SUBJECT - ECONOMIC

LECTURE- 3

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LAW OF DEMAND

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

Law of Demand =inverse ratio of Quantity Demand to price of Goods

It is one of the most important laws of economic theory. According to this law, other things remaining constant (ceteris paribus), if the price of a commodity falls the quantity demanded of it will rise and if price of the good rises quantity demanded will fall. Thus, there is inverse relationship between price and quantity demanded. .

Law of demand only applies when certain conditions are met, which have been mentioned as under.

Assumptions of the law The law of demand assumes the following:

1. Incomes of consumers do not change. If consumer's income increases or decreases, the law will not hold good.

2. People's tastes and preferences remain unchanged; and

3. Prices of substitutes and complements do not change.

A demand schedule is shown as under.

Price of apples per (in Rs)	Quantity demanded (in nos.)
8	5
6	7
4	8
2	10

It is seen in the table that when

the price of the Apple is Rs. 8/- per unit, consumers buy 5 units only
the price of the Apple is Rs. 6/- per unit, consumers buy 7 units only
the price of the Apple is Rs. 4/- per unit, consumers buy 8 units only
and at Rs. 2/- per unit, they buy 10 units of the commodity. Thus, as price goes down, consumers buy more of a commodity and vice versa

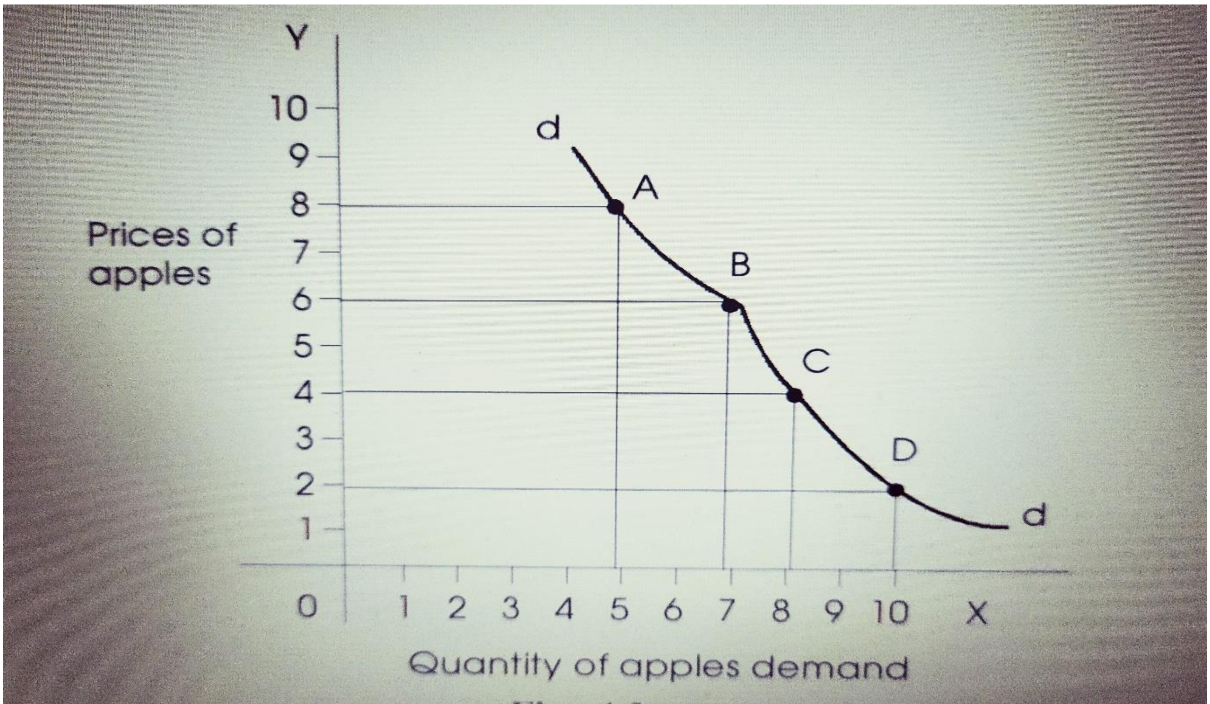

Fig. 4.3

. The demand curve drawn from this schedule i. Along x-axis, quantity is measured and along y-axis price of the commodity is measured.

By joining various points or combinations of price and quantity demanded, we get a curve 'dd' falling downwards from left to the right. This is known as the demand curve.

The demand curve clearly indicates that price is inversely related to quantity demanded. As price falls, demand rises and it shrinks when price rises.

It is to be noted here that we have assumed 'other factors' to be constant.

Thus, any changes in these factors such as tastes, fashion, income or prices of related goods etc, will falsify the law of demand. In that case, the demand curve will not behave in the manner stated above. For instance, if income of consumer rises at the time when price of goods have risen, demand will not go down. Rather, it may increase. We do not bother of rise in price of goods when our income also increases.

Note

> Demand curve is shifted slopes downward to the right. This is because of operation of the law of diminishing marginal utility.
> When the price of a commodity decreases, new demand is created. Also that existing buyers buy more. As the particular commodity has become cheaper, some people will purchase it in preference to other commodities. If the law of diminishing marginal utility is true, the demand curve must slope downwards.
> This is because only a downward sloping demand curve represents increase in demand due to fall in the prices of a commodity.
> Further, when price of a commodity falls, real income of the people increases. In other words, they are able to buy more goods and services now with the same amount of money they have. This is called income effect. Likewise, when the

commodity is cheaper, it tends to be substituted for other commodities, which are dearer. This is called substitution effect. Both income effect and substitution effect together increase the capacity of the consumers to buy more of a commodity, when its price comes to low level. Another reason for downward sloping demand curve is that when a commodity becomes cheaper.