

## DETERMINANTS OF ELASTICITY OF DEMAND

The main factors which affect the magnitude of price elasticity of demand are as follows:

- (i) **Income of the Consumers:** Consumers' income acts as an important determinant of the elasticity of demand. For high-income groups, the elasticity of demand will be less. It is because change in price will not affect the quantity demanded by greater proportion. But, for low-income groups, the demand is said to be more elastic. The rise and fall in the price have a significant influence on the quantity demanded. In this case when the price falls the demand increases in greater proportion and vice-versa.
- (ii) **Availability of Substitutes:** The substitutes are the goods that replace the consumption of other goods. The goods which have close substitutes are said to have an elastic demand, while goods with no close substitute will have an inelastic demand. Commodities such as, Pepsi and Coca cola (or tea and coffee) are close substitutes and hence, if the price of pepsi increases, people will switch to the coca cola and reduce the demand for pepsi. Whereas, goods like salt or sugar which do not have close substitutes, price elasticity will be much less. Substitutes have a positive cross elasticity of demand.
- (iii) **Amount of Money Spent:** The elasticity of demand for a product is determined by the proportion of income spent by the individual consumer on that product. In case of certain goods, such as, match box, salt, etc. a small fraction of consumers' income is to be spent, and thus, even if their prices rise the demand for these products will not be affected much.

Whereas cars, AC and even clothing are the items where an individual spends a major proportion of the total expenditure and therefore, if there is any change in the price of these items, the demand will get affected. The demand for such products is said to be relatively elastic.

- (iv) **Nature of the Commodity (Luxuries versus necessities):** The price elasticity of demand also depends on the nature of the commodity. The elasticity is likely to be low for necessities and comforts and high for luxuries (cars, ACs and jewellery, etc.). The demand for the necessities of life, such as foodgrains, clothing and textbooks, etc. is inelastic as their demand cannot be postponed. The demand for the comfort goods such as fan is neither elastic nor inelastic. Here, demand decreases or increases only moderately with the rise and fall in their prices.

For example, when the price of salt varies widely, we continue to buy almost the same quantity; since we cannot postpone its demand (inelastic). But when the price of TV sets falls many people who could not afford earlier may now buy it. Thus, the demand for TV sets will be elastic.