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Course: BBA
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QUESTION 1: Explain the law of demand. Why does a demand curve slope downward? How is a market demand curve derived from individual demand curves?

Answer1 a.

Law of demand: the law of demand states that, a demand has inverse relationship with the price It means that "conditional on all else being equal, as the price of a good increases, quantity demanded decreases; conversely, as the price of a good decreases, quantity demanded increases".

Why downward slope: First is the "income effect": When prices drop (or rise), people can buy more (or less) of a good for the same amount of money. Second is the "substitution effect": If consumers don't see a meaningful difference between products, they'll buy the one with the lowest price, so a price increase will drive them toward substitutes, while a reduction will draw them in.

how a market demand curve derived from individual demand curve: The market demand curve is obtained by adding together the demand curves of the individual households in an economy. As the price increases, household demand decreases, so market demand is downward sloping and vice versa. So we can say that the market demand curve is the aggregate of the individual demand curve

Answer1 b.

determinant of demand:

- The price of the good or service.
- The income of buyers/consumers

- The prices of related goods or services (substitute effect)

change in determinants resulted in:

- if the ***price*** of the goods rises, being all other factors are remained the same, so the demand of the goods are decreases and if the price of the goods is decreasing then the demand of that goods are increasing. Point to be noted that all other factors and conditions are remained unchanged
- if the buyers have a modest ***income*** then the demand of that product will be high
- if the ***price of related goods*** or substitute goods which are similar to these good are lower than buyers will switch to that substitute goods and purchase those goods, resulted in decreasing the demand for the first good

distinction of change in demand and change in quantity demanded:

Change in demand means change in demand due to the factors of demand other than price whereas Change in quantity demanded means change in the quantity purchased due to change in the price of a product

Question 2: Suppose that when everyone wakes up tomorrow, they discover that the government has given them an additional amount of money equal to the amount they already had. Explain what effect this doubling of the money supply will likely have on the following:

a) the total amount spent on goods and services
b) the quantity of goods and services purchased if prices are sticky
c) the prices of goods and services of prices can adjust

Answer2 a. If someone has more money so they will spend more so that it will increase the total amount spent on goods and services

Answer2 b. If someone has more money so he will purchase more goods and services and increasing their standard of living, so this will increase the quantity of goods or services purchased, but this will only be the case if the prices of the goods and services are sticky and unchanged. If with increasing the money supply, the prices of goods and

services are also changing with the same proportion then there will be very low effect on the quantity of goods and services purchased, because there will be lesser money to spent on more goods.

Answer2 c. A change in money supply results in changes in price levels. An increase in money supply results in a decrease in the value of money because an increase in money supply causes a rise in inflation. As inflation rises, the purchasing power, or the value of money, decreases and hence the prices are also affected and decreasing.

Question 3: Explain any of the five principles of economics in your own words?

Answer 3: **Rationality**: Rationality means that people act in their own best interest with the information that they have available to them. It doesn't mean they make the *best long term* decisions; it just means they make the best decisions according to their own desire for happiness (with the information that they have).

Costs: The most common use of the word cost is a monetary cost. Generally, we are concerned with the tradeoffs that are associated with decisions we make. We have to pay for food, movies, or classes

Benefits: The reason we incur costs is because we also derive benefits from them, the reason we incur costs is because we also derive benefits from them. We are interested in benefits because they are typically the thing that individuals and firms are trying to maximize with their behavior (utility and profit respectively).

Incentives: incentives are the rewards and punishments we experience every day. The incentive is a benefit trying to make someone do something (positive reinforcement) while the punishment is a cost trying to scare someone into doing something (negative reinforcement).

We like to get rewards, so we will generally make a decision so that we will get rewarded. At the same time, we don't like punishment so we will avoid decisions that will result in us getting

punished. Economists are interested in how people respond differently to rewards and punishments for similar scenarios.

Marginal analysis: almost everything analyzed in economics is done so on the margin. This means that economists are interested in the NEXT decision being made. It means that we look at the need of that thing we want to purchase.