[Frequently Asked Questions]

Consumer Demand: Demand Analysis

Subject:	Business Economics
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Paper No. & Title:	Paper – 101 Microeconomics – I
Unit No. & Title:	Unit – 2 Consumer Demand
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Frequently Asked Questions

Q1. Discuss movement and shift in demand.

A1. When quantity demanded of a commodity increases or decreases due to a change in price of that commodity only, other things remaining constant, the buyer moves at different points on the demand curve, this is called extension or contraction in demand, or movement in demand. When quantity demanded of a commodity increases or decreases due to a change in factors other than price, the buyer shifts from one demand curve to another, this is called increase and decrease in demand.

Q2. What is Inverse Demand Function?

A2. The inverse function represents the original relationship in the function in reverse form, i.e. interchanging the variables. The inverse demand function represents price as a function of quantity demanded. Mathematically it is expressed as: $P = f^{-1}(Q)$ where f^{-1} = inverse function

Q3. Explain the relation between elasticity and marginal revenue.

A3. The relation between elasticity and marginal revenue is important since both concepts play a key role in decisions regarding price and production in the economy. It is mathematically proven that: $MR = P * [(1 + e)/e]$, where MR = marginal revenue, P = price, e= elasticity. The formula implies when $(-\infty < e < -1)$, demand is elastic and MR is positive; when (e

= -1), demand is unitary elastic and MR is positive; when ($-1<e<0$), demand is inelastic and MR is negative.

Q4. Write a note on income elasticity of demand.

A4. Income elasticity of demand represents the percentage change in quantity demanded due to percentage change in price. It is defined as the degree of responsiveness of quantity demanded of a good to a small change in the income of the buyers. Income elasticity of demand is measured as:

$$e_y = \frac{\text{Proportionate change in quantity demanded}}{\text{Proportionate change in income}}$$

$$e_y = \frac{\Delta Q/Q}{\Delta Y/Y}$$

Income elasticity e_y is greater than 1 in case of luxuries, less than 0 in case of inferior goods and equal to 1 in case of normal goods.

Q5. Write a note on consumer surplus.

A5. Consumer Surplus is the difference between the willingness to pay for the commodity and the actual price that the consumer pays.

Consumer Surplus = Willingness to pay – actual payment

The consumer has different willingness to pay at different points on the demand curve and his satisfaction decreases as he moves down the demand curve and consumes more of the commodity. Once his willingness to pay equals the price that he has to pay for the commodity, he will be fully satisfied and will not consume more of the commodity. The area between these two points represents the surplus enjoyed by the consumer.