

Elasticity essay

[Business](#), [Accounting](#)



1. In the automotive industry, is price elasticity of demand considered elastic or inelastic? Are there substitutes available? Is the good a luxury or a necessity? Explain. In the automotive industry, price elasticity of demand is elastic. When speaking of automobiles, it generally means cars.

Having a new car is just one option in all available modes of transportation; since there are many substitutes, like taking a bus or train or buying cheaper vehicle, like a bicycle or motorcycle. More importantly, people nowadays prefer to buy used cars. In fact, wholesale prices of used vehicles in 2005 showed their largest annual percentage gain in nine years. Overall, used-vehicle prices rose 4.6 percent last year over 2004 (Sawyers, 26 January 2006). Thus, upon viewing all possible cheaper alternatives, choosing to have a new car is considered to be a luxury. 2. What is the price elasticity of supply for the industry? Explain.

When the automobile prices increase, many people would delay buying new cars since they could settle for used or their own old cars. In this case, quantity demanded would be very sensitive to a change in price, in consideration of a short run perspective. However, an old car wears out and must be replaced, so quantity purchased will pick up again. Thus, if taking this in a long run perspective, price elasticity of demand is less than short run.

If the price of automobiles decrease this year, then that will increase the willingness of people to buy the latest car models. According to the Economist Intelligence Unit (December 14, 2005), the U. S.

demand for cars usually rise by 4% annually. Since the U. S. is the largest manufacturer of passenger cars and light trucks in the world, with its output of 11. million units in 2003 accounting for over 20% of world production, this will augment the purchase of new cars this year significantly. Therefore, in a short period of time, quantity demanded is very sensitive to the change in price. However, once the stock is rebuilt, people will stop buying new cars because people will only buy new cars to replace old cars Therefore, in a long period of time, demand is less elastic. References Economic Intelligence Unit.

(2005, December 14). United States of America: Automotive Background. Retrieved March 16, 2006, from [http://www. iu. com/](http://www.iu.com/) Sawyers, A. (2006, January 23). Used-vehicle prices take biggest jump since '96. *Automotive News*, 80 (6186), p.

46. Appendix B Annotated Bibliography Economic Intelligence Unit. (2005, December 14). United States of America: Automotive Background.

Retrieved March 16, 2006, from [http://www. eiu. com/](http://www.eiu.com/) As the largest automotive market in the world, the United States accounts for around one-third of world automotive sales in 2004. The automotive industry is one of the prime drivers of the US economy, with an output valued at US\$442bn (3. % of GDP) in 2004, according to the Bureau of Economic Analysis (BEA). The vastness of the US market has traditionally inhibited domestic manufacturers from focusing on exports, while most US vehicle models are designed specifically for the US market and have limited appeal to buyers in most

other countries. But for foreign manufacturers, the US market provides significant potential in terms of sales and profits.

The result is an enormous US trade deficit in automotive goods, which has climbed relentlessly from 1989 to reach US\$139bn in 2004 (imports of US\$228bn; exports of US\$89bn). The industry is dominated by the “ Big Three” US firms (General Motors, Ford and DaimlerChrysler) and three Japanese companies with large-scale operations in the US (Honda, Toyota and Nissan). General Motors and Ford are US-owned, DaimlerChrysler is a German-registered company created by Daimler’s acquisition-merger of Chrysler Motor Company in 1998. The US is the world’s biggest producer of passenger vehicles, typically defined in the US to include light trucks as well as passenger cars. On this definition, the US produced 11. 8m units in 2003, compared with 10. 1m units in Japan and 5.

m units in Germany. Passenger-vehicle sales amounted to 16. 9m units in 2004. Sawyers, A. (2006, January 23). Used-vehicle prices take biggest jump since ’96. *Automotive News*, 80 (6186), p. 46.

The wholesale prices of used vehicles in 2005 showed their largest annual percentage gain in nine years. Overall, used-vehicle prices rose 4. 6 percent last year over 2004, the Manheim chief economist Tom Webb informed.

According to Webb, this increase occurred despite a price slump for used vehicles summer last year, when the Big 3 offered employee pricing on new vehicles. Furthermore, he said that there’s no doubt the pricing environment for used vehicles in 2005 became very strong. Last December, prices of used

cars and trucks increased in nearly every segment over November 2005 and December 2004, Manheim and ADESA Analytical Services reported. Analysts attributed the increase to: 1.) Less-generous incentives on new vehicles, 2.) Fewer retired rental vehicles entering the used-car market, and 3.) Higher sales by used-car dealers.