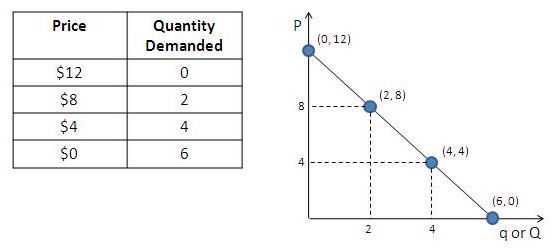
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|  | **Instructor:** | **Mr. Zohaib Ali** |
|  | **Total time:** | **6 Days** |

**Q1: (a) Explain the law of demand. Why does a demand curve slope downward? How a market demand curve is derived from individual demand curves? (5 Marks)**

**Answer: a:**

**Law of demand:** The claim that the quantity demanded of a good falls when the price of the good rises, other things equal. For example, airlines want to lower costs when oil prices rise to remain profitable. They also don't want to cut flights. Instead, they buy more fuel-efficient planes, fill all seats, and change operations to improve efficiency. The law of demand would describe this as the quantity of fuel required by the airlines dropped as the price rose. Of course, all other things are not equal during these periods. In fact, demand for jet fuel can be further lessened because airlines' income also drops at the same time. The 2008 global financial crisis meant that travelers cut back on their demand for air travel. The airlines' expectations about the price of jet fuel also changed. They realized it would probably continue to rise over the long term. The other two determinants of airline's demand for jet fuel stayed the same. They couldn't switch to another fuel, and their tastes or desire to use jet fuel didn't change. Retailers use the law of demand every time they offer a sale. In the short-term, all other things are equal. Sales are very successful in driving demand. Shoppers respond immediately to the advertised price drop. It works especially well during massive holiday sales, such as Black Friday and Cyber Monday.

**Now here is that why a demand curve slopes downward.**

The demand curve describes the relationship between price and quantity. It states how much of a good a consumer is willing to purchase for a given price. The demand curve is a negative relationship, which means that as the price of good increases, the quantity demanded decreases - thus, the demand curve slopes downwards.  Superficially, the demand curve is a negative relationship because people desire to purchase more of a good the cheaper it becomes. The reason why the demand curve is downward sloping is because of the following two reasons:

**Income and Substitution effect:**

**Income effect**: The income effect says that as the price of a good increases, consumers are able to afford less goods, and therefore purchase less goods.

**Substitution effect**: The substitution effect says that as the price of a good increases, consumers will substitute towards other goods, and therefore decrease their consumption of this good.

**Now we will explain that how a market demand curve is derived from individual demand curve?**

The market demand curve is simply the sum of individual demand curves. For example, say one person is willing to buy 30 slices of pizza per month if the price is $1 per slice. A second person is willing to buy only 10 slices if the price is $1 per slice. The equilibrium will be at 40 slices demanded per month with the market price being at $1. Or although the behavior of an individual in respect of selection and purchase of goods forms the basis of demand theory, the aggregate demand or market demand for a good is most important for its producer. The aggre­gate quantity of a good that the buyers purchase or demand at a particular price and in a particu­lar period (e.g., in a day) is called the market demand for the good at the said price. Also, the curve that gives us the market demand for a good at any particular price is known as its market demand curve.

**(b) What are the determinants of demand? What happens to the demand curve when any of these determinants change? Distinguish between a change in demand and a change in the quantity demanded, noting the cause(s) of each. (5 Marks)**

**Answer: b:**

**The following are determinants of demand:**

1. The price of the good or service.
2. The [income](https://www.thebalance.com/what-is-average-income-in-usa-family-household-history-3306189) of buyers.
3. The prices of related goods or services. These are either complementary (those purchased along with a particular good or service), or substitutes (those purchased instead of a certain good or service).
4. The tastes or preferences of consumers.
5. Consumer expectations. Most often, this refers to whether a consumer believes prices for the product will rise or fall in the future.

For aggregate demand, the number of buyers in the market is the sixth determinant.

When there is a change in any one of these determinants of demand there will be an **alteration in the demand curve**. Since these changes are not a cause of changes in price, there will be a shift in the demand curve. When more is purchased at the same price, the demand curve will shift to the right as demand increases.

**We can distinguish between a change in demand and a change in quantity demanded as given below:**

1. **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.
2. **Change in demand** has no price effect whereas **Change in quantity** has price effect.
3. **Change in demand** implies a change in demand curve whereas **Change in quantity**does not change the demand curve.
4. **Change in demand** will result in the shift in the demand curve whereas **Change in quantity**will result in movement of demand curve.

**The following are main causes of changes in demand**.

1. Changes in the Price of the Commodity

2. Changes in the Quantity of Money

3. Change in Habit, Taste and Fashion

4. Change in Climate and Season

And the **cause** of a change in **quantity demanded** is a change in the specific quantity of a good that buyers are willing and able to buy. This change in quantity demanded is caused by a change in the demand price.

**Q2: 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: (10 Marks)**

**Answer:**

1. **The total amount spent on goods and services**

In general they people will spend double of money on these goods and services and some may save some amount of money and a doubling of the money supply will make prices increase as you have much more money to get the same amount of goods. Amount spent on goods and services will increase. Sticky prices - shortages of these goods, Increase in prices when goods become available. Or the total amount spent will rise. If everyone had more money, more spending would occur. According to supply and demand, if prices are fixed regardless of the increase in demand the suppliers will still only be willing to offer the same quantity. According to supply and demand, if the demand is raised for a product, the supply will increase to meet that demand as prices rise. Therefore, the prices will rise until a new supply-demand equilibrium is reached. Prices will increase but not necessarily double.

1. **The quantity of goods and services purchased if prices are sticky**

Overall we can say that people will buy the double in terms of goods and services, taking in account some consideration. Price stickiness (or sticky prices) is the resistance of market price to change quickly despite changes in the broad economy that suggest a different price is optimal. "Sticky" is a general economics term that can apply to any financial variable that is resistant to change. When applied to prices, it means that the prices charged for certain goods are reluctant to change despite changes in input cost or demand patterns. For example, an increase in the money supply, a (nominal/real) variable, will cause the price level, a (nominal/real) variable, to increase but will have no long-run effect on the quantity of goods and services the economy can produce, a (real/nominal) variable.

1. **The prices of goods and services if prices can adjust.**

The prices automatically become the double. Or Use this free inflation calculator with built in US Consumer Price Index - Urban data or ... Inflation is the increase in the prices of goods and services across an economy. When prices inflate, you need more money to buy the same things Social Security benefits, too, are subject to Cost of Living Adjustments.

**Q3: Explain any of the five principles of economics in your own words? (10 Marks)**

**Answer;**

**PRINCIPLE 1: PEOPLE FACE TRADEOFFS**:

The first lesson about making decisions is summarized in the saying: “There is no such thing as a free lunch.” To get one thing that we like, we usually have to give up another thing that we like. Making decisions requires trading off one goal against another. Consider a student who must decide how to allocate her most valuable resource— her time. She can spend all of her time studying economics; she can spend all of her time studying psychology; or she can divide her time between the two fields. For every hour she studies one subject, she gives up an hour she could have used studying the other. When people are grouped into societies, they face different kinds of trade-offs. The classic trade-off is between “guns and butter.” The more we spend on national defence to protect our shores from foreign aggressors (guns), the less we can spend on consumer goods to raise our standard of living at home (butter).

**PRINCIPLES 2: THE COST OF SOMETHING IS WHAT YOU GIVE UP TO GET IT:**

Because people face trade-offs, making decisions requires comparing the costs and benefits of alternative courses of action. In many cases, however, the cost of some action is not as obvious as it might first appear. Consider, for example, the decision whether to go to college. The benefit is intellectual enrichment and a lifetime of better job opportunities. But what is the cost? To answer this question, you might be tempted to add up the money you spend on tuition, books, room, and board. Yet this total does not truly represent what you give up to spend a year in college. The first problem with this answer is that it includes some things that are not really costs of going to college. Even if you quit school, you would need a place to sleep and food to eat. Room and board are costs of going to college only to the extent that they are more expensive at college than elsewhere. Indeed, the cost of room and board at your school might be less than the rent and food expenses that you would pay living on your own. In this case, the savings on room and board are a benefit of going to college.

**PRINCIPLE 3: RATIONAL PEOPLE THINK AT THE MARGIN:**

Decisions in life are rarely black and white but usually involve shades of gray. When it’s time for dinner, the decision you face is not between fasting or eating like an animal, but whether to take that extra spoonful of mashed potatoes. When exams roll around, your decision is not between blowing them off or studying 24 hours a day, but whether to spend an extra hour reviewing your notes instead of watching TV. Economists use the term marginalchangesto describe small incremental adjustments to an existing plan of action. Keep in mind that “margin” means “edge,” so marginal changes are adjustments around the edges of what you are doing. As these examples show, individuals and firms can make better decisions by thinking at the margin. A rational decision maker takes an action if and only if the marginal benefit of the action exceeds the marginal cost.

**PRINCIPLE 4: MARKETS ARE USUALLY A GOOD WAY TO ORGANIZE ECONOMIC ACTIVITY:**

Market Economy is the concept where a centralize judgment planner is substituted by judgment of millions of households and firms. The place where the households and firm can communicate with each other for services and goods is known as market and it is taken place under the influence of the price and self-interest, which helps them to take decision. For example: Taxes that impose by the government always change the goods price and decision of producer and consumers.

**PRINCIPLE 5: PRICES RISE WHEN THE GOVERNMENT PRINTS TOO MUCH MONEY:**

Inflation is the state in which the price level increases in the economy. Inflation occurs when the supply of the money, which is under the hood of government, increased drastically in compare to the accessibility of services and goods in the markets. When the government produce high quantity of nation’s money, than it has lose its value. For example. When in Germany the average price of the commodity is tripling every month so the production of money is also tripling every month.