Exception to the law of demand economics essay

ASSIGN
BUSTER

Explanation-

In this diagram X-axis shows the quantity demanded for a product and y-axis shows the price of the product. Initial price of the product be P and the quantity demanded be Q. When the price of the good increases from P to P1, the quantity demanded for that good falls from Q to Q1. when the price of the good falls from P to P2, the quantity demanded for that good rises from Q to Q2.

Exception to the Law of Demand

The law of demand does not apply in every case and situation. The circumstances when the law of demand becomes ineffective are known as exception of the law. Some of these are as under:

1) Giffen Good

The good is named after Sir Robert giffen (1873-1910). Giffen Good is necessarily an inferior good with very high negative income elasticity of demand. The good is consumed by low-paid wage earners who spend a large proportion of their income to buy it. Examples of giffen goods are bajra and jowar. In case of giffen goods, the demand curve is upward sloping.

2) Expectation of a price rise in future

Buyers’ expectations about price dominate their buying behavior. If price rises and the buyer expects further rise in price then it causes increase in the quantity bought at higher prices. The reverse also holds. This is specially true in case of shares.

3) Emergency

In case of emergencies like war, flood, drought, the law of demand does not hold. In such case there is general insecurity and fear of shortage of necessities. Hence, consumers demand more good even at higher prices.

4) Conspicuous necessities

Certain things become the necessities of modern life. So we have to purchase them despite their high price. The demand for T. V sets, automobiles and refrigerator etc have not gone down inspite of the increase in their price. These things has become the symbol of status. So they are purchased despite their rising price.

5.) Change in fashion

A change in fashion and tastes affect the market for a commodity. e. g. When a broad toe shoe replaces a narrow toe, the people will go for broad one even though its price may be going up.

Inferior Good

An Inferior good is a good which a consumer buys more of when his or her income falls and less of when income rises. ceteris paribus. It has a negative income elasticity of demand.

An inferior good is a good that decrease in demand when consumer income rises.

What is Income effect?

Income effect

The Income effect is the change in an individual's or economy's income and how that change will impact the quantity demanded of a good or service. The relationship between income and the quantity demanded is positive one, as income increases, so does the quantity of goods and services demanded.

When an individual's income increases, other things remaining the same, that person will demand more goods and services, thus increasing their consumption.

In other words, change in demand due to change in income is called income effect.

Inferior good v/s Giffen good

Inferior good

An inferior good is a good which a consumer buys more of when his or her income falls and less of when income rises. It has a negative income elasticity of demand.

Example of Inferior good is public transportation when consumers have less wealth, they may forgo using their own forms of private transportation in order to cut down costs(costs like car insurance, gas and other car upkeep cost) and instead of these, opt to use a less expensive form of transportation(like bus pass).

Another example of inferior good, used books could be inferior for some consumers if they switch to new books. When their income rises, no longer

having to economize by buying those massively highlighted used texts. After a change in price, such goods are inferiors because the income and substitution effects work in opposite direction, with the substitution effect being large in magnitude.

Giffen Good:-

A special type of inferior good may exist known as the giffen good, which would disobey the " law of demand".

When the price of a giffen good increases, the demand for that good increases.

In economics and consumer theory, a giffen good is one which people paradoxically consume more of as the price rises; the substitution effect causes consumers to purchase less of it and more of the substitute goods. In giffen good situation, the income effect dommates, leading people to buy more of the good even as its price rises.

For most products, price elasticity of demand is negative. In other words, price and quantity demanded pull in opposite directions, if prices goes up, then quantity demanded goes down, or vice-versa, giffen goods are an exception to this. Their price elasticity of demand is positive. When price goes up, the quantity demanded also goes up and vice-versa.

In order to be a true giffen good, price must be the only thing that changes to get a change in quantity demand, and a giffen good should not be confused with products bought as status symbol or for conspicuous consumption.

" All Giffen goods are inferior goods; all inferior goods are not giffen goods"

The demand for an inferior good decrease when income rises. Demand increases for normal goods when income rises. The classic example of an inferior good is top ramen noodles. When income rises, people buy better food.

A giffen good is any good where quantity demand increases when price increases. Most goods have an negative elasticity of demand, that is, when price increases, quantity decreases. Giffen goods have a positive elasticity of demand. Giffen goods also lack close substitutes. It is very difficult to find good examples of giffen goods, but sometimes fine wines are used as an example. A fine wine is often judged by its price-high price is indicative of quality. If the price falls, less may be demanded because it is no longer considered a premium product. Additionally, there are not a lot of close substitutes for a fine, aged bottled of wine.

The negative income effect is always greater than the positive substitution effect (true for giffen goods, but not all inferior goods). Since giffen goods always have a negative income effects, they must always be inferior goods. Thus, a giffen good is always an inferior good, but an inferior good is not always a giffen good.

Question no. 2

In a given situation, there is only one spring catering to the drinking water requirement of a village in a remote area. This spring happens to be under

control of one individual. This is the case of the monopoly. Let's firstly explain what is monopoly?

What is Monopoly?

The word monopoly comes from two Greek words-" monos" and " polein". The meaning of mono is single and polein means selling. Monopoly therefore prevails in the market when there is single seller. In economic theory, Monopoly is defined as single firm producing commodities for which there are no close substitutes.

According to Allen Deserpa -" A pure monopoly industry is characterized by one producer, a unique product with no close substitute and significant barriers to entry."

Features of Monopoly:-

One seller and large number of buyers-

Monopoly is a form of imperfect market structure where there is only one seller of a product. A monopoly firm may be owned by a person, a few numbers of partners or a joint stock company. The characteristics feature of single seller eliminates the distinct between the firm and the industry. A monopolist firm is itself ' the industry'. Under monopoly there are large numbers of buyers although the seller is one. No buyer's reaction can influence the price.

No close substitute-

Under monopoly a single producer produces single commodities which have no close substitute. As the commodity has no close substitute, the

monopolist is at liberty to change a price according to his own whimsy. Monopoly can not exist when there is competition.

A firm is said, to be monopolist only when it is the single producer and supplier of the product which have no close substitute. Under monopoly the cross elasticity of demand is zero. Cross elasticity of demand shows a change in the demand for a good as a result of change in the price of another good.

Strong barriers to the entry into the industry exist-

In a monopoly market there is strong barrier on the entry of new firms. Monopolist faces no competition. As there is one firm no other rival producers can enter the market of the same product. Since the monopolist has absolute control over the production and sale of the commodity certain economic barriers are imposed on the entry of potential rivals.

Nature of demand curve-

In case of monopoly one firm constitutes the whole industry. The entire demand of the consumers for a product goes to the monopolist. Since the demand curve of the individual consumers' slopes downward, the monopolist faces a downward sloping demand curve.

A monopolist can sell more of his output only at a lower price and can reduce the sale at a high price. The downward slopping demand curve expresses that the price (AR) goes on falling and sales are increased. In monopoly AR curve slopes downward and MR curve lies below AR curve. Demand curve under monopoly otherwise known as average revenue curve.

Condition of Equilibrium in monopoly

The necessary condition of equilibrium is the equality of marginal cost and marginal revenue. The same condition applies to monopoly also. Therefore equilibrium of a monopoly firm is established at a point where MC is equal to MR.

However, the following points should be noted with regard to short-run and long-run equilibrium.

In the short period, a monopoly firm can also sustain losses.

In the long run, a monopoly firm can have abnormal profits.(AR> AC) which is not possible in the case of a competitive firm.

TR is maximum when MR is 0.

Let’s take an example to find out TR, MR and AR

Quantity (Q)

Price (p) (Rs.)

Total revenue (TR)

(P*Q)

Average revenue (AR) (TR/Q)

Marginal revenue (MR)

0

1

2

3

4

5

6

7

8

11

10

9

8

7

6

5

4

3

0

10

18

24

28

30

30 Maximum

28

24

–

10

9

8

7

6

5

4

3

–

10

8

6

4

2

0 MR= 0

-2

-4

Answers:-

He would sell 6 liters of water.

TR is Maximum at Rs. 30.

Graphical Representation

Explanation-

In this figure, X-axis shows the quantity and y-axis shows the price and total revenue respectively.

AR is the average revenue curve or demand curve and MR and TR is marginal revenue and total revenue curve respectively. When MR is positively decreasing TR is increasing. When MR= 0 TR is maximum at RS. 30. When MR starts decline TR also starts decline.

Question 3.

Advanced economies or developed economies

The developed countries are the high income countries such as USA, Canada, and UK etc. These countries have strong and diversified economic structures, well developed industrial, agriculture and service sectors, efficient, and skilled, well disclipned manpower, all of which contribute to their higher national and per capita income and ensure decent living standards to their people. To be categorized as a developed economy, the country must have a ‘ strong and diversified economic structure’.

Features of this economies and the changes in the economies-

Inflation rate:-

The inflation rate in Australia was recorded at 12% in the second quarter of 2012. Historically, from 1973 until 2012, Australia inflation rate averaged 5. 9% reaching on all time high of 17. 6% in March of 1975 and a record low of -0. 3% in September of 1997. Inflation rate refers to a general rise in price measured against a standard cost of purchasing power. The inflation rate in Canada was recorded at 1. 5% in June of 2012. Historically, from 1915 until 2012, Canada inflation rate averaged 3. 3% reaching an all time high of 21. 6% in June of 1920 and a record low of -17. 8% in June of 1921.

Agriculture:-

Agriculture plays an important role in the global and Canadian and Australian economies. However, potential changes in climate may reduce productivity and output in agricultural industries in major producing countries, including Australia, Canada, UK in the medium to long term.

Real net disposable(a) per capital(b)

Australia experienced significant real per capital income growth during the past decade from $35000, in 1999 to $45300 in 2009 and in Canada $34500 in 1999 to $41730 in 2009.

Between 1998-1999 and 2008-2009, real net national disposable income per capital grew by 2. 6% a year appreciably than during the preceding ten years, when it grew by 1. 5% per year.

A strong resource rich country:-

An abundance of natural resources gives Canada a unique advantage. Mining, forestry and oil have a bastion of Canadian experts and trade for quite some time. Energy resources accounts from more than 50% of Canada's total resources wealth, followed by timber and mineral resources.

Underdevelopment economies:

The term underdevelopment refers to the state of an economy where levels of living of masses are extremely low due to very low levels of per capital income resulting from low levels of productivity and high growth rates of population.

Features of underdevelopment economies:-

Low levels of living

Since, about three-fourths of world population lives in underdeveloped countries which have less than one-fifth share in world income, it is obvious that a vast majority of people in these countries must be living under condition of poverty, malnutrition, disease, illetracy etc. Even basic

necessities of subsistence such as minimum food, clothing and shelter are not easily accessible to the poor masses.

High rates of population growth

Low productivity combined with high growth rates of population is largely responsible for low income and poor living standards in the underdeveloped countries. High growth rate of population means more people to be fed, clothed and provided other necessary goods year after year.

Population growth rate between 1990 and 2000 averaged around 0. 6% p. a. in the case of developed countries. However, it was high at around 2% p. a. in the case of low income countries. For example, India had, during this decade, an average annual birth rate of a little less than 2%, it was 4% in Yemen, 3% in Uganda, 2. 5% in Pakistan and 1. 6% in Bangladesh.

High unequal income distribution

Apart from a wide gap between incomes levels in advanced and underdeveloped economies there also exist grave income Inequalities between the rich and the poor people within the underdeveloped countries. Though inequalities in income distribution also exist in the advanced countries as well, but the extent of inequalities is far greater in the less developed economies.

For example, according to the data published in the world development report 2001-2002, the share of bottom 10% of population in national income was just about 3. 5% as against 33. 5% of top 10% population in 1997. While the highest 20% people got a share of 46% in national income, the bottom 40% had less than 20% share.

Low per capita income

The level of income as measured by per capital real GNI is very low in underdeveloped countries. For example, in 2008, per capita GNI as measured in us dollars was $280 in Ethiopia, $520 in Bangladesh and $1070 in India as compared to $47, 580 for USA, $45390 for UK and $65330 for Switzerland.

Developing Economies

A developing economy is essentially an underdeveloped economy on the march to progress and prosperity. It is an economy which has, through conscious efforts, shed off some burden of its backwardness and stagnation and is making reasonable progress in many socio-economic spheres of activity. However, in many other areas, the economy may still be showing not much perceptible change and thus continue persisting with its backward character and underdeveloped status.

Features of this economies-

Employment

Low unemployment and strong domestic demand pushed 12 month inflation to 7. 3% through the first three quarters of 2011, above the upper limit of the government target of 2. 5%-6. 5%. The central bank believes, however that the global economic downturn will dampen inflationary pressure and projects inflation tp fall within the target band by the end of 2011 and throughout 2012.

Agriculture

Agriculture is a major sector of the developing economy, and is key for economic growth and foreign exchange. Agriculture accounts for about 6% of GDP (25% when including agribusiness) and 36% of exports. Developing economy enjoyed a positive agriculture trade balance of $55 billion in 2009.

Low levels of productivity

Low income levels and poor living standards are a direct consequence of low productivity. Productivity means output produced per person of workforce. In all developing countries, output per worker is very low when compared with per worker output in the USA, Canada, Australia or Japan.

Research Assignment

Of

Managerial Economics

Submitted by-

Meenakshi rani

Enrollment no. 01215903912

MBA I sem

Sec-‘ A’

Subject code: MS-105