

Answer on Question #43974 – Economics – Microeconomics

Explain the law of demand. Why does a demand curve slope downwards?

Solution

The **law of demand** states that the quantity demanded and the price of a commodity are inversely related, other things being constant. If the income of the consumer, prices of the related goods, and preferences of the consumer remain unchanged, then the change in quantity of good demanded by the consumer will be negatively correlated to the change in the price of the good. There are, however, some possible exceptions to this rule (see Giffen goods and Veblen goods).

The demand curve slopes downwards due to the following reasons:

- (1) **Substitution effect:** When the price of a commodity falls, it becomes relatively cheaper than other substitute commodities. This induces the consumer to substitute the commodity whose price has fallen for other commodities, which now become relatively expensive. As a result of this substitution effect, the quantity demanded of the commodity, whose price has fallen, rises.
- (2) **Income effect:** When the price of a commodity falls, the consumer can buy more quantity of the commodity with his given income, as a result of a fall in the price of the commodity, consumer's real income or purchasing power increases. This increase induces the consumer to buy more of that commodity. This is called income effect.
- (3) **Number of consumers:** When price of a commodity is relatively high, only few consumers can afford to buy it, And when its price falls, more consumers would start buying it because some of those, who previously could not afford to buy, can afford to buy it now, Thus, when the price of a commodity falls, the number of its consumers increases and this also tends to raise the market demand for the commodity.