

Demand, Supply & Govt. Policies

(31)

(32)

↳ Price ceiling → A legal maximum on the price at which a good can be sold.

↳ Price floor → A legal minimum on the price at which a good can be sold.

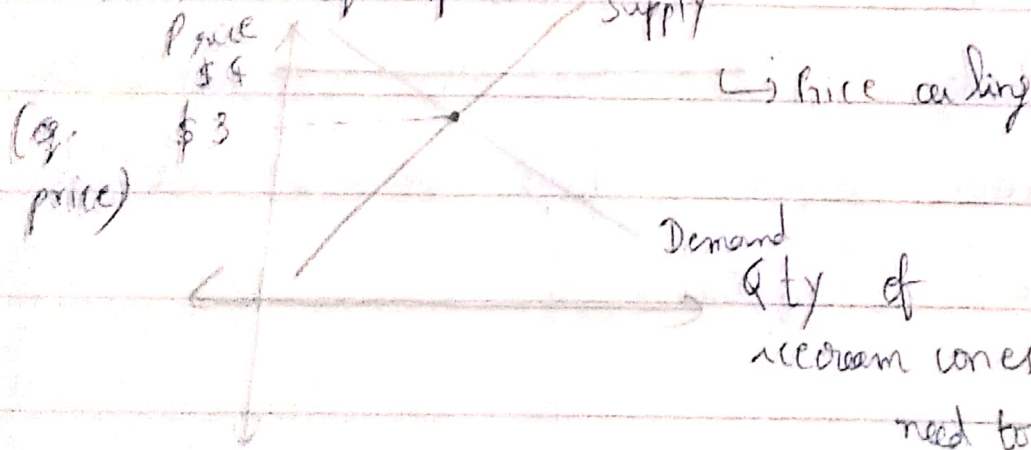
↳ Price ceiling:

- Price ceiling that is not binding
- Price ceiling that is binding.

→ Price ceiling Not binding:

Govt. policy → fixes → price of a gty

> its eq. price. Supply



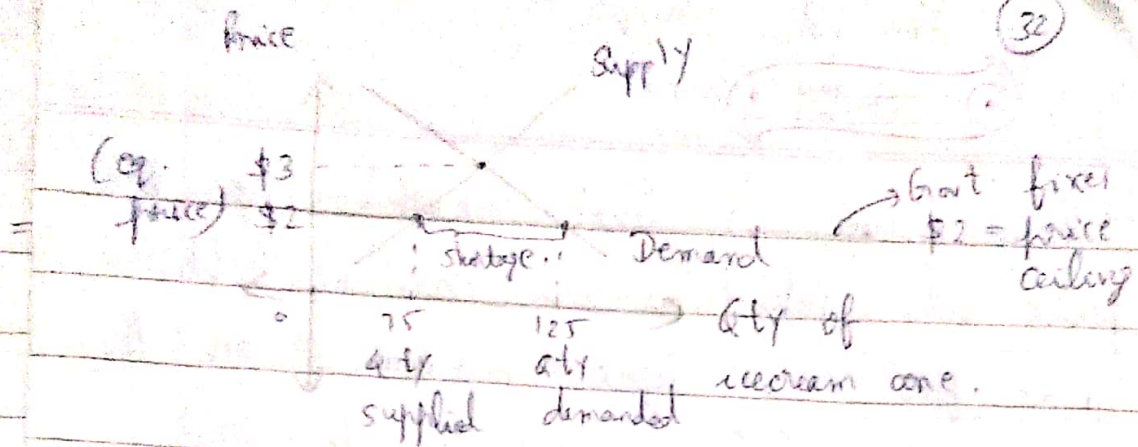
• Smooth market functioning → no change

any price as sellers → already obey laws

→ Price ceiling That is binding:

Govt. policy → fixes → price ceiling

< equilibrium price.



→ gives a binding constraint.

⇒ qty supplied < qty of icecream cones demanded. ⇒ SHORTAGE → To avoid it → rationisation → ppl ^{wait} in queue, pay \$2 a less and buy. Waiting wastes buyers' time.

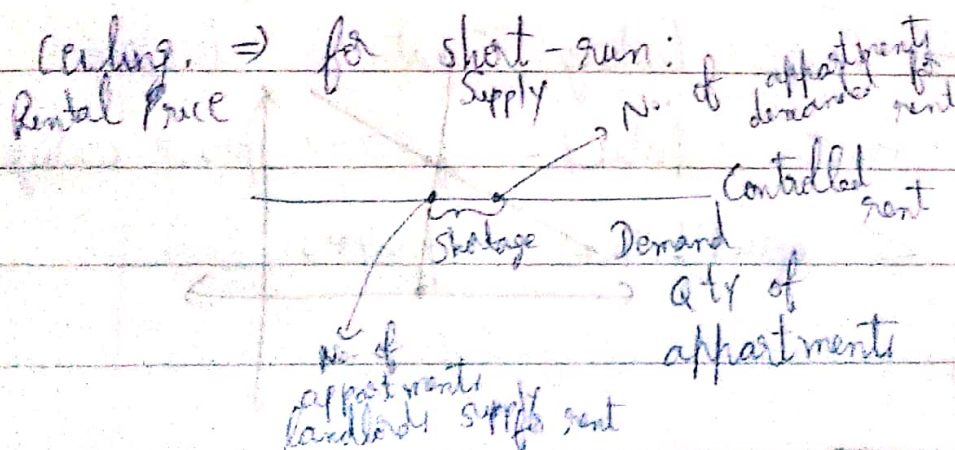
→ Policy → not all buyers get to buy due to shortage. Sellers may sell icecreams to their known buyers. Though price ↓ → not all buyers → benefitted.

Eg:

(i) Rent Control in Short-run & Long-run:

→ Govt. fixes controlled rent → rent

ceiling. ⇒ for short-run:



→ Supply & demand → inelastic.

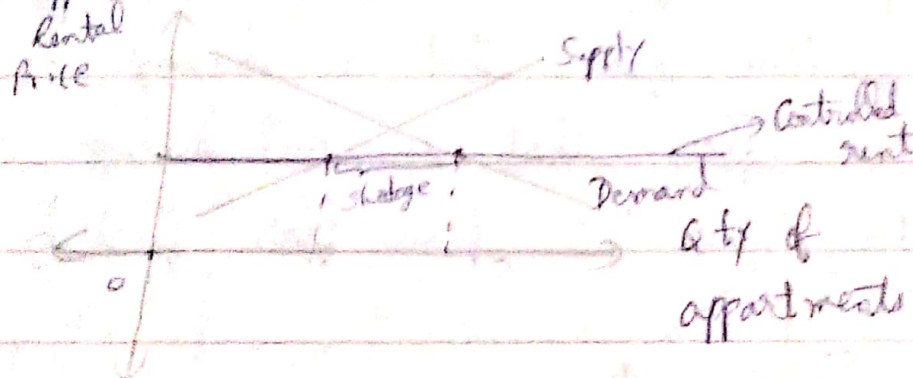
⇒ less shortage.

② → Rent

→ Govt. fixes ^{some} controlled rent → rent cap

⇒ for long-run:

→ Supply & demand → elastic.



→ More shortage

Reason: Landlords are not interested in building new houses for ↓ rents.

As rent is low, ↑ demand ⇒ ↑ ppl prefer to live for rent.

→ Rationing → landlords prefer tenants with no children, no pets, friends (bias).

↳ Max. Rent a landlord can ask his tenant to pay = controlled rent.

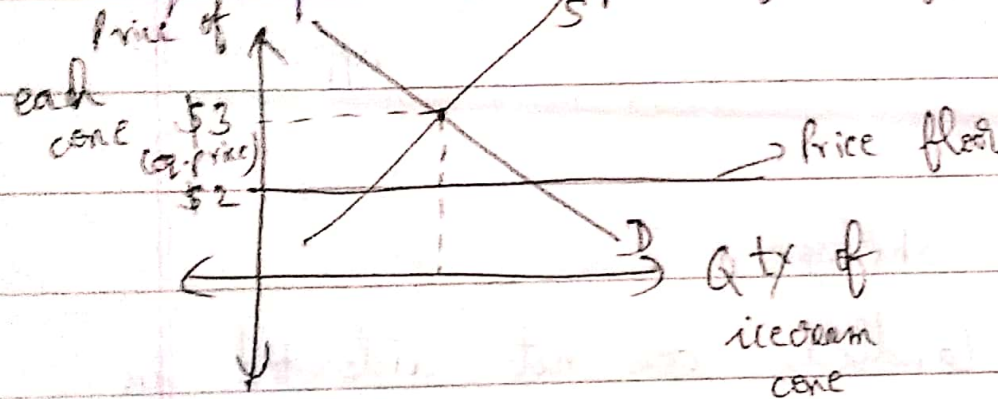
② Americans waited for lines to buy gasoline when OPEC ^{reduced} supply \rightarrow price $<$ eq. price \Rightarrow shortage of oil \Rightarrow rationing.

• Price Floor:

- \rightarrow Price floor that is not binding
- \rightarrow Price floor that is binding

① Price floor that is not binding:

\rightarrow Eg. price $>$ price floor fixed by Govt.

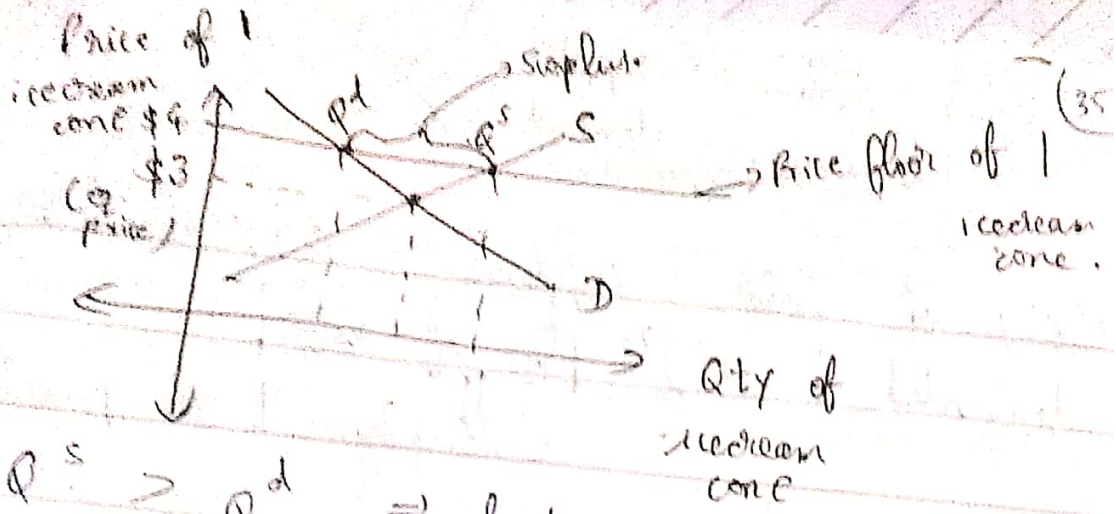


\rightarrow Market forces naturally bring economy to equilibrium. Price floor has no effect. \rightarrow

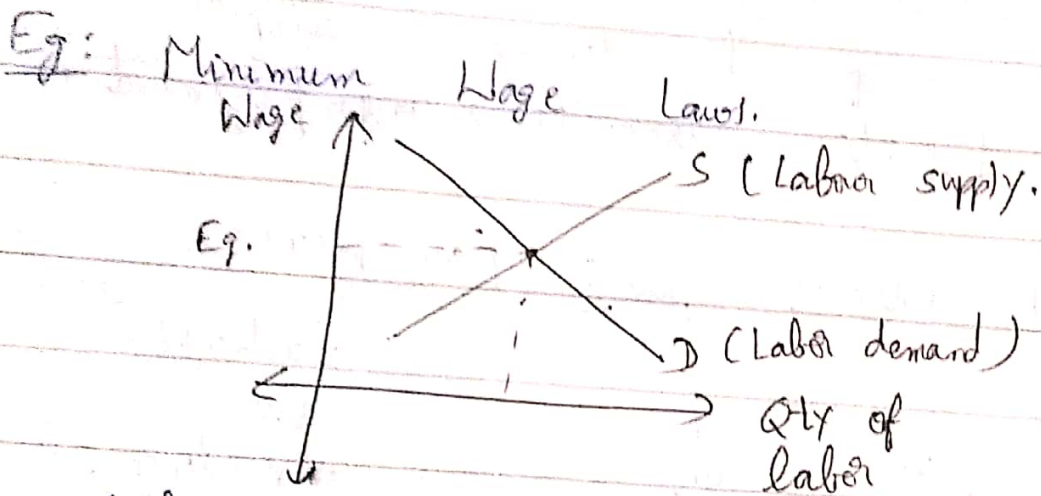
② Price floor that is binding:

\rightarrow when Govt. fixes a price floor $<$ eq. price.

\rightarrow leads to surplus of goods.



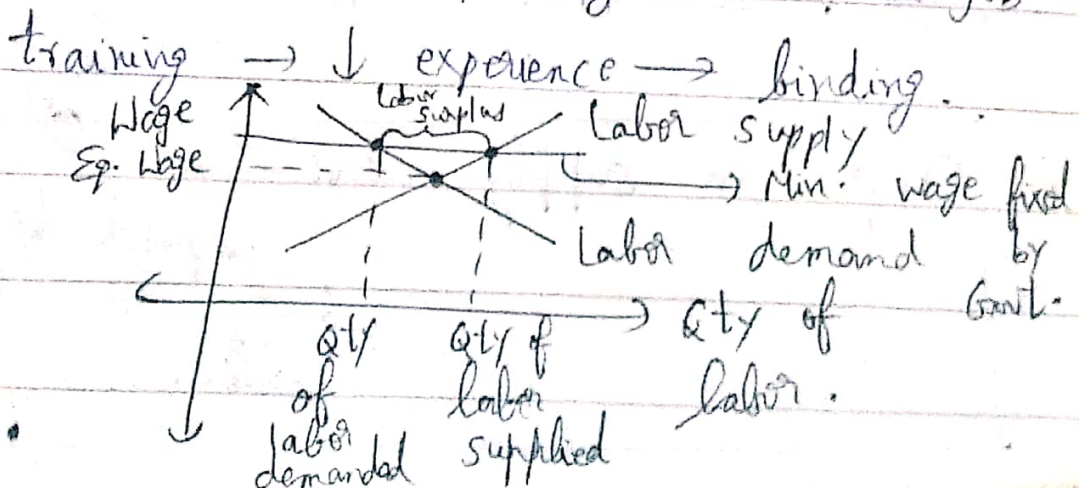
$\rightarrow Q^s > Q^d \Rightarrow$ leads to surplus.
 \rightarrow binding constraint = \$4.



After min-wage law:

(1) For highly experienced & skilled workers, not binding \rightarrow their ^{eq.} wages $>$ min. wage set by Govt.

(2) For interns / teenagers \rightarrow on-the-job



\Rightarrow Qty of labor supplied $>$ Qty of labor demanded \Rightarrow [Surplus of labor]

\Downarrow
Unemployment & poverty.

Reason:

Min. wage $\uparrow \rightarrow$ many teenagers,
school dropouts \rightarrow hunt for job \rightarrow
some of the teenagers displace the
dropouts \rightarrow dropouts \rightarrow unemployment.