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Paper	**Microeconomics**
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Submit Date	**April, 19-2020**

Question No # 1

(A) Explain the law of demand. why does a demand curve slope downward? How is market demnad curve derived from individual demand curves?

Ans: Law of Demand: The law of demand states that all other things being equally, the quantity bought of a good or service is a function of price. If the amount bought changes a lot when the price does, then its called elastic demand. An example of this is ice cream. You can easily get a different dessert if the price rises too.

The demand of a product refers to the desire of acquirig it by the consumer but backed by his purchasing power and willingness to pay the price. The law of demand state that there is an inverse proportional relationship between price and demand of a commodity. When the price of commodity increases, its demand decreases.

Causes of Downward Sloping of Demand Curve

- Law of dimnishing the marginal utility
- Substitution effect
- Income effect
- New buyers
- Old buyers

1. Law of dimnishing the marginal utility

The law od diminishig marginal utility states that with each increasing quantity of the commidity, its margial utility declines.

For example, when a person is very hungry the first chapatti that he eats will give him the most satisfaction. As he will consume more chapattis, his level of satisfaction will diminish.

Hence, the demand curve slopes downwards from left to right.

2. Substitution effect

Let us understand this with an example. Tea ad coffee are substitute goods. If the price of tea rises, consumers will shift to coffee.

This will decrease the demand for tea and icrease the demand for coffee. Thus the demand curve of tea will slope downwards.

3. Income effect

Income effect refers to the change in the real income or the purchasing power of the consumers. When the price level falls the purchasing power of the consumers increases and they buy more goods.

Similarly, whe the price level rises, the purchasing power of the cosumers decreases and they buy less quantity of goods.

4. New buyers

Due to the fall in the price of a commodity new buyers get attracted towards it ad buy it. Thus this icreases the demand for the commmodity.

5. Old buyers

When the price of the goods fall the old buyers tend to buy more goods tha usual thereby increasing its demand. This causes the downward sloping of demand curve.

Market Demand curve Derived from Individual Demnad Curve

A market demand curve is the horizontal summotion of all individual demand curves. Any factor that can shift an idividual demand curve can shift a market demand curve To derive a market demand curve, simply add the quantities that each consumer buys at each price connect the points to get the market demand curve.

(B) what are the determintaes of demand? What happens to the demand curve when any of these determinates change? Distinguish between a change in demand and a change in the quantity

demand, noting the cause of each.

Determinates of Demand

In economics, there are several factors or determinates which effect the demand. Following are the Five most common determinates of demand are the price of the goods are service.

- Income (normal, inferior)
- Prices of related goods (substitutes, complements)
- Tastes
- Expectations
- Number pf buyers (market demand curve)

Market Versus Individual Demand

- Market demand is the horizontal sum of all individual demands for a particular good or service.
- Market demand is derived from individual demands andthus depends o all those factors that determie idividual demand (icome or expectations, etc.
- In our case, market demand curve shows the variatios in the quatity demanded of a good or price changes.

Demand curve when any of these determinates change

when any of the determinates of demand change a change in the demand of the item will change. An increase in demand can be shown as a shift of the demand curve to the right and a decrease in demand will be shown as a shift in the curve to the left.

If there is icreased demand from an increased market, increased desire for a good, higher competitor prices or the fear of a price increase the curve will shift to the right. If the reverse is true, the market is shrinking, the item is outdated, competitor prices are dropping or there is a predicted price reduction the demand will fall which will move the etire curve to the left.

Question No (2)

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)

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 if prices can adjust

Question No # 3

Explain Any Five Principles of Economics

(1) People Face Trade-offs

There is no such thing as a free lunch! To get one thing we usually have to give up another thing.

Examples:

Trade-off between studying one subject over studying another subject.

(2) The Cost of Something Is What You Give Up to Get It

Oppertunity cost is the second best alternatives foregone.

Example:

The oppertunity cost of going to college is the money you could have earned if you used that time to work.

(3) Ratioal People Think At Margin

Marginal changes are small, incremental changes to an existing plan of action.

Example:

- Deciding to produce one more pencil or not.
- people will only take action of the marginal benefit exeed the marginal cost.

(4) People Responed To Incentives

incentive is something that causes a person to act. Because peopple use cost and beefit analysis, they also respoed to incentives.

Example:

When sigrette taxes increase then smoking falls.

(5) Trade Can Make Everyone Better Off

Trade allows countries to specialize according to their comparative advantages and to enjoy a greater variety of goods and services.

The End