

Demand: Elasticity

Exercise 2-2 ANSWERS

1) Why is a demand curve downward sloping?

Because consumers buy less at high prices and more at low prices.

2) How does the principle of diminishing marginal utility relate to question 1 above?

Because marginal utility diminishes with each successive purchase of a product, lower prices are necessary to encourage consumers to make more purchases. Consumers buy less at high prices and more at low prices—the principle illustrated by the downward slope of the demand curve

3) Finish charting the effects of demand elasticity below:

Type of Elasticity	Change in Price	Change in Total Receipts	Movement of Price and Total Receipts
Elastic	↓	↑	Inverse/Opposite
Inelastic	↓	↓	Same or sympathetic
Unit Elastic	↓	No change	No relationship

4) Why is it important for businesses to understand elasticity?

It is useful to assist firms in developing pricing policies that can be used to increase revenues/profitability.

5) Why is the demand for a product with many substitutes elastic?

Because consumers are able to switch between the various substitutes.

6) List three examples of products or services that are so important that their use cannot be delayed or postponed. What type of demand elasticity are these products likely to have?

- a) *Ambulance Service-Inelastic*
- b) *Emergency Room Physicians Services-Inelastic*
- c) *Towing Services (without insurance)-Inelastic*

7) List the three determinants of demand elasticity and describe their effects on the demand curve.

- a) *Delay; if delay able- elastic; if not-inelastic*
- b) *Substitutes; If available-elastic; if not-inelastic*
- c) *Income; if requires substantial percentage of income-elastic; if not-inelastic*