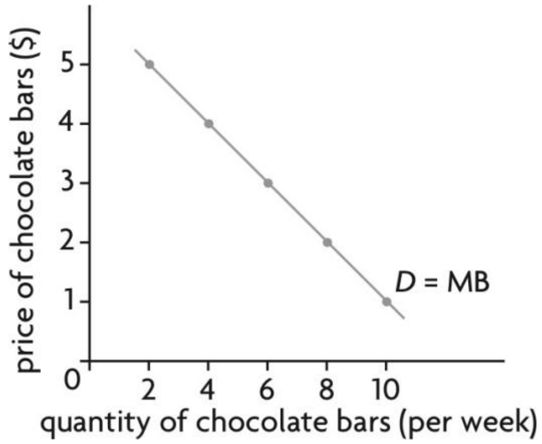
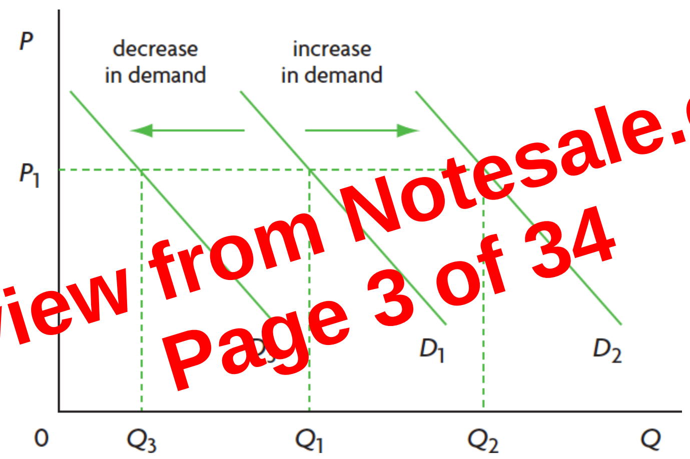
Draw a demand curve



<u>The non-price determinants of demand</u>

Explain how factors including changes in income, preferences, prices of related goods and demographic change may change demand

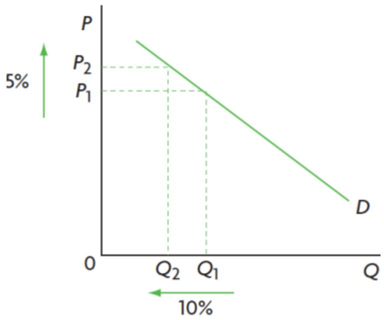
Non-price determinants of demand are variables other than price that can influence demand. They cause shifts of the demand curve, meaning the curve moves to the right or left



The non-price determinants of demand include:

1. **The income effects**
    - As income increases the demand for a good increase (normal goods)
    - For inferior goods as income rises consumers will buy less (left shift)
2. **Preferences and tastes**
    - If preference favour the product consumers will buy more (and vice versa)
    - E.g. during rainy reason the demand for umbrellas would rise
3. **Prices of substitute goods**
    - Fall in price of a substitute goods means increase in demand for it and decrease in demand for other substitutes
    - E.g. Fall in price of IPhone → increase in quantity demanded for IPhone → decrease in quantity demanded for Samsung

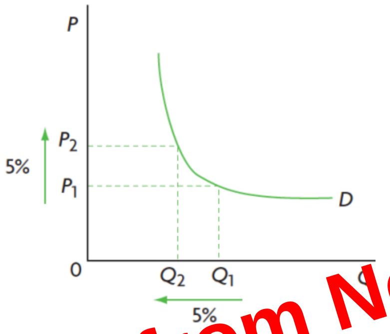
(b) Price elastic demand: $1 < PED < \infty$



3. Unit elastic demand

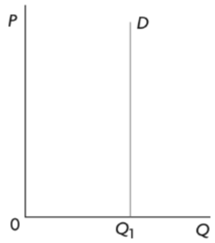
- Happens when PED = 1
- Change in price → proportionate opposite change in quantity demanded → total revenue gained by the firm stays the same when price increases

(c) Unit elastic demand: $PED = 1$



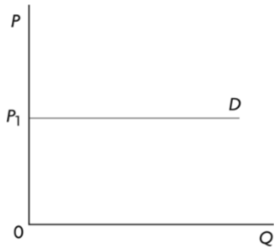
4. Perfectly inelastic demand

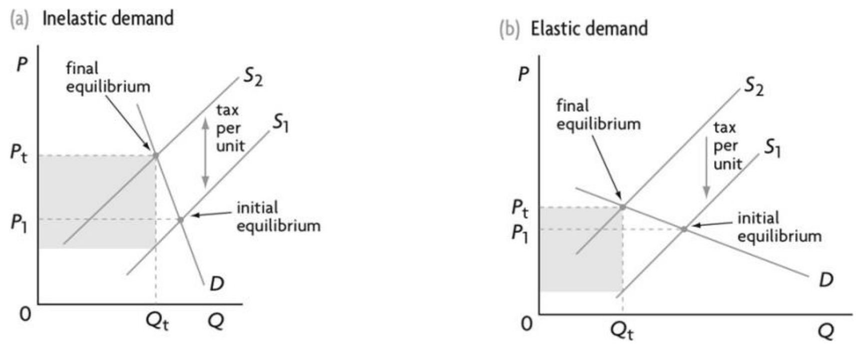
- Demand is unresponsive to price changes
- E.g. an essential operation



5. Unit elastic demand

- Demand is infinitely responsive to price



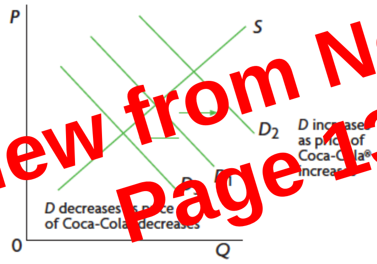
<table>
<tr><td>relation to indirect taxes</td><td>


</td></tr>
<tr><td colspan="2"><u>Cross price elasticity of demand (XED)</u></td></tr>
<tr><td>Underline the concept of cross price elasticity of demand, understanding that it involves responsiveness of demand for one good to a change in the price of another good</td><td>
Cross price elasticity od demand is a measure of how much the demand for a product changes when there is a change in price of another product

$$XED = \frac{\%\text{ change in quantity demanded of product X}}{\%\text{ change in price of product Y}}$$

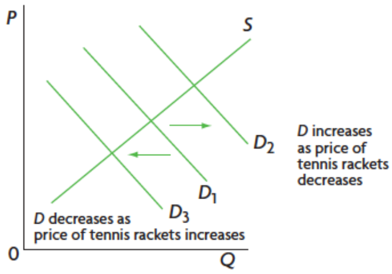
When XED is positive (XED>0)

Means they are substitutes
When demand for a good changes in the same direction
The larger the number the stronger the substitutes

(a) Substitutes and positive XED: demand for Pepsi®


When XED is negative (XED<0)

Demand for a good changes in the reverse direction (as price of one goes up, demand for the other goes down)
They are complements
Larger the number, stronger the complements

(b) Complements and XED: demand for tennis balls


When XED = 0

Two products are independent of each other

</td></tr>
</table>

Summary of Elasticities

$$PED = \frac{\%\text{change in quantity demanded}}{\%\text{change in price}}$$

0 < PED < 1	1 < PED < ∞	PED= 1	PED = O	PED = ∞
Inelastic Demand	Elastic Demand	Unit Elastic Demand	Perfectly Inelastic Demand	Perfectly Elastic Demand

$$YED = \frac{\%\text{change in quantity demanded}}{\%\text{change in income}}$$

YED > O	YED < O	0 < YEO < 1	YEO > 1
The product is a normal good	The product is an inferior good	The product is considered a necessity (income inelastic)	The product is a luxury good and has income elastic demand

$$XED = \frac{\%\text{change in quantity of good A demanded}}{\%\text{change in price of good B}}$$

XED >O	XED <O	XED = 0
The two products are substitutes	The two products are complements	The two products are independent of each other

$$PES = \frac{\%\text{change in quantity supplied}}{\%\text{change in price}}$$

0 < PES < 1	1 < PED< ∞	PES = 1	PES = 0	PED= ∞
Inelastic Supply	Elastic Supply	Unit elastic supply	Perfectly inelastic supply	Perfectly elastic supply

Topic 1: Microeconomics

1.3 Government intervention

Indirect taxes

Explain why governments impose indirect (excise taxes)

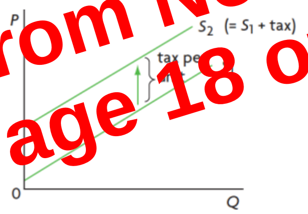
Indirect taxes are taxes on spending to buy goods and services. They are indirect because consumers pay some of or all of the tax. They are paid to the government by the firms indirectly.

Excise taxes are imposed on spending on specific goods or services. Reasons for imposing taxes include:

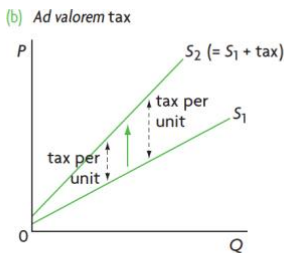
- Restrict/discourage consumption of demerit goods
- Increase tax revenue
- Redistribute income if taxes focus on luxury goods, only affects high income earners
- Improve allocation of resources (improve allocative efficiency) by correcting negative externalities

Two types of indirect tax include:

6. **Specific tax**
   - Fixed amount of tax imposed on a product
   - E.g. $1 per bar of chocolate
   - Shifts supply curve upwards by amount of tax



7. **Ad Valorem tax**
   - % of the selling price
   - As price of product increases tax increases



Evaluation of indirect taxes:

- Reduce consumption of demerit goods
- Increase in government revenue