PRICE ELASTICITY OF DEMAND

Meaning and factors influencing consumer responsiveness

ECONOMICS | CLASSROOM PRESENTATION

What is Price Elasticity of Demand?

A measure of how strongly quantity demanded responds to a price change

Price Elasticity of Demand (PED) measures the degree of responsiveness of quantity demanded to a change in the price of a commodity, keeping other factors constant.

THE BASIC IDEA

If a small price change causes a large change in quantity demanded, demand is elastic.

THE CONTRAST

If quantity demanded changes only slightly despite a price change, demand is inelastic.

Illustration: A 10% rise in price may reduce demand by 20% for one product, but by only 2% for another.

Measuring Price Elasticity

The percentage method

PED = % change in quantity demanded ÷ % change in price

PED > 1 | ELASTIC

Quantity demanded changes by a greater percentage than price.

PED = 1 | UNITARY

Quantity demanded changes by the same percentage as price.

PED < 1 | INELASTIC

Quantity demanded changes by a smaller percentage than price.

For classification, economists generally use the absolute value because price and quantity demanded usually move in opposite directions.

Availability of Close Substitutes

FACTOR 1 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

More close substitutes generally make demand more elastic.

HOW IT WORKS

When the price of a product rises, consumers can switch to similar alternatives. The easier it is to switch, the greater the fall in demand for the original product. If suitable alternatives are limited, consumers have fewer options and demand is less responsive.

REAL-LIFE EXAMPLE

If the price of Pepsi rises, some consumers may switch to Coca-Cola or another soft drink. A patient may have fewer options if a prescribed medicine has no suitable substitute.

TAKEAWAY

More substitutes → more elastic demand.

Nature of the Commodity: Necessities and Luxuries

FACTOR 2 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

Demand for necessities is usually less elastic than demand for luxuries.

HOW IT WORKS

Necessities satisfy basic needs, so consumers may continue buying them even when prices rise. Luxury purchases are easier to reduce, replace or postpone when prices increase.

REAL-LIFE EXAMPLE

A family may continue buying rice after a price rise. It may postpone buying a designer handbag or a luxury watch if its price rises.

TAKEAWAY

Necessities: less elastic. Luxuries: more elastic.

Proportion of Income Spent

FACTOR 3 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

The larger the share of income spent on a product, the more carefully consumers tend to respond to its price.

HOW IT WORKS

A small increase in the price of an inexpensive item may have little effect on a household budget. A similar percentage increase in an expensive item can add substantially to expenditure and may lead consumers to compare options or delay purchase.

REAL-LIFE EXAMPLE

A rise in the price of salt from ₹25 to ₹30 may barely affect buying decisions. A refrigerator becoming ₹6,000 more expensive may lead a buyer to wait or choose another model.

TAKEAWAY

Higher budget share → usually more elastic.

Time Period

FACTOR 4 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

Demand is generally more inelastic in the short run and more elastic in the long run.

HOW IT WORKS

Consumers cannot always change habits, equipment or travel arrangements immediately. Over time, they can search for alternatives, adopt new technology and reorganise their routines, making it easier to respond to a price increase.

REAL-LIFE EXAMPLE

After petrol prices rise, a car owner may keep driving at first. Over time, the person may use public transport, carpool or consider an electric vehicle.

TAKEAWAY

More time to adjust → more elastic demand.

Possibility of Postponing Consumption

FACTOR 5 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

Products whose purchase can be delayed generally have more elastic demand.

HOW IT WORKS

If a purchase is not urgent, consumers can wait for a discount, save more money or reconsider whether they need the product. If consumption is urgent or essential, postponement is difficult and demand is less elastic.

REAL-LIFE EXAMPLE

A consumer may postpone buying a television when its price rises. Emergency medical treatment generally cannot be delayed simply because the cost has increased.

TAKEAWAY

Can postpone → more elastic; cannot postpone → less elastic.

Number of Uses of a Commodity

FACTOR 6 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

A commodity with several uses may have more elastic demand.

HOW IT WORKS

When its price rises, consumers can reduce less essential uses while retaining it for important purposes. This allows overall consumption to fall. A product with only one essential use may offer less scope for adjustment.

REAL-LIFE EXAMPLE

If electricity tariffs rise, a household may reduce air-conditioning, water-heater use and unnecessary lighting while continuing to use electricity for essential needs.

TAKEAWAY

More uses → more ways to cut consumption.

Habits and Addictive Consumption

FACTOR 7 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

Strong habits can make demand less responsive to price changes, especially in the short run.

HOW IT WORKS

Consumers who are accustomed to a product may find it difficult to reduce consumption immediately when its price rises. Over time, however, they may change habits or find alternatives, so responsiveness can increase.

REAL-LIFE EXAMPLE

If cigarette prices rise because of higher taxes, a habitual smoker may not reduce consumption immediately, although the increase may encourage reduction or quitting over time.

TAKEAWAY

Stronger habits → often less elastic demand.

Definition of the Market

FACTOR 8 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

Demand for a narrowly defined product is generally more elastic than demand for a broad product category.

HOW IT WORKS

A narrowly defined product has many alternatives within the wider category. When the market is defined broadly, fewer alternatives exist outside that category, so consumers may find it harder to switch.

REAL-LIFE EXAMPLE

If the price of one cola brand rises, buyers can choose another brand. If prices of all beverages rise, alternatives become more limited than when switching between beverage brands.

TAKEAWAY

Narrow market → more elastic; broad market → less elastic.

Price Level of the Commodity

FACTOR 9 | HOW IT AFFECTS PRICE RESPONSIVENESS

CORE PRINCIPLE

The absolute cost of a purchase can influence how carefully consumers react to a price change.

HOW IT WORKS

A small absolute increase in a low-cost item may not justify the effort of changing buying behaviour. A rise in the price of an expensive product can have a noticeable effect on the amount paid and encourage comparison or delay. This is a general tendency, not a universal rule.

REAL-LIFE EXAMPLE

A buyer may continue purchasing a pencil if its price rises slightly. If a laptop becomes ₹12,000 more expensive, the buyer may compare brands or wait for a sale.

TAKEAWAY

Expensive purchases often prompt more comparison and delay.

Quick Recap: Factors Affecting PED

Use the direction of influence to remember each factor

Close substitutes

More substitutes → more elastic

Share of income

Higher share → usually more elastic

Postponement

Can delay purchase → more elastic

Habits

Stronger habits → often less elastic

Price level

High-cost purchases often prompt more comparison

Nature of product

Necessity → less elastic; luxury → more elastic

Time period

Long run → more elastic

Number of uses

More uses → more scope to reduce use

Market definition

Narrow market → more elastic

KEY TAKEAWAY

Price elasticity depends on how easily consumers can adjust their choices when prices change.

Think like a consumer. Analyse like an economist.