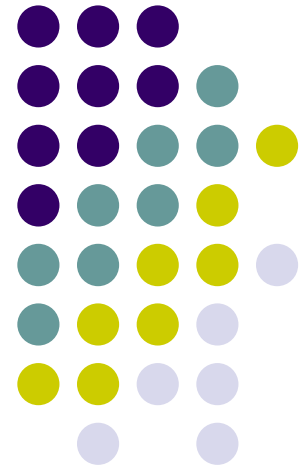
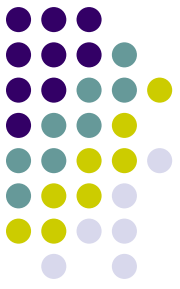


Chapter 4, Section 3

- Elasticity of Demand



Elasticity



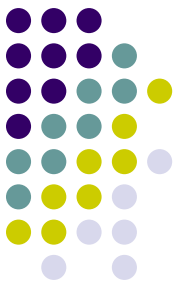
- A measure of responsiveness that tells us how a dependent variable such as quantity responds to a change in an independent variable such as price.

Demand Elasticity



- The extent to which a change in price causes a change in the quantity demanded

Elastic Example



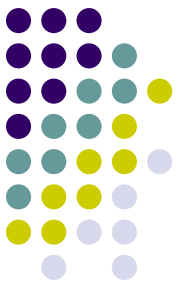
- Products such as jewelry, expensive clothing, books, etc.
- All these are not necessary for living, therefore if the prices go up on these products, demand goes down.

Inelastic



- Means that a given change in price causes a relatively smaller change in the quantity demanded.

Inelastic Example



- Products such as prescription drugs and gas do not have much change in demand even if the price changes.
- These are products that we need and have to have.

Unit Elastic



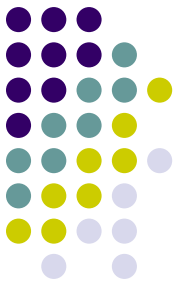
- A given change in price causes a proportional change in quantity demanded.

Unit Elastic



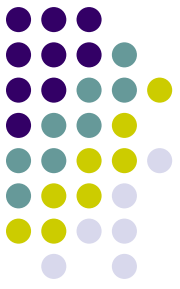
- This is when demand for a product is not quite elastic OR inelastic (somewhere in between).

Unit Elastic Example



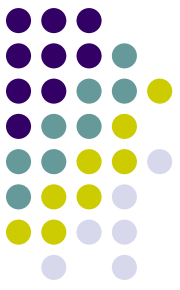
- A five percent drop in prices would cause a five percent increase in quantity demanded.

Total Expenditures Test



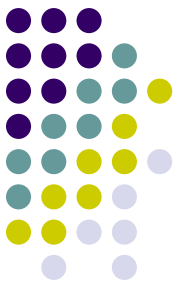
- Found by multiplying the price of a product by the quantity demanded for any point along the demand curve.

Total Expenditures Test



- Reason for test is to look at the impact of a price change on total expenditures, or the amount that consumers spend on a product at a particular price.

Total Expenditures Test



- By observing the change in total expenditures when the price changes, we can test for elasticity.

Total Expenditures Test



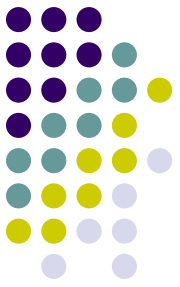
- If the change in price and expenditures move in opposite directions, demand is elastic.

Total Expenditures Test



- If the change in price and expenditures move in the same direction, demand is inelastic.

Total Expenditures Test



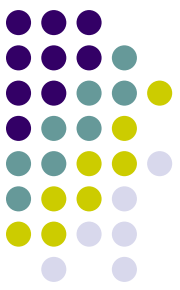
- If there is no change in expenditures, demand is unit elastic.

Elasticity and Profits



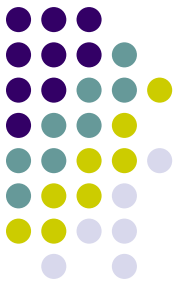
- Businesses that raise prices on products that have elastic demand will lose profit.
- Why?

Determinants of Demand Elasticity



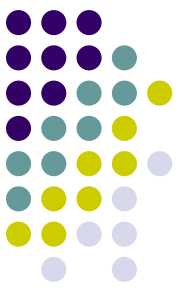
- To determine whether a product is elastic or inelastic we ask three questions...

Can the Purchase Be Delayed?



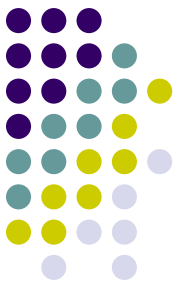
- Answer yes:
demand is elastic
- Answer no: demand
is inelastic

Are Adequate Substitutes Available?



- The more substitutes you have for a product, the more elastic the demand.
- The less substitutes you have for a product, the more inelastic the demand.

Does the purchase use a large portion of income?



- Answer yes: demand tends to be elastic
- Answer no: demand tends to be inelastic

Does the purchase use a large portion of income?



- Sometimes the answer is not necessarily yes or no.