**Dear Economics Students**,

Income elasticity of demand is a fascinating concept that we get to fully wrap our business brains around today.

**Description**:

Income elasticity of demand measures the responsiveness of the demand for a good to a change in the income of the people demanding the good, ceteris paribus. It is calculated as the ratio of the percentage change in demand to the percentage change in income. For example, if, in response to a 10% increase in income, the demand for a good increased by 20%, the income elasticity of demand would be 20%/10% = 2.

\epsilon_Y = \frac{\%\ \mbox{change in demand}}{\%\ \mbox{change in income}}

**Interpretation / Analysis:**

1) A **negative income elasticity** of demand is associated with inferior goods; an increase in income will lead to a fall in the demand and may lead to changes to more luxurious substitutes.

2) A **positive income elasticity** of demand is associated with normal goods; an increase in income will lead to a rise in demand. If income elasticity of demand of a commodity is less than 1, it is a necessity good. If the elasticity of demand is greater than 1, it is a luxury good or a superior good. This ties in closely with our discussion of Veblen Goods.

3) A **zero income elasticity** of demand occurs when an increase in income is not associated with a change in the demand of a good. This occurs when the change in Qd for a given change in price is 0. These would be sticky goods.

**Selected Income Elasticities of Demand:**

Automobiles 2.98

Your Own Human Life… 0.50 (I’m serious with this one)

Restaurant Meals 1.40

Tobacco 0.64

Margarine −0.20

Public Transportation −0.36

**Questions:**

1. Income elasticity of demand is defined as:

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2. When demand for a product is income inelastic, the percentage change in quantity demanded is (more/less) \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ than the percentage change in income. What type of good/service might this this be?

3. You know a good is a normal good because the income elasticity of demand will be \_\_\_\_\_\_\_

4. It is estimated that No Name Macaroni and Cheese has an income elasticity of demand of -0.6. What can be concluded about the product from this information?

5. An income reduction of 15% causes Mrs. Economics to increase her purchases of minced beef by 10%. Which of the following statements is most likely to be correct?

A. The income elasticity of demand for minced beef is -2/3 and ground beef is a superior good

B. The price elasticity of demand for ground beef is -1.5 and ground beef is a normal good

C. The income elasticity of demand for minced beef is -2/3 and ground beef is an inferior good

D. The price elasticity of demand for ground beef is -2/3 and minced beef is a normal good

6. The income elasticity of demand for Caribbean Cruises, Coca-Cola, and second-hand clothing have been estimated to be +2.5, +0.8, and -1.5 respectively. Write an answer interpreting these coefficients for income elasticity:

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

7. As you personally grow wealthier due to your increased knowledge of business and economics, what will you likely have a positive >1, negative <0, and close to zero income elasticity of demand for?