

TERMS & TOPICS – Price Controls, Taxes, and Welfare

Should there be a price? Michael Sandel (Market economy v. market society)

Prices as signals

Government Policies That Alter the Private Market Outcome

Price controls

- Price ceiling

- Price floor

Binding constraint

How Price Ceilings Affect Market Outcomes

- Shortages

- Rationing

- Rationing mechanisms: 1) long lines 2) lottery 3) discrimination according to sellers' biases

- Efficiency of rationing mechanism

How Price Floors Affect Market Outcomes

- Minimum Wage

- Surplus

Evaluating efficiency of price controls

Taxes

- Tax on Buyers

- Tax on Sellers

- A tax drives a wedge between the price buyers pay and the price sellers receive.

Tax Incidence/Who Will Bear the Burden of a Tax?

Elasticity (*Responsiveness*) and Tax Incidence

Welfare Economics

Allocation of resources

Willingness to pay

Consumer Surplus (CS)

- Price Changes Affect CS

Cost for seller/Willingness to sell

Producer Surplus (PS)

- Price Changes Affect PS

Area of a triangle formula

Total Surplus

dead weight loss

Evaluating the Market Equilibrium with respect to efficiency; with respect to total surplus

The Free Market vs. Govt Intervention

Laissez faire

Dead weight loss and elasticity

Price controls and efficiency loss (CS and PS)

increasing taxes

- revenue implications

- “layered” taxes for various levels of government