2.2 Price elasticity of demand

Key Words	
Price elasticity of demand	The responsiveness of quantity demanded to a change in the price of the product
Elastic demand	When the percentage change in quantity demanded is greater than the percentage change in price
Inelastic demand	When the percentage change in quantity demanded is less than the percentage change in price
Unitary price elastic	When PED=1, the change in price matched the change in quantity

Evaluate the importance of PED

Effects on consumers

For consumers with inelastic demand:
1, government could impose high levels of taxation on these goods and services because they know they will pay the higher prices, such as alcohol, motor fuel and tobacco;
2, firms could charge more if consumers have inelastic demand, such as consumers who have to travel at peak times

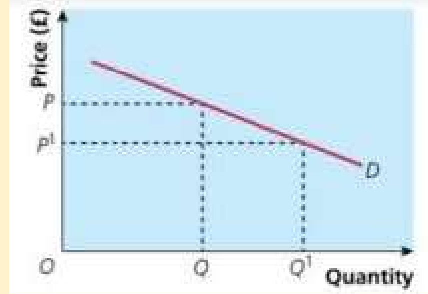
Effects on producers

Producers can use their knowledge of the PED for their products to increase their total revenue

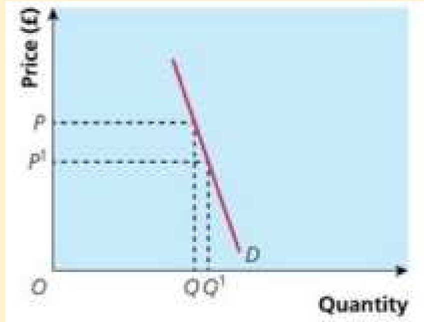
1, If the product had an elastic demand then cutting the price would lead to a larger percentage rise in quantity so total revenue would increase

2, If the product had an inelastic demand then increasing the price would lead to a smaller percentage fall in quantity so total revenue would increase

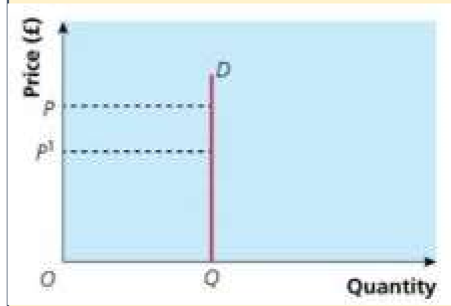
How to draw demand curves of different elasticity



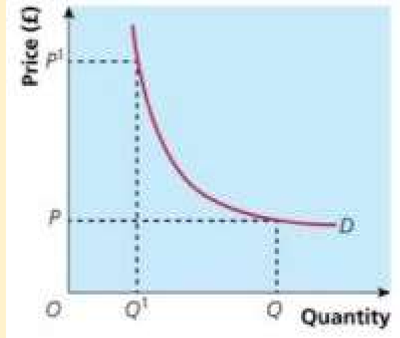
Price elastic demand curve



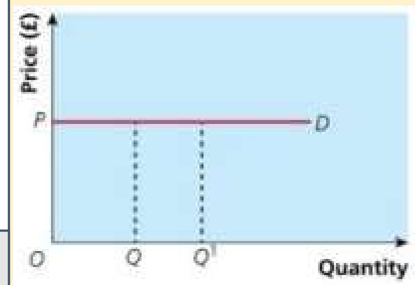
Price inelastic demand curve



Perfectly price inelastic demand crve



Unitary price elastic demand curve



Perfectly price elastic demand

What do the PED values mean?

*PED is negative because the demand curve slopes downwards, we take absolute value to simplify it

1, 0<PED<1, quantity demanded is relatively unresponsive to a price change

2, PED>1, quantity demanded is responsive to a change in price

3, PED=0, quantity demanded would not change at all along the change of price

4, PED=1, quantity demanded change at the same percentage as price inversely

5, PED=∞, quantity demanded is perfectly price elastic to the change in price

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