Chapter 5

Thursday, October 13, 2016 11:46 AM

THE ELASTICITY OF DEMAND

Elasticity : a mesure of the responsiveness of quantity demand or quantity supplied to one of it
much consumers respond to changes in these variables. (how much it will go up in down in yo

The price elasticity of demand and its determinants **(GIVES % USE THI**

The law demand : fall in price = good raise the quantity demand
Price elasticity of demand : measures how much the quantity demanded responds to a change
change in quantity demand divided by the percentage change in price.

$$\frac{\%\text{ change quantity}}{\%\text{change price}} = \text{Formula elasticity}$$

Elastic : demand for a good , if the quantity demand changes in the price.
Inelastic : quantity demanded responds only slightly to change in the price (price goes down) (

Price elasticity : demand for any good measures how willing consumers are to buy less of the g
(DEMAND CURVE: reflects on economic, social and psychological .

Influence the price elasticity of the demand

- **Availability of close substitutes**

more **elastic** demand because its is easier for consumers to switch from that good to others .

- **Necessities vs luxuries**

Necessities tend have **inelastic** demand (dentist : price goes up= less ppl but its necessities)
Luxuries have a elastic demand (boat : price goes up=less ppl not a necessity "nice to have")
HOW EVER…. DEPENDS ON THE BUYER

ts determinants. (how
ur demand)

S EQUATION)

in price. Percentage

no substitute)

ood as its price rises.

EX : butter to margarine

Sailor needs more sailboat so it's a necessity with inelastic demand and dentist luxury with elas

- **Definition of the market**

Depends on how we draw the boundaries of the market.

Narrow = market tends to have more elastic demand (easy to find substitutes for a narrowly d
EX: food = inelastic demand because no good substitute for food other than food.
Ice cream = More narrow : elastic demand because its easy to substitute other deserts then ice
Vanilla ice cream = narrow category : other flavours

- **Time horizon**

Good tend have more **elastic** demand over longer time.
Ex : gas goes up= less ppl will buy------ eventually the over years quantity of gas demanded falls

Computing the price elasticity of demand

$$\frac{\text{\% change in Q demand (- decrease)}}{\text{\% change in in price (+) increase}} = \text{Price elasticity of demand}$$

EX : 10% increase price of ice cream cone cuz the amount of ice cream you buy fall by 20 %

Elastic demand : 20/10 = 2
Elasticity is 2 : change in the quantity demand is proportionate twice large as the price

The midpoint method : a better way to calculate % change and elasticities **(USE THIS EQUATION)**

Point : (A,B) OR (B,A) = PRICE AND QUANTITY
Midpoint menthods : a : 4$ b : 6$ = midpoint : PRICE :6-----5------4=5$ QUANTITY :80-----100---

A to B = price rise :40% quantity false 40%
B TO A = price false 40% and quantity rise 40%

so 40 % (6-4/5x100=40%)

stic demand.

efined goods)

cream.

substantially

ONLY GIVES U POINTS

----120= 100

Price elasticity demand= (Q2-Q1) / [(Q2+Q1)/2]

(P2-P1) / [(P2+P1)/2]

THE VARIETY OF DEMAND CURVES 5.1

Demand is elastic = elasticity is bigger then 1 (quantity moves more then the price) -less dema
Demand inelastic = elasticity is less than 1 (quantity moves less than the price) - more demand
IF same mvoes of price and quantity = unit elasticity

VERTICAL CURVE : price increase , leaves the quantity the same at 100 awlays (A))
Inelastic demand :elasticity is less than 1 : 22% price increase - 11% decrease quantity (B)

Unit elastic demand: elasticity equals 1 : 22% increase price- 22% decrease demande (C)

Elastic demand : elasticity bigger than 1 : demand increase 67% more than price - price increas

Perfectly elastic demand
: horizontal any price above 4$ is demand is 0 or lower than 4$ is 0

TOTAL REVENUE AND THE PRICE ELASTICITY OF DEMAND

Study changes in supply or demand in the market we want to study the TOTAL REVENUE.

Total revenue (the box) : amount paid by the buyer and received by sellers of the good .

In a market : total revenue - P (price of good times) x Q (quantity of good solds)

CHANGE IN TOTAL REVENUE?
....depends on the price elasticity of demand

Inelastic :increase in price cause increase in total revenue. (price less than 1 = 1 price and reve
Elastic: increase in price cause decrease in revenue (price is greater then 1 = 1 price and revenu

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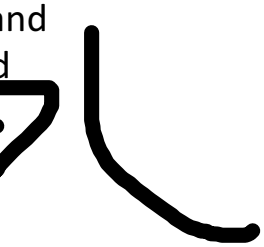

e less 22%

enue move the same way)
ue move opposite sides)

Elasticity of linear demand curve : use midpoint method fill out the demand schedule table (5.4

THE INCOME ELASTICITY OF DEMAND

How the quantity demanded changes as consumers income changes as consumer income chan

Income elasticity of demand = percentage change in quality demanded

Percentage change in income

Normal goods :higher income , higher demand
Inferior goods : higher income lower the quantity demand

Cross price elasticity of demand : measures how the quantity demanded of one good changes a
measures how the quantity demanded of one good changes as the price of another good chang

= % change in quantity demanded of good 1
% change in price good 2

THE ELASTICITY OF SUPPLY

PRICE ELASTICITY OF SUPPLY = % change in quantity supplied
% change in price

Mid point =	(S2-S1) / [(S2+S1)/2]

(P2-P1) / [(P2+P1)/2]

Elastic : if the quantity supplied responds substantially to changes in the price
Inelastic : if the quantity supplied responds only slightly to a change in the price.

Key determinant price elasticity of supply : consider the time periode

THREE APPLICATIONS OF SUPPLY,DEMAND AND ELASTICITY
(THE MARKET DEMAND AND SUPPLY)

1. Can good news for farming be bad news for farmers? 5.7 p112

4)

ges.

as the price of another
ges.

Demand is inelastic , an increase in supply, price goes down quantity increase
40% down the price
9.5 % up quantity

Total revenue : 300$ ----- 220$ now.

2. Why did OPEC FAIL TO KEEP THE PRICE OF OIL HIGH? P.113-114
3. DOES DRUGS INTERDICTION INCREASE OR DECREASE DRUG RELATED CRIME P.11