**Price Elasticity of Demand (PED)**

**1. Missing words**

Price elasticity of demand measures the extent to which demand for a product is affected by price changes. A product will have a large change in quantity demanded following a price rise is said to be \_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. A product that will see a small change in quantity demanded following a price rise is said to be \_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. When a product is price elastic, an increase in price will bring about a \_\_\_\_\_\_\_\_\_\_\_\_\_\_ in revenue, whereas a decrease in price will bring about an \_\_\_\_\_\_\_\_\_\_\_\_\_\_ in revenue.

**HINT: words from price elastic, price inelastic, increase, decrease**

**2. Consider a rise in price for the following products. Are they elastic or inelastic? Briefly state your reasoning.**

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| **product** | **Elastic / InELASTIC** | **brief explanation of your logic** |
| 2.1 Rolls Royce cars |  |  |
| 2.2 Tesco Value Baked Beans |  |  |
| 2.3 A Box of Maltesers |  |  |

**3. True or false**

3.1 All consumer goods are price elastic

3.2 A product that has a lot of competition is likely to be price elastic

3.3 A product that is the first onto the market is likely to be price inelastic

3.4 When a product is price inelastic a change in price will bring about no change in demand

**4. Outline on advantage and one disadvantage when:**

The price of a return economy airfare to the USA is £400 and at this price an airline sells 1000 seats. However, the airline has a lot of spare seats and in order to try and sell these, it cuts its airfare to the USA to £300. This pushes demand up to 1500 seats.

4.1 Advantage:\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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Disadvantage; \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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**5. What is the effect on a firm’s total revenue of the following changes?**

5.1 A price increase on a price elastic product. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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5.2 A 10% price cut on a product with a price elasticity of -1 \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

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Income elasticity

**1. Missing words**

Income elasticity of demand measures the extent to which a change in income affects \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. It is often abbreviated to YED. Unlike price elasticity of demand, income elasticity can be either \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ or \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. Most goods have a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ income elasticity of demand. If a product has a positive income elasticity of demand, when income increases, demand for the good \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_. Goods for which demand increases (approximately) in line with rising incomes are called \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ goods. Goods for which an increase in income is followed by a more than proportionate change in demand are called \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ goods. However, for some goods, an increase in income will lead to a fall in demand. These goods have a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_income elasticity of demand. These goods are called \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_goods. **HINT: words from luxury, positive, inferior, demand, normal, negative, positive/negative, positive/negative, increases**

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| **2. Judgement**2.1 In America’s Midwest in early 2008 a 1% fall in real incomes led households to cut back their spending on anti-ageing creams by 10%, yet they spent 5% extra on meals at McDonalds.i) Are anti-ageing creams luxuries, necessities or inferior goods? \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ii) Are McDonalds meals luxuries, necessities or inferior goods? \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**3. Match the letters to the numbers**, i.e. one from the middle & one from the right column to match 3.1 to 3.4.

|  |  |
| --- | --- |
|  | **Types of product** |
| 3.1 A normal good | A. Eating out at an expensive restaurant |
| 3.2 A luxury good | B. Buying rolls of toilet paper |
| 3.3 An inferior good | C. Buying an umbrella |
| 3.4 A good with very low income elasticity (highly income inelastic) | D. Buying clothes |
|  | E. Tesco Value Baked Beans |

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Price and Income Elasticity of Demand Worksheet

Knowledge and understanding

1. State two methods Nestle might take to reduce the price elasticity of KitKat chocolate bars. [2]
2. Explain three ways a firm could make use of information about the price elasticity of its brands. [6]
3. Identify three external factors that could increase the price elasticity of a brand of chocolate [3]
4. Suggest two brands that:
	1. Have low price elasticity but high income elasticity [2]
	2. Have low income elasticity but high price elasticity [2]

Extension: Research Task

1. Find three examples of each of the following product types. Explain why they fit into these categories.

INFERIOR
NORMAL
LUXURY
2. Investigate and analyse the demand for one product out of each category over the last fifteen years. (i.e. one NORMAL good, one INFERIOR good and one LUXURY good).
Use the theory of INCOME ELASTICITY OF DEMAND to explain these shifts in demand.