

Quadrant II – Transcript and Related Materials

Programme: Bachelor of Arts (First year)

Subject: Economics

Paper Code: ECC101

Paper Title: Microeconomics-I

Unit: 1

Module Name: Law of demand

Module No: 8

Name of the Presenter: Ms. Gouri K. Manerkar

Notes

In this module we have explained law of demand.

DEMAND Refers to purchasing power of the consumer to acquire a given product at a given period.

It means that the consumer should have a desire to buy the product.

But mere desire is not demand. It should be backed by the willingness and ability to pay for that commodity.

If example, you may desire to own a big bungalow. But if you don't have the willingness and ability to pay for it, it is not demand.

Demand is the relationship between the quantity of a good or service consumers will purchase and the price charged for that good.

Law of Demand

The law of demand expresses a relationship between the quantity demanded and its price.

It may be defined in Marshall's words as "the amount demanded increases with a fall in price, and diminishes with a rise in price".

Thus it expresses an inverse relation between price and demand.

The law refers to the direction in which quantity demanded changes with a change in price.

There are certain assumptions that need to be fulfilled for the law of demand to hold good.

Assumptions

- 1) No change in prices of related goods.**
- 2) No change in consumer's taste, preference, habits and fashions.**
- 3) No expectation of future price change.**
- 4) No change in consumer's income**
- 5) No change in the size and composition of population.**

The law of demand can be explained with the help of demand schedule and demand graph.

Demand Schedule

Price (Rs.)	Quantity demanded
5	100
4	200
3	300
2	400
1	500

The above table shows that when the price of say, orange, is Rs. 5 per unit, 100 units are demanded. If the price falls to Rs.4, the demand increases to 200 units. Similarly, when the price declines to Re.1, the demand increases to 600 units. On the contrary, as the price increases from Re. 1, the demand continues to decline from 600 units.

Demand graph

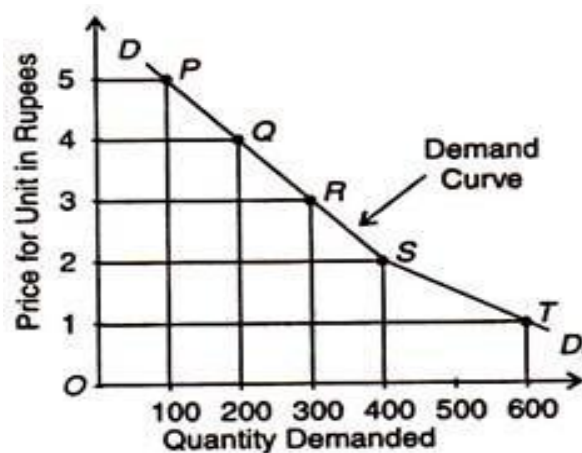


Fig. 7

In the figure, point P of the demand curve DD1 shows demand for 100 units at the Rs. 5. As the price falls to Rs. 4, Rs. 3, Rs. 2 and Re. 1, the demand rises

to 200, 300, 400 and 600 units respectively. This is clear from points Q, R, S, and T. Thus, the demand curve DD1 shows increase in demand of orange when its price falls. This indicates the inverse relation between price and demand.

Exceptions to the Law of Demand

In certain cases, the demand curve slopes up from left to right, i.e., it has a positive slope. Under certain circumstances, consumers buy more when the price of a commodity rises and less when price falls, as shown by the D curve in Figure. Many causes are attributed to an upward sloping demand curve. They are as follows:

1) War

If shortage is feared in anticipation of war, people may start buying for building stocks or for hoarding even when the price rises. This all of us might have experienced during the lock down which was announced due to the pandemic. Even when the prices were increasing people used to buy in bulk because of the fear of shortage.

2) Giffen Paradox

If a commodity happens to be a necessity of life like wheat and its price goes up, consumers are forced to curtail the consumption of more expensive foods like meat and fish, and wheat being still the cheapest food they will consume more of it. The Marshallian example is applicable to developed economies. In the case of an underdeveloped economy, with the fall in the price of an inferior commodity like maize, consumers will start consuming more of the superior commodity like wheat. As a result, the demand for

maize will fall. This is what Marshall called the Giffen Paradox which makes the demand curve to have a positive slope.

3) Demonstration Effect

If consumers are affected by the principle of conspicuous consumption or demonstration effect, they will like to buy more of those commodities which confer distinction on the possessor, when their prices rise. On the other hand, with the fall in the prices of such articles, their demand falls, as is the case with diamonds.

4) Ignorance Effect

Marshall mentions speculation as one of the important exceptions to the downward sloping demand curve. According to him, the law of demand does not apply to the demand in a campaign between groups of speculators. When a group unloads a great quantity of a thing on to the market, the price falls and the other group begins buying it. When it has raised the price of the thing, it arranges to sell a great deal quietly. Thus when price rises, demand also increases.

5) Speculation

Marshall mentions speculation as one of the important exceptions to the downward sloping demand curve. According to him, the law of demand does not apply to the demand in a campaign between groups of speculators. When a group unloads a great quantity of a thing on to the market, the price falls and the other group begins buying it. When it has raised the price of the thing, it arranges to sell a great deal quietly. Thus when price rises, demand also increases.

6) Necessities of Life

Normally, the law of demand does not apply on necessities of life such as food, cloth etc. Even the price of these goods increases, the consumer does not reduce their demand. Rather, he purchases them even the prices of these goods increase often by reducing the demand for comfortable goods. This is also a reason that the demand curve slopes upwards to the right.