

THEORY OF DEMAND



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What is Demand?

- The willingness to buy a good or service at all prices backed by purchasing power
- What is the law of Demand?
 - People demand more at lower prices and low at higher prices.



Determinants of Demand

- **Prices of other goods (substitute or complementary)**
- **Outlook (consumers' expectation of future income and prices)**
- **Income (normal goods versus inferior goods)**
- **Number of potential customers**
- **Tastes and fashions**

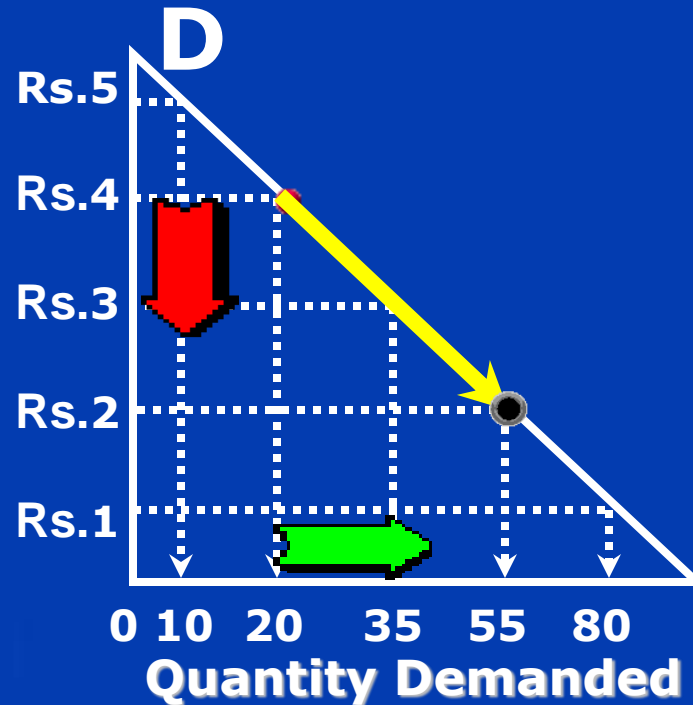


DEMAND SCHEDULE

Consumers "willingness to buy"

Price decreases; QD increases

P	Q _D
Rs. 5	10
4	20
3	35
2	55
1	80



...in a given time period

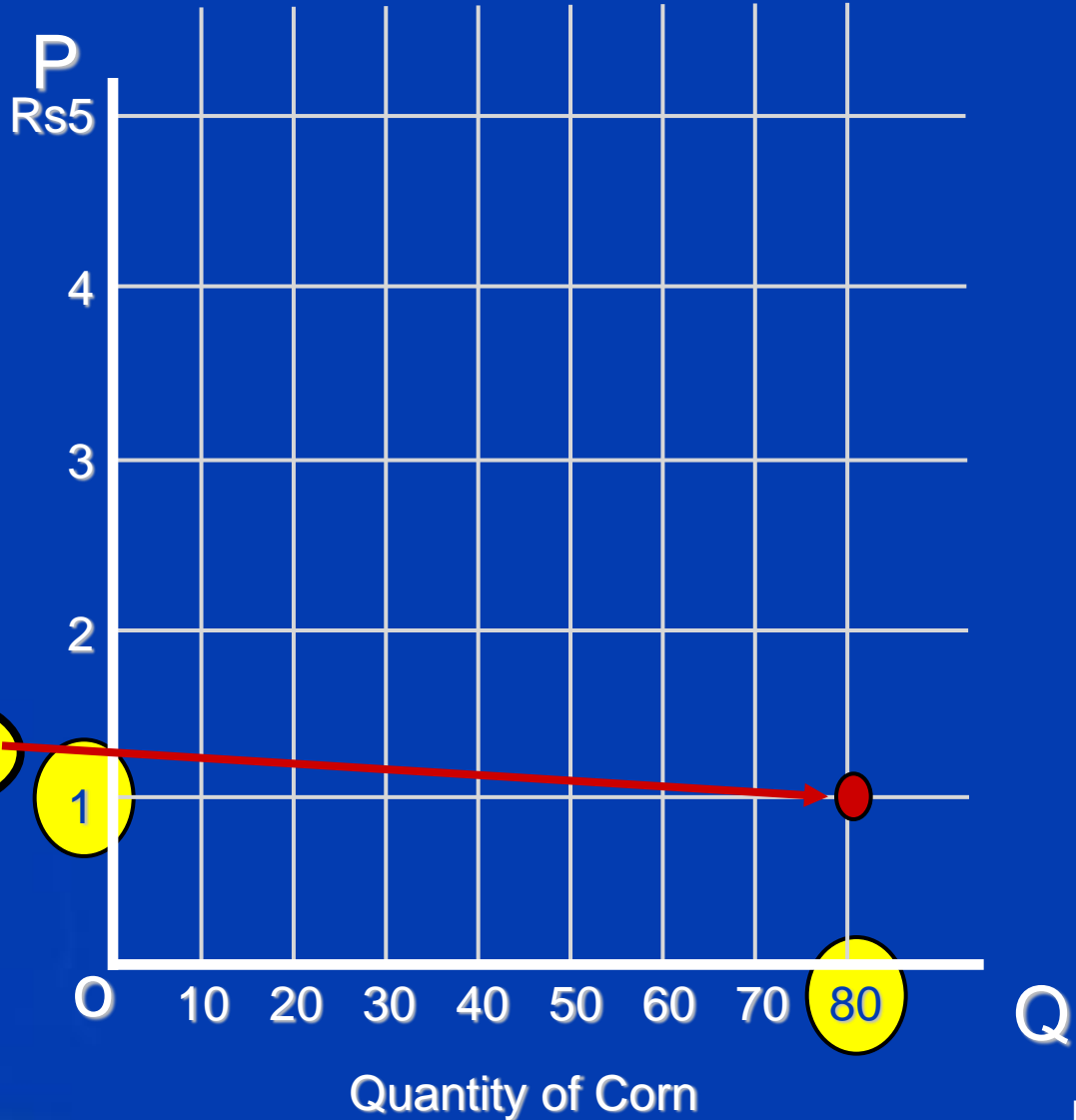
...other things remaining constant

GRAPHING DEMAND

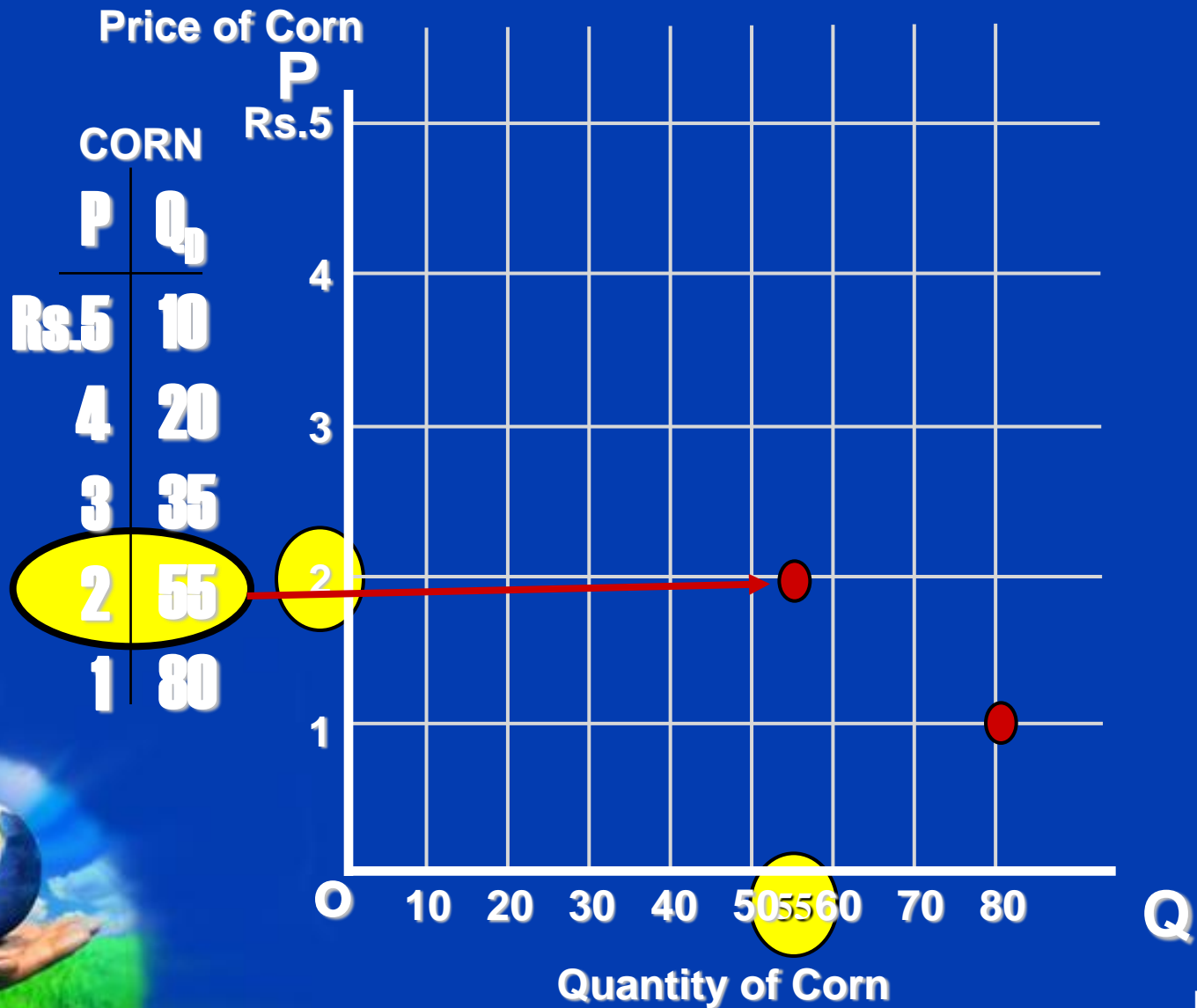
Price of Corn

CORN	
P	Q _d
\$5	10
4	20
3	35
2	55

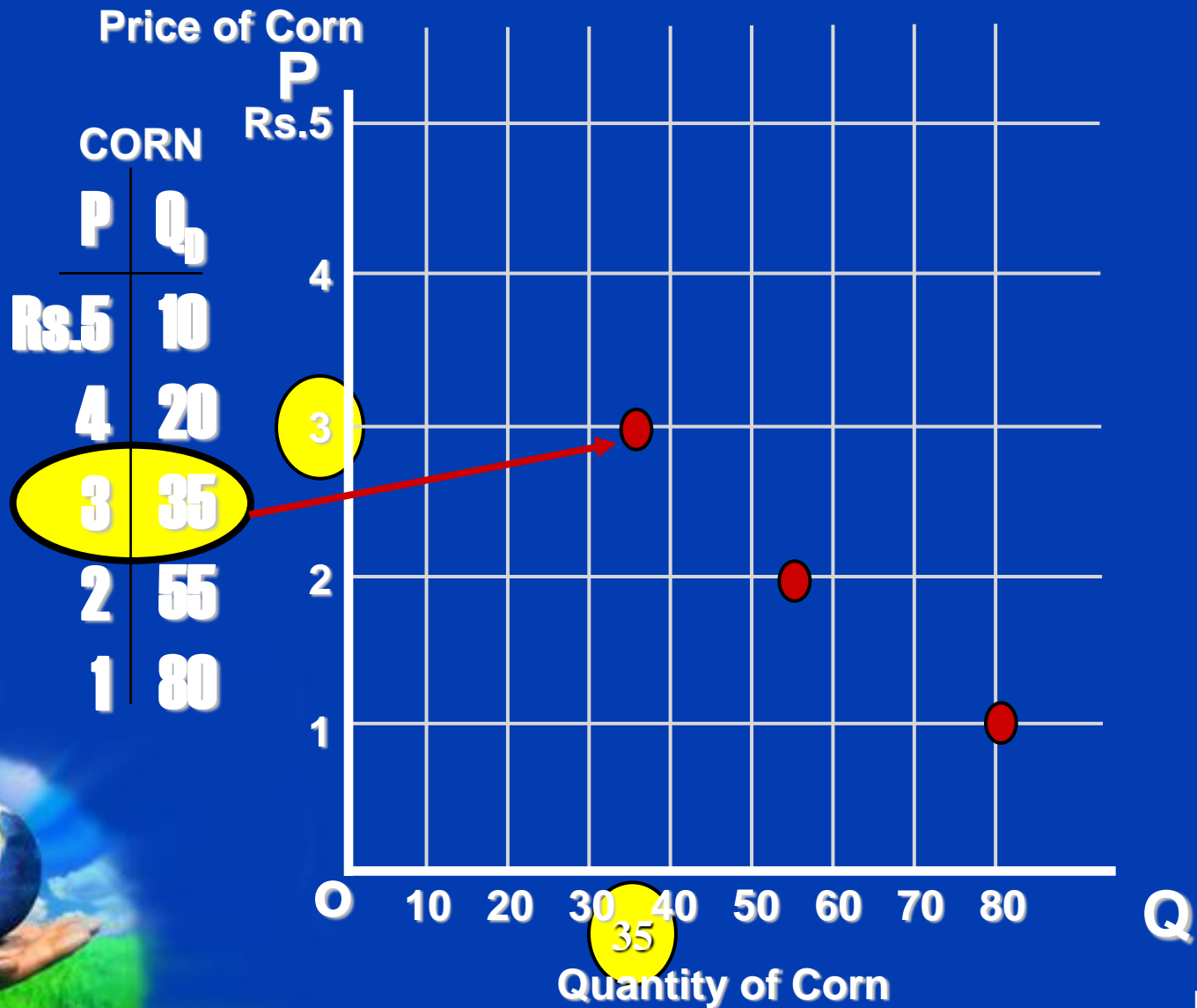
1 | **80**



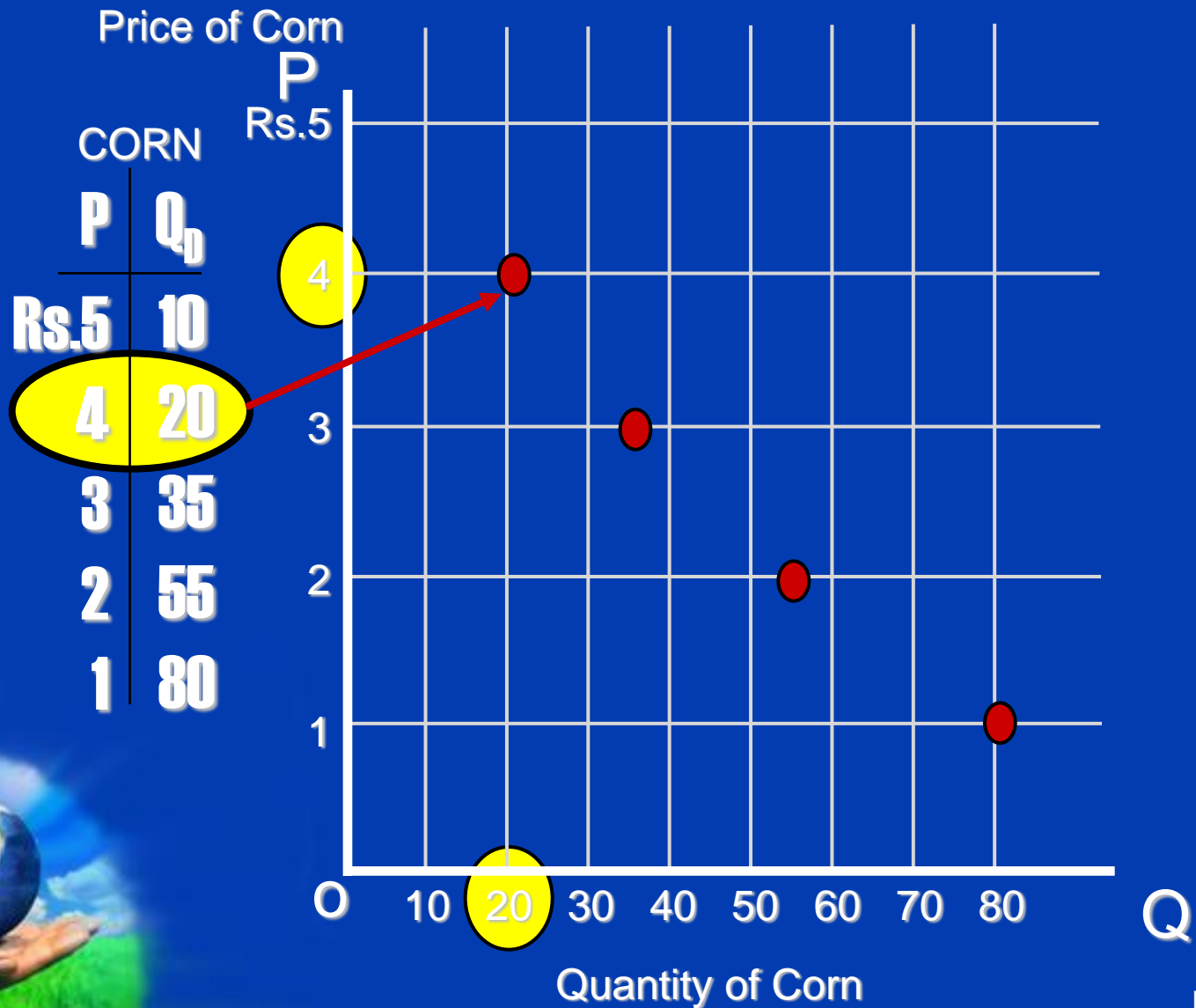
GRAPHING DEMAND



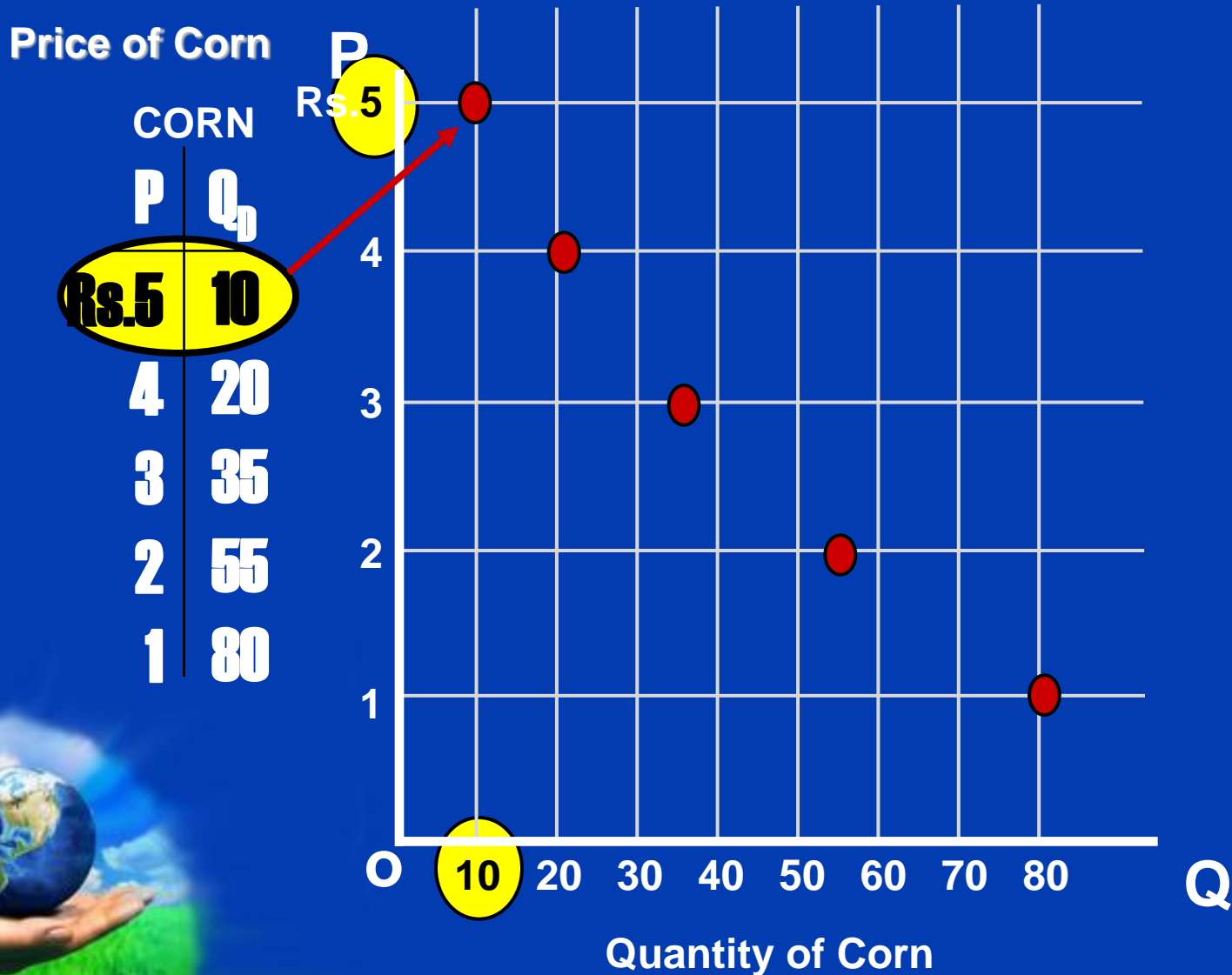
GRAPHING DEMAND



GRAPHING DEMAND



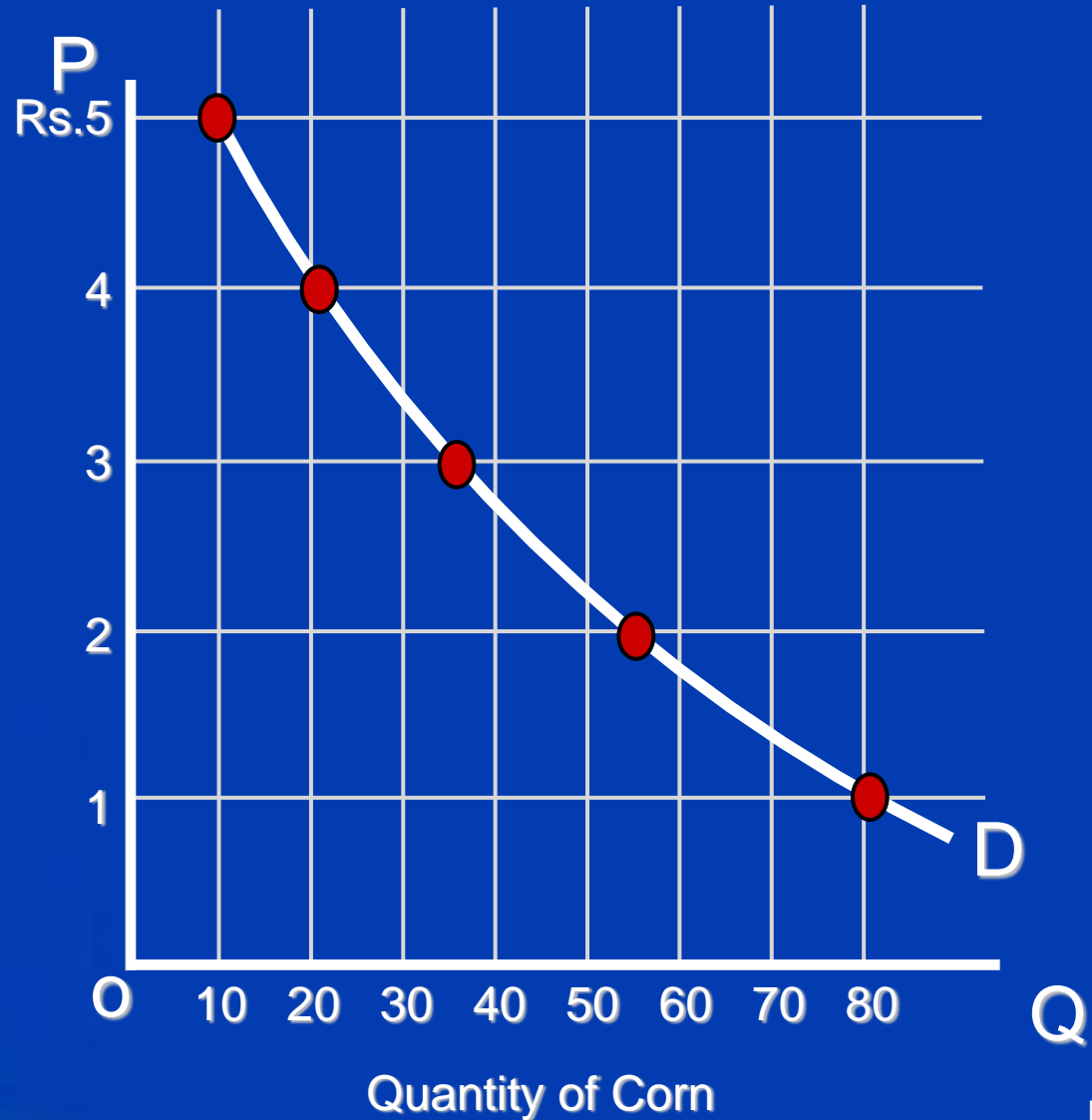
DEMAND CURVE



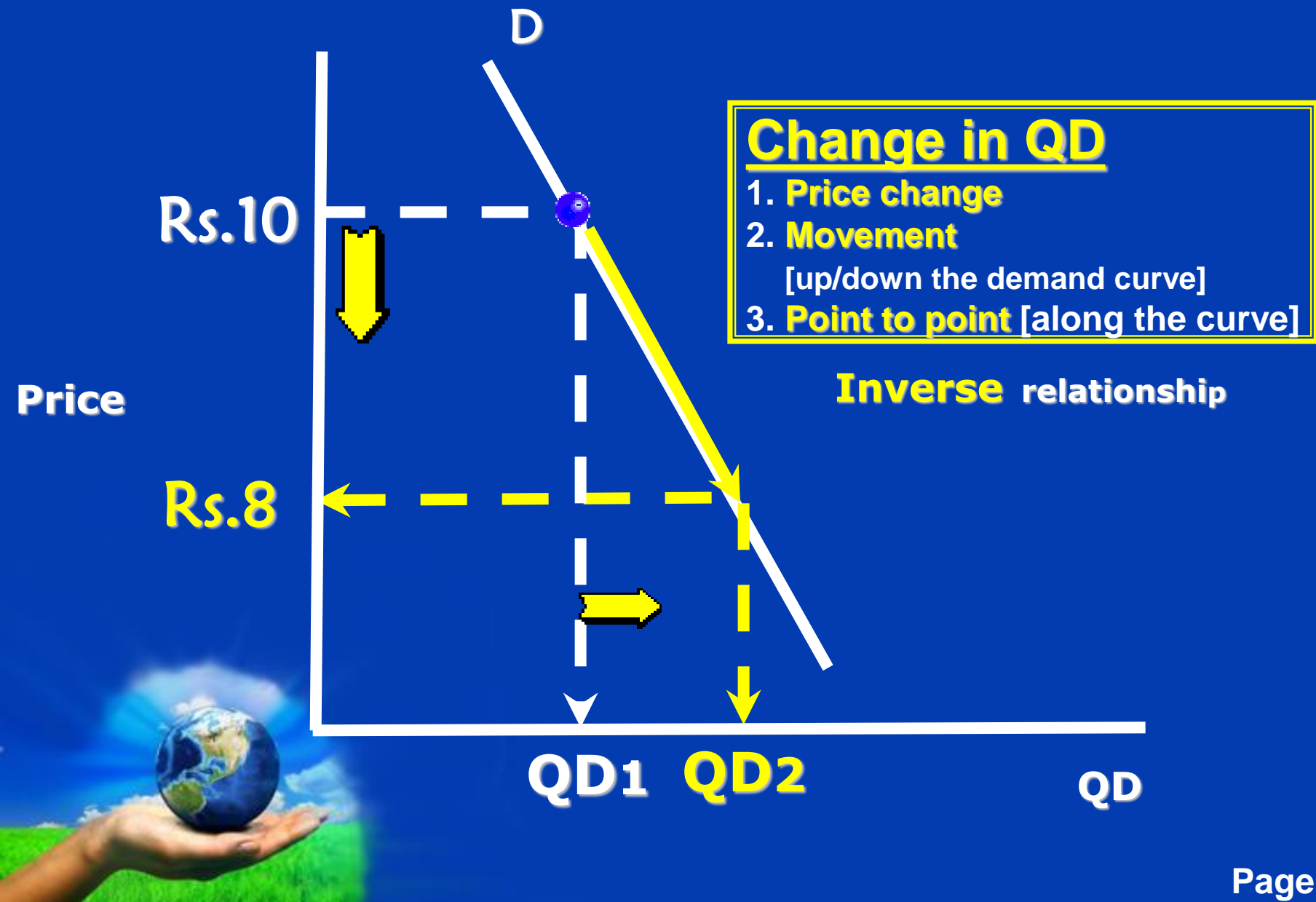
DEMAND CURVE

Price of Corn

CORN	
P	Q _d
Rs.5	10
4	20
3	35
2	55
1	80



Law of Demand



Reasons for inverse relation

1. **Income Effect** – current buyers buy more.
2. **Substitution Effect** – new buyers.
3. **Diminishing Marginal Utility** - because buyers of successive units receive less marginal utility, they will buy more only when the price is lowered.



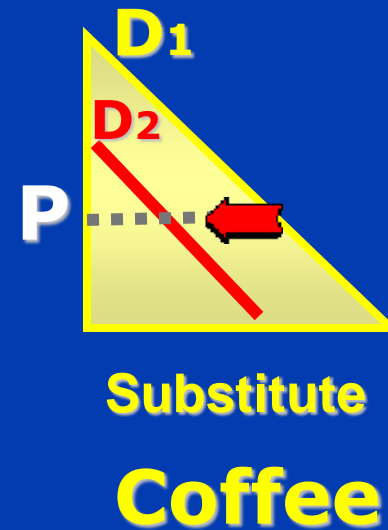
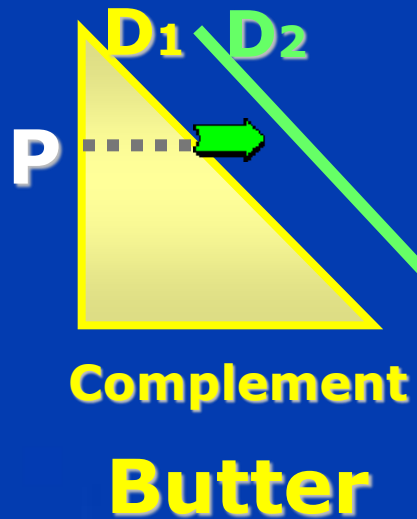
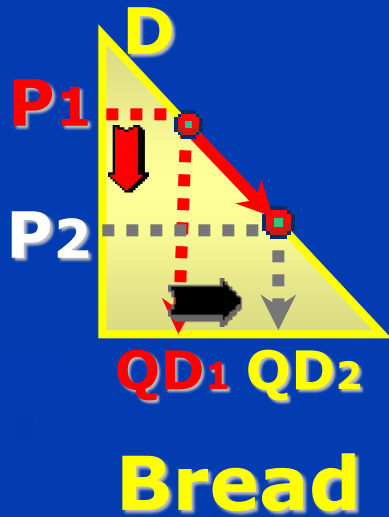
“Demand Shifters”

- 1. Taste**
- 2. Income**
- 3. Market Size**
- 4. Expectations of consumers about future price, Income, availability of good**
- 5. Prices of related goods**

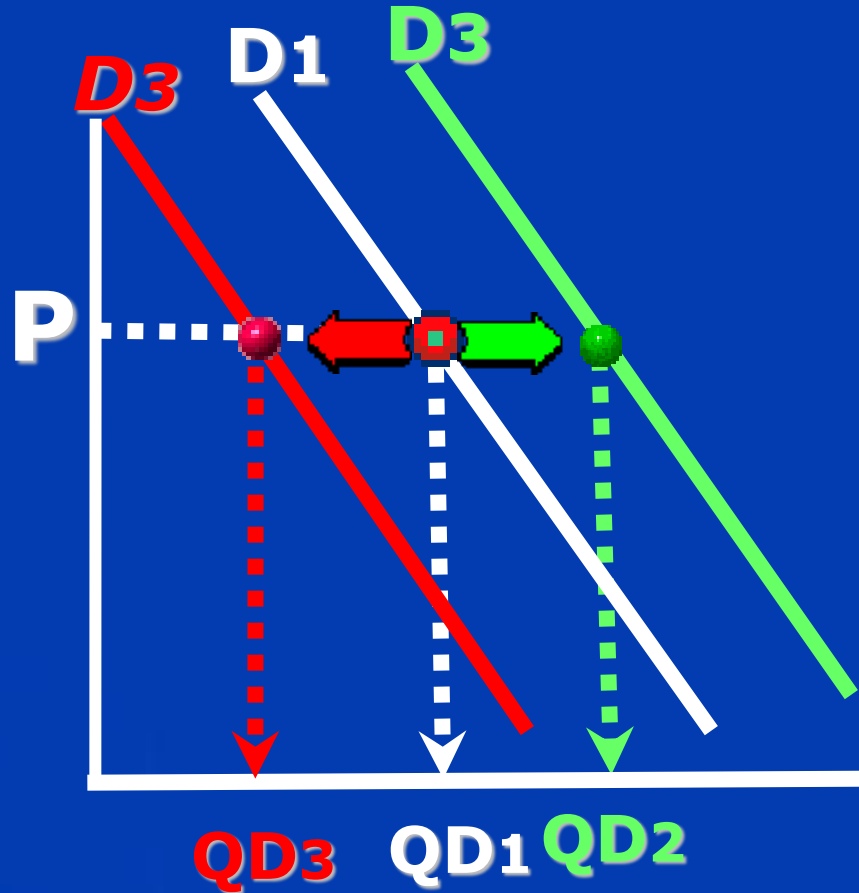


“Demand Shifters”

Substitutes & Complements



Change in Demand



ELASTICITY OF DEMAND



ELASTICITY OF DEMAND

“Relationship between proportionate change in price and quantity demanded”



Factors governing the elasticity of demand:

- **Number and closeness of substitutes**
- **Significance of commodity in budgets**
- **Degree of necessity of goods**
- **Habits and attitude of consumer**
- **Uses of the commodity**
- **Time of demand**



Factors influencing demand

- Number of consumers**
- Price level**
- Availability of substitutes**
- Distribution of wealth**
- Tastes & Fashions**
- Possibility of change in price**
- Climate**
- Advertisement**



Importance

- **In Consumption**
- **For producers**
- **In exchange**
- **In distribution**
- **Public finance**



LAW OF SUPPLY



SUPPLY

Supply tells about the amounts of a product that producers are willing and able to make available for sale at each of a series of possible prices.



LAW OF SUPPLY

A direct relationship that exists between price and quantity supplied

- As Price Rises...
...Quantity Supplied Rises
- As Price Falls...
...Quantity Supplied Falls



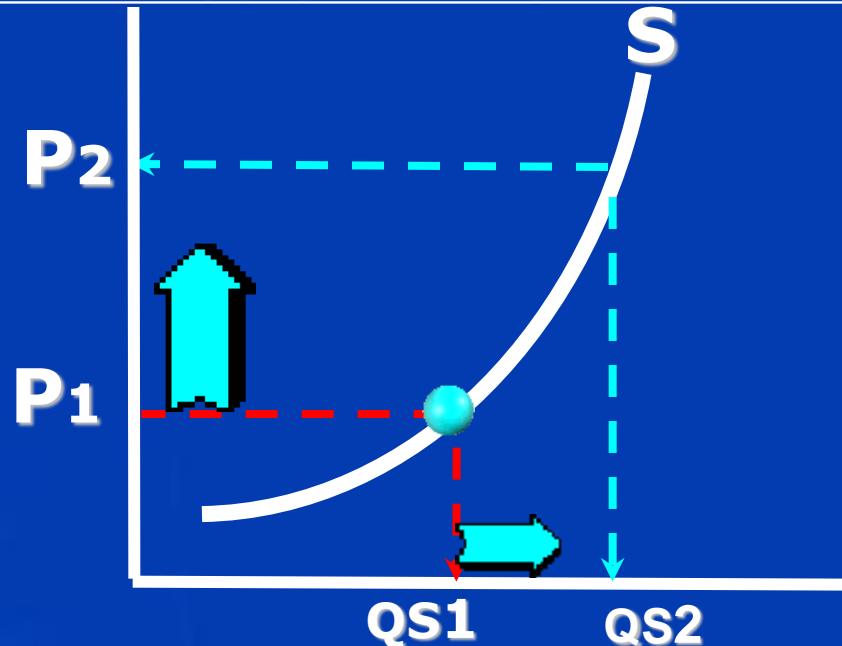
Law of Supply

Price increases; QS increases
Price decreases; QS decreases

} Direct

"S" refers to the "whole supply curve" and refers to what producers will supply at "different prices"

"QS" refers to a "point on the curve" and refers to what producers will supply at a "particular price"

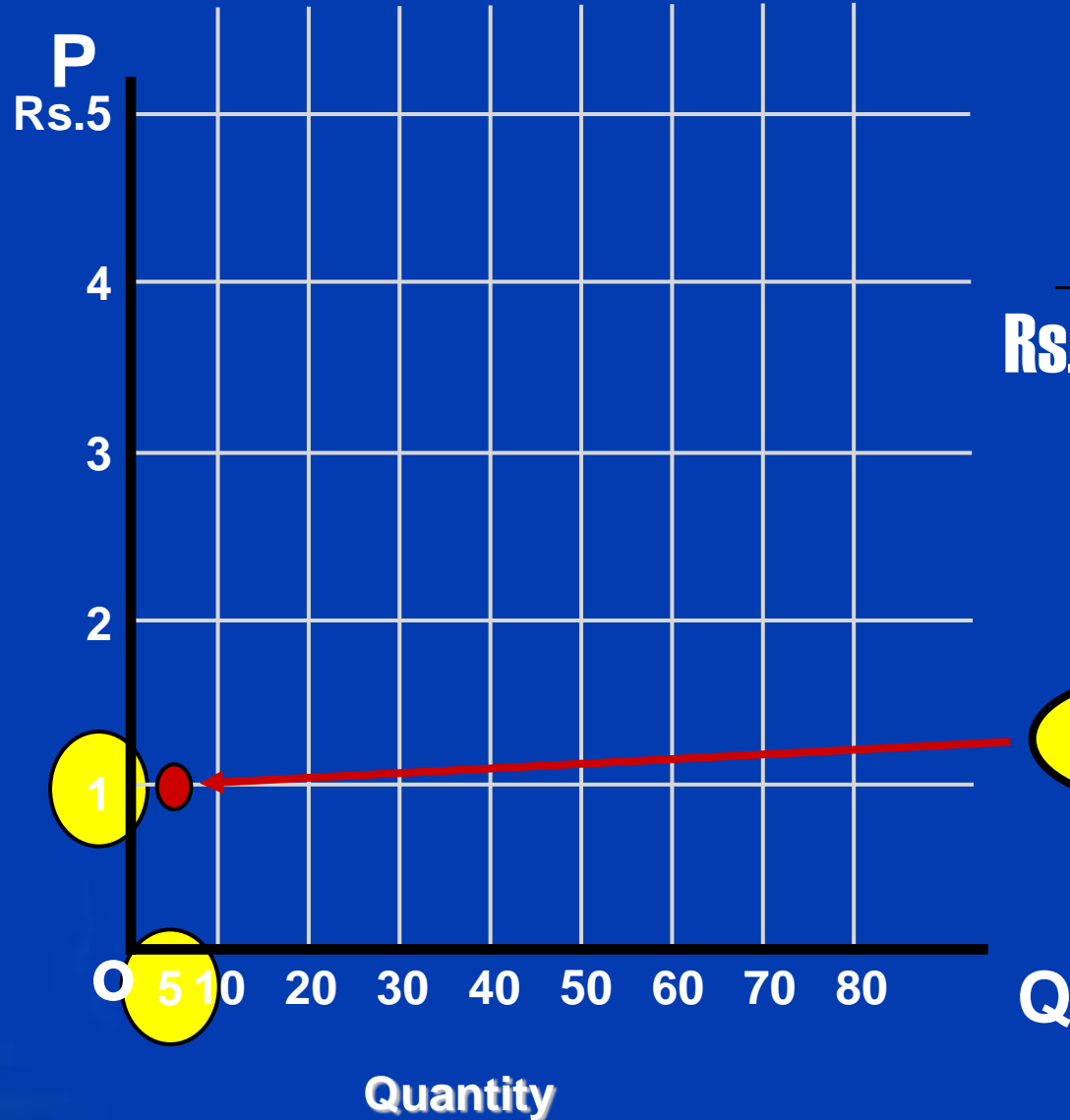


Reasons For Upward sloping "S" Curve

1. Current producers produce more
2. New producers are attracted to the market.

SUPPLY CURVE

Price

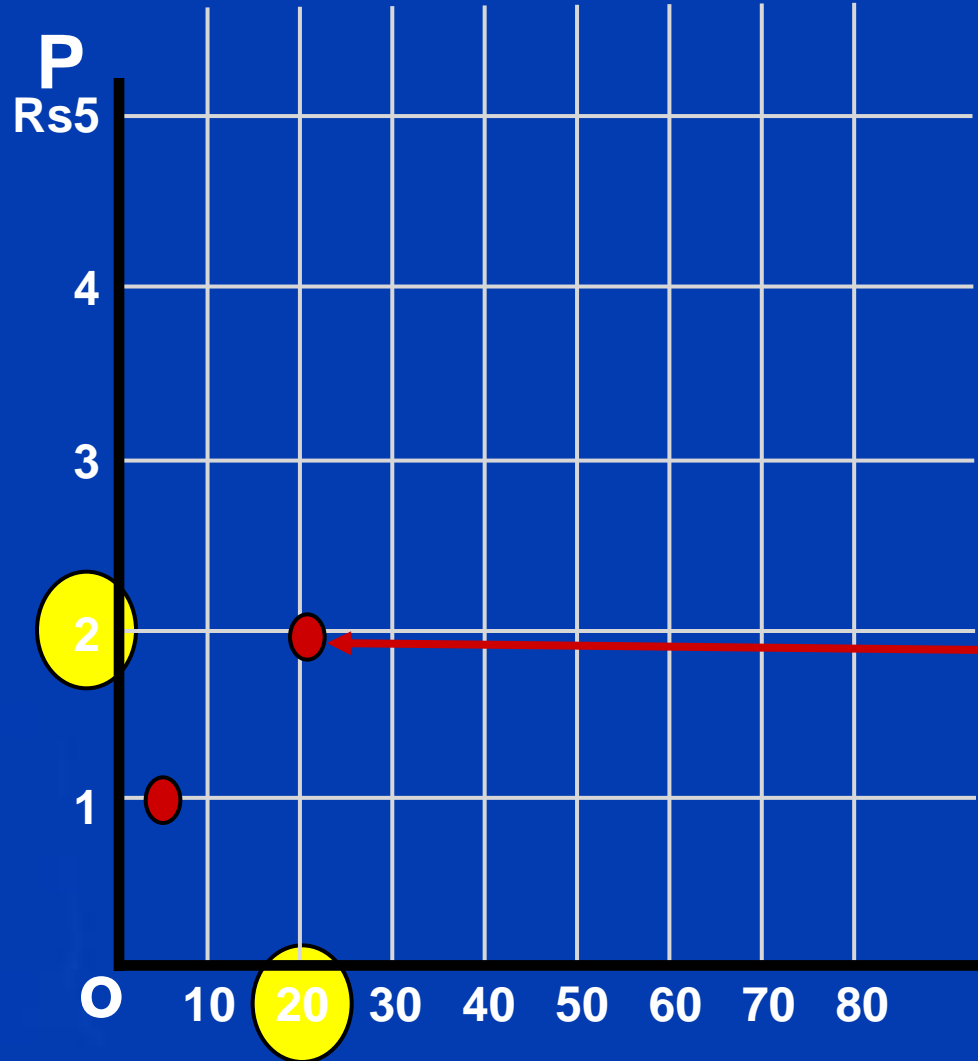


Supply
Schedule

P	Q _s
Rs.5	60
4	50
3	35
2	20
1	5

SUPPLY CURVE

Price

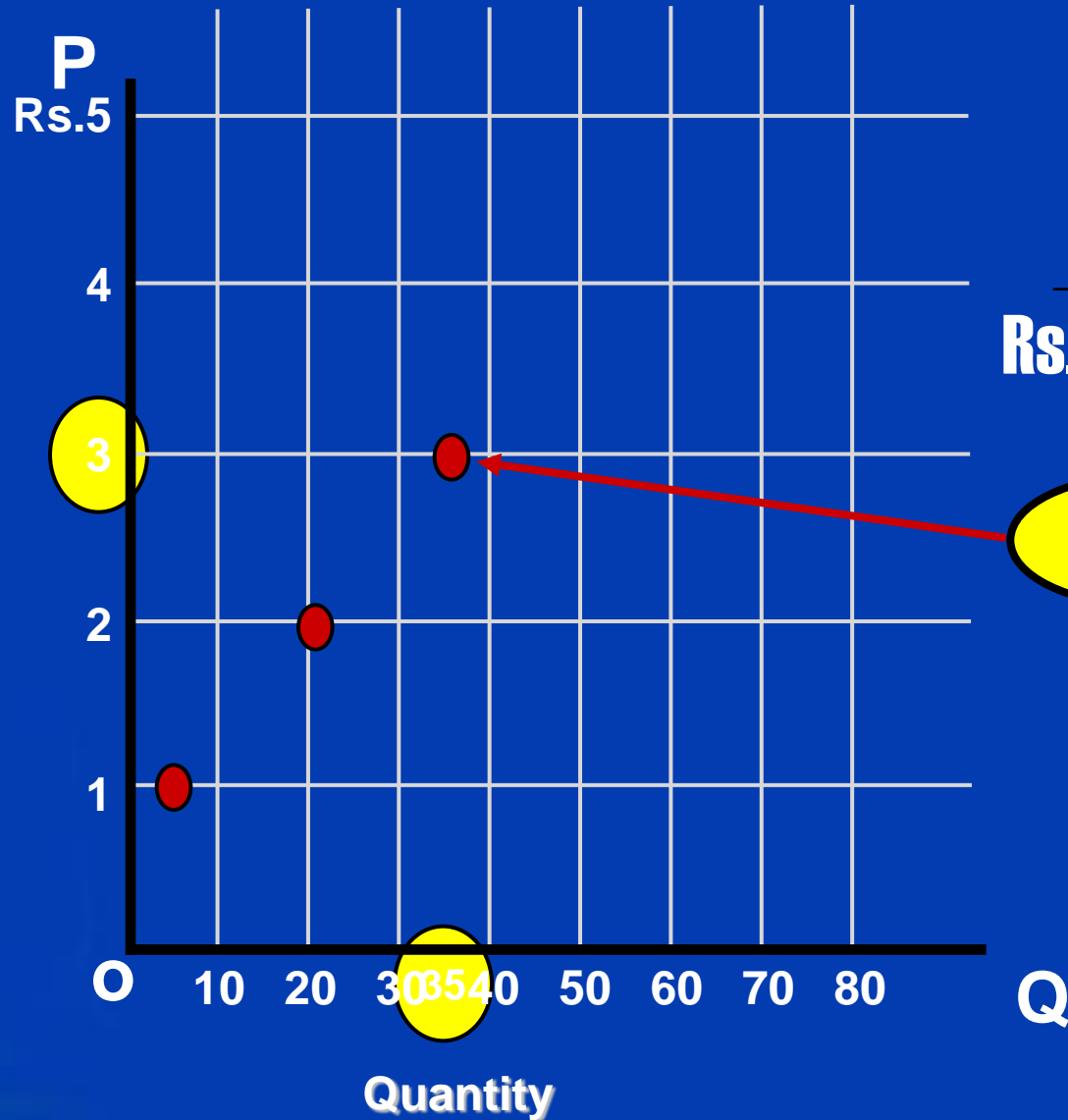


Supply
Schedule

P	Q _s
Rs.5	60
4	50
3	35
2	20
1	5

SUPPLY CURVE

Price

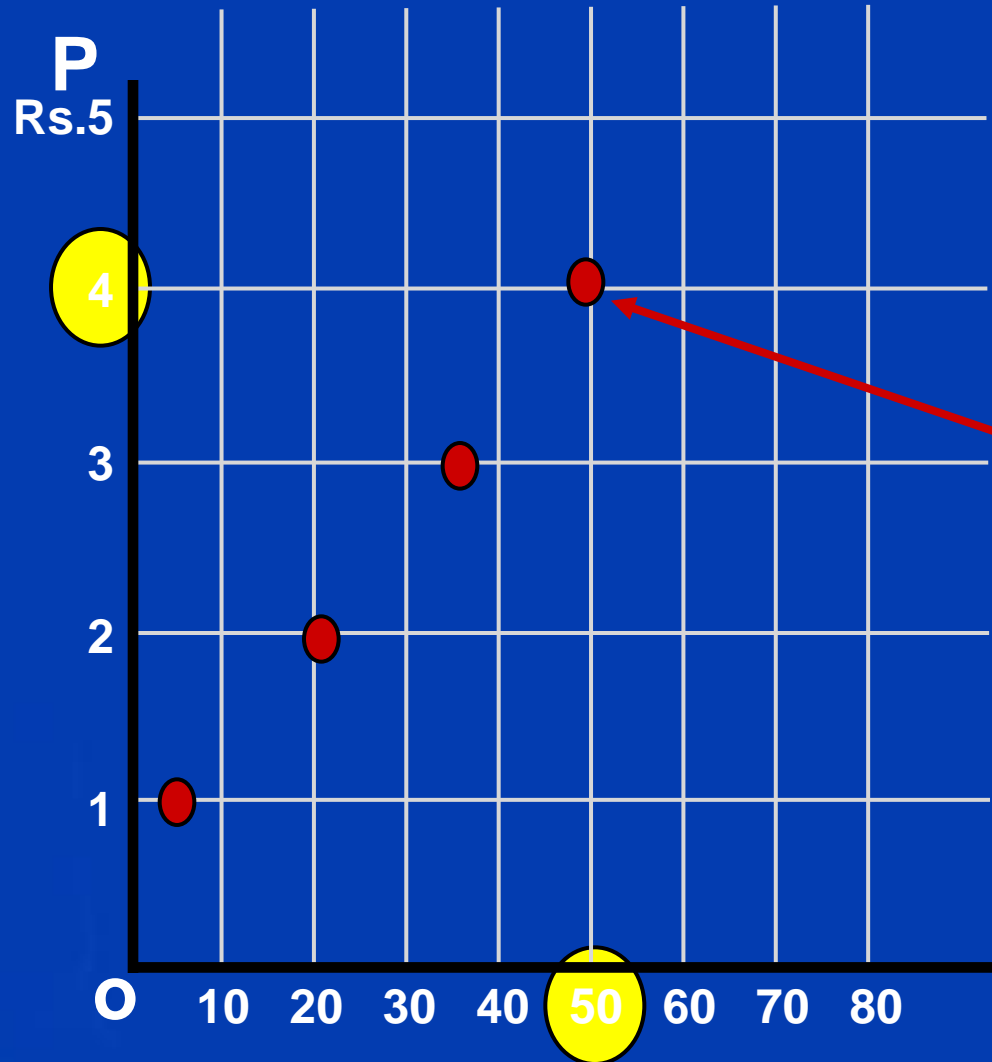


Supply
Schedule

P	Q _s
Rs.5	60
4	50
3	35
2	20
1	5

SUPPLY CURVE

Price

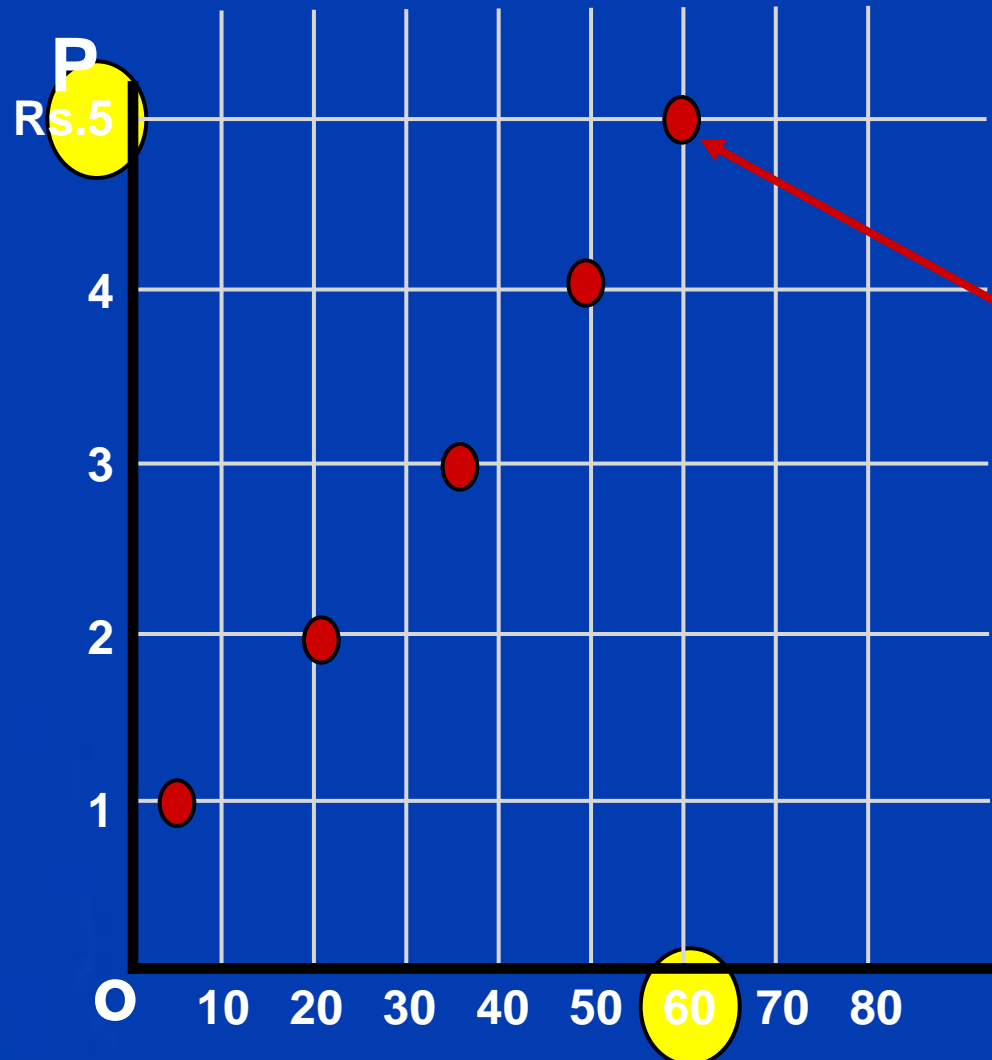


Supply
Schedule

P	Q _s
Rs.5	60
4	50
3	35
2	20
1	5

SUPPLY CURVE

Price



Supply
Schedule

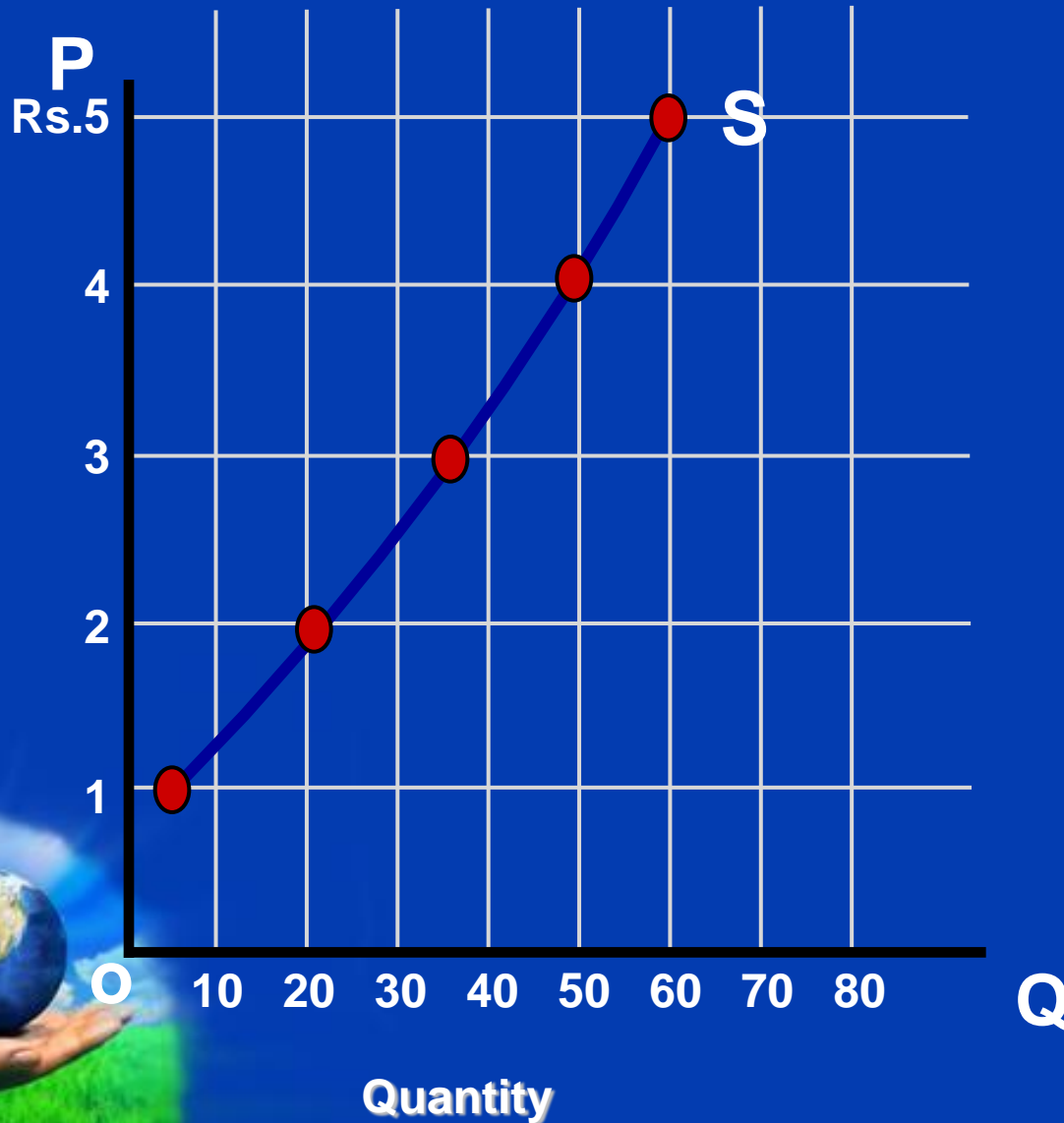
P	Q _s
Rs.5	60
4	50
3	35
2	20
1	5

Quantity

Q

SUPPLY CURVE

Price



Supply
Schedule

P	Q _s
Rs.5	60
4	50
3	35
2	20
1	5

The Supply Shifters



1. Cost of Inputs [wages & raw materials]

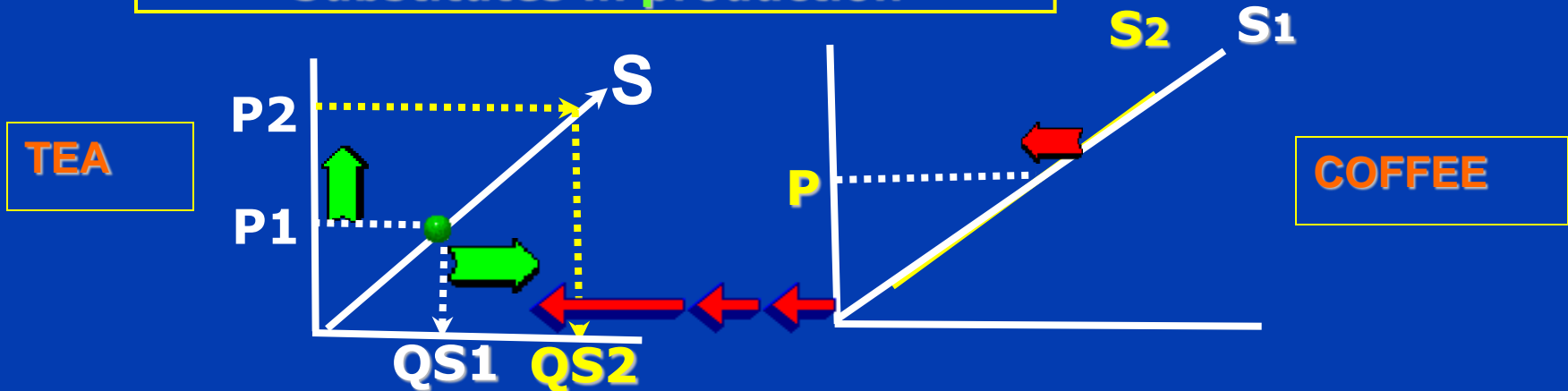
If cost of inputs
Decreases,
supply
Increases

If cost of inputs
increases
supply
Decreases

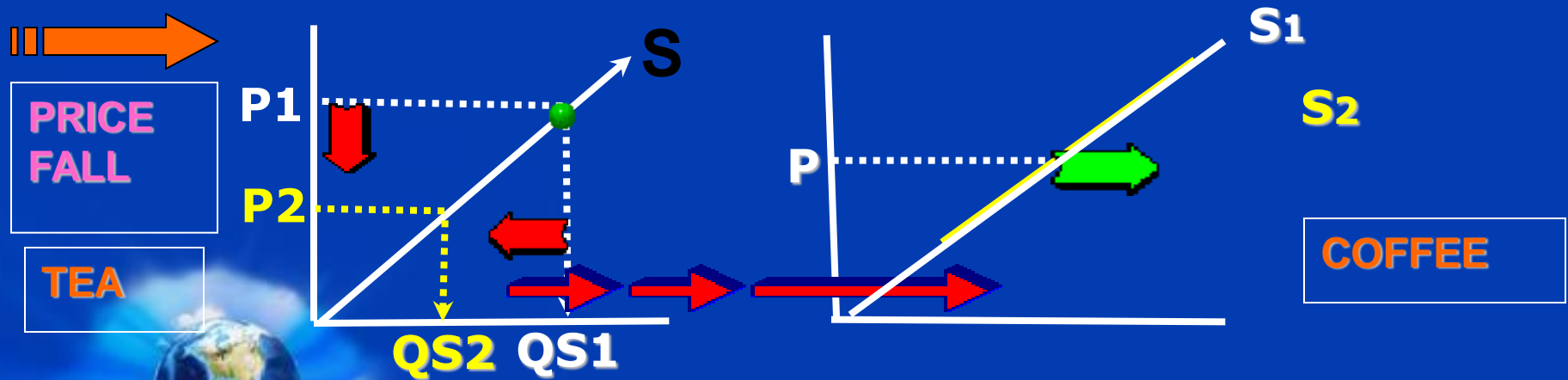


2. Prices of alternative goods

"Substitutes in production"



Producers want to produce more of the good where price is increasing,

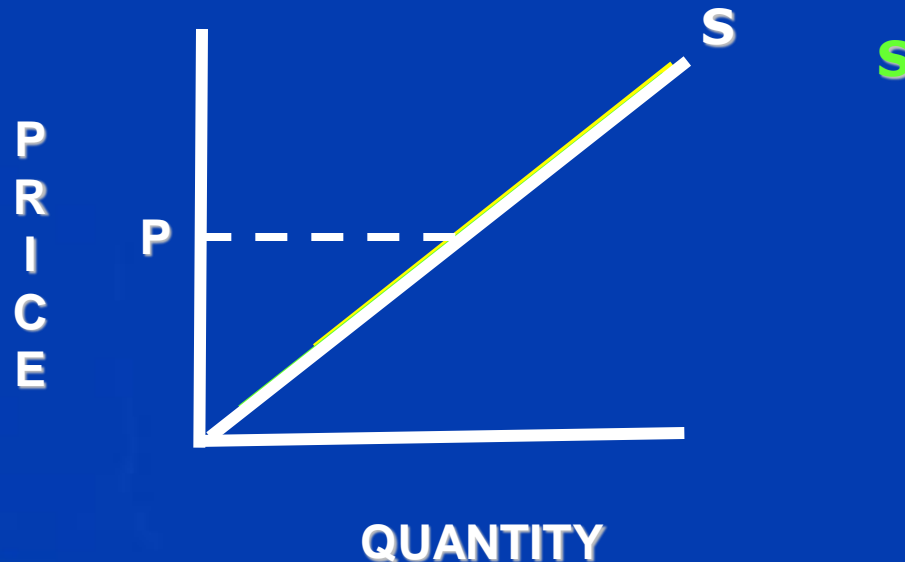


or at least, where the price is not going down.

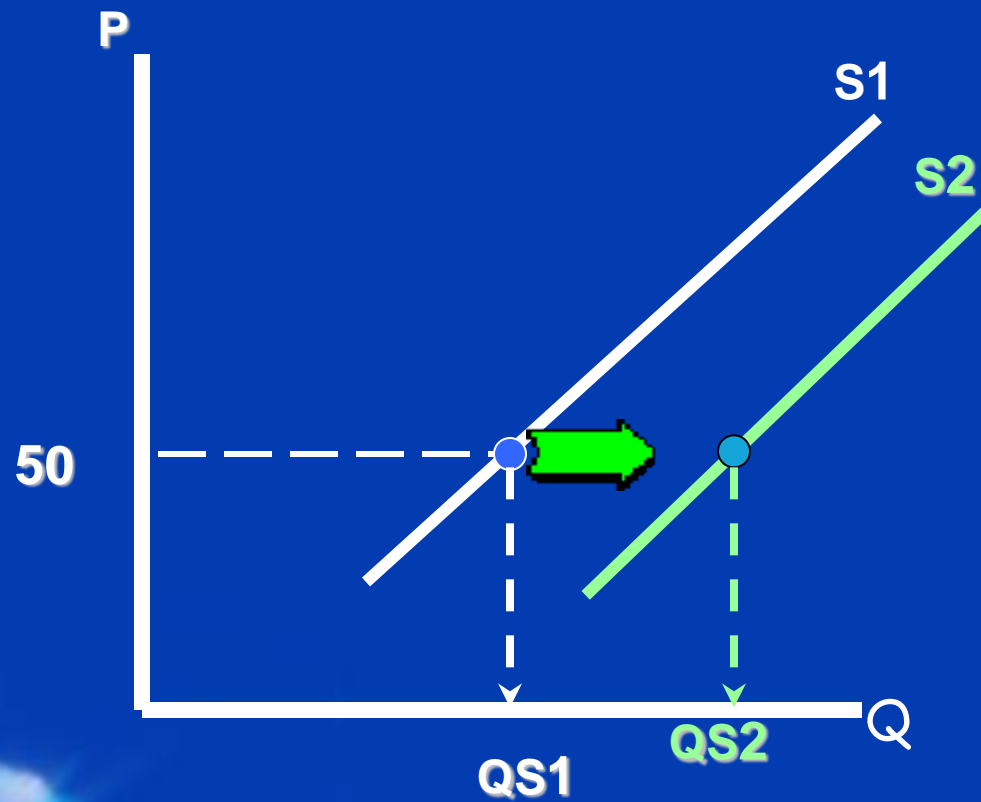
3. Technological Improvement

Because technical improvement helps to produce more , producers don't have to have as many [saves Rs]

Supply curve moves to the right.



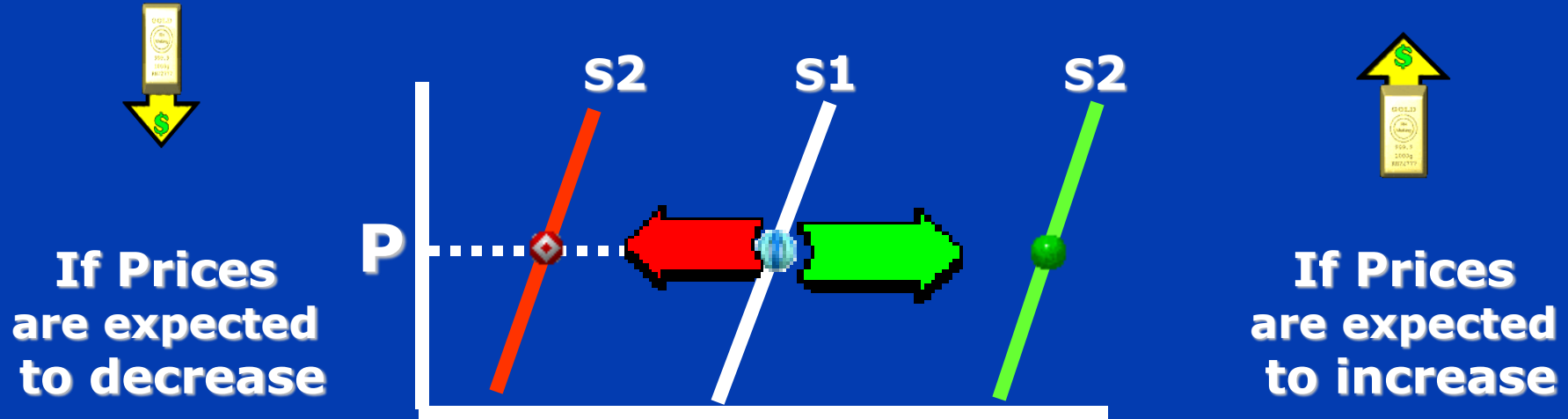
4. Number of Suppliers



Supply



5. Producer Expectations about Future Price

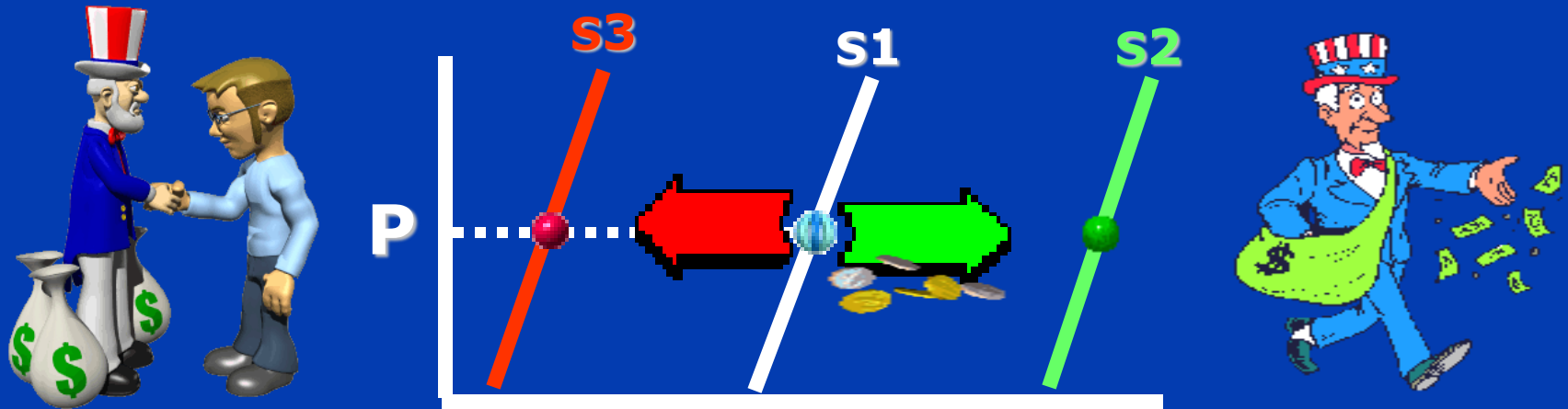


If producers expect future prices to decline, they will (increase/decrease) current production.

If producers expect future prices to increase, they will (increase/decrease) current production.



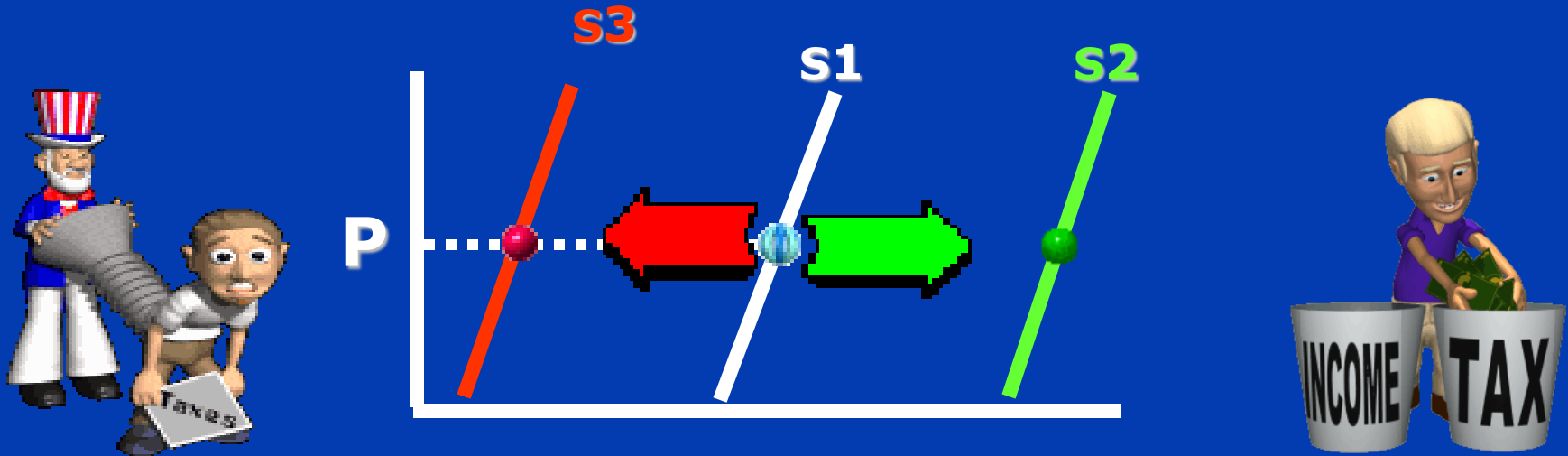
6. Subsidies - free money from Government



Free money from the Government (subsidies) induces suppliers to supply more.

When subsidies are taken away, then suppliers lose money and will decrease supply.

7. Taxes



When **taxes are decreased**, the supply curve moves to the right.

When **taxes are raised**, the supply curve moves to the left.



DETERMINANTS OF SUPPLY

- **Resource Prices**
- **Technology**
- **Taxes & Subsidies**
- **Prices of Other Goods**
- **Price Expectations**
- **Number of Sellers**



Market Equilibrium



The Market Mechanism

- **Market Mechanism Summary**

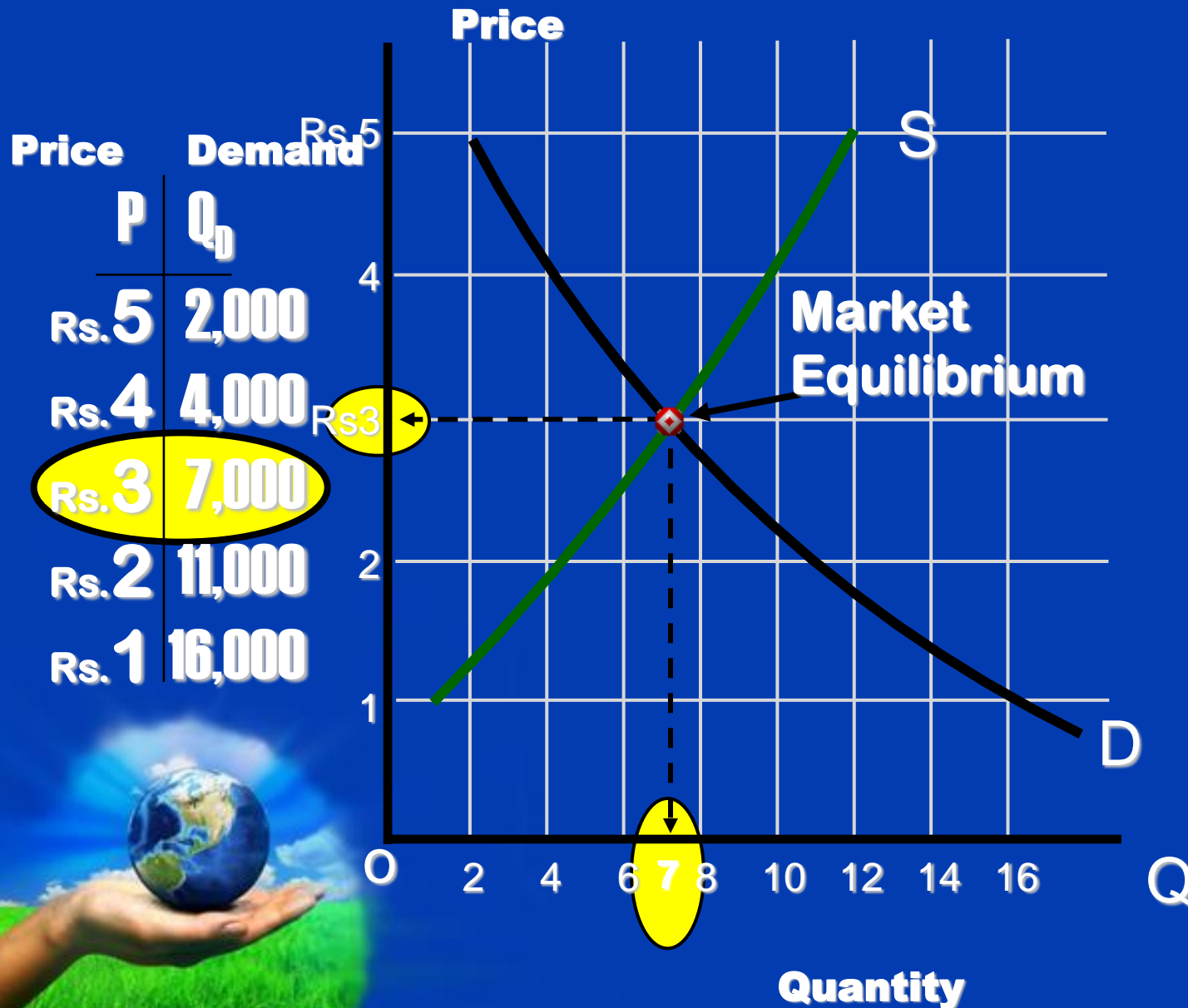
- 1) **Supply and demand interact to determine the equilibrium price.**

- 2) **When not in equilibrium, the market will adjust to a shortage or surplus and return to the equilibrium.**

- 3) **Markets must be competitive for the mechanism to be efficient.**



MARKET DEMAND & SUPPLY

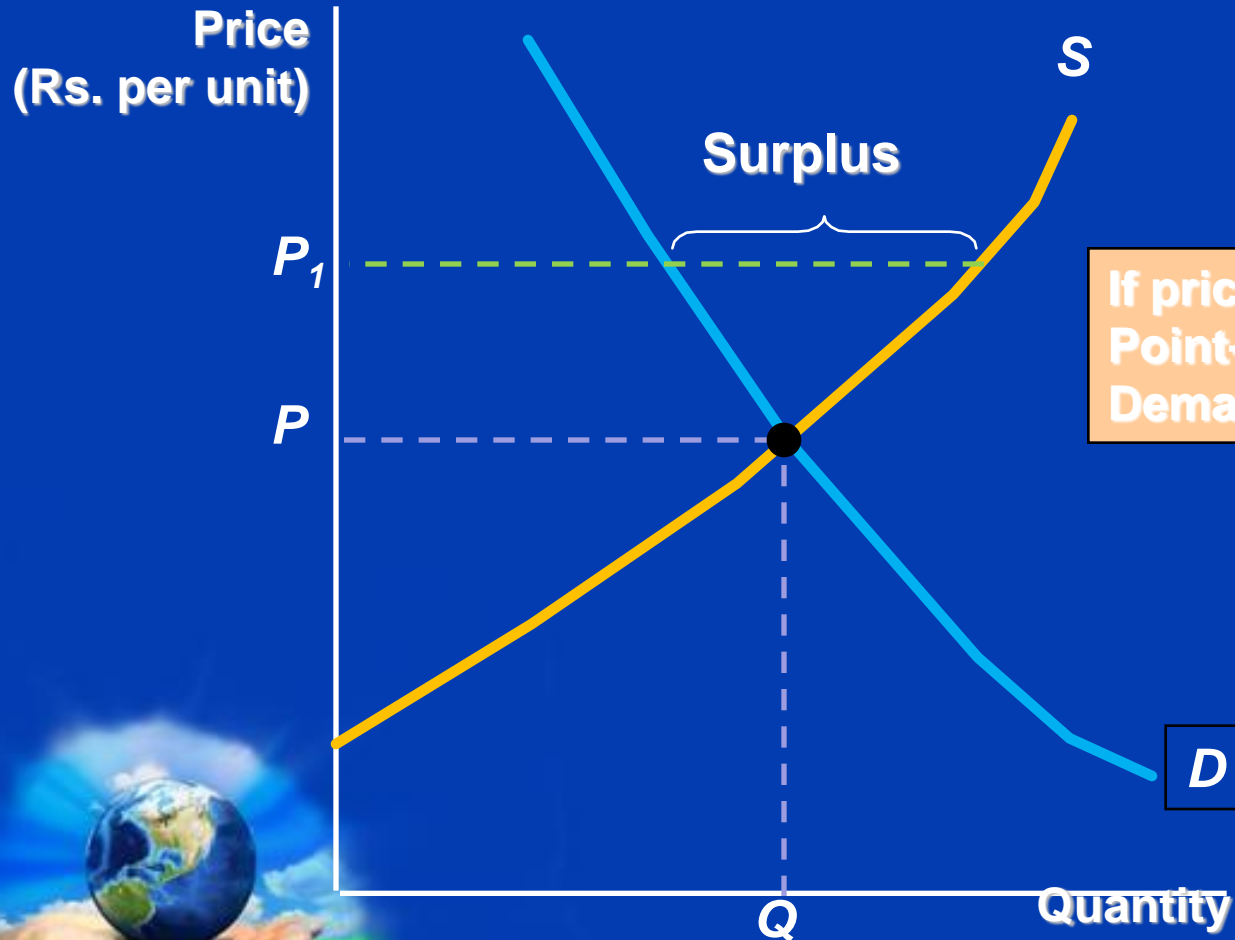


Price	Supply
P	Q
Rs.5	12,000
Rs.4	10,000
Rs.3	7,000
Rs.2	4,000
Rs.1	1,000

The Market Mechanism



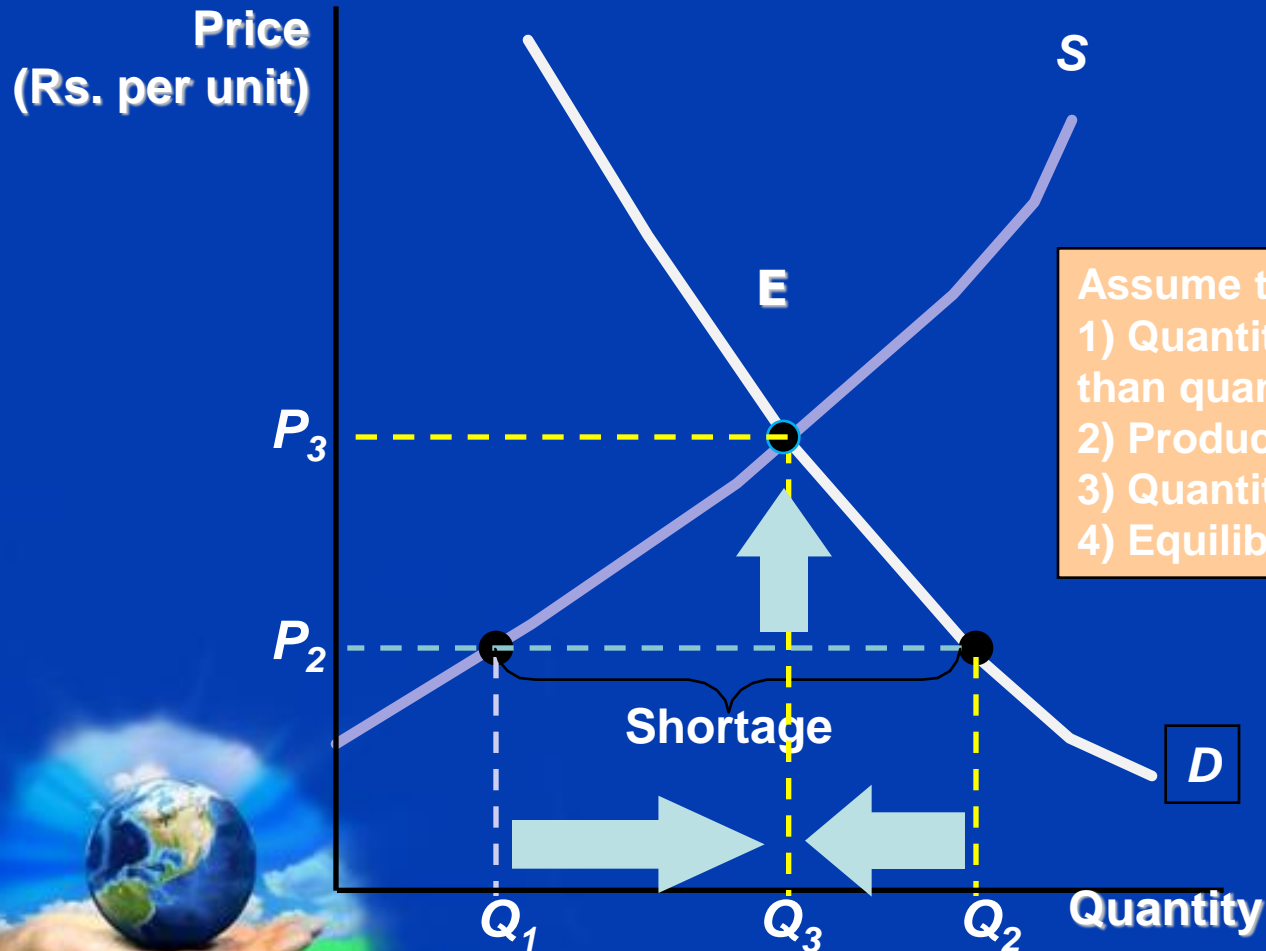
The Market Mechanism



If price is above equilibrium
Point-Supply exceeds
Demand.



The Market Mechanism



Assume the price is P_2 , then:

- 1) Quantity Demanded is greater than quantity Supplied
- 2) Producers raise price
- 3) Quantity supplied increases
- 4) Equilibrium is restored

Effects of Government Intervention Price Controls

- If the Government decides that the equilibrium price is too high, they may establish a maximum allowable *ceiling price*.



Price Ceilings and Price Floors

- ***Price Ceiling***

- is a legally established *maximum price* which a seller can charge or a buyer must pay.

- ***Price Floor***

- is a legally established *minimum price* which a seller can charge or a buyer must pay.



A close-up photograph of a bouquet of yellow roses. The petals are covered in small, glistening water droplets, suggesting they have been recently watered or are in a humid environment. The roses are in various stages of bloom, with some showing the classic spiral pattern of rose petals. The background is dark and out of focus, making the bright yellow flowers stand out.

THANK YOU

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