Price Elasticity of Demand

Saturday, 21 November 2015 4:05 pm

Equation

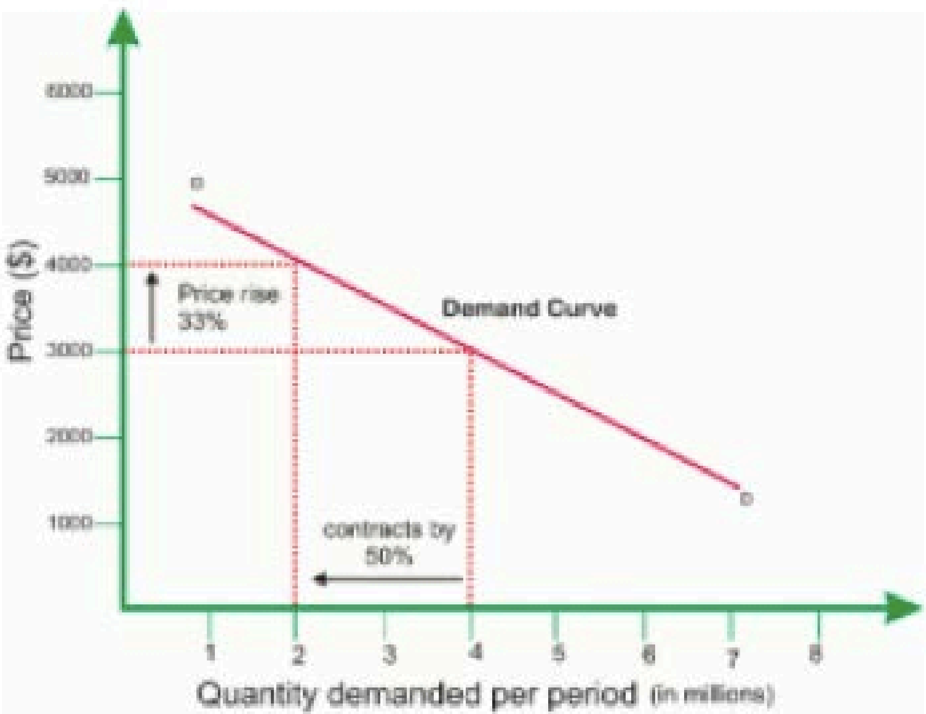
$$\text{Price Elasticity of Demand} = \frac{\text{\% change in quanity demanded}}{\text{\% change in price}}$$

Elastic PED

When the % change in quantity is more than the % change in price

If PED > 1

People ARE VERY WORRIED about changes in price



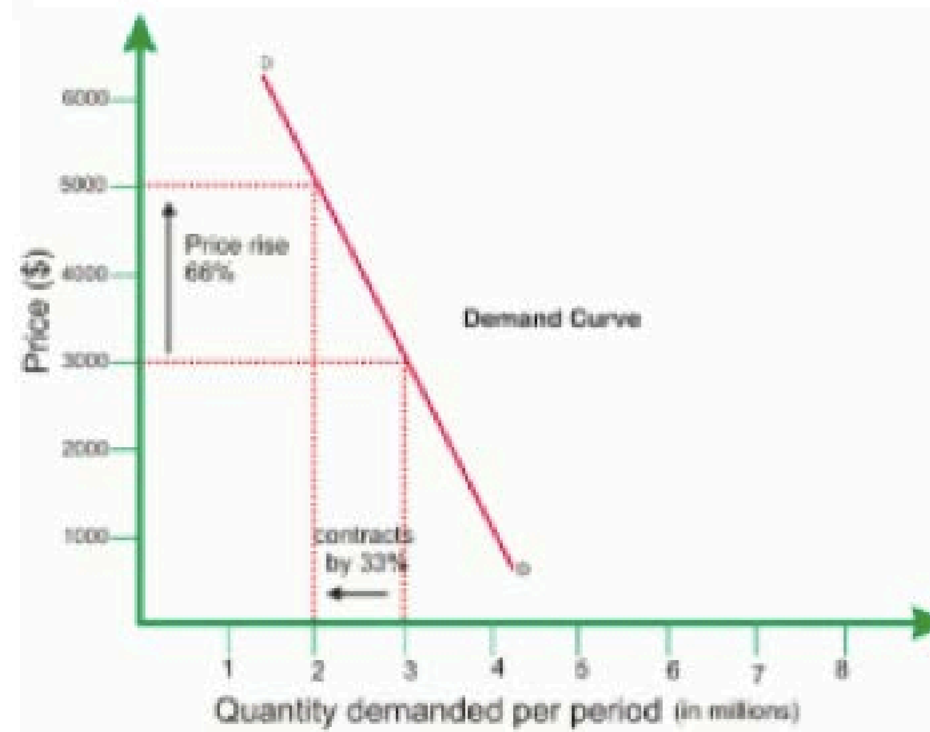
Demand is Price Elastic

Inelastic PED

When the % change in quantity is less than % change in price

If PED < 1

People ARE NOT WORRIED about changes in price



Demand is Price Inelastic

Determinants of PED

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1. **Substitutes**: A good with more close substitutes will likely have a higher elasticity.
2. **Proportion of Income:** The higher the percentage of a consumer's income, more elastic
3. **Luxury or necessity:** Luxury makes it more elastic, necessity more inelastic
4. **Addiction:** More addiction more inelastic
5. **Time:** Less time product is available for more inelastic.

Price Elasticity of Supply

Saturday, 21 November 2015 4:25 pm

Equation

$$\text{Price Elasticity of Supply} = \frac{\text{\% change in quanity supplied}}{\text{\% change in price}}$$

Elastic PES

When the % change in quantity is more than the % change in price
If PED > 1
Firms ARE VERY WORRIED about changes in price

Inelastic PES

When the % change in quantity is less than % change in price
If PED < 1
Firms ARE NOT WORRIED about changes in price

Determinants of PES

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1. **Time:** In the short run firms will only be able to increase input of labour to increase supply of commodities may not be able to increase the supply in response to the price change but the supply change will be little because other factors of production may not be increased in the same proportion and may limit the supply. However, in the long run a firm will increase the input of all factors of production and thus the supply becomes more price elastic.
2. **Availability of resources**: Very scarce resources means less room for expansion so, the supply of most of goods and services will therefore be price inelastic.
3. **Ease of storing stocks:** If goods can be stocked with ease and have a long shelf life, the supply will be elastic. For example perishable goods such as fresh flowers, vegetables have comparatively inelastic supply because it is difficult to store them for longer periods.
4. **Increase in cost of production as compared to output:** In cases where there is a significant increase in cost of production when output is increased, supply is inelastic. This is because suppliers will have to have to do a significant investment in order to increase the output. It will take time and some suppliers may be hesitant in doing so.
5. **Improvement in Technology**: In industries where there is a rapid improvement in technology, the PES of such goods will be more elastic as compared to industries where there is not much improvement in technology.

Government Intervention

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Government intervention is when governments intervene in markets to improve efficiency or equity.

Affect Firms (Supply)

Subsidies

1. Grant paid by the government to reduce cost of production for firms.
2. Increases supply
3. E.g.. police, education, public transport

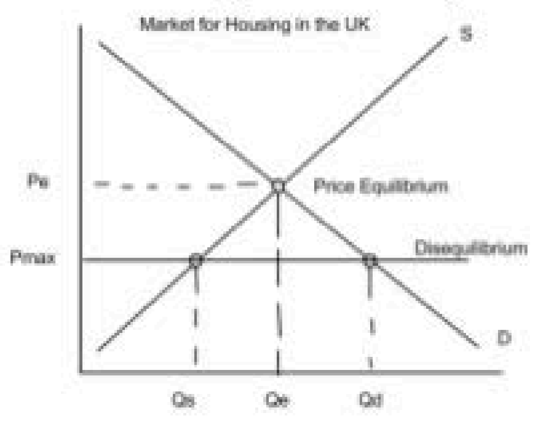
Indirect Tax

1. Value added tax, charged on goods / services
2. **PES is elastic:** the cost of taxation will be borne by the producer more than the consumer
3. **PES is inelastic:** the cost of taxation will be borne by the consumer more than the producer

Maximum / Minimum Price

Maximum Price

To help CONSUMERS by reducing price
Creates shortage: lead to illegal markets



Minimum Price

To help FIRMS by increasing price
Creates surplus: lead to illegal markets