

Neoclassical theory
on downward sloping
demand curve
economics essay



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This paper explains the reason why according to neo classical economic theory the demand curve is downward sloping. It also highlights some of the factors that affected the demand of a commodity by a consumer, the relationship between these factors and demand. It also seeks to explain the marginal utility theory and historical distinction between use- value and exchange- value of a commodity.

Neoclassical Economic theory

It's an economic term used for approaches to economics focusing on the determination of price, output, and income distribution in markets through supply and demand. this term was originally introduced by Thorstein Veblen in 1990, in his Preconception of Economic Science.

Why the demand curve is downward sloping according to neoclassical economic theory.

It's absolutely impossible to talk about demand and leave out the aspect of price is a key factor that influences consumer demand of a commodity. The following are the major factors that influence consumer demand of a commodity:-

Price of that commodity (P_x)

Price of other commodities (P_r)

The income of the consumer (Y)

Taste and preferences of the consumer (T_a)

Future price expectations (E_i)

Advertisements (Ad) among others

A demand curve can be described as a line joining different points that depict the relationship between price and quantity demanded. The quantity demanded of a commodity is a function of price *ceteris paribus*. When the price of a commodity increases the demand of the same commodity reduces, when the price reduces then the demand increases leading to a downward sloping demand curve from left to right with a negative gradient. This therefore means that there is an inverse relationship between price and quantity demanded of a commodity. (The higher the price the lower the demand and vice versa). This leads us to the law of demand which states that “ The higher the price, the lower the demand and the lower the price the higher the demand *ceteris paribus* (holding other factors constant)”

There can be a change in the demand curve in two ways, a movement along the demand curve caused by a change in price and also a shift on the demand curve which is caused by a change in other factors holding the price constant.

Marginal utility may be defined as additional satisfaction, or amount of utility gained from each extra unit of consumption. Although total utility usually increases as more of a good is consumed, marginal utility usually decreases with each additional increase in the consumption of a good. This decrease demonstrates the law of diminishing marginal utility. Because there is a certain threshold of satisfaction, the consumer will no longer receive the same pleasure from consumption once that threshold is crossed. In other words, total utility will increase at a slower pace as an individual increases

the quantity consumed. For example chewing gum, after chewing four or five your jaws get tired and the utility you will derive from the sixth will reduce compared to the pleasure you had in the first one. Hence the law of diminishing marginal, this leads to negatively sloping demand curve.

Economists assume the consumer is rational and will thus maximize his or her total utility by purchasing a combination of different products rather than more of one particular product. Thus, instead of spending all of your money on five chewing gums, which has a total utility of 85, you should instead purchase the one chewing gum, which has a utility of 70, and perhaps a glass of milk, which has a utility of 50. This combination will give you a maximized total utility of 120 but at the same cost as the cost of five chewing gums.

Assumptions of marginal utility

Utility can be measured by assigning definite numbers such as 1, 2, 3, 4, e. t. c. That is it is assumed that utility is the quantifiable entity.

The utilities of different commodities are independent of one another. That is the utility of one commodity does not in any way affect that of another.

Marginal utility of money remain constant even though the quantity of money with the consumer is diminished by the successive purchase made by the consumer.

From ones own experience (judging what happens in ones own mind), it is possible to draw inference about another person.

For these assumptions to hold there must be,

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Suitable units

Suitable time

No change in consumer tastes

Normal person

Constant income

Comparison of the neoclassical idea of marginal utility (and utility) with the conceptual/ historical distinction between use-value and exchange value, and the corresponding distinction between the economy and the private sphere.

According to neoclassical idea on marginal utility, the marginal utility of a good diminishes with the consumption of more of that good. This leads to opting for an alternative good which is a perfect substitute of the good. Given this case, the demand of this commodity will reduce leading to a downward sloping demand curve. While utility is the value derived from the consumption of a commodity, marginal utility is the extra satisfaction derived from each extra unit of consumption.

Use-value is the material use to which the commodity can actually be put and the human need it fulfills while exchange-value indicates the rate at which two commodities can be exchanged in an open market (attaching a monetary value to a commodity). In production, increase in labour increases the exchange value of a commodity and vice versa.

An economy constitutes the realized economic system of a country to include labour, capital and land resources, and the factors of production, <https://assignbuster.com/neoclassical-theory-on-downward-sloping-demand-curve-economics-essay/>

exchange, distribution and consumption of goods and services in the region. The end result of technological evolution, history, geography, natural resources, social organizations and ecology breeds the end product of an economy. Other contributors of the economy include: - management, business administration, engineering, finance, applied science, and all kinds of professions.

The private sphere is a sector in which an individual enjoys a degree of authority without the intervention of the government or any other institution. Here one works for himself