal goods we get a positive correlation between the income of the consumer and the demand for the commodity i.e. as the income increases or decreases the quantity demanded will also increase or decrease. However, in case of inferior goods the demand for the commodity declines with an increase in the income of the consumer.

- Cross demand : If the demand for a commodity depends on the price of a related commodity it is called cross demand. For example the demand for petrol driven motorcycles is influenced by the price of petrol. Similarly the demand for cotton shirts depends on the price of non cotton shirts as they are substitutes.

- Joint demand : When the demands for different complementary goods are created at a time it would be termed as complementary demand for joint demand. For example the demand for computer hardware and software are created jointly similarly the demands for guns and bullets are also an example of joint demand.
- Composite demand : When any commodity or service is demanded for many alternative uses it is called a composite demand. For example the electricity services are demanded both for domestic and commercial uses.
- Competitive demand: If any commodity or a service has some substitute in the market then the demand for any of these substitutes would be termed as competitive demand. For example in case of domestic aviation services in India the demand for the services provided either by Kingfisher or Jet Airways or Indian airlines will be considered as competitive demand.

  There are other forms of demand like direct demand, derived demand, notional demand and effective demand.

Answer2. Following are the differences between want and demand:

1. Want means the desire for having some goods without the ability to purchase these goods whereas demand refers to the willingness to have some goods backed by adequate purchasing power

2. Want cannot be communicated to the seller’s through price mechanism whereas demand can be communicated to the seller's through price mechanism.

3. Want has no relation with actual purchase of a commodity at any given price whereas demand has a relation with the actual purchase of a commodity at any given price during any particular time period.

Answer3. **The demand of any particular individual for any commodity depends on various factors such as:**

1. **Income of the consumer :**The demand for any commodity depends on the income of the consumer. An increase in individual income, other things remaining unchanged, would mean an increase in the purchasing power of the consumer. As a result, the consumer can purchase more of the commodity.
2. **Price of the commodity:** The price of a commodity also determines the demand for the commodity. Giving the money income of the consumer, an increase in the price level reduces the purchasing power of the consumer and vice-versa. Hence if the price of a commodity increases the consumer purchases less of it. On the other hand if there is a fall in the price of that commodity the consumer purchases more of it.
3. **Prices of related goods:** Demand for any commodity also depends on the prices of the related commodities. For instance, if the price of tea falls, the demand for coffee may fall, because a consumer may now substitute tea for coffee. In the economist language,tea and coffee are substitutes. Again when the price of sugar falls tea drinking may go up because people usually use sugar with it. Tea and sugar are complements.Thus the demand for any commodity also depends on the prices of its substitute and complements.

   There are other factors also like taste and preference pattern of the consumer and price expectations.

Answer 4: The law of demand states, keeping all other factors constant, when the price of a commodity rises the demand for it falls. When the price falls, demand rises.

Assumptions: the law of demand is based on the following assumptions:

- Prices of related goods remain unchanged
- Income of the consumer remains unchanged
- The taste and preference pattern of the consumer remains unchanged
- total number of consumers of a commodity within a region remains constant
- The pattern of income distribution in a society remains unaltered
- The consumers behave normally that is consumption decisions are not influenced by any other considerations except the present movements of the price of a commodity
- No new substitute are discovered

The law of demand assumes that all other demand determining factors except the price of a commodity remains unchanged.

Answer 5:

Bandwagon effect : Bandwagon effect takes place when the consumer's demand for a good may be affected by the taste and preferences of the social class to which he belongs. If playing golf is fashionable among section successful businessmen then as the price of a golf ball rises a businessman may increase demand for golf balls in order to show that he is a successful businessman.

Snob effect: A consumer tries to show that he no longer belongs to a particular social class. This is known as the snob effect. Consider a good which is consumed typically by poor people. When the price of this good falls, this consumer may decrease his purchase of this good in order to show that he no longer belongs to the class of the poor.

Answer6: There is an inverse relationship between the price of a commodity and the demand for that commodity. As a result the demand curve for any commodity becomes downward-sloping. Following are the main reasons behind a negatively sloped demand curve:

Income effect: When the price of a commodity falls, the consumer will have greater purchasing power (even if his income does not change). This usually induces him to increase his demand for the commodity. This effect of a price fall on demand is called the income effect, because it is as if the consumer's income has increased.

Substitution effect : The fall in price will have another effect on demand. This other effect is known as the substitution effect. When the price of a commodity falls, this commodity becomes more attractive to the consumer than other commodities. The consumer will then substitute this commodity for other commodities. And the demand for this commodity will increase.

Apart from these two one more reason is there that is the law of diminishing marginal utility.

Answer 7:

A movement from left to right along the demand curve shows an increase in quantity demanded or an expansion in demand due to a fall in the price of the commodity.

A movement from right to left along the demand curve indicates a fall in quantity demanded for a contraction in demand due to an increase in the price of the commodity.

Answer 8: Effect on the demand curve due to:

Change in income of the consumer: if the national income of a country increases, the consumers will usually buy more of any particular commodity. The demand schedule will shift to the right (however if the good is an inferior good whose demand falls when the consumer's income rises the schedule will shift to the left). A fall in income will usually shift the schedule to the left. (It will shift the schedule to the right if the good is inferior).

Change in prices of other commodities: if the price of a substitute good falls, consumers will be attracted to this other good. The demand for the good in question (that is the good whose demand curve we are drawing) will, therefore, fall at any given price. Thus, the demand curve will shift to the left.

For example the demand curve of cotton shirts may shift in the leftward direction with a fall in the prices of non cotton shirts. Similarly, a rise in the price of a substitute will shift the demand curve to the right.

Again, if the price of a complementary good falls, the consumers will buy more of the complementary good. Hence the demand for the good in question will also rise at any given price. The demand curve shifts to the right. For example the demand curve of Bajaj scooters may shift in the rightward direction with a fall in the price of petrol. A rise in the price of a complementary good will, similarly, shift the demand curve to the left.

Answer 9 : Price elasticity of demand = - $\Delta Q/\Delta P \ X \ P/Q$

Answer 10 : (a)

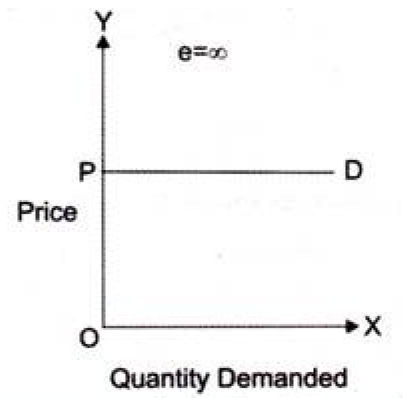

Figure-2: Perfectly Elastic Demand

(b)

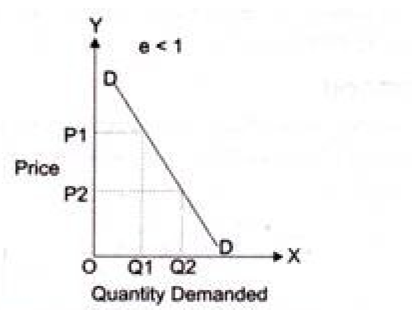

Figure-5: Relatively Inelastic Demand