Tuesday, February 11, 2020 8:15 PM

Elasticity

1. IED

Consider a local car dealership that gathers data on changes in demand and consumer income for its cars for a particular year. When the average real income of its customers falls from $50,000 to $40,000, the demand for its cars plummets from 10,000 to 5,000 units sold, all other things unchanged. The income elasticity of demand is calculated by taking a negative 50% change in demand, a drop of 5,000 divided by the initial demand of 10,000 cars, and dividing it by a 20% change in real income — the $10,000 change in income divided by the initial value of $50,000. This produces an elasticity of 2.5, which indicates local customers are particularly sensitive to changes in their income when it comes to buying cars.

The factors influencing income elasticity of demand

The main factor affecting income elasticity of demand is whether or not goods are necessities or luxuries.

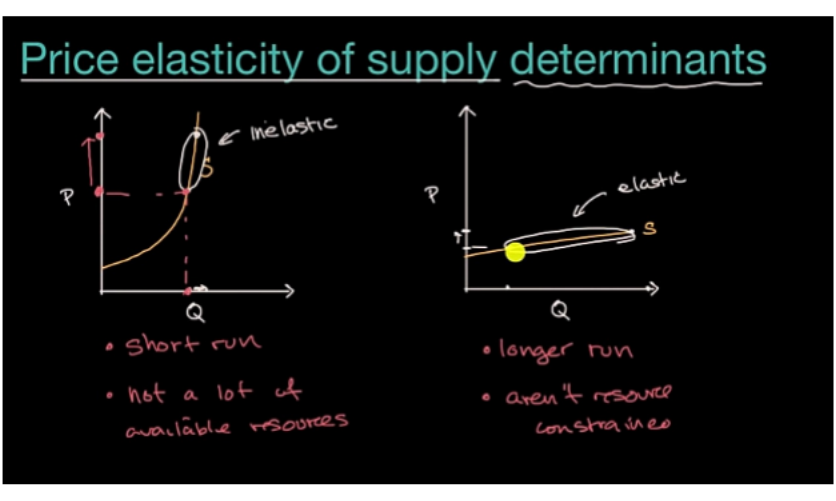
● Necessities are basic goods that consumers need to buy. Examples include food in general, electricity and water. Demand for these types of goods will be income inelastic. Another example of a good which is income inelastic is cigarettes. A study in the Ukraine a number of years ago found that the income elasticity of demand for cigarettes was 0.06. It could be argued that cigarettes are a necessity once people become addicted to them.

● Luxuries are goods that consumers like to buy if they can afford them. Spending on these types of goods is discretionary, which means that it does not have to be undertaken. Demand for these goods is income elastic. Examples include air travel, satellite television, fashion accessories and many goods and services in the leisure and tourism industry. It is also argued that the demand for imported goods is income elastic. It has been found that as developing nations become better off, their demand for imports rises significantly.

So Depending on the values of the income elasticity of demand, goods can be broadly categorized as inferior goods and **normal** goods. Normal goods have a positive income elasticity of demand; as incomes rise, more goods are demanded at each price level. Normal goods whose income elasticity of demand is between zero and one are typically referred to as necessity goods, which are products and services that consumers will buy regardless of changes in their income levels. Examples of necessity goods and services include food products, haircuts, water and electricity. As income rises, the proportion of total consumer expenditures on necessity goods typically declines. **Inferior** goods have a negative income elasticity of demand; as consumers' income rises, they buy fewer inferior goods. A typical example of such type of product is Palm oil which is much cheaper than Refined oil.

So,4 is IED

2.PES

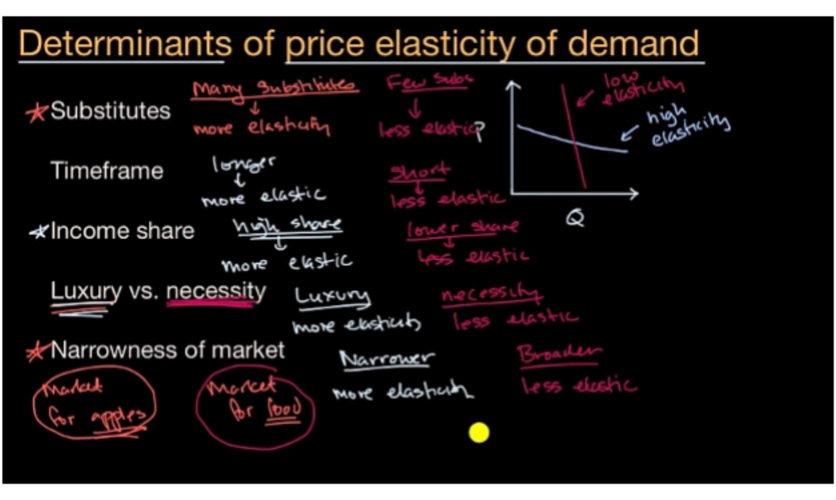


Here in first case, consider if the price increases...in short span of time, I can't produce lots of goods because I need resources, need more labor and train them, and there should be more and more factories to be built which is nearly impossible to do...that's y change in quantity of supply is almost vertical for a big change in price..

But in second Case, change in supply is horizontal for a small change in price because now I have lots of time to build more factories, produce more goods, train many labors...

So, Time is PES

3.PED



So, 1,2&3 is PED

Answer is option C