**1.2 Demand, Elasticity of Demand**

1. Rational Decision Making

a) The assumption of rationality in decision-making: consumers aim to maximise utility by making rational choices; firms aim to maximise profits.

b) Reasons why consumers may not aim to maximise utility:

• the influence of other people’s behaviour (herding)

• habitual behaviour

• inertia

• poor computational skills

• the need to feel valued

• framing and bias

1. The Demand Curve

a) The concept of ‘demand’.

b) The distinction between movements along a demand curve and shifts of a demand curve.

c) The concept of diminishing marginal utility and its significance for the shape of the individual demand curve.

d) Factors that may cause a shift in the demand curve:

• changes in the price of substitutes or complementary goods

• changes in real income

• changes in tastes

• changes in size and age distribution of the population

• advertising

1. Price, Income and Cross-elasticities of demand

a) The concepts of ‘price’, ‘income’ and ‘cross-elasticities of demand’.

b) How to use formulae to calculate price, income and cross-elasticities of demand.

c) Interpretation of numerical values of price elasticity of demand:

• perfectly price elastic demand

• price elastic demand

• unitary price elastic demand

• price inelastic demand

• perfectly price inelastic demand.

d) The factors influencing price elasticity of demand:

• availability of substitutes

• branding

• percentage of total expenditure

• addictiveness of product

• durability of product.

e) How to calculate total revenue.

f) How price elasticity of demand varies along a straight line demand curve.

g) The relationship between price elasticity of demand and total revenue.

h) Interpretation of numerical values of income elasticity of demand:

• perfectly income elastic demand

• income elastic demand

• income inelastic demand

• perfectly income inelastic demand

• the distinction between normal goods and inferior goods.

i) Interpretation of numerical values of cross elasticity of demand. Significance for the degree to which goods are:

• substitutes

• complements

• unrelated.

j) The significance of price, income and cross-elasticities of demand for firms, consumers and the government.