Demand, Supply & Market

📘 CDS Economics · ECC02 📑 CDS Level : High Priority

Demand, Supply & Market is a core scoring chapter in CDS Economics. Questions test the Law of Demand, shifts vs movements, elasticity, and the effects of price controls like MSP (Minimum Support Price) and rent control. Understand the *logic* behind each curve shift — CDS presents these as real-world application questions.

📌 **CDS Pattern:** Law of Demand inverse relationship • Movement vs Shift of demand curve • Substitutes vs Complements • Price elasticity interpretation • MSP as price floor • Equilibrium price changes

1. Law of Demand

- **Law of Demand:** Ceteris paribus (all else equal), as price of a good rises, quantity demanded falls, and vice versa. Inverse relationship between price and quantity demanded.
- **Demand Curve:** Downward sloping (left to right). Price on Y-axis, Quantity on X-axis.
- **Exceptions (Giffen Goods):** Inferior goods where demand increases with price (e.g., low-quality staple food). Also: Veblen goods (luxury status goods), essential medicines, speculative goods.
- **Movement vs Shift — critical distinction:**
  - **Movement along demand curve:** Caused by change in the good's own price only. Quantity demanded changes.
  - **Shift of demand curve:** Caused by change in any factor OTHER than own price. Demand (not just quantity) changes.

2. Determinants of Demand (Shift Factors)

- **Income:** Rise in income → demand for normal goods rises (shift right). Rise in income → demand for inferior goods falls (shift left).
- **Price of Related Goods: Substitutes** (tea & coffee): rise in tea price → demand for coffee rises. **Complements** (petrol & car): rise in petrol price → demand for cars falls.
- **Tastes & Preferences:** Fashion trend towards a product → demand rises (right shift).
- **Expectations:** If consumers expect price to rise tomorrow, demand rises today.
- **Number of Consumers:** More consumers in market → demand rises.

3. Law of Supply & Market Equilibrium

- **Law of Supply:** Ceteris paribus, as price rises, quantity supplied rises. Direct (positive) relationship. Supply curve = upward sloping.
- **Market Equilibrium:** Where demand curve = supply curve. Equilibrium price (market-clearing price) where quantity demanded = quantity supplied. No surplus, no shortage.
- **Surplus:** Price above equilibrium → QS > QD → producers reduce price.
- **Shortage:** Price below equilibrium → QD > QS → consumers bid price up.

4. Price Controls

- **Price Ceiling (Maximum Price):** Set *below* equilibrium price to keep prices low (e.g., rent control for housing, essential medicine price caps). Effect: creates *shortage* (QD > QS). Black markets can emerge.
- **Price Floor (Minimum Price):** Set *above* equilibrium price to ensure minimum income (e.g., Minimum Support Price (MSP) for farmers, minimum wage). Effect: creates *surplus* (QS > QD).
- **MSP (Minimum Support Price):** Price floor set by Government of India for agricultural commodities. Ensures farmers receive at least this price even if market price falls below. Implemented via procurement by FCI (Food Corporation of India).

5. Price Elasticity of Demand (PED)

- **PED = % Change in Quantity Demanded / % Change in Price.** Always negative (inverse relationship).
- **Elastic Demand (|PED| > 1):** Luxury goods, goods with many substitutes. Consumers highly responsive to price. E.g., branded soft drinks.
- **Inelastic Demand (|PED| < 1):** Necessities, goods with few substitutes, addictive goods. E.g., salt, insulin, petrol (short run).
- **Unit Elastic (|PED| = 1):** % change in QD = % change in price.
- **Perfectly Inelastic (PED = 0):** Quantity demanded does not change regardless of price. E.g., life-saving medication for a specific disease.
- **Perfectly Elastic (PED = infinity):** Any price increase → zero demand. e.g., commodity sold in perfectly competitive market.

CDS PYQ **Demand, Supply & Market — CDS Pattern Questions**

Q1. An increase in income leads to a decrease in the demand for a good. This good is called: (CDS I 2024)

(a) Normal good (b) Inferior good (c) Giffen good (d) Complementary good

Answer: (b) Inferior good

Normal good: income rises → demand rises (positive income effect). Inferior good: income rises → demand falls (negative income effect). Examples: low-quality staple grains (when income rises, people switch to better food). Giffen goods are a special extreme case of inferior goods where even the demand curve is upward sloping.

Q2. MSP (Minimum Support Price) is an example of which type of price control? (CDS II 2023)

(a) Price ceiling (b) Price floor (c) Equilibrium price (d) Market price

Answer: (b) Price floor

Price floor = set above equilibrium price to ensure a minimum. MSP guarantees farmers a minimum price for their crops even if market prices fall below it. Results in government surplus — FCI procures the surplus. Opposite: Price ceiling (e.g., rent control) = set below equilibrium, causes shortage.

Q3. If a rise in the price of tea leads to an increase in demand for coffee, then tea and coffee are: (CDS I 2023)

(a) Complementary goods (b) Substitute goods (c) Inferior goods (d) Giffen goods

Answer: (b) Substitute goods

Substitutes serve similar purposes. When one becomes expensive, consumers switch to the other. Tea → coffee; Pepsi → Coke; butter → margarine. Complements are used together (car + petrol; phone + charger): price of one rises → demand for BOTH falls.

Q4. When price changes and we move along the same demand curve, it is called: (CDS II 2022)

(a) Shift in demand (b) Change in demand (c) Extension or contraction of demand (d) Expansion of supply

Answer: (c) Extension or contraction of demand (Movement along demand curve)

Change in own price → movement along the same curve (extension if quantity rises when price falls; contraction if quantity falls when price rises). Shift = demand curve itself moves, caused by non-price factors (income, tastes, related goods prices). CDS tests this distinction directly.

Q5. Which of the following goods has a perfectly inelastic demand? (CDS I 2022)

(a) Luxury cars (b) Table salt (c) Life-saving insulin for a diabetic patient (d) Foreign holidays

Answer: (c) Life-saving insulin for a diabetic patient

Perfectly inelastic = PED = 0; any price change has zero effect on quantity demanded. Life-saving medication is the closest real-world example. Salt is nearly inelastic (PED close to 0) but not perfectly so. Luxury cars and foreign holidays are elastic (PED > 1) as they have alternatives and are not necessities.

📝 Rapid Revision — ECCo2

📊 Demand Basics

- Law of Demand: price up → quantity down (inverse)
- Movement = price change (same curve)

🍽 Related Goods

- Substitutes: price of A up → demand for B up
- Complements: price of A up → demand for B down

- Shift = non-price factor (curve itself moves)
- Giffen good: upward sloping demand curve

- Normal: income up → demand up
- Inferior: income up → demand DOWN

📌 Price Controls

- Price Ceiling = below equilibrium → shortage
- Price Floor = above equilibrium → surplus
- MSP = Price Floor (farm income protection)
- Rent control = Price Ceiling (urban housing)

📈 Elasticity

- Elastic: |PED| > 1 (luxuries, many substitutes)
- Inelastic: |PED| < 1 (necessities, no substitutes)
- PED=0: perfectly inelastic (essential medicines)
- PED=inf: perfectly elastic (competitive market)