EXCEPTIONS OF DEMAND

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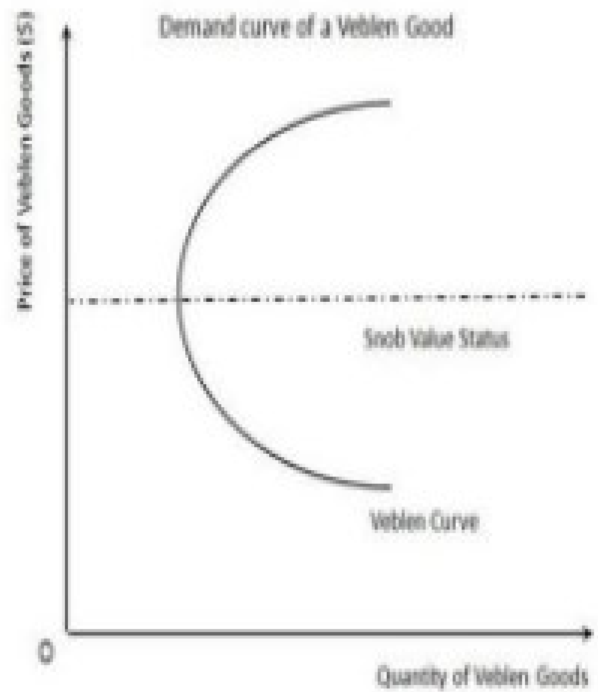
Exceptions

- Goods that obey the law of demand are normal goods.
- There are goods which doesn't obey the law of demand
- Such goods are either superior goods or inferior goods
- Named as Veblen and Giffin goods respectively

source: www.tutor2u.net

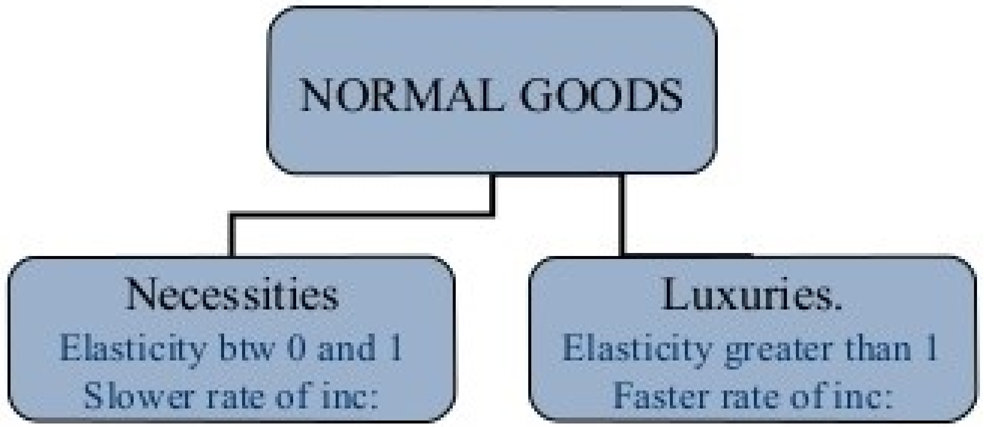
VEBLEN GOODS:

- Veblen goods are things primarily bought to show-off the wealth.
- Positional good.
- **Veblen effect** : Extent to which the demand for a consumer product increases, owing to the fact that, it bears a higher price than the other commodities.
- If the price decreases, then more people can afford them and they become less effective as an indicator of wealth, so demand falls.
- This phenomenon is **snob effect**: Extent to which demand of a commodity is decreased, owing to the fact that number of people are using the same commodity



Income elasticity of Veblen goods.

- Normal goods have a positive income elasticity of demand, (income rises, demand also rises.)

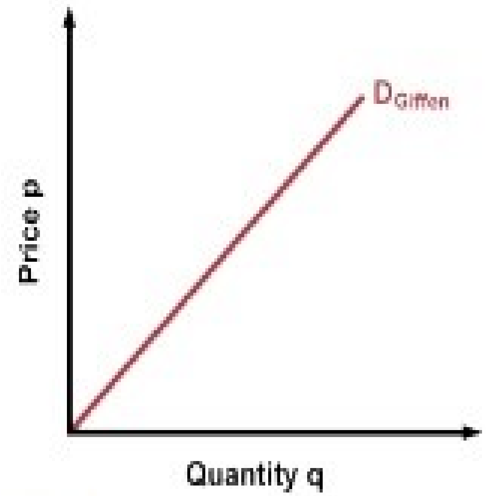


- For example (luxury) a 8% increase in income might lead to a 16% rise in the demand for restaurant meals. The income elasticity of demand in this example +2.0. Demand is highly sensitive to (inc: or dec: in) income.

SUMMARY

- When Price inc: demand dec:
- Called Goods of conspicuous consumption.
- Gives psychic satisfaction. not material satisfaction.
- In case of some Veblen goods (paintings, antiquities etc.), supply is not controlled by demand.
- in boom times, demand for luxury goods grow faster than the growth of economies (as measured by GDP).
- slowdowns can cause sales to retreat rapidly, as consumers buy fewer high-priced luxury goods

- **Giffen good** is a good that which decreases in demand when consumer income rises.
- Income elasticity is less than 0
- Giffen goods can be categorized into three.



a. necessary staple goods

VICTORIAN SOCIETY

- purchasing tendency of the poor Victorian subjects
- when the price of *necessary staple goods* such as bread, food grain, vegetables, etc., rose, the poorer sections, concentrated all their purchasing power on procuring the necessary staples.
- gave up on purchasing other goods
- This kept the demand for these good high despite an increase in their price

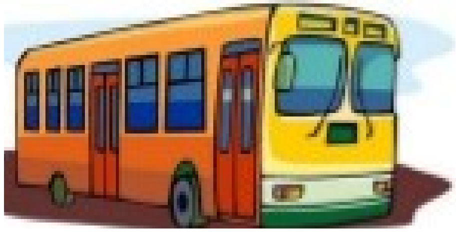
b. inferior goods

- those for which the demand rises when the price to procure them forms a relatively substantial part of the buyer's income without eating into the amount of income set aside for the consumption of other regular items.

- Cheaper cars are examples of the inferior goods.
- generally prefer cheaper cars when their income is constricted
- As a income increases the demand of the cheap cars will decrease,

while demand of costly cars will increase, so cheap cars are inferior goods.

- Inter-city bus service is also an example of an inferior good. This form of transportation is cheaper than air or rail travel.
- When money is constricted, travelling by bus becomes more acceptable.
- but when money is more abundant than time, more rapid transport is preferred.



Expensive Good or Luxury good

- Demand forecasting essentially involves ascertaining the expected level of demand during the period under consideration.
- Sales is a function of demand. Likewise, even cost of production depends upon demand.
- Production of any commodity requires time and resources.
- In order to plan the level of production and make arrangements for the resources to be consumed, it is important to estimate future demand.

Stages in forecasting demand

- Specification of objective(s)
- Selection of appropriate technique
- Collection of appropriate data
- Estimation and interpretation of results
- Evaluation of the forecasts

FORECASTING TECHNIQUES

- Accuracy
- Least possible cost
- Minimum use of other resources
- Choice of technique depends on
- Urgency
- Availability of data

SIGNIFICANCE OF DEMAND FORECASTING

- Useful to following decision makers:

Producers

- To allocate various factors of production for maximization of profit
- To plan for expansion of scale of operations

Policy makers and planners

- To formulate economic policies through planning commission for allocating resources
- To ensure adequate supply of inputs for achieving the objectives of industrial policy, import export policies, credit policy, public distribution system and other related policies

Other groups of the society

- Useful to researchers, social workers and others with futuristic approach
- To understand the gaps in supply and their impact on prices or the economy

USEFULNESS OF PED:

The usefulness of price elasticity for producers .

Firms can use price elasticity of demand (PED) estimates to predict:

The effect of a change in price on the total revenue & expenditure on a product.
The likely **price volatility** in a market following unexpected changes in supply – this is important for commodity producers who may suffer big price movements from time to time.

The effect of a **change in a government indirect tax** on price and quantity demanded and also whether the business is able to pass on some or all of the tax onto the consumer.

Information on the price elasticity of demand can be used by a business as part of a policy of **price discrimination** (also known as yield management). This is where a monopoly supplier decides to charge different prices for the same product to different segments of the market e.g. peak and off peak rail travel or yield management by many of our domestic and international airlines.

APPLICATIONS OF PED.

The price elasticity of demand can be applied to a variety of problems in which one wants to know the expected change in quantity demanded or revenue given a contemplated change in price.

Elasticity is an important concept in understanding the incidence of indirect taxation, distribution of wealth and different types of goods as they relate to the theory of consumer choice. Elasticity is also crucially important in any discussion of welfare distribution, in particular consumer surplus, producer surplus, or government surplus.