# Economics commentary

Economics

Economics Internal Assessment Writing a Commentary on News article Task 1 Headline: Pharmaceutical giant Paladol misjudge its market by raising the price on its best-selling headache relief tablet. Price elasticity of demand (PED) is a measure of the responsiveness or sensitivity of consumers to a change in the price of a particular good. In this article, Paladol raised the price of its product, which was a mistake; there are a lot of other medicines for a headache and most of them would be cheaper which is what Paladol should have considered before raising their price.

PED= Percentage change in quantity demandedPercentage change in price= %? QD%? P Cross-price elasticity of demand (XED) measures the responsiveness of consumers of a particular good to a change in the price of a related good, both complements and substitutes. In this article, however, we will be focusing more on the substitute goods. XED= Percentage change in quantity of good APercentage change in price of good B=%? QA%? PB Substitute goods are goods or products that one might easily use in place of another; because they're so similar, an increase in the price of one may lead consumers to switch consumption to the substitute.

The substitution effect (which underlies the law of demand) states that as the price of a good decreases, consumers switch from other goods to this good because its price is comparatively lower. As the price of Paladol increases we can see the substitute effect, people switching from Paladol which is expensive to Tylonel, for example; because its price is still the same which is cheaper than Paladol. Demand is a curve showing the various amounts of a product consumers want and can purchase at different prices during a specific period of time.

When Paladol increased its price for a particular headache relief medicine, consumers responded by decreasing their purchase of that expensive product, which decreased the quantity demanded; a movement up and left along the demand curve. Consumers will now demand another good that is cheaper, a substitute, for example tylonel. Graph A represents Paladol. As the price increase for the product the supply decreases (a shift of the supply curve to the left) because the producers want to make more profit and increase their total revenue.

However, the demand is slowly decreasing for Paladol as people realize that there are cheaper headache relief medicines; a movement up and left along the demand curve as was mentioned earlier. So, consumers start switching to substitute goods. Graph B represents Tylonel (a substitute good for Paladol). As the demand for Paladol decreases, the demand for tylonel starts increasing; a shift of the demand curve to the right. This happens as it’s less costly for consumers.

The total revenue for Paladol will definitely decrease due to the decrease in quantity purchased and that will also decrease their profit as the cost is now more than the sales. However, the total revenue for Tylonel will now increase in response to the decrease in Paladol’s decrease of quantity demanded. Paladol misjudged their market by thinking it has a relatively inelastic demand and that if they increased their prices a little it won’t change the quantity demanded by much.

A firm producing at a quantity and price combination along the inelastic range of its demand curve can always benefit by reducing its output and increasing its price, since consumers will be relatively unresponsive and total revenues will therefore increase—that didn’t work well with Paladol. As their demand wasn’t inelastic, that plan couldn’t work out for them. They had a relatively elastic demand and one of the reasons of why they have an elastic demand is that they have a lot of substitute goods and competition in that particular good (headache relief medicines are very common).

As a result of this misjudgment made by them, the quantity demanded decreased and caused a decrease in the total revenue and profit made by Paladol as well. Due to their bad decision, Paladol will certainly suffer a loss which is a decrease in total revenue. However, their competition (firm of substitute goods) will gain more consumers thus increasing their total revenue. The consumers won’t suffer or in other words they won’t be affected by Paladol’s decision to raise their price as they will have many substitutes to choose from.

As Paladol is producing at an output and price combination along the elastic range, the firm could benefit if they change their prices again, this time by lowering them since consumers are relatively price sensitive and the percentage increase in quantity sold will exceeded the percentage decrease in price, improving the firm’s revenue figures and giving Paladol a competitive advantage over the market of headache medicines once again.