DETERMINANTS OF PRICE ELASTICITY OF DEMAND

The price elasticity of demand (PED) is a measure of how much the quantity demanded changes with a change in price. The PED for a given good is determined by one or a combination of the following factors:

- Availability of substitute goods: The more possible substitutes there are for a given good or service, the greater the elasticity. When several close substitutes are available, consumers can easily switch from one good to another even if there is only a small change in price . Conversely, if no substitutes are available, demand for a good is more likely to be inelastic.
- Proportion of the purchaser's budget consumed by the item: Products that consume a large portion of the purchaser's budget tend to have greater elasticity. The relative high cost of such goods will cause consumers to pay attention to the purchase and seek substitutes. In contrast, demand will tend to be inelastic when a good represents only a negligible portion of the budget.
- Degree of necessity: The greater the necessity for a good, the lower the elasticity. Consumers will attempt to buy necessary products (e.g. critical medications like insulin) regardless of the price. Luxury products, on the other hand, tend to have greater elasticity. However, some goods that initially have a low degree of necessity are habit-forming and can become "necessities" to consumers (e.g. coffee or cigarettes).

- Duration of price change: For non-durable goods, elasticity tends to be greater over the long-run than the short-run. In the short-term it may be difficult for consumers to find substitutes in response to a price change, but, over a longer time period, consumers can adjust their behavior. For example, if there is a sudden increase in gasoline prices, consumers may continue to fuel their cars with gas in the short-run, but may lower their demand for gas by switching to public transportation, carpooling, or buying more fuel-efficient vehicles over a longer period of time. However, this tendency does not hold for consumer durables. The demand for durables (cars, for example) tends to be less elastic, as it becomes necessary for consumers to replace them with time.
- Breadth of definition of a good: The broader the definition of a good, the lower the elasticity. For example, potato chips have a relatively high elasticity of demand because many substitutes are available. Food in general would have an extremely low PED because no substitutes exist.
- Brand loyalty: An attachment to a certain brand (either out of tradition or because of proprietary barriers) can override sensitivity to price changes, resulting in more inelastic demand.