

6 Demand

Multiple Choice Answers

1	C	6	A	11	B
2	A	7	C	12	B
3	B	8	C	13	C
4	A	9	B	14	D
5	C	10	A	15	D

Short Answer Questions

Question 1

(a) and (b)



(c) A correct answer may include any two of the following:

- A fall in the price of substitute goods would encourage consumers to switch to the substitute good, reducing demand for the original good.
- A rise in the price of a complementary good would discourage consumers from purchasing the original good due to the increased price of the complement.

- An expectation of a future fall in prices will cause consumers to postpone their spending, causing a decrease in demand.
 - A fall in income levels will generally result in lower consumer spending on goods and services, lowering demand.
 - A change in consumer tastes and preferences away from the product which result in the product moving out of fashion may cause a decrease in demand.
- (d)** According to the law of demand, as the price of a good falls, quantity demanded will rise. As prices fall, consumers will be more likely to reduce demand for substitute goods, and quantity demanded of the original good will expand. Conversely, if prices rise, consumers will be more likely to switch to substitute goods, and quantity demanded of the original good will contract.

Question 2

- (a)** Price elasticity of demand is the responsiveness of quantity demanded to changes in the price of the product.
- (b)** Revenue at \$5 = $5 \times 100 = \$500$
Revenue at \$10 = $\$10 \times 90 = \900
- Since price has risen and total revenue has risen, the product is relatively inelastic between \$5 and \$10.
- (c)** Revenue at \$10 = $\$10 \times 90 = \900
Revenue at \$15 = $\$15 \times 60 = \900
- Since price has risen, but total revenue has remained constant, the product is unit elastic between \$10 and \$15.
- (d)** Revenue at \$15 = $\$15 \times 60 = \900
Revenue at \$20 = $\$20 \times 20 = \400
- Since price has risen, but total revenue has fallen, the product is relatively elastic between \$15 and \$20.
- (e)** Price elasticity information is important to firms when setting their prices. If a firm knows that prices are elastic, it will prefer to lower prices to increase revenue. If a firm knows that prices are inelastic, it will prefer to raise prices to increase revenue. Elasticity information is also important to governments when setting taxes. Governments will avoid setting taxes on elastic goods, and will prefer to set taxes on inelastic goods, where there will be a small change in quantity.
- (f)** A correct answer may include any two of the following:
- If consumers considers wasabi to have many close substitutes, it is more likely to be relatively elastic, since consumers can easily switch to other substitutes in response to a change in price.
 - However since wasabi is a very small proportion of income, it would have a lower price elasticity of demand, since a small percentage change in price will have a negligible affect on income.
 - As time after a price change increases, the demand is likely to become more price elastic, since there will be more time for consumers to substitute to other goods and services.

Question 3

- (a) 25 units
- (b) 5 units
- (c)



- (d) A rise in the price of a substitute good could cause an increase in demand as consumers would buy fewer of the more expensive substitute good, and buy more of the cheaper original good. A rise in the price of a complement however could cause a decrease in demand as consumers would buy fewer of the original good to avoid paying higher prices for the complement.
- (e) The price of coffee will be closely influenced by the price of its substitutes and complements. If the price of a complement to coffee, such as sugar or milk, rises, it will raise the overall cost of drinking coffee. If consumers think that the rise in the price of the complement is significant, they will demand less coffee. If the price of a substitute for coffee, such as tea, were to rise, consumers would be likely to switch towards coffee and away from the more expensive substitute. The relationship between coffee and its substitutes may be relatively weak though since coffee (and to a lesser extent, tea) are mildly addictive products, which may mean consumers are reluctant to switch to another product.