

Essay on elasticity of demand

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The law of demand states that a change in the price of a good or service results in a change of quantity demanded by the consumer. There is an inverse relationship between price and quantity demanded in that a price increase will result in a decrease in quantity demanded and vice versa. The degree of responsiveness of quantity demanded as a result of a change in price varies with the type of good or service. Elasticity of demand measures this responsiveness or sensitivity of demand of a commodity to price change (Brue, McConnell, & Flynn, 2010).

Price elasticity of demand may be elastic, unitary or inelastic. It is shown as a percentage change of quantity demanded as a result of 1% change in price (Brue, McConnell, & Flynn, 2010). A price elasticity of demand of more than one means that the commodity is price elastic, if it's less than one, the commodity is price inelastic. Price elasticity of demand is unitary when the value is one, meaning that a 1% change in price brings about a proportionate change in quantity demanded.

A percentage price increase of a product which is price elastic will result to more than a proportionate percentage decrease in quantity demanded (Brue, McConnell, & Flynn, 2010). Therefore, a price increase of a product which is highly elastic will lead to reduced revenue. Conversely, the percentage change in quantity demanded will be less than the percentage change in price if the product is price inelastic. A price increase of products which have inelastic price elasticity of demand will increase revenue.

The goal of taxation is to increase revenue for the taxman. Imposition of tax on a product leads to an increase in its price and reduced sales for the producer. If a tax is levied on products which are price elastic there will be

more than proportionate drop in sales and the government may not raise targeted revenue from such a tax. Imposing a tax on those products which are price inelastic will achieve the desired results of increasing tax revenue because a price increase as a result of tax will not affect sales significantly (Brue, McConnell, & Flynn, 2010). Knowledge of price elasticity of various items is critical in determining which products to impose taxes on.

References

Brue, S., McConnell, C., & Flynn, S. (2010). *Essentials of economics* (2nd ed). New York, US: McGraw-Hill.