What is Demand Elasticity? What Factors Influence It?

You no doubt already have a good idea of what elasticity means in the everyday world—rubber bands and bungee cords come immediately to mind. In the world of economics, elasticity retains this idea of "stretchiness." Economists define **elasticity** as the degree to which a quantity demanded or a quantity supplied changes in response to a change in price. The degree of elasticity tells economists how responsive consumers and producers will be to a change in the price of a good or service.

Elasticity of Demand: A Measure of Consumer Sensitivity to Price Changes The economist Alfred Marshall first developed the idea that demand is elastic more than a century ago. He introduced the term elasticity to describe the way quantity demanded responds to changes in price. Economists since Marshall have referred to **elasticity of demand** as a measure of consumers' sensitivity to a change in price.

How sensitive are you to price changes? The answer most likely depends on what you want to buy. If the price of toothpaste were to increase by 50 percent, for example, you would probably buy it anyway. The demand for necessities like toothpaste tends to be **inelastic**, meaning that it responds slightly or not at all to a change in price.

In contrast, if your favorite energy bars were marked up by 50 percent, you might decide to buy something else instead. Your demand in this case would be **elastic**, or responsive to a change in price.

Factors that Influence Elasticity of Demand Why is consumer demand more elastic for some goods than for others? The following factors help economists predict the elasticity of demand for a good or service.

Availability of substitutes. Demand for products that have close substitutes tends to be elastic. If the price of a sports drink goes up, for example, many consumers will switch to bottled juice or water. Chocolate, however, has no close substitutes. When its price increases, most consumers continue to buy it. Demand for chocolate is inelastic.

Price relative to income. Consumers are more responsive to changes in price when buying "big ticket" items, which eat up more income, than when making minor purchases. If you were considering buying a computer, for example, a price decrease of 20 percent might very well motivate you to buy. Your demand in this case would be elastic. Your demand for an inexpensive item like soap, however, would be inelastic. You might not even notice if its price were to increase or decrease 20 percent.

Necessities versus luxuries. When a product is perceived as a necessity, demand for it tends to be highly inelastic. Demand for luxuries, in contrast, is elastic. People will always buy food, a necessity, even

if prices increase. Luxuries like fancy watches, on the other hand, are goods we can live without. If their price goes up, we can easily stop buying them.

Time needed to adjust to a price change. Elasticity of demand can change over time. When gas prices increased sharply in 2011, many people found it difficult to reduce their gas consumption in response. They still needed gas to drive to work, shop, and get around. Over time, however, people adjusted to the price rise. They formed carpools, began using public transportation, and bought smaller cars that used less fuel. As they did so, the demand for gas gradually became more elastic.