The Use of Price Elasticity of Demand

Why Elasticity matters?

Elasticity, Total Revenue, and Demand

- The elasticity of demand tells suppliers how their total revenue will change if their price changes.
- ***Total revenue*** equals total quantity sold multiplied by price of good.

Elasticity, Total Revenue, and Demand

- If E_D is elastic ($E_D > 1$), a rise in price lowers total revenue.

- Price and total revenue move in opposite directions.

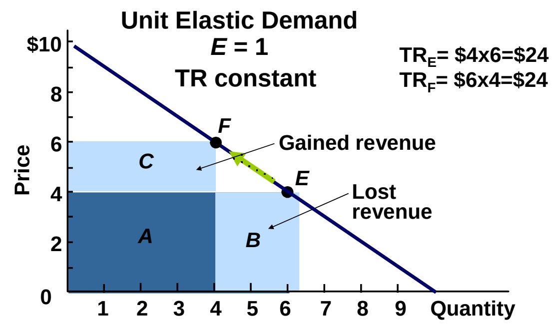
Elasticity, Total Revenue, and Demand

- If E_D is unit elastic ($E_D = 1$), a rise in price leaves total revenue unchanged.

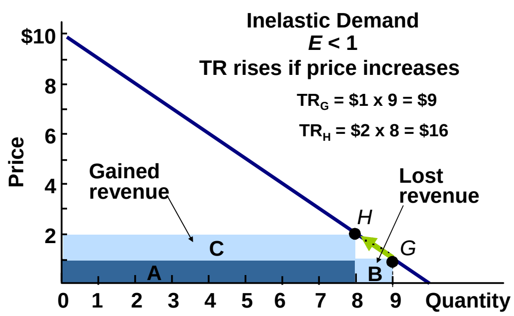
Elasticity, Total Revenue, and Demand

- If E_D is inelastic ($E_D < 1$), a rise in price increases total revenue.
- Price and total revenue move in the same direction.

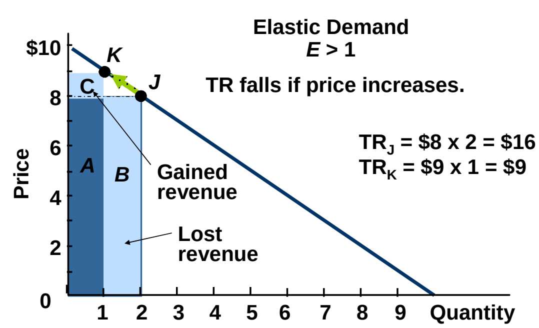
Elasticity and Total Revenue



Elasticity and Total Revenue



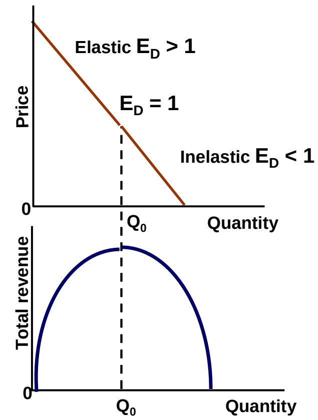
Elasticity and Total Revenue



Total Revenue Along a Demand Curve

- With elastic demand – a rise in price lowers total revenue.
- With inelastic demand – a rise in price increases total revenue.

Total Revenue Along a Demand Curve



Relationship Between Elasticity and Total Revenue

	Price Rise	Price Decline
Elastic ($E_D > 1$)	TR decreases	TR increases
Unit Elastic ($E_D = 1$)	TR constant	TR constant
Inelastic ($E_D < 1$)	TR increases	TR decreases

7-11

Elasticity of Individual and Market Demand

- ***Price discrimination*** occurs when a firm separates the people with less elastic demand from those with more elastic demand.

Elasticity of Individual and Market Demand

- Firms that price discriminate charge more to the individuals with inelastic demand and less to individuals with elastic demands.

Elasticity of Individual and Market Demand

- Examples of price discrimination include:
  - Airlines' Saturday stay-over specials.
  - The phenomenon of selling new cars.
  - The almost-continual-sale phenomenon.