

Chapter 3 Demand

Answers to Knowledge checks

- 3.1** This will come under the fourth heading as your preferences have been affected by the popularity of the good.
- 3.2** The law of demand states that there is an inverse relationship between quantity demanded and the price of a good or service, *ceteris paribus*.
- 3.3** An extension of demand occurs when demand changes in response to a change in price (a movement *along* the demand curve). An increase in demand involves a shift in the demand curve in response to a change in one of the conditions of demand.
- 3.4** A normal good is one for which the quantity demanded increases with an increase in consumer income.
- 3.5** In general, people tend to respond more strongly to a price change in the long run than in the short run. For example, they may continue with their normal spending habits until they realise that the price change is permanent, or it may be that it may be costly to change those habits.
- 3.6** The demand curve can be interpreted as representing the willingness of consumers to pay for the good at any given price. The total area under the demand curve up to the price charged is the total value that its consumers place on the good. The surplus over and above what they have paid for the good then reflects the net gain that the consumers (jointly) gain from consuming the good.

Answers to Exercises and Case studies

Exercise 3.1

- a** See Figure A3.1.

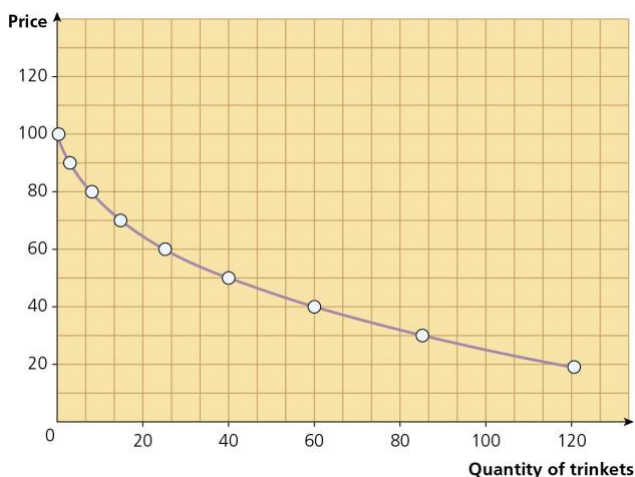


Figure A3.1 The demand for trinkets

- b** 20 trinkets would be sold if the price were at £65. You can read this from the graph you have drawn.
- c** 50 trinkets would be demanded if the price were at £45.

Exercise 3.2

- a A digital camera is likely to be a **normal good**, as we expect demand to increase as consumer incomes increase.
- b If the demand for magazines increases as consumer incomes increase, this is likely to be an example of a **normal good**. On the other hand, if increasing incomes leads to a fall in demand for magazines because more people rely on the internet instead of reading magazines, then a magazine would become an example of an **inferior good**.
- c Potatoes are a classic example of an **inferior good** because as consumer incomes increase, so people tend to switch to other types of food. This may be especially the case for low-income families, where potatoes may form a high portion of the diet, but an increase in incomes enables the purchase of a wider range of foodstuffs.
- d Again, it is difficult to say whether a bicycle is a **normal** or an **inferior** good, as this may depend upon context. There may be situations in which rising consumer incomes lead to a fall in the demand for bicycles, as consumers are able to afford motor bikes or cars. For example, this has been seen in China, where rapidly rising incomes have led to a substantial shift from bicycles to cars in recent years. On the other hand, in some developing countries, an increase in incomes may enable more people to purchase bicycles. Remember that the distinction between normal and inferior goods is wholly about how the demand will respond to a change in consumer incomes.
- e A bottle of fine wine is likely to be an example of a **normal good**, as demand will tend to increase as incomes rise.
- f On the other hand, a bottle of cheap wine may be an **inferior good**, if people with rising incomes buy more expensive wines.

Exercise 3.3

In this exercise, there are three possible responses, represented by Figures A3.2, A3.3 and A3.4.

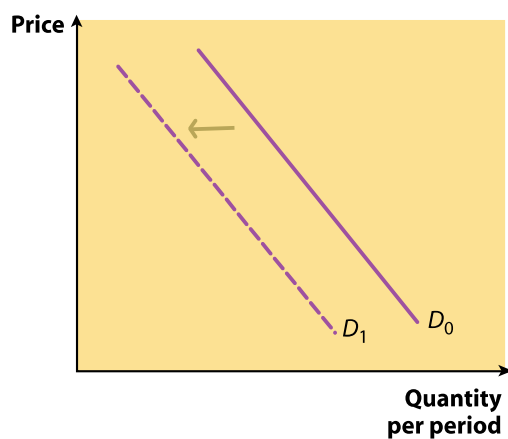


Figure A3.2 A leftward shift of the demand curve

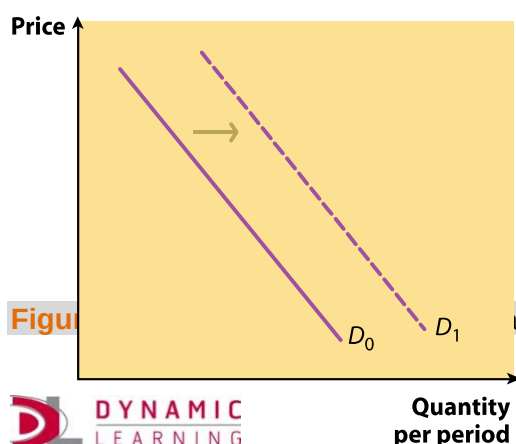


Figure A3.3 A rightward shift of the demand curve

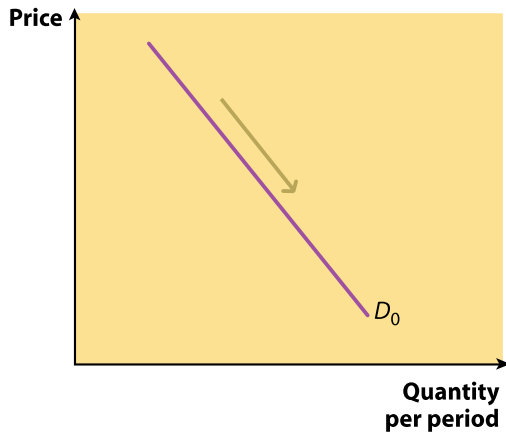


Figure A3.4 A movement along the demand curve

- a** If the campaign is successful, people will eat less chocolate, and the demand curve will shift to the left — less will be demanded at any given price (see Figure A3.2).
- b** As the price of apples increases, some people may choose to buy oranges instead (in other words, we would expect apples and oranges to be **substitutes**), so the demand curve for oranges will shift to the right — more will be demanded at any given price (see Figure A3.3).
- c** A decrease in the price of oranges will induce a movement **along** the demand curve — more oranges will be demanded but the demand curve does not shift (see Figure A3.4).
- d** Blu-ray discs and Blu-ray players are considered to be **complements**, so a decrease in the price of Blu-ray players is likely to increase the demand for Blu-ray discs — the demand curve shifts to the right (see Figure A3.3).
- e** In general, private transport is expected to be a **normal good**: as incomes rise, more people are likely to have their own cars rather than relying on buses. Therefore, a rise in consumer incomes will lead to a rise in the demand for private transport and the demand curve will shift to the right (see Figure A3.3).
- f** In contrast, public transport tends to be regarded as an **inferior good**: demand falls as income rises. Therefore, an increase in consumer incomes will lead to a shift of the demand curve to the left (see Figure A3.2).

Exercise 3.4

- a** Given Table 3.2 (see page 40 of the book) and a market price of £14, only consumers A, B, C and D would be prepared to buy the good.
- b** Consumer A would have been prepared to buy the good even if the price had been £20, so enjoys a surplus of £6 if only £14 has to be paid.
- c** The total consumer surplus with the price at £14 would be £12 (as A has a surplus of £6, B of £4 and C of £2).
- d** With the price at £16, the total consumer surplus would be only £6. Consumer A would get a surplus of £4 and B would get £2. However, C would get no surplus and D would no longer be prepared to buy the good.

Case study 3.1

Fast food

- a** In general, the demand for a good or service is said to depend on the price of the good or service, the price of other goods, consumer incomes, preferences and the size of the market. In this particular case, the campaign is likely to have affected people's preferences, if people are now more aware of the health dangers of fast food.
- b** The question here is whether fast food is a normal or an inferior good. If a rise in consumer incomes allows people to switch to more tasty and more healthy food, then fast food would be seen as an inferior good, so the demand curve for fast food would shift to the left.
- c** If McDonald's found that its market share was being squeezed by competition from companies serving healthier and more upmarket burgers, then one response from McDonald's would be to use its advertising to draw attention to the healthiness of its own products — which is exactly what they have been doing.

Answers to end-of-chapter questions

A Multiple-choice questions

- 1** d. Other things being equal
- 2** b. There is a successful advertising campaign for the television programme
- 3** c. Substitute goods
- 4** a. An increase in consumer surplus and a decrease in price

B Knowledge and understanding questions

- 5** As the price of a good decreases the quantity demanded increases.

A full explanation of the relationship	2 marks
A vague or partial explanation of the relationship	1 mark

- 6** Factors may include:
- Price of the meals
 - The price of meals at another restaurant
 - A person's income — as their income increases the demand is also likely to increase (a normal good)
 - Other factors including advertising, tastes, trends/fashion, number of other restaurants in the area

Two factors explained	4 marks
One factor explained AND one factor identified	3 marks
One factor explained OR two factors identified	2 marks
One factor identified	1 mark

- 7** As the price of petrol increases the demand for cars is likely to decrease at each price level.

An explanation of how the demand may reduce at each price level	up to 2 marks
A diagram showing an appropriate shift to the left of the demand curve	up to 2 marks

- 8** An inferior good is one where the quantity demanded decreases in response to an increase in consumer incomes.

An explanation of an inferior good AND a relevant example	2 marks
An explanation of an inferior good	1 mark

C Stimulus response question

9 a Factors may include:

- Price — the price of Navpreet's cleaning service
- Price of substitutes — how many other businesses in the area charge for their dog-cleaning service
- Income — as people earn more, they are likely to demand more of Navpreet's service (normal/luxury good)
- Advertising — that Navpreet might have produced for her business/service
- Fashions/trends — for dog-cleaning services
- Competition — the number of other businesses offering dog-cleaning services in the area

Identification of a factor that may affect demand for Navpreet's service	1 mark for each factor, up to max. 3 marks
Explanation of each factor	1 mark for each factor, up to max. 3 marks

b

Correctly labelled axis	1 mark
Correctly labelled demand curve	1 mark
Demand curve that matches the points in Table 1 in the book (see page 41)	up to 2 marks

c

An explanation of the increase in consumer surplus resulting from a decrease in price	up to 2 marks
Reference to the points on the graph used in student's answer to Question 9(b)	up to 2 marks