Name ______________________ Date ______________ Class ________________________

STUDY GUIDE Chapter 7, Section 1

For use with textbook pages 169–175

DEMAND

KEY TERMS

demand Amount of a good or service that consumers are able and willing to buy at various possible prices during a specified time period *(page 170)*

supply Amount of a good or service that producers are able and willing to sell at various prices during a specified time period *(page 170)*

market Process of freely exchanging goods and services between buyers and sellers *(page 170)*

voluntary exchange Transaction in which a buyer and a seller exercise their economic freedom by working out their own terms of exchange *(page 170)*

law of demand Economic rule stating that the quantity demanded and price move in opposite directions *(page 171)*

quantity demanded Amount of a good or service that a consumer is willing and able to purchase at a specific price *(page 172)*

real income effect Economic rule stating that individuals cannot keep buying the same quantity of a product if its price rises while their income stays the same *(page 172)*

substitution effect Economic rule stating that if two items satisfy the same need and the price of one rises, people will buy the other *(page 172)*

utility The ability of any good or service to satisfy consumer wants *(page 173)*

marginal utility An additional amount of satisfaction *(page 174)*

law of diminishing marginal utility Economic rule stating that the additional satisfaction a consumer gets from purchasing one more unit of a product will lessen with each additional unit purchased *(page 174)*

DRAWING FROM EXPERIENCE

Have you ever seen something on the store shelf and thought, "I wonder who would ever buy that"? Perhaps you did not want it, but someone else did. The greater the number of people who want an item, the more of such items producers will supply.

This section focuses on the willingness and ability of people to purchase particular goods and services—what economists call demand.

ORGANIZING YOUR THOUGHTS

Use the cause-and-effect diagram below to help you take notes as you read the summaries that follow. Think about how price changes affect the amounts of goods people buy.

Change in Price		Effect on Demand
If the price increases,	→	then demand ____________
If the price decreases,	→	then demand ____________

READ TO LEARN

Introduction *(page 169)*

Demand includes only those people who are both willing and able to buy something.

The "Marketplace" *(page 169)*

Did you know that when you buy something you are having an influence over the price of that item? Together buyers and sellers in a market economy determine prices. All consumers together help to determine the price of goods and services through ***demand.*** Consumer decisions determine what products will sell and for how much. The people who sell those items also decide how much to sell and at what price. This is called ***supply.***

The ***market*** represents the freely chosen actions between buyers and sellers of goods and services. A market can be local, national, international, or a combination of these. In a market economy, buyers or sellers decide for themselves the answers to the economic questions WHAT?, HOW?, and FOR WHOM?

1. How are prices determined in a market?

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Voluntary Exchange *(page 170)*

Buyers and sellers are free to make choices in a market economy. Their decisions represent the principle called ***voluntary exchange.*** In order for such an exchange to take place, the buyer and seller must agree on the price and be satisfied that they will be better off for having made the exchange.

Economists analyze the actions of buyers and sellers in the marketplace to show how supply and demand affect prices.

2. What conditions must be met in order for a voluntary exchange to take place in the market?

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The Law of Demand *(page 171)*

Demand represents the goods or services that consumers are both willing and able to purchase at various prices. The ***Law of Demand*** explains how people react to changes in price. It states:

As price goes up, quantity demanded goes down.

As price goes down, quantity demanded goes up.

In other words, more people will buy more of an item if the price is lowered. There is an inverse relationship between price and ***quantity demanded.*** When one goes up the other goes down.

There are three other reasons that people will adjust the amount they are willing to buy. First, ***real income effect*** means that if a person's real income decreases he or she will purchase less. If real income goes up, people will purchase more. Second, ***substitution effect*** says that people may substitute one item for another. This will happen if there are two items that satisfy the same need, and their cost is about the same. If the price of one falls, people will most likely buy it instead of the other good.

Finally, ***diminishing marginal utility*** affects how much people will purchase. You purchase things in order to receive satisfaction. The term that economists use for satisfaction is ***utility***—the power that a good or service has to satisfy a want. A cold soft drink at a baseball game on a hot day provides utility. How many cups will you purchase? The decision depends on the satisfaction, you expect to receive from each additional soft drink. Your *total* satisfaction will rise with each one bought. The amount of *additional* satisfaction, or ***marginal utility,*** diminishes, or lessens, with each additional cup. This illustrates the ***law of diminishing marginal utility.***

At some point, you will stop buying soft drinks altogether. Sometimes, however, if the price is lowered, you will consider another purchase. So, while you may not buy another drink for $3, you might buy one for $1.

3. How do the real income effect, substitution effect, and law of marginal utility relate to the law of demand?

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