

OCR Economics A-level **Microeconomics**

Topic 2: The Role of Markets 2.2 Demand

Notes

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- 📖 A **market** is created when buyers and sellers interact. A **sub-market** is part of an overall market, but it has some unique characteristics. In each sub-market, there is a different market structure. For example, from the market of banking, each sub-market could be credit cards, loans, mortgages or savings accounts.

Demand:

- 📖 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.

The relationship between price and quantity demanded using marginal utility theory and income and substitution effects:




- 📖 Marginal utility is the extra satisfaction derived from consuming one extra unit of the good.
- 📖 The demand curve is downward sloping because of **diminishing marginal utility**. The law of diminishing marginal utility suggests that consumer surplus generally declines with extra units consumed. This is because the extra unit generates less utility than the one already consumed. Therefore, consumers are willing to pay less for extra units.
- 📖 With an increase in price:
 - The good becomes more expensive than alternatives. This is the **substitution** effect and it assumes the same level of income. It measures how much a high price on a good causes the consumer to switch to substitutes.
 - Disposable income reduces, which may lead to a fall in demand. This is the **income** effect. It explores how price changes affect disposable income.
- 📖 These explain the downward sloping nature of the demand curve.
- 📖 **Individual demand** is the demand of an individual or firm, measured by the quantity bought at a certain price at one point in time.
- 📖 **Market demand** is the sum of all individual demands in a market.

📖 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.
-  **Competitive demand:** This is the demand for goods which are substitutable, so the sale of the good is in competition with the substitute. For example, a Samsung TV is in competitive demand with a Sony TV.

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 D_1 to D_2 is an inward shift in demand, so a lower quantity of goods is demanded at the market price of P_1 . A shift from D_1 to D_3 is an outward shift in demand. More goods are demanded at the market price of P_1 .
-  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.

