The Use of Price Elasticity of Demand

Elasticity, Total Revenue, and Demand

Why Elasticity matters?
Better than chapter 6-2

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

Inelastic Demand \( E < 1 \)
- TR rises if price increases
  - \( TR_{in} = 2 \times 8 = 16 \)
  - \( TR_{ex} = 1 \times 9 = 9 \)

Elastic Demand \( E > 1 \)
- TR falls if price increases
  - \( TR_{in} = 8 \times 2 = 16 \)
  - \( TR_{ex} = 9 \times 1 = 9 \)

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.

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.
- 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.