Microeconomic analysis of the tobacco industry

Economics, Microeconomics

Introduction

Cigarette is known as a small of finely cut tobacco leaves enfolded in a cylinder of thin paper for smoking. When the cigarette is ignited, and is allowed to smoulder, while the other end is where the smoke is inhaled. The manufactured cigarettes are filtered in the most modern and include reconstituted tobacco and other addictive.

Most of the smokers in the world would want to stop and do indeed try, but only one over three success in stop smoking by the age of 60 . By this time, there are a lot of harm tob the body and some even have cancer. For those who succeed to quit smoking, they need 2 to 3 times before they are successful. The reason that why many people fail to stop is because they are addicted to the cigarette. Government needs to set the price for cigarettes because the government wants to reduce the amount of people who smoke and help these people to save their money.

iv) Suppose that the price of a packet of 20s' cigarette is RM Pe in the market. Now consider a decision by the federal government to impose a cigarette tax RM t per packet. Who bear more of the tax – sellers or buyers? Illustrate your answer with diagrams.

Taxes is a fee (levied) by a government on a product, income, or activity . Taxes can be define into 2 groups , indirect taxes and direct taxes. Indirect taxes is means that taxes on expenditures. For example , taxes on goods and services However, direct taxes are taxes paid by individual or organization such as personal income tax and corporate tax

Demand of Inelastic to supply

Diagram demand inelastic is show the increasing of unit tax. In this diagram, consumer will pay more tax then producer. The initial equilibrium of this diagram is at point E. So, when the government increases the tax, it's shown at point E to L. For the shifted of supply curve, it will shift to the left. After increasing the tax, based on the diagram there will be the new equilibrium and the new equilibrium is at the point J. It's also show that the increasing tax will be separate to two part for consumer paid and producer paid. In this diagram, M Pe1 Pe3 J is borne by producer which means producer need to pay for the price. However, the consumer need pay more than producer, which show at point K Pe2 Pe1 M. This means if the government use demands curve into inelastic, the change of quantity will not affect much to the quantity but is effect much to the price.

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V) State another example of government intervention and analyze the effects of such intervention to the market.

Other than the minimum price, the other government intervene are maximum price and the per unit tax . . For the maximum price, the government sets this intervene is to prevent it to rise above a certain level. Sellers are allowed to charge any price up to the price level but they are not permitted to go above it when a maximum price is introduced. In order to let the maximum price to be effective, government must set below the equilibrium price as shown in the diagram below.

Referring to the diagram above, maximum price of Pmax is set below the equilibrium price of Pe. Qe to Q2 brings quantity demands raise but fall in quantity supply from Qe to Q1. The shortage is Q1Q2. To overcome the shortage from maximum price, the government may encourage supply by giving subsidies, tax relief to producer, releasing surplus stocks accumulated in earlier production periods and intervene directly to increase output by directing resources to the production of goods.

Government may impose two types of tax, which are direct tax and indirect tax . Direct tax are paid by individual or organization for example personal income tax and corporate tax. In direct tax are tax on expenditure for example tax on goods and tax on service. When a unit tax is imposed the producer cost of production will raise and shift the supply curve upward by the same amount of tax.

From the above diagram, initially the equilibrium price was Pe and equilibrium quantity is Qe . The supply curve will shift left and new equilibrium price is higher but the new equilibrium quantity is lower. The diagram below show the reproduce and analysis how the producer shift the tax burden to the consumer.

Referring to the above diagram, the initial equilibrium is point E, if the unit tax is EH, the total tax to be paid to government is EH x 0Q2. The supply curve shift to the left from the right as a result of the tax, the new equilibrium is now at point G. Amount of tax need to be paid is FG x 0Q2 which is the same as FGP2Pe . Of this amount, GJP3P2 is born by consumers. The paying price of consumer are P2. The rest of the tax is FJP3Pe .