

STUDY GUIDE Chapter 7, Section 2

For use with textbook pages 177–185

THE DEMAND CURVE AND ELASTICITY OF DEMAND

KEY TERMS

demand schedule Table showing quantities that would be demanded at various prices (page 178)

demand curve Downward-sloping line that graphs the quantities demanded at each possible price (page 179)

complementary good For a product often used with another product; as the price of one product decreases, the demand for the other increases (page 181)

elasticity Measures consumers' responsiveness to an increase or decrease in price (page 181)

price elasticity of demand Measures the amount that demand varies according to changes in price (page 181)

elastic demand The rise or fall in a product's price greatly affects the amount that people are willing to buy (page 184)

inelastic demand A product's price change has little impact on the quantity demanded by consumers (page 184)

DRAWING FROM EXPERIENCE

If the price of gasoline drops significantly, people travel more. However, if the price of salt drops sharply, people still buy the same amount of salt.

This section focuses on the measurement of change in buying habits when prices change. It is called elasticity of demand.

ORGANIZING YOUR THOUGHTS

Use the diagram below to help you remember the summaries that follow.

What Determines Demand?	What Determines Price Elasticity of Demand?
1	1
2	2
3	3
4	
5	

STUDY GUIDE (continued)**Chapter 7, Section 2****READ TO LEARN****Graphing the Demand Curve** (page 177)

Economists use graphs to show the relationship between two sets of statistics or two concepts. The law of demand can be graphed to show that as the price goes up, quantity demanded goes down, and vice versa.

To create a demand curve graph, first you need a **demand schedule**—a table of prices and quantity demanded. The schedule shows the relationship of price to quantity demanded. To plot the numbers from the schedule onto a graph, use the bottom (or horizontal) axis to show the quantity demanded. The side (or vertical) axis will show the price per item. Each pair of numbers (price and quantity demanded) represents a point on the graph. When the points are connected with a line, we end up with the **demand curve**. A demand curve shows the quantity demanded of a good or service at each possible price. Demand curves always slope downward from left to right.

1. Why does the demand curve on a graph slope downward?
-

Quantity Demanded Versus Demand (page 180)

Quantity demanded is a specific point on the demand curve that shows how much is demanded at a specific price. However, a *change in quantity demanded* is caused by a change in price. This is shown as a movement to a different point along the demand curve.

Sometimes, however, something other than price causes demand to increase or decrease. This is known as a *change in demand* and is shown as a *shift* of the entire demand curve. The curve may shift to the left (decrease in demand) or right (increase in demand). If demand increases, people will buy more per year at all prices. If demand decreases, people will buy less per year at all prices.

2. What is the difference between a change in quantity demanded and a change in demand?
-

Determinants of Demand (page 180)

What causes a change in demand? Many factors can affect demand for a specific product. First, consider changes in population. When population increases, the demand for most products increases. This means that the demand curve for products like television sets, shifts to the right. At each price, more television sets will be demanded.

Second, demand for most goods and services depends on income. For example, the demand curve for CDs will shift to the left if people's income goes down. Having less to spend, they will demand fewer CDs at all possible prices.

Third, changes in tastes and preferences determine demand. *Tastes and preferences* refer to what people like and prefer to choose. Fads best illustrate the changes in demand caused by tastes and preferences. When a fad dies out, fewer goods are sold at every possible price.

STUDY GUIDE (continued)**Chapter 7, Section 2**

Fourth, the existence of **substitutes** also affects demand. Consider butter and margarine. If the price of butter remains the same and the price of margarine falls, people will buy more margarine and less butter at all prices of butter. The demand curve for butter will shift to the left.

Finally, when two goods are complementary products, the decrease in the price of one will increase the demand for it as well as its complementary good. For example, cameras and film are complementary goods. If the price of cameras drops, people will probably buy more of them. They will also probably buy more film to use with the cameras. So, a decrease in the price of cameras leads to an increase in the demand for its **complementary good**, film.

3. What are the five determinants of demand?

▣ **The Price Elasticity of Demand** (page 181)

If you were the owner of a music store, you might use the law of demand to determine your prices for DVDs. If you lower prices, consumers will buy more DVDs. By how much should you lower the price? You cannot answer this question unless you know how *responsive consumers* will be to a decrease in the price. Economists call this price responsiveness **elasticity**. They measure the **price elasticity of demand**—*how much* consumers respond to a given change in price.

The demand for some goods is elastic. That means a rise or fall in price greatly affects the amount people are willing to buy. For example, any particular brand of coffee probably has **elastic demand**. Because there are many competing brands of coffee a small rise in the price of one brand will probably cause many consumers to purchase the cheaper substitute.

If a price change does not result in a substantial change in the quantity demanded, that demand is considered inelastic. Salt, pepper, sugar, and certain types of medicine normally have **inelastic demand**. If the cost of salt were cut in half, for example, you probably would still use about the same amount.

At least three factors determine the price elasticity of demand for a particular item:

(1) the existence and similarity of substitutes; (2) the percentage of a person's total budget devoted to the purchase of that good; (3) the amount of time consumers are given to adjust to a change in price.

If suitable substitutes exist, prices for an item are elastic. People will not buy much of an item that is considered too expensive, if they can substitute another item. However, if the percentage of your budget you spend on an item is small, demand is inelastic. For example, you will not likely change your consumption of pepper if the price doubles. On the other hand, if the price of a particular new car doubles, many people will buy a different make of car. The demand for pepper, then, is relatively inelastic, while demand for new cars is relatively elastic.

Finally, people take time to adjust and adapt to changes in prices. If the price of electricity goes up by 100 percent tomorrow, you will have a hard time adjusting your behavior immediately. Over time you will figure out ways to reduce the amount of electricity you use—by putting in lower wattage light bulbs, adding insulation to your attic and so on. Therefore, the longer the time allowed for adjustment to the changes, the greater the price elasticity of demand.

STUDY GUIDE (continued) **Chapter 7, Section 2**

4. What is the price elasticity of demand and what factors help to determine it?
