Demand

AP Microeconomics | Unit 2 | the law of demand, shifts versus movements, the five determinants

Running example. A cafe sells 20 cups of coffee a day at \$4 and wants to sell 40. It can cut the price to \$2, or a health study can make people want more coffee at every price.

1. The law of demand

Law of demand

Holding everything else constant: price up ⇒ quantity demanded down; price down ⇒ quantity demanded up. The demand curve slopes downward.

Price	\$5	\$4	\$3	\$2	\$1
Quantity demanded (cups)	10	20	30	40	50

Why it slopes down. *Substitution effect*: other goods become relatively cheaper. *Income effect*: a higher price reduces purchasing power. *Diminishing marginal utility*: each extra unit is worth less, so more is bought only at a lower price.

2. Movement along the curve vs a shift

The good's **own price** changes	movement *along* the curve	change in **quantity demanded**
Anything else changes	the whole curve *shifts*	change in **demand**

Price \$4 → \$2: slide down the same curve from 20 to 40 cups. Health study, price still \$4: the curve shifts right (35 cups at \$4 instead of 20). *Right* is an increase in demand, *left* is a decrease.

3. The five determinants of demand (TRIBE)

T	Tastes and preferences	coffee becomes fashionable
R	prices of Related goods	substitutes and complements
I	Income	normal and inferior goods
B	number of Buyers	a new office opens next door
E	Expectations	buyers expect a higher price next week

The good's own price is *not* on the list: it never shifts the curve.

4. Which way does it shift?

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Normal good	income up ⇒ demand up	restaurant meals, new clothes
Inferior good	income up ⇒ demand *down*	instant noodles, bus rides
Substitutes (used instead)	price of tea up ⇒ demand for coffee up	same direction
Complements (used together)	price of milk up ⇒ demand for coffee down	opposite directions

5. Adding buyers, and two changes at once

Market demand is the horizontal sum of the buyers' quantities at each price. With $Q_1 = 30 - 2P$ and $Q_2 = 18 - P$, at \$6 the buyers want 18 and 12, so the market wants 30. From a table, add down the column for one price ($3 + 2 + 3 = 8$ at \$6). Add quantities, never prices.

Two changes at once. Income rises for a normal good (right) and a substitute's price rises (right): demand increases for sure. A complement gets cheaper (right) while a substitute gets cheaper (left): the net shift is ambiguous without the sizes. Loan interest is part of the price of goods bought on credit: higher car-loan rates act like a pricier complement and shift car demand left.

Other elasticities. Income elasticity $= \dfrac{\%\Delta Q_d}{\%\Delta \text{income}}$: income +5%, Q_d +8% gives 1.6 (normal; above 1 a luxury; negative means inferior). Cross-price elasticity $= \dfrac{\%\Delta Q_X}{\%\Delta P_Y}$ with midpoints: tea \$4 to \$6 is +40%, coffee 100 to 120 is +18.2%, so $\approx +0.45$: substitutes (negative: complements).

Where students lose points

1. Writing "demand increases" when the price fell: that is quantity demanded.
2. Shifting the curve when the good's own price changes.
3. Mixing up substitutes and complements.
4. Assuming every good is normal.
5. Saying "shifts up" or "down": say right (increase) or left (decrease).

Now practise it

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