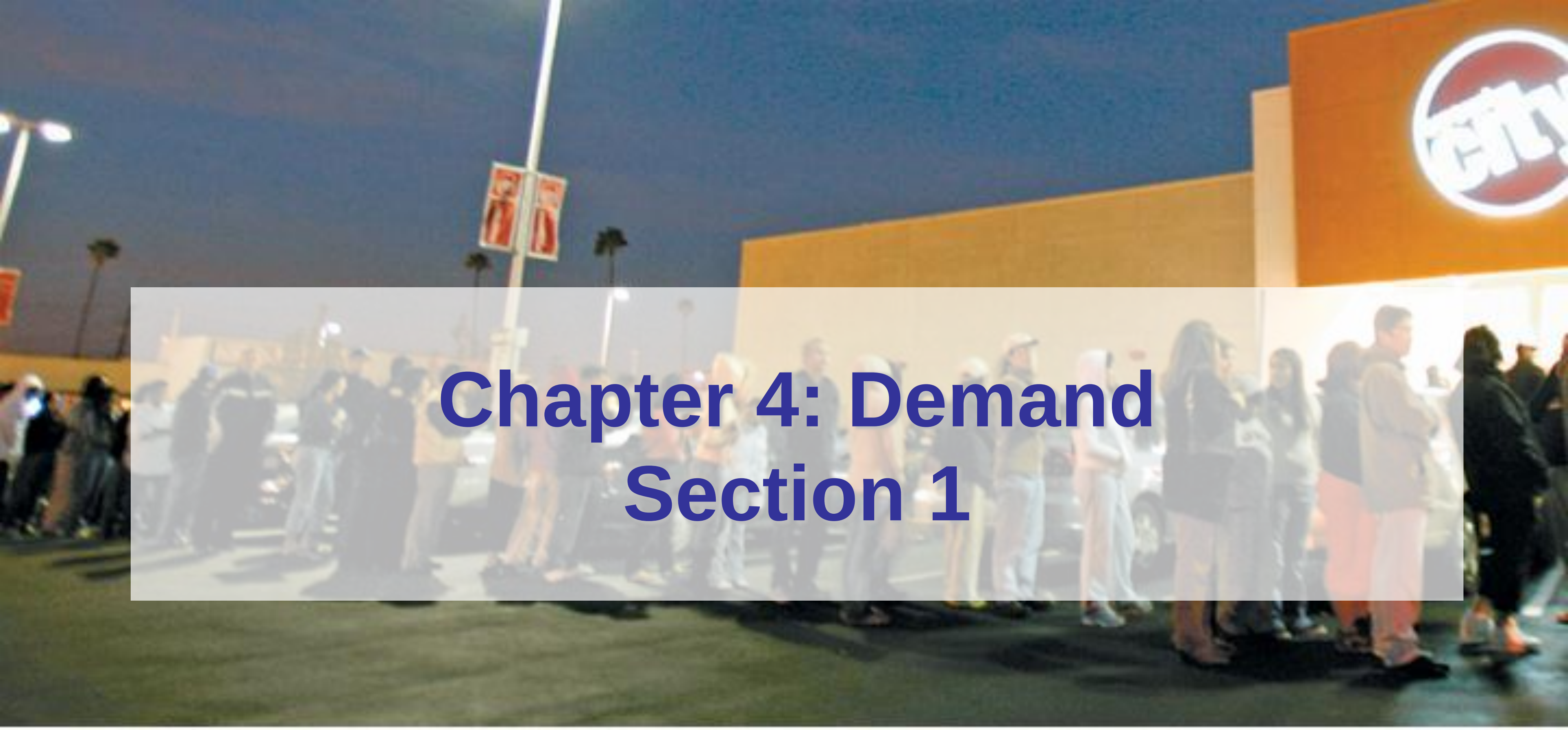

Chapter 4: Demand
Section 1

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ECONOMICS

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Objectives

1. **Explain** the law of demand.
2. **Describe** how the substitution effect and the income effect influence decisions.
3. **Create** a demand schedule for an individual and a market.
4. **Interpret** a demand graph using demand schedules.

Key Terms

- **demand**: the desire to own something and the ability to pay for it
- **law of demand**: consumers will buy more of a good when its price is lower and less when its price is higher
- **substitution effect**: when consumers react to an increase in a good's price by consuming less of that good and more of a substitute good

Key Terms, cont.

- **income effect**: the change in consumption that results when a price increase causes real income to decline
- **demand schedule**: a table that lists the quantity of a good a person will buy at various prices in a market
- **market demand schedule**: a table that lists the quantity of a good all consumers in a market will buy at various prices
- **demand curve**: a graphic representation of a demand schedule

Introduction

- How does the law of demand affect the quantity demanded?

  – Price changes always affect the quantity demanded because people buy less of a good when the price goes up.

  – By analyzing demand schedules and demand curves, you can see how consumers react to changes in price.

Demand

- Demand is the desire to own something and the ability to pay for it.
  - The law of demand states that when a good's price is lower, consumers will buy more of it. When the price is higher, consumers will buy less of it.
    - The law of demand is the result of the substitution effect and the income effect --two ways that a consumer can change his or her spending patterns. Together, they explain why an increase in price decreases the amount consumers purchase.


LAW OF DEMAND
PRICE
As prices go down…
DEMAND
quantity demanded goes up.
PRICE
As prices go up…
DEMAND
quantity demanded goes down.

The Law of Demand in Action

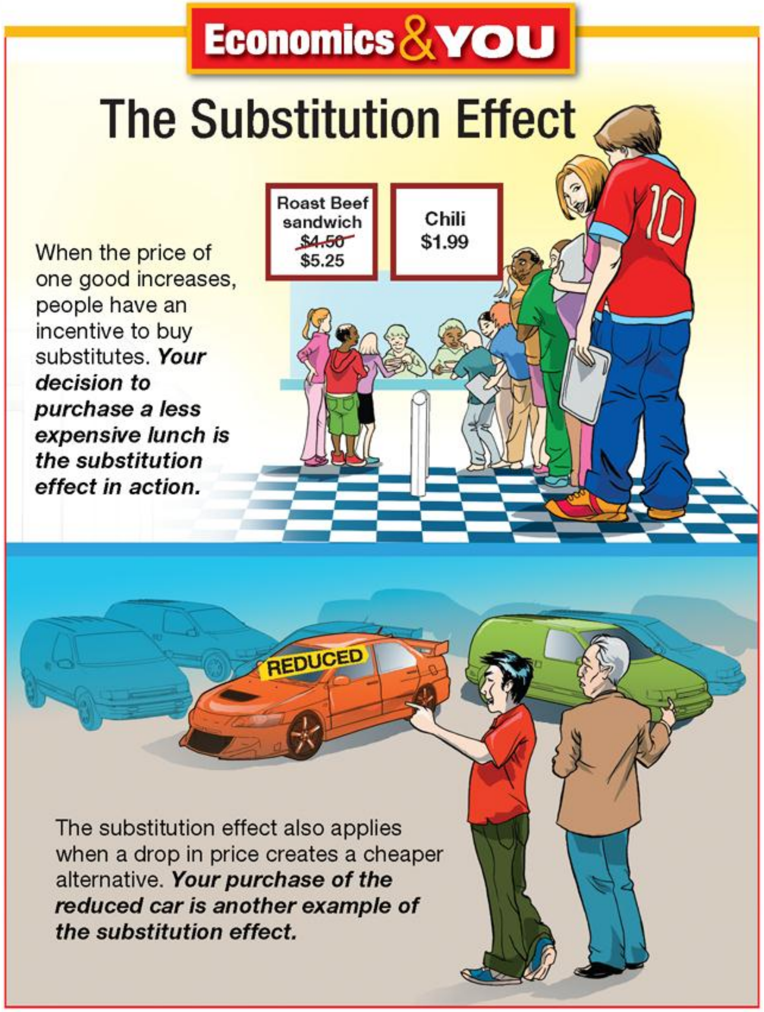
- Checkpoint: What happens to demand for a good when the price increases?

  – Changes in price are an incentive; price changes always affect quantity demanded because people buy less of a good when its price goes up.

	Price of A Increases		Price of A Decreases	
	Consumption of A	Consumption of other goods	Consumption of A	Consumption of other goods
Income effect	↓	↓	↑	↑
Substitution effect	↓	↑	↑	↓
Combined effect	↓	↕	↑	↕

The Substitution Effect

- The substitution effect takes place when a consumer reacts to a rise in the price of one good by consuming less of that good and more of a substitute good. The substitution effect can also apply to a drop in prices.



The Income Effect

- The income effect is the change in consumption that results when a price increase causes real income to decline.
  - Economists measure consumption in the amount of a good that is bought, not the amount of money spent on it.
  - The income effect also operates when the price is lowered. If the price of something drops, you feel wealthier. If you buy more of a good as a result of a lower price, that’s the income effect at work.

Demand Schedules

- The law of demand explains how the price of an item affects the quantity demanded of that item.
- To have demand for a good, you must be willing and able to buy it at a specified price.
- A demand schedule is a table that lists the quantity of a good that a person will purchase at various prices in the market.

Market Demand Schedules

- A market demand schedule shows the quantities demanded at various prices by all consumers in the market.
  - Market demand schedules are used to predict the total sales of a commodity at several different prices.
  - Market demand schedules exhibit the law of demand: at higher prices the quantity demanded is lower.

Demand Schedules

- Demand schedules show that demand for a good falls as the price rises.
  - How does market demand change when the price falls from $3 to $2 a slice?

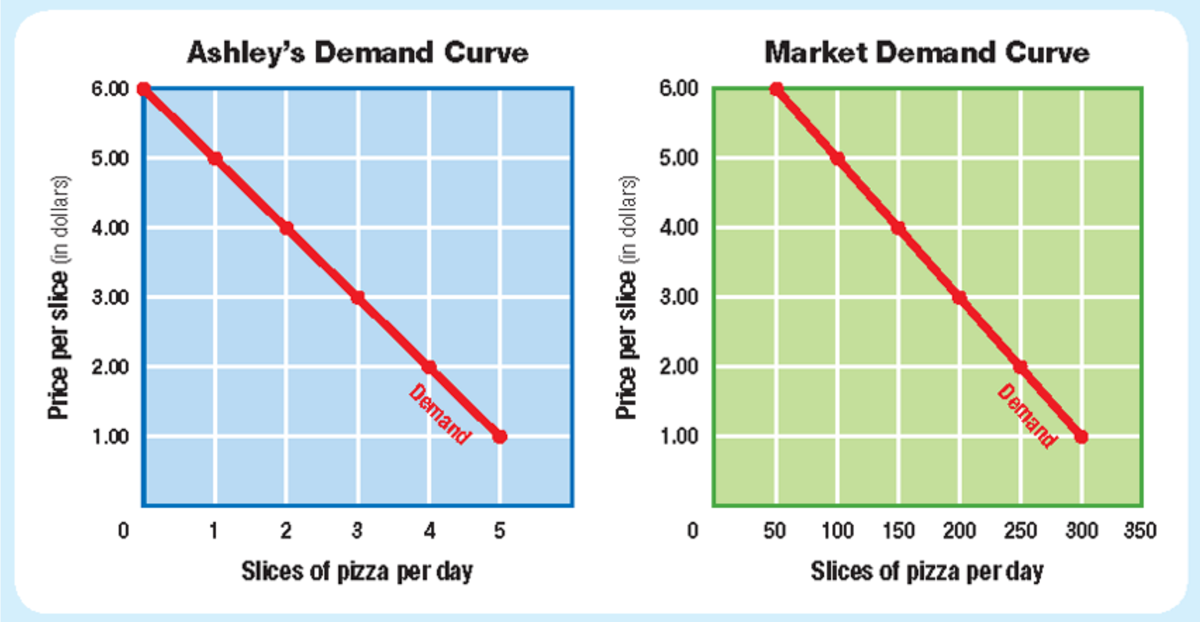
Individual Demand Schedule		Market Demand Schedule	
Price of a slice of pizza	Quantity demanded per day	Price of a slice of pizza	Quantity demanded per day
$1.00	5	$1.00	300
$2.00	4	$2.00	250
$3.00	3	$3.00	200
$4.00	2	$4.00	150
$5.00	1	$5.00	100
$6.00	0	$6.00	50

The Demand Graph

- A demand curve is a graphic representation of a demand schedule.
  - The vertical axis is always labeled with the lowers possible prices at the bottom and the highest prices at the top.
  - The horizontal axis should be labeled with the lowest possible quantity demanded at the left and the highest possible quantity demanded on the right.

Demand Curves

- Ashley's demand curve shows the number of slice she is willing and able to buy at each price, while the market demand curve shows demand for pizza in an entire market.
  - How are the demand curves similar?



Action Graph online

Market Demand Curves

- All demand schedules and demand curves reflect the law of demand.
- Market demand curves are only accurate for one very specific set of market conditions. They cannot predict changing market conditions.

Review

- Now that you have learned how the law of demand affect the quantity demanded, go back and answer the Chapter Essential Question.
  - How do we decide what to buy?