Law of Demand

The Law of Demand was first stated by Augustin Cournot in 1838. Later it was refined and elaborated by Alfred Marshall.

Definitions

The Law of Demand says as "the quantity demanded increases with a fall in price and diminishes with a rise in price".

–Marshall

"The Law of Demand states that people will buy more at lower price and buy less at higher prices, other things remaining the same".

- Samuelson

Assumptions of Law of Demand

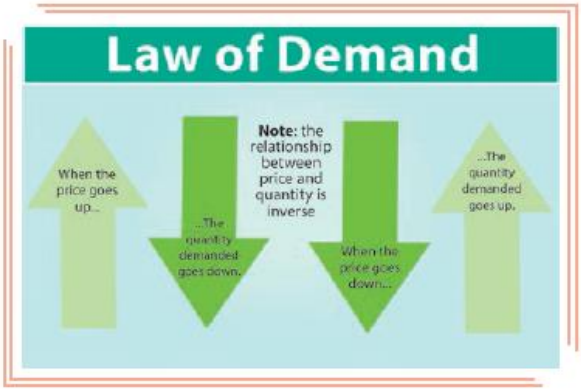
1. The income of the consumer remains constant.
2. The taste, habit and preference of the consumer remain the same.
3. The prices of other related goods should not change.
4. There should be no substitutes for the commodity in study.
5. The demand for the commodity must be continuous.
6. There should not be any change in the quality of the commodity.

Table 2.4 Demand Schedule

Price (₹)	Quantity Demanded (Units)
5	1
4	2
3	3
2	4
1	5

Explanation

The law of demand explains the relationship between the price of a commodity and the quantity demanded of it. This law states that quantity demanded of a commodity expands with a fall in price and contracts with a rise in price. In other words, a rise in price of a commodity is followed by a contraction demand and a fall in price is followed by extension in demand. Therefore, the law of demand states that there is an inverse relationship between the price and the quantity demanded of a commodity.



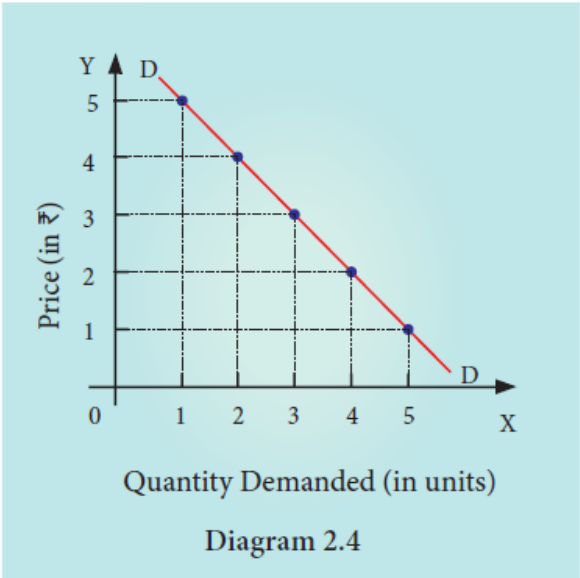


Diagram 2.4

In the diagram 2.4, X axis represents the quantity demanded and Y axis represents the price of the commodity. DD is the demand curve, which has a negative slope i.e., slope

downward from left to right which indicates that when price falls, the demand expands and when price rises, the demand contracts.

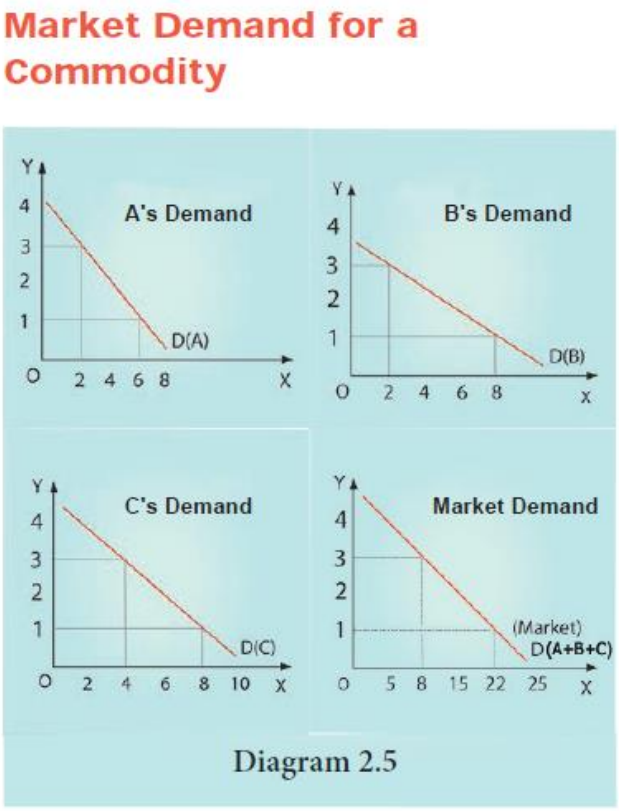


Diagram 2.5

The market demand curve for a commodity is derived by adding the quantum demanded of the commodity by all the individuals constituting the market. In the diagram given above, the final market demand curve represents the addition of the demand curve of the individuals A, B and C at the same price.

When Price is ₹3, the Market demand is 2+2+4 = 8

When Price is ₹1, the Market demand is 6+8+8 = 22

As in the case of individual demand schedule, the Market Demand Curve is at a price, at a place and at a time.

Determinants of Demand

1. ***Changes in Tastes and Fashions***:

The demand for some goods and services is very susceptible to changes in tastes and fashions

2. ***Changes in Weather*:**

An unusually dry summer results in a increase in the demand for cool drinks.

3. ***Taxation and Subsidy:***

If fresh taxes are levied or the existing rates of taxation on commodities are increased their prices go up. The subsidies will bring down the prices. Therefore taxes reduce demand and subsidies raise demand.

4. ***Changes in Expectations:***

Expectations also bring about a change in demand. Expectation of rise in price in future results in increase in demand.

5. ***Changes in Savings:***

Savings and demand are inversely related.

6. ***State of Trade Activity*:**

During the periods of boom and prosperity, the demand for all commodities tends to increase. On the contrary, during times of depression there is a general slackening of demand.

7. ***Advertisement:***

In advanced capitalistic countries advertising is a powerful instrument increasing the demand in the market.

8. ***Changes in Income:***

An increase in family income may increase the demand for durables like video recorders and refrigerators. Equal distribution of income enables poor to get more income. As a result consumption level increases.

9. ***Change in Population:***

The demand for goods depends on the size of population. An increase in population tends to increase the demand for goods and a decrease in population tends to decrease the demand (if other things remain constant).

Exceptions to the law of demand

Normally, the demand curve slopes downwards from left to right. But there are some unusual demand curves which do not obey the law and the reverse occurs. A fall in price brings about a contraction of demand and a rise in price results in an extension of demand. Therefore the demand curve slopes upwards from left to right. It is known as exceptional demand curve.

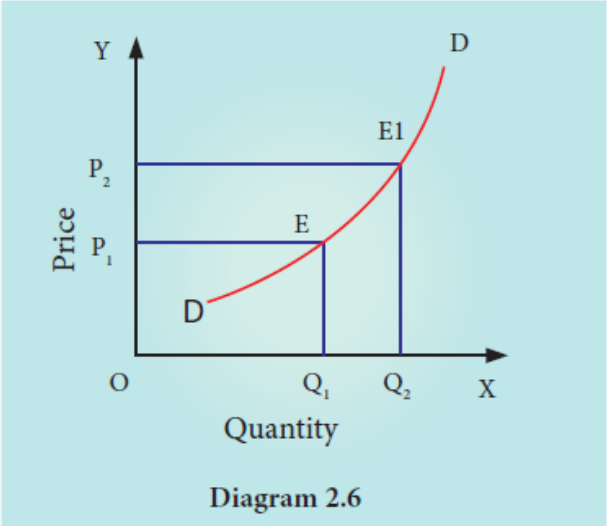


Diagram 2.6

In the diagram 2.6, DD is the demand curve which slopes upwards from left to right. It shows that when price is OP1, OQ1 is the demand and when the price rises to OP2, demand also extends to OQ2.

Reasons for Exceptional Demand Curve

1. Giffen Paradox:

The Giffen good or inferior good is an exception to the law of demand. When the price of an inferior good falls, the poor will buy less and vice versa. For Example: Rice, Ragi

2. Veblen or Demonstration effect:

Veblen has explained the exceptional demand curve through his doctrine of conspicuous consumption. Rich people buy certain goods because it gives social distinction or prestige. For example, diamonds.

3. Ignorance:

Sometimes, the quality of the commodity is judged by it's price. Consumers think that the product is superior if the price is high. As such they buy more at a higher price.

4. Speculative effect:

If the price of the commodity is increasing then the consumers will buy more of it because of the expectation that it will increase still further. Eg stock markets.

5. Fear of shortage:

During times of emergency or war, people may expect shortage of a commodity and so buy more.

Extension and Contraction of Demand

The changes in the quantity demanded for a commodity due to the change in its price alone are called "Extension and Contraction of Demand". In other words, buying more at a lower price and less at a higher price is known as "Extension and Contraction of Demand".

Movement along Demand Curve

In the diagram 2.7, at point A, the price OP2 and quantity demanded is OQ2. When price falls to OP3 (movement along the demand curve A to C) the quantity demanded increases to OQ3. If price rises to OP1 (movement from A to B) quantity demanded decreases to OQ1.

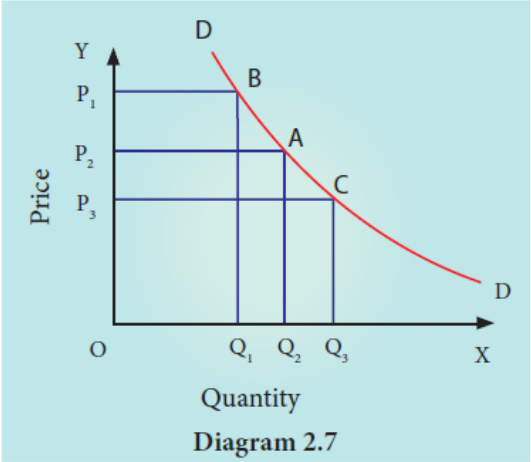


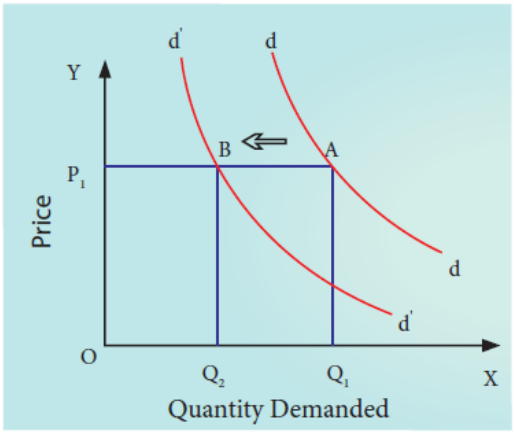
Diagram 2.7

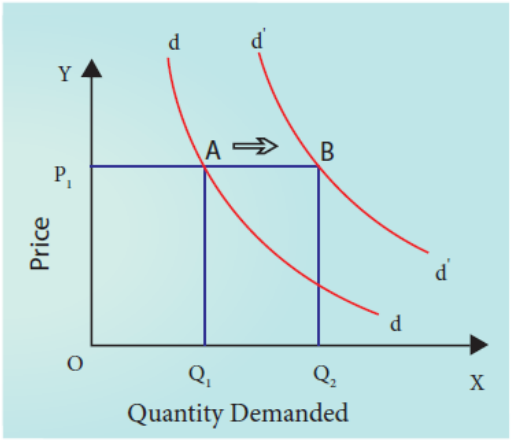
Shift in the Demand Curve

A shift in the demand curve occurs with a change in the value of a variable other than its price in the general demand function. An increase or decrease in demand due to changes in conditions of demand is shown by way of shifts in the demand curve.

On the left hand side of the diagram 2.8, the original demand curve is dd, the price is OP1 and the quantity demanded is OQ1. Due to change in the conditions of demand (change in income, taste or change in prices of substitutes and /or complements) the quantity demanded decreases from OQ1 to OQ2. This is shown in the demand curve to the left. The new demand curve is d1d1. This is called decrease in demand.

On the right hand side of the diagram 2.8, the original price is OP1 and the quantity demanded is OQ1 . Due to changes in other conditions, the quantity purchased has increased to OQ2 . Thus the demand curve shifts to the right d1d1. This is called increase in demand.





'Extension' and 'Contraction' of demand follow a change in price. Increases and decreases in demand take place when price remains the same and the other factors bring about demand changes.