Unit 2
Theory of Demand

MEANING OF DEMAND

Demand is a fundamental concept in economics. It refers not just to a desire to own a good or service, but also to the ability and willingness to pay for it at a specific price, during a specific period of time.

Key Points:

- Desire alone is not enough; one must also have purchasing power and readiness to spend.
- Demand must be measurable in terms of time and price.

Prof. Benham:
"The demand for anything is the amount purchased per unit of time at a given price."
Hansen:
"Demand is the quantity bought at a particular price, not just the desire for it."
Essential Components of Demand:

1. *Desire* – The want or need for the commodity.
2. *Ability to Pay* – Availability of sufficient income or resources.
3. *Willingness to Pay* – A person must be ready to exchange money for the good.

DEMAND FUNCTION

The demand function shows the relationship between the quantity demanded and its influencing factors.
General Form:

$$Q_d = f\ (P, I, Pr, T, A, E)$$

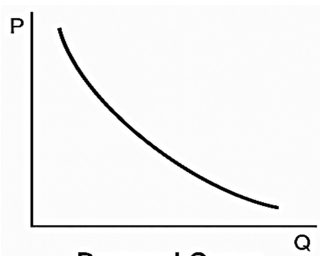
Where:

- Q_d = Quantity demanded
- **P** = Price of the commodity
- **I** = Consumer's income
- **Pr** = Price of related goods (Substitutes and Complements)
- **T** = Tastes and preferences
- **A** = Advertising
- **E** = Future expectations about prices

This function explains how multiple variables simultaneously influence demand.

LAW OF DEMAND

Statement: *"Other things being equal, as the price of a good falls, the quantity demanded increases; and as the price rises, the quantity demanded decreases."*
This shows an inverse relationship between price and demand.



Demand Curve

Assumptions:

1. Consumer's income remains constant.
2. Prices of related goods do not change.
3. Tastes and preferences are stable.
4. No change in population.
5. No expectation of future price changes.

Why Demand Falls with Rise in Price?

- Law of diminishing marginal utility.
- Substitution effect (cheaper alternatives).
- Income effect (real income falls as price rises).
- New buyers enter when price is low.

EXCEPTIONS TO THE LAW OF DEMAND

Despite being a general rule, there are some exceptions where demand may increase with price.

Exception	Explanation
Giffen Goods	Inferior goods where price rise leads to increased consumption. Example: Cheap bread for poor people.
Veblen Goods	Prestige goods whose demand increases with price due to status symbol (e.g., luxury cars, diamonds).
Speculative Goods	When prices rise, people expect further increases and buy more (e.g., shares, property).
Bandwagon Effect	People buy a commodity to be part of a trend or group.
Snob Effect	Opposite of bandwagon. People buy expensive goods to be exclusive.

ELASTICITY OF DEMAND

Elasticity of Demand measures how much the quantity demanded of a good respond to a change in one of its determinants, mainly price.

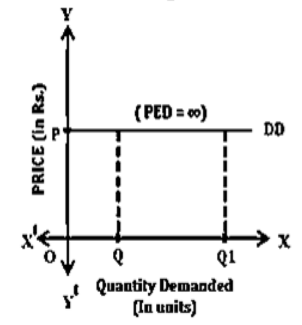
Price Elasticity of Demand (PED)

$$E_P = \frac{\%\text{Change in Quantity Demanded}}{\%\text{Change in Price}}$$

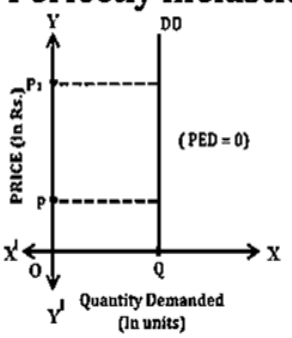
Types of Price Elasticity:

Type	Value	Meaning	Example
Perfectly Elastic	$E_p = \infty$	Small price change → infinite demand change	Rare theoretical case
Perfectly Inelastic	$E_p = 0$	Price change → No change in demand	Life-saving drugs (e.g., insulin)
Unitary Elastic	$E_p = 1$	% Change in Q.D. = % Change in Price	Balanced revenue
Relatively Elastic	$E_p > 1$	% Change in Q.D. > % Change in Price	Luxury items
Relatively Inelastic	$E_p < 1$	% Change in Q.D. < % Change in Price	Necessities like salt

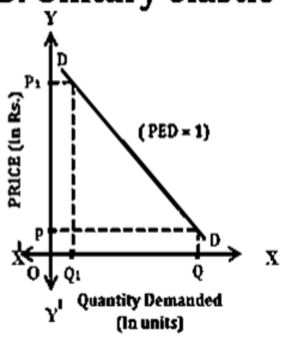
1. Perfectly elastic

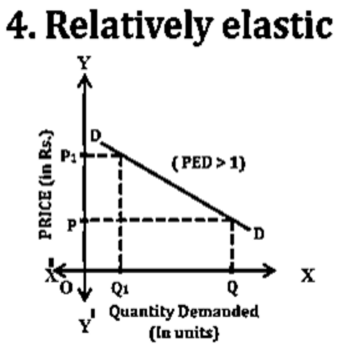


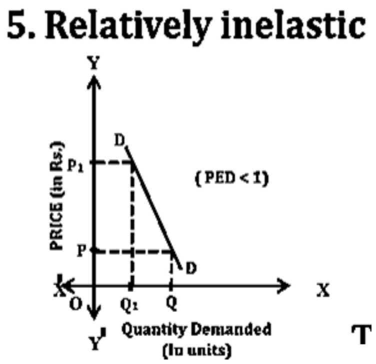
2. Perfectly inelastic



3. Unitary elastic



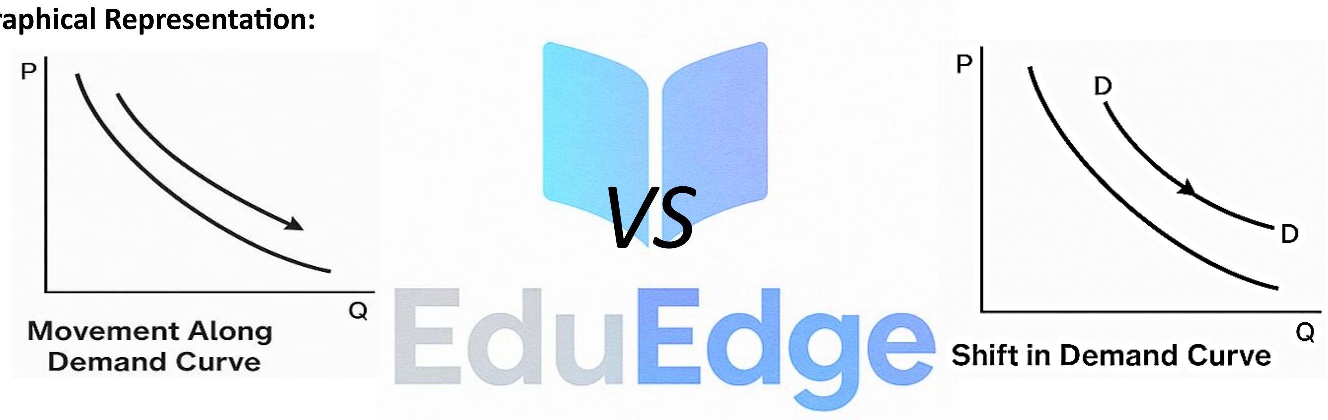




MOVEMENT VS SHIFT IN DEMAND CURVE

Type	Cause	Explanation
Movement Along the Demand Curve	Price Change	*Extension:* Price ↓ → Quantity Demanded ↑
Contraction: **Price ↑ → Quantity Demanded ↓**		
Shift in Demand Curve	Non-price Factors	*Increase in Demand:* Income ↑, tastes improve → Curve shifts right
Decrease in Demand: **Income ↓, preferences worsen → Curve shifts left**		

Graphical Representation:



KINDS/TYPES OF DEMAND

Demand can be classified based on different variables:

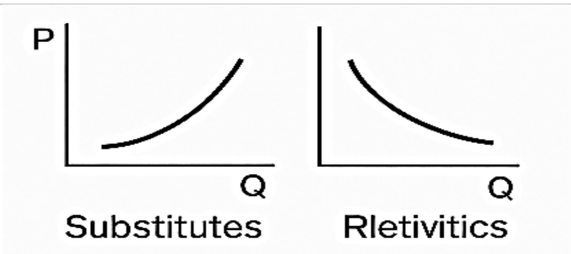
1. Price Demand

- Demand varies inversely with price.
- As price falls, demand rises (ceteris paribus).

2. Income Demand

- Relationship between consumer income and demand.

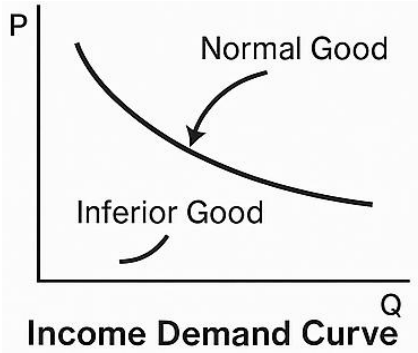
Type	Relation
Normal Goods	Income ↑ → Demand ↑
Inferior Goods	Income ↑ → Demand ↓ (e.g., low-quality food items)



3. Cross Demand

- Demand of one commodity in response to the price change of a related good.

Relationship	Effect
Substitute Goods	Tea ↑ → Coffee Demand ↑
Complementary Goods	Petrol ↑ → Car Demand ↓



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