Edexcel (A) Economics A-level

Theme 1: Introduction to Markets and Market Failure

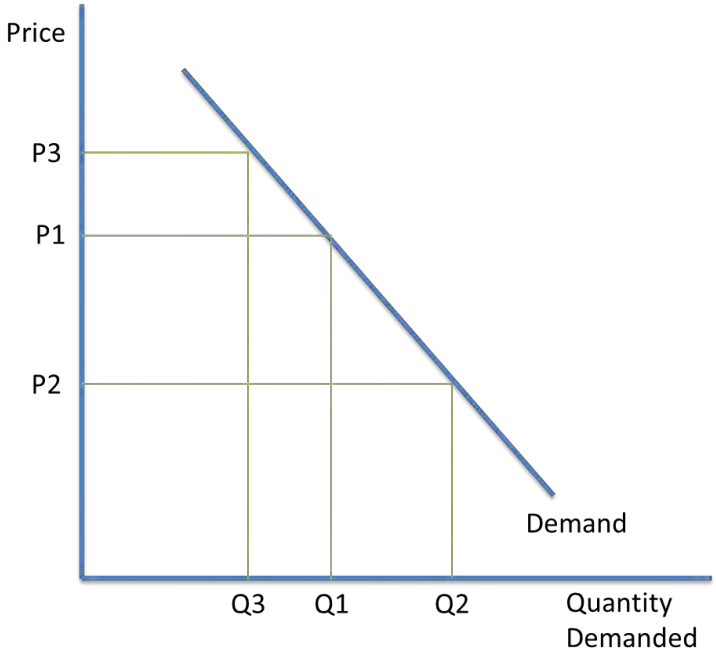
1.2 How Markets Work

1.2.2 Demand

Notes

- Demand is the **quantity of a good or service that consumers are able and willing to buy at a given price during a given period of time.**
- Demand varies with price. Generally, the lower the price, the more affordable the good and so consumer demand increases. This can be illustrated with the demand curve.

Movements along the demand curve:



- At price P1, a quantity of Q1 is demanded. At the lower price of P2, a larger quantity of Q2 is demanded. This is an **expansion** of demand. At the higher price of P3, a lower quantity of Q3 is demanded. This is a **contraction** of demand. Only changes in price will cause these movements along the demand curve.

- **Shifting the demand curve:**

- Price changes do not shift the demand curve. A shift from D1 to D2 is an inward shift in demand, so a lower quantity of goods is demanded at the market price of P1. A shift from D1 to D3 is an outward shift in demand. More goods are demanded at the market price of P1.
- The factors that shift the demand curve can be remembered using the mnemonic PIRATES:
    - **P- Population.** The larger the population, the higher the demand. Changing the structure of the population also affects demand, such as the distribution of different age groups.
    - **I- Income.** If consumers have more disposable income, they are able to afford more goods, so demand increases.
    - **R- Related goods.** Related goods are **substitutes** or **complements**. A substitute can replace another good, such as two different brands of TV. If the price of the substitute falls, the quantity demanded of the original good will fall because consumers will switch to the cheaper option. A complement goes with another good, such as strawberries and cream. If the price of strawberries increases, the demand for cream will fall because fewer people will be buying strawberries, and hence fewer people will be buying cream.
    - **A- Advertising.** This will increase consumer loyalty to the good and increase demand.
    - **T- Tastes and fashions.** The demand curve will also shift if consumer tastes change. For example, the demand for physical books might fall, if consumers start preferring to read e-books.

- **E- Expectations.** This is of future price changes. If speculators expect the price of shares in a company to increase in the future, demand is likely to increase in the present.
- **S- Seasons.** Demand changes according to the season. For example, in the summer, the demand for ice cream and sun lotions increases.

Types of demand:

- **Derived demand:** This is when the demand for one good is linked to the demand for a related good. For example, the demand for bricks is derived from the demand for the building of new houses. The demand for labour is derived from the goods the labour produces. For example, if the demand for cars increases, the demand for the labour to produce those cars will increase.
- **Composite demand:** This is when the good demanded has more than one use. An example could be milk. Assuming there is a fixed supply of milk, an increase in the demand for cheese will mean that more cheese is supplied, and therefore less butter can be supplied.
- **Joint demand:** This is when goods are bought together, such as a camera and a memory card.

Diminishing marginal utility:

- The demand curve is downward sloping, showing the inverse relationship between price and quantity.
- The law of diminishing marginal utility states that as an extra unit of the good is consumed, the marginal utility, i.e. the benefit derived from consuming the good, falls. Therefore, consumers are willing to pay less for the good.
- This can be explained using the example of chocolate. The first chocolate bar will benefit the consumer more, because it satisfies more of their needs, and so the consumer is willing to pay more for it. The second bar will satisfy the consumer less, because they have less need for it, and the consumer will be willing to pay less for it. Eventually the utility derived will become zero.