An Introduction to Microeconomics
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Lecture - 27
Factors Affecting Price Elasticity of Demand

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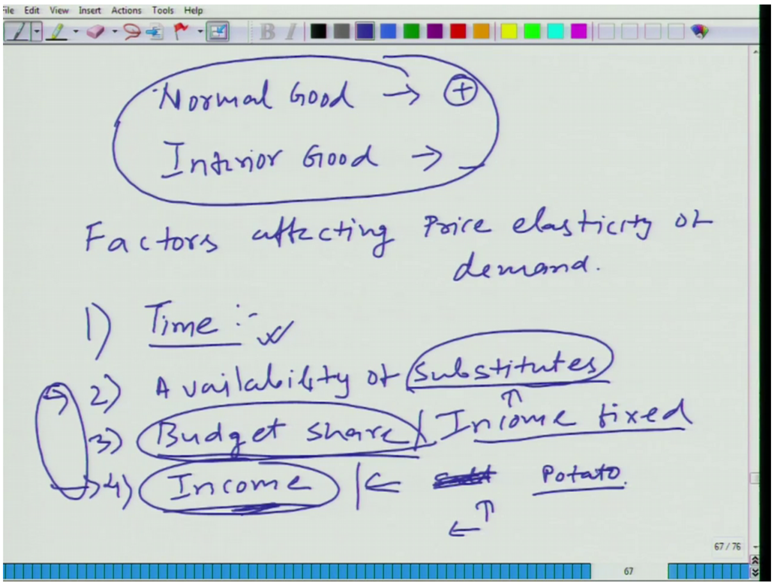

Now, let us talk about factors affecting price elasticity, we are again coming back to price elasticity, price elasticity of demand. Can you think of factors? Time; can you explain it how.

Student: Airlines.

Student: Air like with time like today we are producing one good and today we think that there here we can [FL] the utility is very high because.

We have not discussed utility yet.

Student: Sir, demand for the good is like take the example of insulin like today for diabetes there is only one medicine insulin. So, its elastic it is completely inelastic, but tomorrow we can have more substitute medicines for diabetes.

Student: So, that is not a factor of time sir.

So, he is expecting that with time it will change. So, more realistic example would be let us talk about today we had a huge increase in petrol price. Let us take example today the demand for petrol is very inelastic you already have a car, you already have a vehicle motor bike and you need to travel to the destination wherever you want to go you do not have any other option, but tomorrow in the long run little longer run you may buy you know people when it comes to buying decision you will buy more fuel efficient car or you will buy car which.

Student: Does not require petrol.

Does not require petrol may be electric car or diesel car. So, in the long run your demand for petrol is not that inelastic. So, time matters fine is it clear. Again the same example that we are talking about, but that is unrealistic we do not know whether we will have new medicine tomorrow or not, but theory was same thanks and any other.

Student: Sir, location.

Location how.

Student: Like the price of some the price of an item increases if its availability at some places more difficult to deliver.

Ok.

Student: For example, if we have a [FL] in a airport it is of 20 rupees, but we have that same [FL] in a flight it would be of rupees 100. So, it is the service that provide in the airlines, so that.

See again when we change the location basically we are talking about two different goods. In airline it is not the same [FL] even though it is a, it tastes the same or same product. When we are talking about [FL] here we are talking about [FL] in this particular locality. So, we are changing the change in the price would be explained by elasticity of the demand. So, when you want to buy let us say [FL] on a in a city you know there substitutes what you are talking about basically is the availability of substitutes.

Student: (Refer Time: 03:33),

For example, let us say Ramu kaka is selling [FL] and he has increased his price, but possibly Shamu Chacha is also selling [FL] and he has not increased the price.

Student: Sir, if we go for same product from same (Refer Time: 03:46) for example, Pepsi, if we buy a Pepsi inside a movie hall it is of 50 rupees.

No, it is not you are you are thinking that the products are the same although you did not attend that part where we talked about that we distinguish a product in economics sussing location, attributes you are just thinking that because they are the same attributes they have the same attributes they are the same product, but location also changes the product. For example, a better example would be for you to understand that same umbrella the demand for the because demand would change we are not talking about see in that sense time and location that we are talking about just we are changing the time and we are also going to change the location. Let us say today here in Kanpur the demand for umbrella may not be very high. But if you know if it is rainy today tomorrow the demand would increase.

So, in this context we are talking about two different products umbrella on a summer day, sunny day and umbrella on a in a rainy day. So, these two are two different products. So, when we change the location also when we change the time same thing you can talk about in terms of time that umbrella in October or umbrella in November when it is not raining and umbrella in July I am not using time in that particular sense I am using time in a different sense. So, location or time if you are using location in the same senses you can use time also in that sense. So, you are changing the product you understand that is why I would not say that location is that good explanation.

Student: Sir, but when we talk about like the goods we export like consider an example of jute bags fancy jute bags in India you do not give you do not give much value to them, but in foreign countries they are considered as a good of luxury. So, their prices are much different.

So, demands are different. So, we are talking about two different goods even though they are same bag. The locations are different timings are different that is two different goods. So, time, but one thing you can talk about avail.

Student: Of substitute.

Of substitute, a Pepsi increases its price.

Student: (Refer Time: 06:12).

You will drink coke. So, it cannot your demand for Pepsi will not be very inelastic.

Student: Inelastic.

It is going to be.

Student: Elastic.

Elastic. But petrol in the short run that we are talking about today you it does not have your car runs on petrol then you cannot pour diesel in it. So, at present it is very.

Student: Inelastic.

Inelastic, but in the long run what you would do you would not if the trend continues the petrol price keeps on raising while diesel price remains the same people would buy more and more diesel cars. So, in the long run it will be relatively less inelastic fine.

Third factor is budget share what does it mean? Let us say the price of salt goes up your consumption of salt would not change for two reasons ones one probably you do not have substitutes for it available for it, but also that you spend very tiny fraction of your income on salt. Probably you spend 1000s or 10,000s of your income on salt. So, if it goes up by double you spend on by 5000s hardly it matters. But now if we talk about expensive product the price of LCD goes up LCD TV goes up by 100 percent probably most medium income group people would no longer demand LCD. So, budget share also plays an important role, if the good purchase decision of a good requires significant proportion of your budget spent on that good then it would be highly elastic otherwise it would be inelastic fine. Again in reality these factors work together in or in certain combinations fine.

Fourth is income, now how here I am budget share why I am distinguishing it. Here even though income is fixed and then we are talking about change in the budget share that you need to spend on that good, but here I am talking about the change in income fine. Budget share is the function of the price of that good and also income you can obtain because of change in income or change in price of that particular item, but here now I am talking about income. So, how income is just here it is written normal good and inferior good. Now, let us it works well with combination of the second factor that we will again study more detail later on, but just look at it availability of substitute if no substitute is available what do you get.

Student: Inelastic.

Inelastic and if substitute is available you get elastic why substitute is available you shift to the other good.

Student: Other good.

Now, let us look at the income you can have two different kinds of good normal good or an inferior good when it is normal good your income goes up what will you do you will buy more of that good. So, it will reinforces this effect here in the substitution they work in the same direction. Let us take for an example Pepsi your income goes up your income goes up your probably you will consume more Pepsi fine, because I am considering right now it is a normal good. Now, just to contrast it with salt contrast it with salt what is happening there you do not have or I do not think salt is a good example. Let us take potato, let us take potato because potato I gave you gave as an example of inferior good. So, what is happening income is going up you are consuming less of.

Student: Potato.

Potato and also because income is going up you will have a substitutes available you will move. So, it is reinforcing each other. While if you talk about the normal good Pepsi consumption would go up with income availability of substitute would not matter that much. So, there it is not reinforcing, but these two effects we will look at in more detail when we talk about consumptions consumers' theory. We will come back to this. So, similarly you can think of the factors affecting the supply function you got the drift how we are talking about it.