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.
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.

Relationship Between Elasticity and Total Revenue

<table>
<thead>
<tr>
<th>Elasticity</th>
<th>Price Rise</th>
<th>Price Decline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elastic (ED &gt; 1)</td>
<td>TR decreases</td>
<td>TR increases</td>
</tr>
<tr>
<td>Unit Elastic (ED = 1)</td>
<td>TR constant</td>
<td>TR constant</td>
</tr>
<tr>
<td>Inelastic (ED &lt; 1)</td>
<td>TR increases</td>
<td>TR decreases</td>
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</tbody>
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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.

Examples of price discrimination include:

- Airlines' Saturday stay-over specials.
- The phenomenon of selling new cars.
- The almost-continual-sale phenomenon.