# 1.12 Price Elasticity of Demand: Determinants and Business Applications: 10-minute Pack

AQA 7136 · Calculators not allowed · about 10 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

**Answer all questions. Allocate most time to the final 15-mark essay. No calculator is allowed. Show working for all calculations.**

**1** Classify given PED coefficients for a set of goods, naming perfectly elastic and perfectly inelastic cases.

**(a)** For each PED coefficient below, state the correct elasticity classification and a one-word example of a good that might fit: 0.2, 1.0, infinity, 0. **(4)**

**(Total for Question 1 is 4 marks)**

**2** Short calculation linking PED and margin: consider a retailer with constant marginal cost.

**(a)** A retailer buys a gadget at a constant marginal cost of £10. If demand is price inelastic with PED = 0.5, should the retailer raise price to increase profit margin? Explain using simple reasoning about revenue and quantity effect. No precise profit calculation needed. **(3)**

**(b)** State one practical factor the retailer should consider before raising the price, despite the inelastic PED. **(1)**

**(Total for Question 2 is 4 marks)**


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## Question 1

(a) 0.2 is price inelastic (PED < 1), example one-word: salt **B1**

(a) 1.0 is unitary elastic (PED = 1), example one-word: restaurant-meal **B1**

(a) infinity is perfectly elastic (PED extremely large), example one-word: identical-commodity **B1**

(a) 0 is perfectly inelastic (quantity demanded does not change as price changes), example one-word: lifesaving-drug **B1**

**(a) Answer: 0.2 inelastic, e.g. salt; 1.0 unitary, e.g. restaurant-meal; infinity perfectly elastic, e.g. identical-commodity; 0 perfectly inelastic, e.g. lifesaving-drug.**

## Question 2

(a) if PED = 0.5 (inelastic), a percentage increase in price causes a smaller percentage fall in quantity demanded **M1**

(a) so total revenue will rise after a price increase, since price rise outweighs quantity fall **M1**

(a) with constant marginal cost, higher revenue per unit and only a small fall in quantity suggests higher total profit, so raising price is likely profitable **A1**

**(a) Answer: Yes: with PED 0.5, a price increase raises total revenue while quantity falls little, so with constant marginal cost profit is likely to rise.**

(b) consider competition and potential entry of substitutes, reputational effects, or the risk of longer term elasticity increasing if consumers find alternatives **B1**

**(b) Answer: The retailer should consider competition and the risk that consumers will switch to substitutes or that elasticity may rise over time.**


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