**W4 V5 Determinants of Elasticity**

0:10  
So far, we've done a lot of stuff.

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We've talked about what is elasticity, why we use it, how to calculate it, how to interpret it, how to identify different types of elasticities.

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But at the end of it, we're going to come back down to the question about why is something more or less responsive, right.

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That's ultimately where we wind up at.

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If you want to start thinking more carefully about the economics and you know what's changing and why.

0:34  
OK.

0:34  
So here in this video, we're going to just quickly, I run through some ideas, but I strongly encourage you to think more deeply about this for any elasticity that you're considering because this is where you will end up as an economist and that's where your bread and butter is.

0:47  
OK.

0:48  
So let's start off with the elasticity of demand.

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So what we know with the elasticity of demand is that pricing quantity moving opposite directions, OK.

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So that's my demand curve and roughly it's downward sloping.

1:02  
So if I'm looking at a particular 10% change in prices, let's just think about a 10% increase in price.

1:10  
What determines how large the quantity response is here?

1:14  
The best way for you to do this is to just do a little bit of introspection and think about your favorite good.

1:18  
Prices are rising all the time now, and this is something you've thought about, right?

1:22  
So when prices go up, what determines whether you cut down your quantity by a lot?

1:27  
A little bit, right?

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First thing you're going to do is hopefully go back to module one and think about what your willingness to pay is.

1:34  
Right?

1:35  
Price goes up.

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How many units past that marginal willingness to pay versus price threshold And you know how large is that change?

1:43  
How steep is your the willingness to pay?

1:45  
What does it depend on?

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Well, typically we're going to start thinking about the price of coffee rises.

1:51  
You're going to start thinking about.

1:52  
Is there anything else that I can substitute away towards right?

1:56  
Maybe I can buy tea more, Maybe I can find something else more, Maybe I can just drink less coffee.

2:03  
But it also depends on my willingness to do that right?

2:09  
Are there substitutes available and do I want to substitute away?

2:14  
How important is this to me in terms of the value?

2:16  
What's the value of the next best alternative?

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That is what's going to determine your elasticity of demand.

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So think about that when you're trying to look for patterns.

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So for example, if something is necessary for you, for me coffee is a necessity.

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It cannot function without it.

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You raise the price of coffee by 10%.

2:33  
I'm gonna complain a lot, but my quantity demanded is not gonna change very much.

2:39  
Cuz to me, coffee is a necessity right now.

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On the other hand, if something is not necessary, if it's a luxury here, insert whatever you consider a luxury.

2:49  
Price goes up.

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You're going to say, do I really need it?

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Not really.

2:52  
It's a luxury, Let's say, for example, eating out, not a necessity.

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It's kind of a luxury for you when you're a student with a very limited budget.

3:00  
And in that case, you're going to say, you know what, I'm just going to cut back dramatically.

3:04  
I'm going to eat at home.

3:05  
Maybe it's different from a richer person.

3:07  
They're like, yeah, price of eating out has gone up, but you know what?

3:10  
In my life I need to eat out because it's part of socializing, is part of my job.

3:15  
So I'm not going to cut down very much.

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So thinking about the why people's behavior changes is much more important than memorizing or Luxuries are more or less elastic than necessities, but it all comes down to your willingness and your ability to substitute away.

3:29  
Here's another kind of thing.

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How long are we looking at, if you're looking at right now, what we call a short run, which is very quick, when the price goes up of coffee, you're like, oh, I don't know, I'm still addicted to coffee.

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I need to have my cafe and there's nothing else.

3:44  
Maybe I'm more inelastic in the short run because I I need my coffee.

3:49  
But maybe in the longer run I'll start cutting down my caffeine consumption, I'll start finding alternatives, I'll find other ways to wake up in the morning, I'll sleep better.

3:58  
And maybe in the long run, my quantity demand, it will be more responsive, right?

4:02  
So there is kind of a time dimension in here which effects people's willingness and more importantly ability to switch away because maybe there's more substitutes available.

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As time goes up, you can identify them and be willing to switch away.

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Another thing is kind of what's the market that you're looking at?

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If you're looking at a very narrow market and you're saying, oh, I really like to wear this one particular type of only white cotton T-shirts, very narrow market, right.

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It's very narrow, very specific market and the price of a round neck white cotton T-shirts has gone up, then it's pretty easy to find substitutes.

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You're like fine, only white has gone up.

4:38  
I'll switch to maybe purple, right?

4:41  
You're able to find a lot closer substitutes very quickly and much more responsive in here.

4:47  
However, if the price of all clothing is going up, you need clothes, right?

4:51  
You're not going to necessarily be very responsive if the price of all clothing has gone up.

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So these are ways to think about patterns of why.

4:58  
But please always focus on thinking about people's decisions and how and why their willingness to pay changes with the price.

5:10  
Now the other type of elasticity that we're looking at is the elasticity of supply.

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This is talking about people bringing goods to the market.

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We're typically looking it up with sloping supply curves, right?

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So when the price rises, you have more units passing the marginal cost versus price threshold, and then people bring more to the market.

5:28  
But what determines how large this quantity response is?

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Fine, it's up with sloping.

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They bring more, but how much more, right, for a given 10% change in price?

5:38  
Well, there you're just going to go to the firm and remembering that this is marginal cost, right?

5:44  
How expensive are those additional units when the price goes up?

5:48  
If these additional units are really expensive and they keep kind of ramping up in terms of marginal cost, I'm not going to bring very much.

5:55  
But on the other hand, if the marginal cost increases not that large and it's easier or less costly for me to produce those extra units, I can ramp up production a lot.

6:04  
So there again you're going back to marginal cost of the extra units and how quickly it ramps up with production.

6:10  
To think about your change in quantity supplied, OK, well, that depends on how easy it is for me to increase output and how easy it is for me to get inputs.

6:24  
If it's really easy for me to get the inputs I need, I'm going to have a much larger quantity response if on the other end.

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If it's not, it's gonna become really costly for me to source those inputs.

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Are they available?

6:34  
They're not available.

6:35  
I've got to search.

6:35  
I've got to pay a lot of money.

6:37  
It's gonna be much steeper.

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So what are some factors that you can think about here?

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How specific are my inputs?

6:42  
Do I need something manufactured by one company in one country?

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It's gonna be really hard to get additional inputs, right?

6:48  
How quick is it to produce extra inputs?

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If it is easy, you're gonna get huge increase in production.

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Not so much, Not so elastic, right?

6:58  
Do I need these today, tomorrow, or do I have to wait two years, three years with the extra input?

7:03  
All of these details relate them to marginal cost and the steepness of marginal cost as you produce more to think about how responsive supply will be to a change in price.

7:16  
OK.

7:16  
So please always try and think about what consumers or producers are willing to do right, which comes with what they like, what they dislike and what they're able to do when prices change.

7:31  
And you've understood why something is more or less elastic.

7:46  
Yeah.