

Oil price elasticity



**ASSIGN
BUSTER**

Define the price elasticity of demand for oil. If the demand for oil is price inelastic, explain (using appropriate diagrams) what happens both in the short-run and long-run if oil producers can come together to restrict the output of oil.

Introduction- In this essay I will explain what the price elasticity of demand for oil is and then further investigate what happens to the elasticity of oil in the short and long run as producers restrict the output of oil.

In this essay, I will explain what the price elasticity of demand for oil is and then further investigate what happens to the elasticity of oil in the short and long run as producers restrict the output of oil. Price elasticity of demand is a measure of how much the quantity demanded of a good, responds to a change in the price of that good. It is the percent change in quantity demanded divided by the percent change in price. Oil is price inelastic which means that the quantity demanded does not respond strongly to price change and the price elasticity is less than 1.

The demand curve is always negatively sloped which means that price and quantity will change in opposite directions One change will be positive and the other negative making the elasticity of demand negative. (Lypsey and Chrystal). [pic 1] This diagram shows the demand curve for oil supply- the red graph. The graph at 2004 and 2008 are both steep so that as the price of oil supply increases, the quantity demanded will decrease at a much smaller proportion.

The price inelasticity of oil can be explained because oil does not have any close substitutes. Therefore, if the price of oil supply were to increase,

consumers do not have any choice but to continue buying oil at a higher price as there is no other alternative. A good that has close substitutes will have a more elastic demand. A good with few/no close substitutes, such as oil will have an inelastic demand. (continue para 1, find more research online and in textbook to answer the question).

A durable product can usually be made to last for another year; thus, purchases can usually be made can be postponed with greater ease than purchases for non-durable products such as food and services. If enough customers decide simultaneously to postpone purchases of durables, even for six months, the effect on the economy can be substantial. This means that demand for durables are typically more price elastic in the short run than the long run. (Lipsey and Chrystal textbook).

Nondurable goods are consumption goods purchased by the household sector that generally have a useful, satisfaction-providing existence of shorter than a year. The three main subcategories of nondurable goods in the National Income and Product Accounts are " food," " clothing and shoes," and " gasoline and oil. " The remaining 25 percent of nondurable goods purchased by the household sector includes " fuel oil and coal" (less than 1 percent) and a handy catch-all " other" category (which is the bulk of the remaining 25 percent). (http://www.amosweb.com/cgi-bin/awb_nav.pl?s=wpd&c=dsp&k=nondurable+goods,+consumption).

Durables, as a whole have an inelastic demand, especially in the long run, while many individual brands of durable have elastic demands. This is another example that the broader the category, the fewer the close

substitutes and hence the lower the elasticity. Whether durable or non-durable, many manufactured goods have close substitutes, and studies show that they tend to have price elastic demands. This is why firms try to build strong brands so that consumers of their product remain loyal.

It helps them to raise price without losing substantial market share. (Lipsey and Chrystal textbook). (The above 2 paragraphs all directly copied) Middle paragraph is relevant The short run refers to the period of time when agents in the firm cannot make many adjustments to prices and procedures. It is not a chronological period. An example of the changes in price elasticity of oil in the short run is demonstrated in Simon Taylor's blog. He imagines that he has a car and house heating system which causes him to use a particular fuel and energy efficiency.

If the price of oil or gas rises I will be limited in my scope for changing behaviour so I may not buy much less than before, even though I'm unhappy about the higher price'. This will lead to a steeply sloped demand curve because the price elasticity in the short run is low. But in the long run I can buy a more fuel efficient car (and cars become more efficient partly to reflect increasing demand for fuel efficiency but also because governments set increasingly tough efficiency targets).

And I can buy a house with a different type of central heating system or get the house insulated (these are admittedly less easy to do, which is why buildings are the most intractable area of energy efficiency improvement). My price elasticity is much higher in the long run because I can make more changes than in the short run. The demand curves is therefore less steeply

sloped in the long run. The same is true of supply, which captures the behaviour of producers.