The or addictive. when the price goes up,

[Business](), [Decision Making]()

The term “ price elasticity of demand” mightnot be very common but it is frequent used by firms, organizations andgovernment in decision making. Knowledge of the basic law of demand is notenough to decide about final price of the product or service. It has to bemeasured how change of the price will affect the final outcome. Public policy making uses elasticity to imposetax on goods like cigarettes, alcohol or petrol. Those products are inelastic, they have not manysubstitutes, are essential or addictive.

When the price goes up, the quantitydemanded does not fall significantly. Those goods are not responsive to a pricechange, which means demand will still be high regardless raised price. One ofthe examples of the use of the Elasticity of demand can be Price Reticulationand Crop Restriction of Farm Products used by governments of many countries. InUnited States of America the Government encourages farmers to limit agricultureproduction by offering them grants. The demand of the farm products isinelastic and big supply of those products causes fall of the price whichlowers farmers’ incomes.

The government enacted policy restricting farmproduction and provides subsidy to those who keep their land not cultivated. This policy reduces supply in the market which causes the price of thoseproducts rise. Agricultural products are inelastic and the fall in productionleads to increase of the revenue and farmers’ incomes.

The graph above illustrates how farmers revenueequals to the OP1, E1, Q. After implementation of the Governments rules, supplyshifts to the left. (Supply curve is assumed to be perfectly elastic tosimplify the case).

When agricultural products price increases to P2 andquantity demanded decreases to Q2 the new revenue is OP2, E2, Q2 and it is higherthan what it was before governments regulations which increased farmers’incomes. PriceElasticity of Demand allows calculate responsiveness to price change of thegood or service. It predicts how consumer will react to those changes and howwill it affect the revenue.

The reason why Government uses Price Elasticityof Demand is not only to increase revenue but also environmental or publichealth or safety (crime and drugs) etc. It is important tool to measuresensitivity of the price change in national and international scale.