

## Demand (Chapter 4)

### Section 1 – Understanding Demand

- demand

#### The Law of Demand

- consumers buy more of a good when its price decreases and less when its price increases

#### The Substitution Effect

- when consumers react to an increase in a goods price by consuming less of that good and more of other goods.

#### The Income Effect

- the change in consumption resulting from a change in real income

#### A Demand Schedule

- understanding demand
- market demand schedule

#### The Demand Graph

- Reading a Demand Curve
- Limits of a Demand Curve (The market demand curve is only accurate for one very specific set of market conditions.)

### Section 2 – Shifts in the Demand Curve

#### Changes in Demand

- *ceteris paribus* (Latin for “All other things held constant”)

#### What Causes a Shift?

- Income (Normal Goods and Inferior Goods)
- Consumer Expectations
- Population
- Consumer Tastes and Advertising

#### Prices of Related Goods

- Complements
- Substitutes

### Section 3 – Elasticity of Demand

- Elasticity of Demand - sensitivity of consumers to price change
- Inelastic (<1) - describes demand that is not very sensitive to change in price. (E.G. - Gasoline)
- Elastic (> 1) – describes demand that is very sensitive to a change in price (E.G. – Video Games)
- Unitary (=1)

#### Calculating Elasticity

- Elasticity =  $\frac{\% \text{ change in quantity demanded}}{\% \text{ change in Price}}$
- Percentage Change =  $\frac{\text{Original Number} - \text{New Number}}{\text{Original Number}}$
- Price Range (E.G. Glossy magazines rising 50% from 20 cents to 40 cents vs. magazines that rise 50% from \$4 to \$6.)
- Values of Elasticity (Unitary Elastic)

#### Factors Affecting Elasticity

- Availability of Substitutes
- Relative Importance
- Necessity vs. Luxury
- Change over time

#### Elasticity and Revenue

- Computing a Firm’s Total Revenue
- Total Revenue and Elastic Demand
- Total Revenue and Inelastic Demand
- Elasticity and Pricing Policies