Notes: Chapter 4 Section 1

Demand: the willingness to buy a good or service and the ability to pay for it

Law of Demand: when the price of a good or service falls, consumers buy more of it. Quantity demanded and the prices have an inverse (opposite) relationship.

Demand Schedule: table that shows how much of a good or service an individual consumer is willing and able to purchase at each price in a market.

Market Demand Schedule: shows how much of a good or service all consumers are willing and able to buy at each price in the market.

Demand Curve: graph that shows how much of a good or service an individual will buy at each price. (Information from demand schedule)

Market Demand Curve: data found in the market demand schedule.

4-2 Notes

Why do demand curves slope downward?

- law of diminishing marginal utility
  - using additional unit of a good or service tend to decline as each is used

Why do consumers demand more goods and services at lower prices and fewer at higher prices?

- Income effect: a change in the amount of a product that a consumer will buy because the purchasing power of income changes ie.. buy more $7 books than $15 books You save $/keeping it in your pocket
- Substitution effect: consumers react to a change in price of a good or service by buying a substitute product / one whose price has not changed and that offers a better relative value ie.. not buy a book $20, instead a magazine saving $

Change in Demand

Factors

- income: with a change, your ability to buy either goes up or goes down
  - the demand curve moves either right or left
  - the market demand curve also moves
  - normal goods: goods consumers demand more when their income rises
  - inferior goods: goods consumers demand less of when their income rises ie… discount clothing, store brand foods
- market size: change in market size affect the demand for many products, from essentials ie... homes, clothing and food to non-essential such as movie ticket
- Consumers taste: taste is always changing (fads, hot trends). Advertising has a strong influence on consumers taste. Taste also affects demand for other products. i.e… cell phones
- Consumers expectations: your expectations for the future can affect your buying habits today. Do you buy today or wait? Buy a car now or wait for the end of year model change?
- Substitute goods: goods that can be used in place of other goods and still satisfy the consumers wants ie… price of the original item gets too high, a substitute is bought. The demand for the substitute goes up and the demand for the original goes down.
- Complementary goods: the use of one product increases the use of another product. Product is interchangeable; if the price of one drop the demand will go up and the other products demand will go down. The product works in tandem with the other product. If the price of one product changes, demand for both products will change in exactly the same way.

4-3 Notes

Elasticity of Demand: how responsive consumers are to price changes in the marketplace. Demand is either elastic or inelastic.

- Elastic: when a price change occurs, either up or down, this leads to a <u>larger change</u> in the quantity demanded. Elastic goods and services are price sensitive

- Inelastic: when a price change leads to a relatively <u>smaller change</u> in quantity demanded. Inelastic demand, changes in price have little impact on the quantity demanded.

- Goods that have a large number of substitutes fall into the **elastic category**, since if the prices change, consumers can choose other products. Ie…phones

- Medicine (insulin): regardless of the price, the same # of people need it. This makes this item: **Inelastic**

Elastic Demand Curve: have gradual slopes. They are more horizontal than vertical because of the **greater changes** in quantity demanded.

Inelastic Demand Curve: have steep slopes. They are more vertical than horizontal because **quantity demanded changes very little**.

Unit Elastic: Demand is considered **unit elastic** when the percentage change in price and quantity demanded are the same. Ie… a 10% change in price would cause a 10% drop in the quantity demanded.

What Determines Elasticity?

- Factor 1: Substitute goods or services: if there is no substitute for the goods or service, it is considered inelastic. If many substitutes are available, it is considered elastic. Price of ice cream goes up, people select TCBY instead.

- Factor 2: Proportion of Income: if your % of income you spend on a good or service is 10%, and the cost of the goods for your hobby increase, you will not spend extra money on the hobby due to limited money available. This makes your demand elastic. Demand of products that cost little of your income tends to be inelastic. Ie… camera equipment vs pencils (art). As your income rises, your demand for goods and services will increase.

- Factor 3: Necessities vs Luxuries:
- - Necessities: Demand for necessities tends to be inelastic (food or water). Consumers will not necessarily buy the same quantity, or select a substitute in its place. (powdered milk in place of real milk). Quantity of demand will change (law of demand), but the quantity demanded is smaller than the change in price, so the demand is inelastic.
- Luxuries: something you desire but are not essential for your survival. Demand is elastic. Ie…plasma tv (think twice about the purchase due to the cost). The change in quantity demanded is much greater than the change in price.

Calculating Elasticity of Demand

- Businesses figure the elasticity of demand to help them decide whether to make price cuts. If the goods and service is elastic, a price cut will help. If inelastic, price cuts won't help.
- Determining Elasticity: calculations pg 121

Total Revenue Test: Price x Quantity = total revenue

- If the total revenue increase after the price of a product drops, then demand for that product is considered elastic. Why?? Even with the lower price, there is demand for more quantity which makes up the difference from the lower price.
- If the total revenue decreases after the price is lowered, demand is considered inelastic. Price reduction has only caused a small increase in quantities sold.