

# **ELASTICITY OF DEMAND**



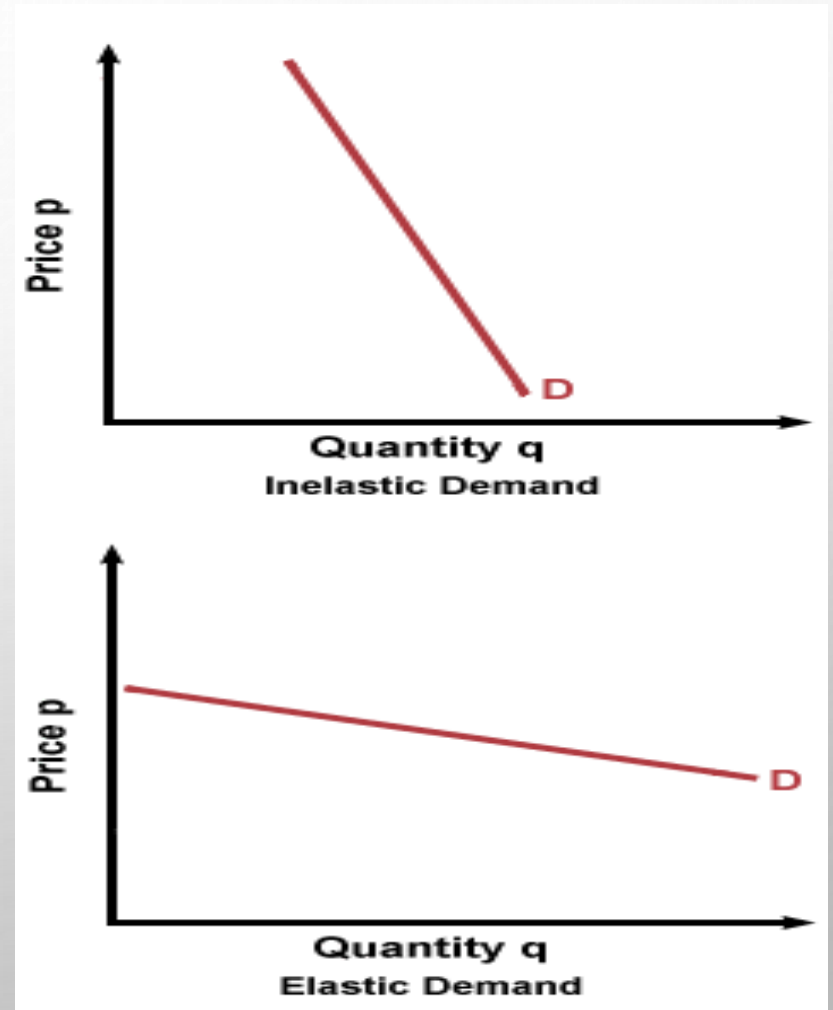
## INTRODUCTION

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- THE ELASTICITY OF DEMAND IS A MEASURE OF THE RESPONSIVENESS OF PRODUCT DEMAND TO CHANGES IN ONE OF ITS DETERMINANTS.
- IT'S CALCULATED AS THE PERCENTAGE CHANGE IN QUANTITY DEMANDED DIVIDED BY THE PERCENTAGE CHANGE IN PRICE.

# ELASTICITY OF DEMAND

- A GOOD OR SERVICE IS CONSIDERED TO BE ELASTIC IF A SLIGHT CHANGES IN PRICE LEADS TO A SHARP CHANGE IN THE QUALITY DEMANDED OR SUPPLIED.
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- ON THE OTHER HAND, AN INELASTIC GOOD OR SERVICE IS ONE IN WHICH CHANGES IN PRICES WITNESS ONLY MODERATE CHANGES IN THE QUANTITY DEMANDED OR SUPPLIED, IF ANY AT ALL.



# FACTORS AFFECTING DEMAND ELASTICITY

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## 1. AVAILABILITY OF SUBSTITUTES:

THE MORE SUBSTITUTES, THE MORE ELASTIC THE DEMAND WILL BE. IF THE PRICE OF A CUP OF COFFEE WENT BY RS. 40, CONSUMERS COULD REPLACE IT WITH A CUP OF TEA.

## 2. AMOUNT OF INCOME AVAILABLE TO SPEND ON THE GOOD:

IF THE PRICE OF A CIGARETTE GOES FROM RS. 0.50P TO RS. 1 AND INCOME STAYS THE SAME, THEN THE RS. 2 IS NOW ENOUGH ONLY FOR TWO CIGARETTE INSTEAD OF FOUR. THERE WILL BE ELASTIC REACTION IN DEMAND.

# TIME

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- DEMAND TENDS TO BE MORE ELASTIC OVER LONGER TIME PERIODS BECAUSE CONSUMERS HAVE MORE TIME TO ADJUST THEIR BEHAVIOR AND FIND SUBSTITUTES.

# INCOME ELASTICITY

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- INCOME ELASTICITY REFERS TO THE RESPONSIVENESS OF THE QUANTITY DEMANDED OF A GOOD OR SERVICE TO A CHANGE IN INCOME. INCOME ELASTICITY OF DEMAND MEASURES HOW CHANGES IN INCOME AFFECT THE DEMAND FOR A GOOD. POSITIVE VALUES INDICATE NORMAL GOODS, NEGATIVE VALUES INDICATE INFERIOR GOODS.

## Income Elasticity of Demand Formula

$$\text{Income Elasticity of Demand} = \frac{\text{Percentage Change in Quantity Demand } (\Delta D/D)}{\text{Percentage Change in Income } (\Delta I/I)}$$

$$\text{Income Elasticity of Demand} = \frac{(D_1 - D_0) / (D_1 + D_0)}{(I_1 - I_0) / (I_1 + I_0)}$$

# CROSS ELASTICITY

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- CROSS ELASTICITY OF DEMAND MEASURES HOW THE QUANTITY DEMANDED OF ONE GOOD CHANGES IN RESPONSE TO A CHANGE IN THE PRICE OF ANOTHER GOOD. IT HELPS DETERMINE IF TWO GOODS ARE SUBSTITUTE OR COMPLEMENTARY. POSITIVE VALUES INDICATE SUBSTITUTES, NEGATIVE VALUES INDICATE COMPLEMENTS, AND ZERO VALUES INDICATE UNRELATED GOODS.