**A Comprehensive Analysis of Price Fluctuation on Consumers and Producers**

**Institution details**

**Unit title**

**Unit code**

**Instructor**

**Date**

**A Comprehensive Analysis of Price Fluctuation on Consumers and Producers**

Price refers to the monetary value assigned to a good, service, or resource in a market. It represents the amount of money a buyer is willing to pay and sellers willing to accept in exchange for a particular product or service. They are determined through the interaction of demand and supply. In economics, price plays a pivotal role in shaping market behaviors, influencing both consumers and producers. The fluctuations in prices, whether low or high, have a sound effect on the welfare and decisions of these market participants. This paper will scrutinize the winding relationship between price changes and their impacts on the consumer and producers, exploring the diverse consequences of high and low prices in the market.

**Higher prices and their effects**

According to Bei and Chiao, (2001) price is described as giving or sacrifice for the acquisition of a service or a product. Therefore, this means that at any given time when the sacrifice exceeds the value of the product then the price is too high to pay for the market participants. The fairness of a price might affect the consumers or suppliers of a product or service, and ultimately their desire to become one. Consequently, when prices soar, consumers and producers experience a multitude of effects that reshape their economic behaviors and outcomes.

**Consumers**

The law of demand states that if all the other market factors remain constant, a relative increase in price will result in a decrease in the quantity demanded. This is not always the case as some products display a rather different behavior than the one stated above. These products are referred to as price inelastic. Consumers are more willing to buy the products even when the price increases. Also, when there is an urgent need that a certain product or service can address, a consumer may be willing to pay more. Similarly, an actual, or perceived shortage of supply of a product or service could make them more willing to pay a higher price. Below are some of the consequences of a higher price on elastic goods;

Reduced purchasing power; Consumer purchasing power diminishes with an increase in price since they need to allocate more of their income to procure their preferred goods and services. This reduction in purchasing power will either lead to consumers purchasing fewer products if they still want to maintain the same basket of utilities. Or rather compel them to cut back on discretionary spending or even seek cheaper alternatives.

Shift in consumption patterns; An increase in prices often prompts consumers to alter their consumption patterns. Price influences the type of decision a consumer makes. Higher prices trigger emotional responses. Thus, consumers may opt for substitute goods. When alternatives are not available, they may reduce the quantity demanded of the expensive product, leading to a redistribution of spending across other market segments.

Economic Strain; Uneven rising prices can have a significant effect on consumers' ability to make purchases and meet their basic needs. When prices increase, consumers may have to spend more of their income on these, leaving less money available for other expenses. This leads to financial strain, particularly for those with fixed incomes. The strain may manifest in decreased overall welfare, heightened financial stress, and a reduced standard of living.

**Producers**

Prices affect producers because higher prices of supplies prompt producers to make decisions on whether or not to supply. The law of supply states that if all other market factors remain constant, a price increase will lead to an increase in the market supply. Therefore, it is only imaginable that a higher price will make a producer supply more. Also, as the price rises, the demand in the market falls. If the price is too high, supply will be greater than demand, and producers may be stuck with the excess goods. Below are some of the consequences of an increase in price to producers;

Increased revenue; When prices increase producers can generate more revenue because they can sell their products at a higher point price. This means that when prices are high, the demand for the products may decrease, but the price increase can often offset the decrease in demand, resulting in higher revenue for the producer. If the demand remains relatively inelastic, producers may capitalize on the price hike, boosting their profits.

Investment in innovation; The prospect of high profitability incentivizes producers to invest in innovation and product development. Particularly in a monopolistically competitive market structure. Higher prices catalyze research and development efforts aimed at providing product quality and differentiation.

Supply expansion; An increase in prices signals favorable market conditions, making producers to increase their supplies. In inelastic markets, producers take advantage of the hike in prices and expand their supply, boosting their profits and financial viability. A good example is the oil industry.

**Lower prices and their effects**

The perception of a given price can have a direct relationship with the decisions to purchase or supply the product, (Zechmeister et al., 1997). The market participants pay attention to their peers and competitors and no one wants to spend more or earn less than their peers or competitors. Consequently, when prices drop, consumers and buyers navigate through a distinct set of challenges and opportunities.

**Consumers**

A price decrease has a substitution effect and an income effect on a consumer. The substitution effect states that because the product price is low relative to other things the consumer buys, a consumer will tend to buy more of the product. An income effect states that since the goods are affordable and the discretionary income is freed then consumers are likely to spend more on another basket of goods and services.

Enhanced purchasing power; Consumers prefer low prices because everybody aims to spend less and gain more satisfaction through a variety of goods or services. Low prices empower consumers with a high purchasing power, enabling them to afford a wider variety of goods and services. However, sometimes low prices might signal low quality of products and services which might lead to a low demand.

Increased demand; Economists call this the law of demand. If prices decrease the quantity demanded increases. This is because the prices of essential goods and services are more affordable for consumers and excess income is redistributed to other expenses. Lower prices typically increase the surge in demand for goods and services because customers perceive them as more attractive and accessible.

Savings and investments; Lower prices have a positive impact on the consumers' savings and investments. Low prices mean discretionary income is freed and consumers can allocate more to savings and investments. The accumulation of more savings and investments will lead to better standards of living.

**Producers**

If prices fall, suppliers are unable to cover their production costs and many of them may drop out or scale down their operations to fit in the current market conditions. Economists generally lump the quantities suppliers are willing to at each price in an equation called the supply curve. The lower the price the lower the supply curve and the fewer products the producers are willing to supply.

Revenue compressions; Price is what the producer receives from selling a single unit of good and service. Therefore, a price decrease only means that the revenue collected will be smaller. Even though the demand will increase, the revenue collected will not offset the cost of producing the units of goods and services supplied.

Cost rationalizing; Faced with revenue compressions, producers may embark on cost-cutting measures as a way to mitigate the effect of lower prices. This includes scaling down their operations, renegotiating the contract with their suppliers, retrenchment of their workers, or even closing down their operations.

Competitive dynamics; Producers are often forced to lower their prices since the market prices are falling to remain competitive and attract customers. This can result in a price war between producers as each may try to undercut prices to gain market share. This reduces the profitability and may even put pressure on lower producers to close their operations.

**Conclusion**

Fluctuations in prices will ever create a contrasting effect on customers and producers, reshaping their economic decisions and outcomes in different ways. An increase in prices will most likely be favorable to producers since it offers revenue opportunities and investment incentives. Similarly, a price decrease will be favorable to consumers as it enhances their purchasing power and frees up discretionary income allowing for more allocated to savings and investments.

To conclude, the effect of price fluctuations underscores the winding interplay between supply and demand dynamics in market economics. Understanding these effects of a higher and lower price is important for market participants and other stakeholders alike in navigating the complexities of economic decision-making.

**REFERENCES**

Bei, L.-T., and Chiao, Y.-C. (2001). An integrated model for the effects of perceived product, perceived service quality, and perceived price fairness on consumer satisfaction and loyalty. *J. Consume. Satisfy. Dissatisfaction Complain. Behave.* 14:125.

Hamilton, R., & Chernev, A. (2013). Low prices are just the beginning: Price image in retail management. *Journal of Marketing*, *77*(6), 1-20.

Huang, A., Dawes, J., Lockshin, L., & Greenacre, L. (2017). Consumer response to price changes in higher-priced brands. *Journal of Retailing and Consumer Services*, *39*, 1-10.

Phan, D. H. B., Sharma, S. S., & Narayan, P. K. (2015). Oil price and stock returns of consumers and producers of crude oil. *Journal of International Financial Markets, Institutions and Money*, *34*, 245-262.

Zechmeister, E. B., Shaughnessy, J. J., and Zechmeister, J. S. (1997). *A Practical Introduction to Research Methods in Psychology.* New York: McGraw-Hill Humanities.