The price elasticity of gasoline in the united states has been estimated to be 0....

Literature, Russian Literature

The price elasti of gasoline in the United s has been estimated to be 0. 15. If this is so, should profit maximizing gasoline stations raise their prices? Explain why or why not Arguments

One of the important concepts that can influence the pricing strategy is price elasticity of demand which shows the change in the quantity demanded of a certain product due to change in the price of the same product. Suppose a certain organization reduces the price of one of its products by 10% and the demand of the same product increases by 20% then the price elasticity is 2. The demand curve of gasoline is said to be elastic. Another important concept is the income elasticity which refers to a change in demand of a certain product (gasoline in this case) due to changes in the income of the people keeping the other conditions constant. Since gasoline is considered as normal goods the income elasticity will be positive. The estimated price elasticity will vary according to income, demography and the geography. The demand for gasoline is closely associated with the fuel economy of the vehicles. If the price of the gasoline rises the profit maximizing gasoline companies will not be able to raise the prices according to their wish as in such cases the consumers will shift to the more fuel efficient vehicles which will ultimately lead to a fall in demand conditions for gasoline1. The rebounding effect will have a role to play in this case. The organizations may witness a rise in demand in the short run but in the long run the demand will not be persistent and in fact the demand will fall further than expected.

The diagram shows the clearer picture. A rise in price leads to a fall in demand.

Reference

Gillingham, K. 2011. How Do Consumers Respond to Gasoline Price Shocks? Heterogeneity in Vehicle Choice and Driving Behavior. Available at: http://www. umass. edu/resec/seminars/docs/Gillingham_ConsumerResponseGasPrices. pdf. [Accessed: 18th October, 2012].