**KEY CONCEPTS AND SKILLS: Unit 1.2 – Elasticity**

**Definitions:**

* **Elasticity**: a measure of the responsiveness (or sensitivity) of a variable to changes in price or any other determinant of that variable
* **Primary commodities**: goods arising directly from the “land” factor of production (i.e., from the primary sector), including agricultural products, fish, wood, minerals, oil, etc.

**Concepts and Applications:**

***A. Price Elasticity of Demand (PED)***

1. Explain the concept of *Price Elasticity of Demand (PED)*, including the formula for calculating it.
2. Given price and quantity demanded data (or specific points on a demand curve), calculate a good’s PED.
3. Explain, using diagrams and numerical PED values, the concepts of:
	* Elastic demand
	* Inelastic demand
	* Unit elastic demand
	* Perfectly elastic demand
	* Perfectly inelastic demand
4. Describe the factors (determinants) that tend to lead to greater or lesser price elasticity of demand.
5. Explain how PED varies along a single straight-line demand curve.
6. Explain how PED can help a firm make pricing decisions.
7. Explain why demand for primary commodities tends to be less elastic than demand for manufactured goods.
8. Explain why governments often tax price-inelastic goods.
9. State four alternative ways to say the following: “Product X’s demand is price elastic”?

***B. Cross Elasticity of Demand (XED)***

1. Explain the concept of *Cross Price Elasticity of Demand (XED)*, including the formula for calculating it.
2. Given price and quantity demanded data, calculate a good’s XED.
3. Explain is meant by “cross price elasticity of demand involves shifts of the demand curve”.
4. Explain, using both words and diagrams, the meaning of positive, negative and zero XED values.
5. Explain the meaning of higher and lower absolute values of XED.
6. Explain why a business might care about product XEDs in the following situations:
	1. The business produces substitute products.
	2. The business produces complementary products.
	3. A rival business produces substitute products.
	4. The company is contemplating a merger with a rival company.

***C. Income Elasticity of Demand (YED)***

1. Explain the concept of *Income Elasticity of Demand (YED)*, including the formula for calculating it.
2. Given income and quantity demanded data, calculate a good’s YED.
3. Explain is meant by “income elasticity of demand involves shifts of the demand curve”.
4. With reference to YED values and demand curves, distinguish between inferior and normal goods, and between necessities and luxuries.
5. Explain how YED can help explain the shifting of an economy to new economic sectors and new products as income in the country rises.

***D. Price Elasticity of Supply (PES)***

1. Explain the concept of *Price Elasticity of Demand (PES)*, including the formula for calculating it.
2. Given price and quantity supplied data, or designated points on a supply curve, calculate a good’s PES.
3. Explain, using diagrams and numerical PES values, the concepts of:
4. Elastic supply
5. Inelastic supply
6. Unit elastic supply
7. Perfectly elastic supply
8. Perfectly inelastic supply
9. Describe the factors (determinants) that tend to lead to greater or lesser price elasticity of supply.
10. Explain why the PES for primary commodities is relatively low relative to the PES of manufactured goods.
11. Explain why it is important to make a distinction between short-run and long-run price elasticities of supply.
	* Explain how PED and PES contribute to price volatility of primary commodities.