WELLAND GOULDSMITH SCHOOL

ECONOMICS

Class 12

CHAPTER - DEMAND AND LAW OF DEMAND

ANSWER KEY

Answer 1: Demand for a commodity refers to the amount of the commodity which consumers are willing and able to purchase at a particular price during a particular period of time.

Answer 2:

- **JOINT DEMAND:** Joint demand refers to the demand for two or more goods which are used jointly or demanded together. For example, cars and petrol, butter and bread, milk and sugar, etc. are goods which are used together.
- **DERIVED DEMAND**: The demand for a commodity that arises because of the demand for some other commodity is called derived demand. For instance, demand for steel, bricks, cement, stones, would, etc. is a derived demand -derived from the demand for houses and other buildings.

Answer 3: Factors affecting demand are:

- **Price of the commodity:** There is an inverse relationship between the price of the commodity and its quantity demanded. It implies that lower the price of the commodity larger is the quantity demanded; and higher the price, lesser is the quantity purchased.
- **Income of the consumer:** Generally, there is a direct relationship between the income of the consumer and his demand for a product, i.e. with an increase in income the demand for the commodity increases. However, this may not always be the case.
  Normal goods are those goods the demand for which increases with increase in income of the consumers and decreases with fall in income for example clothes, refrigerators, television sets and cars.
  Inferior goods are those goods the demand for which falls with increase in income of the consumer for example maize etc.
  In case of inexpensive necessities of life such as salt and Matchbox, the quantity purchased increases with increase in income up to a certain level and thereafter it remains constant irrespective of the level of income.
- **Consumers' tastes and preferences:** Taste and preferences depend on social customs, habits of the people, fashion, the general lifestyle of the people, etc. Some of these factors like fashion keep on changing, leading to change in consumers tastes and preferences. As a result, the demand for different goods changes.
- **Prices of related goods:** the demand for a commodity is affected by the prices of related goods like substitute and complementary goods.
  substitute goods are those goods which satisfy the same kind of need and hence can be used in place of one another to satisfy a given want. For example tea and coffee, Coke and Pepsi are examples of substitute goods. There is a direct relationship between the demand for a product and the price of its substitute. For example if the price of coffee rises, many

customers will shift from the consumption of coffee to the consumption of tea because it has now become relatively cheaper.
Complementary goods are those goods which are complementary to one another in the sense that they are used jointly or consumed together to satisfy a given want like car and petrol, gas and gas stoves. There is an inverse relationship between the demand for a good and the price of its complement. For instance, an increase in the price of petrol causes not only a decrease in the demand for petrol but it also causes a decrease in the demand for cars.

Answer 4:

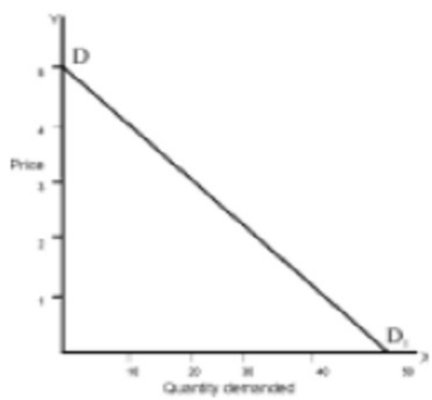
- substitute goods are those goods which satisfy the same type of need and hence can be used in place of one another to satisfy a given want. For example tea and coffee, Coke and Pepsi.
  Complementary goods are those goods which are complementary to one another in the sense that they are used jointly or consumed together to satisfy a given want like car and petrol, gas and gas stoves.
- In case of substitute good there is a direct relationship between the demand for a product and the price of its substitute.
  In case of complementary goods there is an inverse relationship between the demand for a good and the price of its complement.

Answer 5: The law of demand states that other things remaining equal, the quantity demanded of a commodity increases when its price falls and decreases when its price rises.

Table Demand Schedule

Price (Rs)	Quantity Demanded (Units)
5	10
4	20
3	30
2	40
1	50

Figure Demand Curve



Answer 6: Negatively sloping demand curve or inverse relationship between the price and the quantity demanded can be explained in terms of the following factors:

- **Law of diminishing marginal utility:** The law of diminishing marginal utility states that with an increase in the units of a commodity consumed, every additional unit of the commodity gives lesser satisfaction to the consumer. In other words, marginal utility of the commodity falls with an increase in its consumption. A consumer will maximize his satisfaction when he or she equalizes the marginal utility of the commodity with its price. From this equilibrium condition, it follows that a consumer would purchase a larger quantity of a commodity only when its price falls because the marginal utility from additional units falls.

- **Income effect:** a change in demand on account of change in real income resulting from change in the price of a commodity is known as the income effect. The income effect occurs when the price change affects consumer purchasing power and thus leads to change in the quantity demanded. When the price of a commodity falls, the consumer can buy a large amount of the commodity with his or her given money income or he or she can buy the same amount of the commodity as before and at the same time he or she would be able to save some money.

Answer 7: Exceptions to the law of demand are as follows:

- **ARTICLES OF SNOB APPEAL:** The law of demand does not apply to commodities which serve as status symbols, increase social prestige or are a source of display of wealth and richness. Veblen, who was first to coin the term, has termed these goods as goods of conspicuous consumption. These goods are demanded because of the enjoyment they give to their possessor from the feeling that other people envy him or her for possessing these high priced items. Diamond is often given as an example of this case.
- **EXPECTATIONS REGARDING FUTURE PRICES:** If the price of a commodity is rising today and it is likely to rise more in the future, people will buy more even at the existing higher price and store it up. They will do this in order to avoid the pinch of higher price in future. Similarly, when the consumers anticipate a large fall in the price of a commodity in future, they will postpone their purchase even if price falls today so as to purchase this commodity at a still lower price in future.

Answer 8: In case of movement along the demand curve, the price of the commodity changes while all other factors remain constant whereas in case of shift of the demand curve the price of the commodity remains constant while all other factors change.

Movement along the demand curve causes extension of demand or contraction of demand whereas shift in demand curve causes increase in demand or decrease in demand.

Answer 9:

- **Increase in the income of the consumer**: In case of normal goods if income increases demand also increases. Therefore there will be a rightward shift in the demand curve. Demand falls for inferior goods due to an increase in income of the consumer as they shift to superior quality goods.
- **Expectation of rise in price of the commodity:** consumers expectations with regard to future prices, income, availability of goods, etc. play an important role in determining the demand for goods and services in the current period. For instance if consumers expect a rise in the price of a commodity in future, they would demand a greater amount of this commodity today with a view to avoid purchasing it at a higher price in future. Therefore, the demand curve will shift rightward.

Answer 10: while discussing the relationship between income of the consumer and the demand for a commodity, we may distinguish between three types of commodities number 1. normal goods, 2. inferior goods, 3. inexpensive necessities of life.

- **NORMAL GOODS:** Normal goods are those goods the demand for which increases with increase in income of the consumers and decreases with fall in income. For instance, a consumer may increase demand for clothes, refrigerators, television sets and cars as his income increases.
- **INFERIOR GOODS:** Inferior goods are those goods the demand for which falls with increase in income of the consumer. So, there is an inverse relationship between income of the consumer and the demand for inferior goods. For example, the demand for an inferior food like maize may decrease when income increases beyond the particular level because the consumers may substitute it by a superior food like wheat or rice.
- **INEXPENSIVE GOODS OF NECESSITIES:** in case of inexpensive necessities of life such as salt and Matchbox, the quantity purchased increases with increase in income to a certain level and thereafter it remains constant irrespective of the level of income.