

Topic: Price Elasticity of Demand

Q1

Price Elasticity of Demand measures the responsiveness of quantity demanded to a change in price

$PED = \% \text{ change in quantity demanded} / \% \text{ change in price}$

Q2

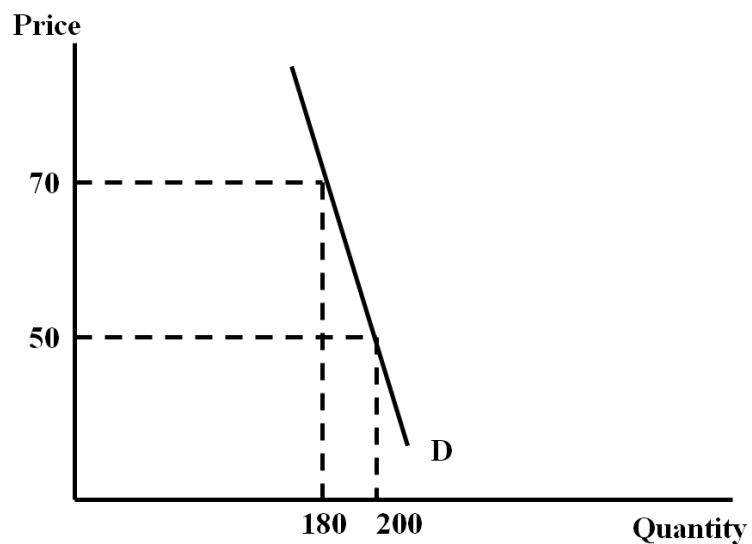
$PED = \% \text{ change in quantity demanded} / \% \text{ change in price}$

$PED = -10 / +40$

$PED = -0.25$

Inelastic

A PED between 0 and -1 is inelastic i.e. the % change in quantity demanded is less than the % change in price



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Q3

In a bid to increase sales and hence revenue, Budget Holidays are contemplating whether to increase or decrease price from their starting point of £500 per holiday. They only know the following:

Price (£)	Quantity Demanded (holidays)	Total Revenue (£)
400	1400	560,000
500	1000	500,000
600	600	360,000

Calculate the PED if the price rises to £600

$PED = \% \text{ change in quantity demanded} / \% \text{ change in price}$

$$PED = -40 / +20$$

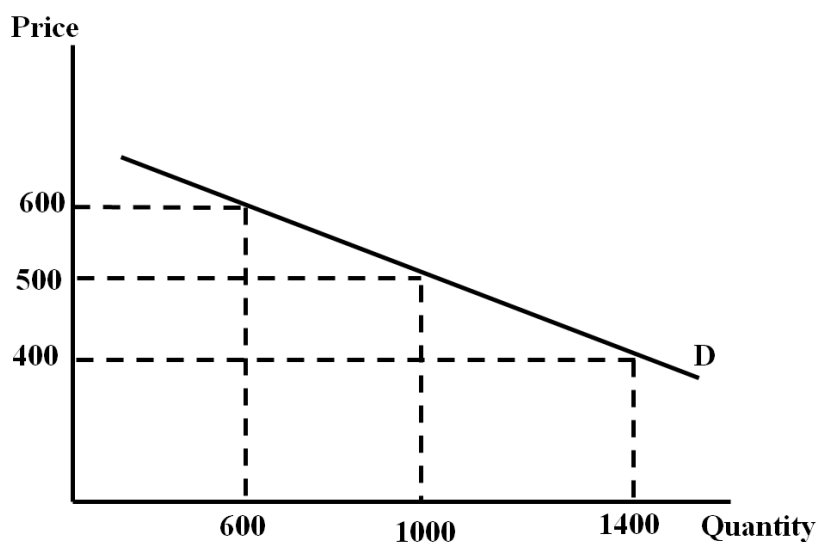
$$PED = +2$$

Calculate the PED if the price falls to £400

$PED = \% \text{ change in quantity demanded} / \% \text{ change in price}$

$$PED = +40 / -20$$

$$PED = +2$$



The demand for this product is elastic (+2.0) so the percentage change in quantity demanded exceeds the percentage change in price. As is shown in the total revenue column, reducing price to

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£400 sees revenues climb significantly and as such, assuming costs don't change disproportionately, the firm should reduce price in order to increase total revenue and profit

Q4

- PED for a normal good should be ~~negative~~/~~positive~~.
- this is because there is an ~~inverse~~/~~positive~~ relationship between price and quantity demanded.
- A ~~steep~~/~~shallow~~ demand curve suggests that the good is inelastic ie it is relatively ~~unresponsive~~/~~responsive~~ to a change in price.
- For a good which is elastic in nature, the percentage change in quantity demanded is ~~less~~/~~more~~ than the percentage change in price.