CONCEPT: INCOME ELASTICITY OF DEMAND

• Income Elasticity of Demand helps us understand whether goods are normal goods or inferior goods.

Income Elasticity of Demand: How does quantity demanded respond to a change in consumer income?

 $Income\ Elasticity\ of\ Demand = \frac{Percentage\ Change\ (\%\Delta)\ in\ Quantity\ Demanded}{Percentage\ Change\ (\%\Delta)\ in\ Income}$

□ We still use the	in this calculation!
□ For Income Elasticity of Den	nand, positive and negative answers make a difference!

Steps for calculating Income Elasticity of Demand:

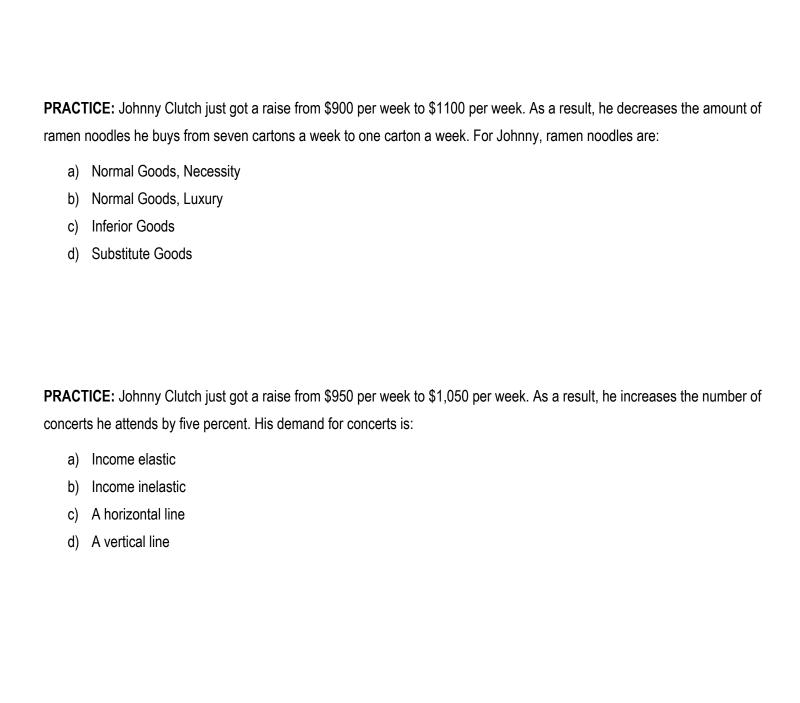
- 1. Subtract the two quantities and subtract the two incomes.
- 2. Sum the two quantities and sum the two incomes.
- 3. Divide your Quantity Sum by two. Divide your Income Sum by two.
- 4. Divide your answers from Steps 1 and 3. (Step 1 ÷ Step 3 for both quantity and income)
- 5. Divide your answers from Step 4. (Quantity ÷ Income)
- 6. Decide whether quantity and income increased/decreased (+/-)

EXAMPLE: At a price of \$75 per serving of caviar, the quantity demanded is 9,000. Although price did not change, consumer income increased from \$950 per week to \$1,050 per week, causing the quantity demanded to increase to 11,000. What is the income elasticity of demand for caviar?

- ☐ The income elasticity of demand helps us determine the type of product:
 - Positive and greater than 1 (income elastic)
- → Normal Good, Luxury
- Positive and less than 1 (income inelastic)
- → Normal Good, Necessity

- Negative

→ Inferior Good



PRACTICE: A twelve percent increase in consumer income has caused the quantity of orange juice demanded to increase

from 24,000 to 26,000. The income elasticity of demand for orange juice is:

a) 0.25

b) 0.33

c) 0.50

d) 0.67