**Essay for Discussion**

**Essay Question 8**

**Explain why the price of coffee bean tends to vary more extensively than the price of designer coffee (when both demand and supply increases).**

Introduction

The price and quantity of coffee or coffee bean can be attained when there is market equilibrium in these respective markets when the demand and supply of the coffee bean or designer coffee intersects respectively in both market. However, the extend of change in price of coffee bean tends to vary more extensively than the price of designer coffee due to the variation in the price elasticity of demand and supply for both designer coffee and coffee bean.

Main body

 Price of coffee bean will vary both extensively when there is increase in demand and supply as the demand and supply of coffee are both price-inelastic. When demand of coffee increases, the price rises more extensively as the supply of coffee bean is price-inelastic, implying that the increase in quantity supplied is less than proportional than the increase in price. This will reflect the change in quantity supplied is unable to respond to increase in demand due a price-inelastic supply condition, creating an excess demand condition they will prompt price to increase excessively. On the other hand, the increase in supply of coffee bean will contribute to the extensive fall in price when the demand is price-inelastic since the fall in price will contribute to a less than proportional increase in quantity demand.

As for price of designer coffee, it will vary less than extensive when there is increase in demand and supply of designer coffee as the price-elasticity of demand and supply are both price-elastic. When demand for designer coffee increases, the rise in price will be less extensive since the supply of designer coffee is price-elastic, implying that the increase in quantity supplied is more than proportional to the rise in price. This will mean that the increase in quantity supplied is able to respond to the increase in demand due to a price-elastic supply condition, implying that there will be no excessive supply condition and thus, price will not fall extensively.

On the other hand, when the supply of designer coffee increases, the fall in price is less extensive since the demand for designer coffee is price-elastic, implying that the increase in quantity demanded is more than proportional to the fall in price. This will mean that the increase in quantity demanded is able to respond to the increase in supply due to the price-elastic condition, implying that that there will be no excess demand condition and price will not fall extensively.

S0 (price-inelastic)

Price of Goods

Price of Goods

S1 (price-elastic)

S1

S0

P1

P0

P2

P2

D1 (price-elastic)

P0

P1

D1

D0 (price-inelastic)

D0

Q0

Q2

Q1

Quantity of Goods

Quantity of Goods

Q2

Q1

Q0

Diagram 2

Diagram 1

As seen from diagram 1, the increase in price due to an increase in demand will be more extensive from P0 to P1 when the supply is price-inelastic along supply curve S0. As compared to supply curve S1, the increase in price from P0 to P2 is less extensive when there is an increase in demand as the supply S1 is price-elastic.

Also, as seen from diagram 2, the fall in price due to an increase in supply will be more extensive from P0 to P1 when the demand is price-inelastic along the demand curve D0. As compared to demand curve D1, the decrease in price from P0 to P2 is less extensive when there is increase in supply as the demand curve D1 is price-inelastic.

The price elasticity of demand for coffee bean is price-inelastic as there is limited availability of substitutes for the use of coffee bean for production of coffee production since it is the only form of resource, being a derived demand based on demand for coffee producers. Furthermore, the demand for coffee is planned and stipulated and will not correspond extensively to sudden fluctuation in the price contributed by increase in supply.

As for the price-elasticity of supply of coffee bean, it is price-inelastic as there is limited capacity of production due to land space and long gestation period of agricultural products, implying that quantity supplied cannot be increased extensively in the short run, contributing to the price-inelastic supply condition.

For price-elasticity of demand for designer coffee, it is price-elastic as there is extensive availability of substitutes since it is a beverage that can be easily replaced by a wide range of alternatives like carbonated drinks and other designer coffee retailers. Since the proportion of income spent on designer coffee is large for average consumers like students, the designer coffee is considered a normal good and the consumer is price-sensitive towards it, influencing the demand to be price-elastic. Furthermore, it is often considered a social activity when consumers patronise the designer coffee retailers, implying that it has a low degree of necessity of demand and thus, the demand is price-elastic.

As for the price-elasticity of supply of designer coffee, it is price-elastic as there is lesser limited production capacity since coffee powder can be stored in anticipation of demand. Furthermore, there is a short production period which means that the supply can be increased easily in the short run to meet demand. This capacity of production can also be raised easily to increase the supply of designer coffee as the cost of labour is cheap, making it easy for the retailer to increase production to increase quantity supplied in the short run.

In sum, the nature of the market for coffee bean and designer coffee differs in term of their demand and supply, influencing the price-elasticity of demand and supply. This will shape the extent of change in price and output when there is a change in price and output when there is a change in market demand and supply, which affects the market equilibrium.

**Question 11**

**Explain why the price elasticity of demand differs for different products. (12)**

Introduction

The price elasticity of demand (PED) refers to the degree of responsiveness of quantity demanded to a given change in its price. It measures the percentage change in quantity demanded of a good with respect to the percentage change in the price, ceteris paribus. It is calculated as follows: Price elasticity of demand = % change in quantity demanded of good X / % change in price of good X.

Main Body

It is often noted that the coefficient of PED is always often negative showing the inverse relationship between the change in quantity demanded and the change in the price of good. This implies that an increase in price of the good itself will lead to a decrease in the quantity demanded and vice versa. The PED value can differ under different types of goods due to the nature of demand. The value of elasticity of demand can range from zero to infinity. When the value of elasticity is 0, the demand is perfectly inelastic. When it is less than 1, the demand is inelastic. When the value of PED is equal to 1, the demand is unitary, when the value is greater than 1, demand is elastic. When value is at infinity, the demand is perfectly elastic.

To understand why the price elasticity of demand differs for different products, we must examine the determinants of price-elasticity of demand. One such determinant is the degree of necessity of the good to the consumer. If the consumer feels that the demand for the good is necessary, the increase in price will not affect the decrease in the quantity demanded extensively (less than proportionate). This will mean that the demand is price inelastic. Consumers will feel that the good is necessary to them if it is a habitual and staple consumption, just like the consumption of cigarettes which is an undesirable, cultivated consumption behaviour. For goods that consumer does not consume often, the demand is price elastic (change in price will lead to a more than proportionate change in quantity demanded). For goods such as restaurant dining, the consumer does not see it as a definite need, he will be easily switch to other form of consumption and thus consume less of the dining once given a choice.

Another determinant that explains the difference in price elasticity of demand is proportion of income spent on the good. When the proportion of income spent on the good is small, demand will tend to be price inelastic. Consumer will be more price insensitive in this situation. However, with the proportion of income spent on the good is large, demand will tend to be price elastic, which means that consumers are price sensitive. This can be seen on how consumer buys good like sweets in the provision stores which occupies a small percentage of the consumer’s income and a Plasma TV from an electrical store which occupies a large percentage of the consumer income. It is obvious that the consumer will be more price-sensitive when he buys the Plasma TV.

Besides this, the time period for the consideration of purchase will affect the price elasticity of demand. When the time period for consideration of purchase is longer, the consumer behaviour will have more time to find for alternative choices and tend to switch their choice of consumption more often and easily and thus, the PED will most likely be price elastic. For those who begin their search of holiday tours earlier before the tour, the consumer will have more choices than those who sign up for tour very near to tour date. The first group of consumer will decrease their quantity demanded more extensively if there is a small increase in the price level of the tour offered by the tour agency as they have more alternatives and are not decisive over the given choices.

Lastly, the availability of close substitutes affects price elasticity of demand. When more substitutes are available, the consumer will have more choices and hence, they will change their quantity demanded upon a slight change in price, contributing to a price elastic demand. There are availability of substitutes depending on how the relationship of the goods is defined and the degree of market competition which are affected by the relationship of goods and the number of firms in the industry. In an industry such as tour coaches to Malaysia, the broader definition of transport services with the inclusion of air travels and cruises will expand the availability of transport services, making it easier for consumers to switch to other alternatives if the price increases. However, when the market competition is low as the demand is high during the peak season, it will be difficult for the consumer to look for alternative form of traveling, influencing the PED to become inelastic.

Conclusion

In conclusion, the above information will help to explain why there is different value of elasticity of demand for different products. This will be helpful in helping firms to derive price strategies to maximize total revenue.

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Conclusion

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**Essay Question 35**

**Explain whether the price elasticity of demand is price elastic or inelastic for the demand of tour packages.**

Introduction

* Definition of price-elasticity of demand
* Meaning of price-elastic or price-inelastic demand for tour packages
* Examine the determinants of PED to assess whether demand for tour packages are price-elastic or price-inelastic

Main Body

**1) Identify the determinants of PED**

* Assess how it will affect the value of PED
* Discuss it in the context of tour packages
* Degree of necessity of dd
* Availability of substitutes
* Proportion of income spent on the good
* Time period for consideration of purchase

**2) Analysis of the significance of determinants of PED**

* Time period - search time is longer – PED-elastic
* Tour agency organizes more tour exhibitions with fall in price to increase in QtyDD

Conclusion
The understanding of the determinants of PES will reveal the economic profile of the consumers which reflects the consumption behavior and purchasing power and thus will determine when the demand for tour packages is price-elastic or price-inelastic.