Chapter 6: Price Controls

ECON 1B

CSUS

Previously

- Equilibrium is determined by the forces of supply and demand.
- A shortage (excess demand) will occur at prices below the equilibrium.
- A surplus (excess supply) will occur at prices above the equilibrium.
- Sliding along a demand or supply curve is caused by a change in the price of the good.

Big Questions

1. When do price ceilings matter?

2. What effects do price ceilings have on economic activity?

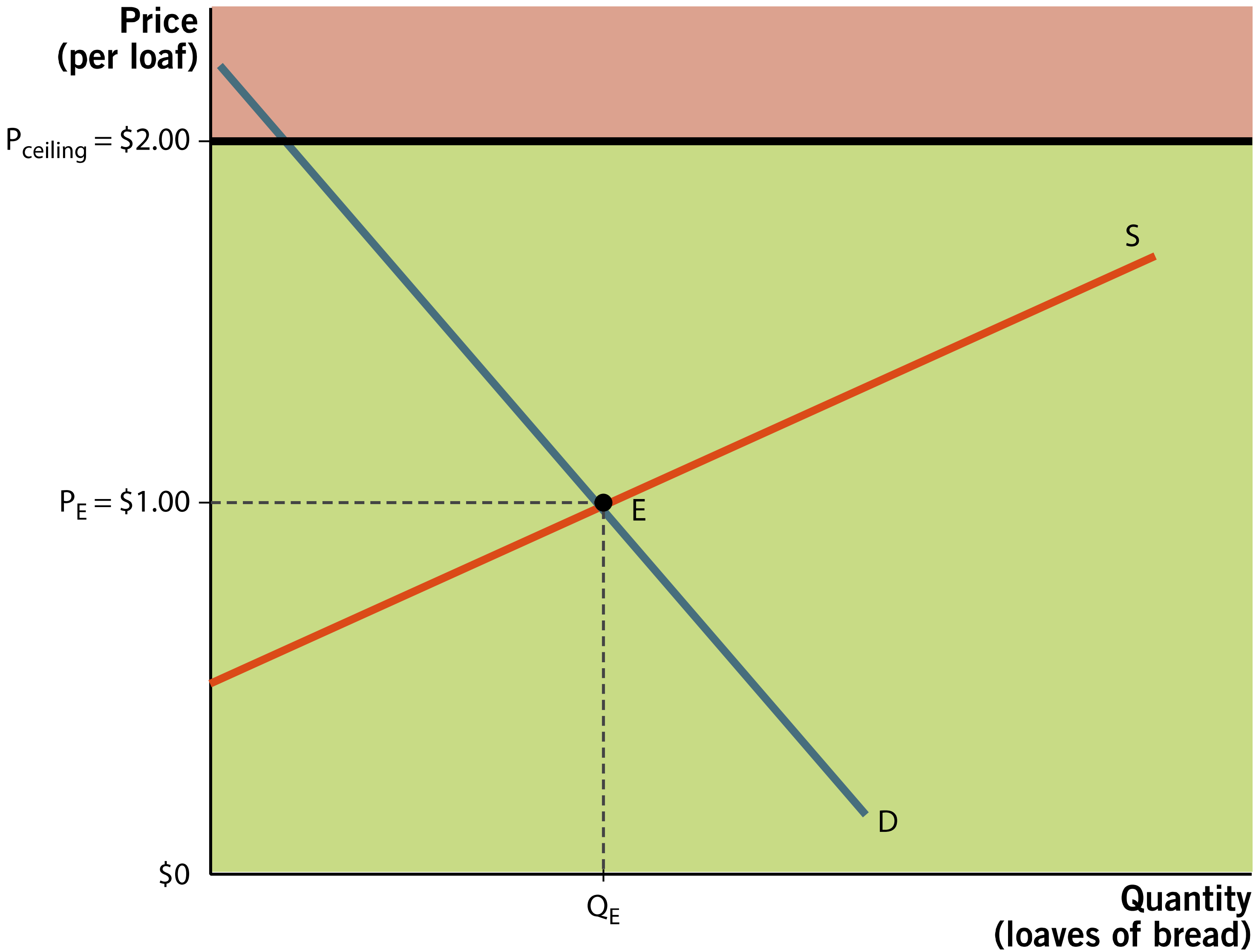
3. When do price floors matter?

4. What effects do price floors have on economic activity?

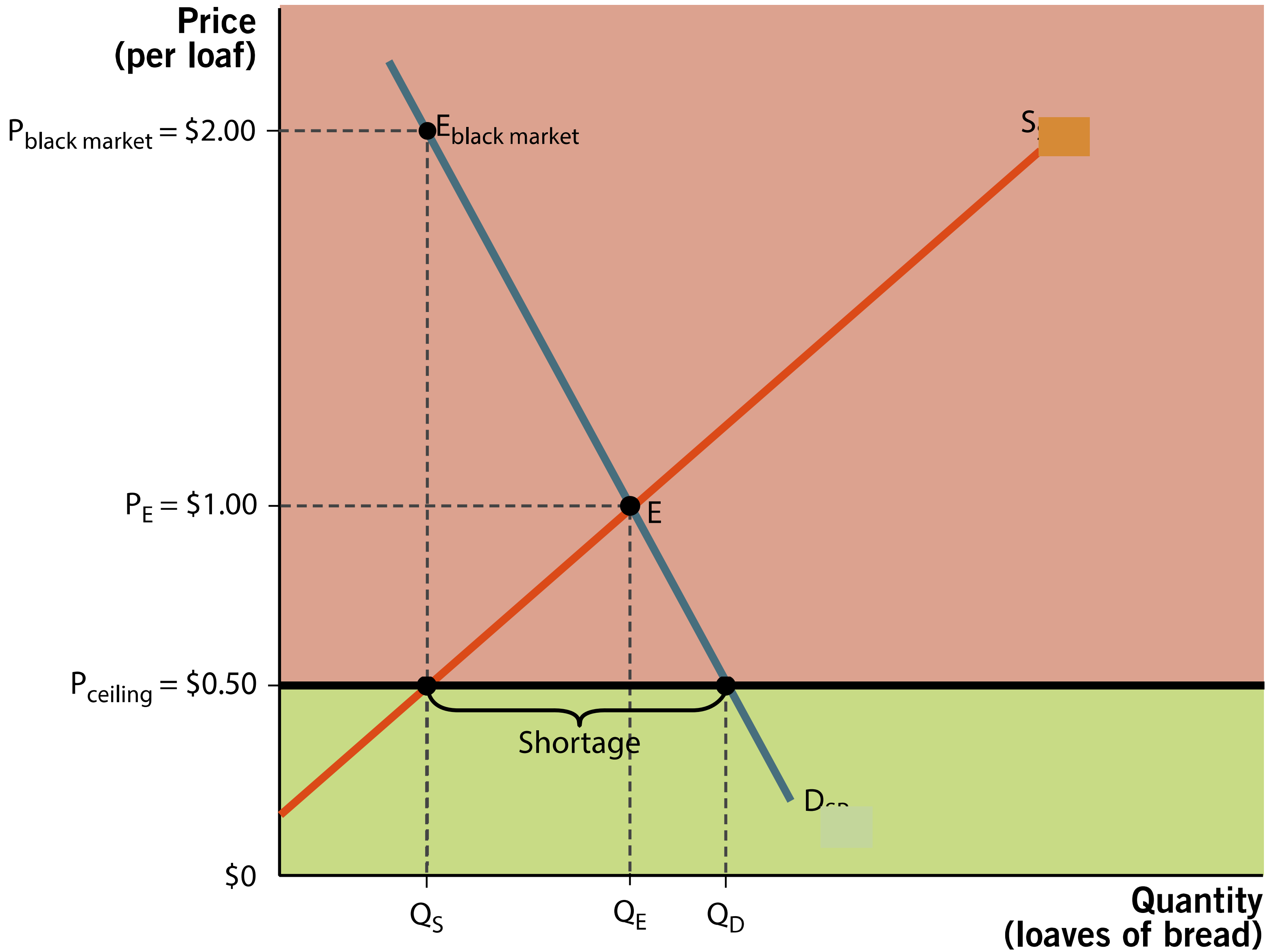
What Are Price Controls?

- Price controls
  - Attempt to set, or manipulate, prices through government involvement in the market
  - Meant to ease perceived burdens on the population
- Price ceiling
  - Legally established <u>maximum</u> price for a good or service
- Price floor
  - Legally established <u>minimum</u> price for a good or service

Non-binding Price Ceiling



Binding Price Ceiling



Case Studies on Price Ceilings

- Rent control
  - Price ceiling on apartments or housing
- Goal:
  - Help low-income renters find affordable places to live

Rent Control

- Unintended consequences of rent control:
  - Shortages ($Q_d > Q_s$)
  - Decreases in long-term investment in the building of new units

  - Reduction in quality of apartments
  - Black markets with higher prices

Practice What You Know—1

- What will be the effect of a nonbinding price ceiling?
  A. A surplus will be created.
  B. A shortage will be created.
  C. There will be no effect.
  D. The effect is unknown.

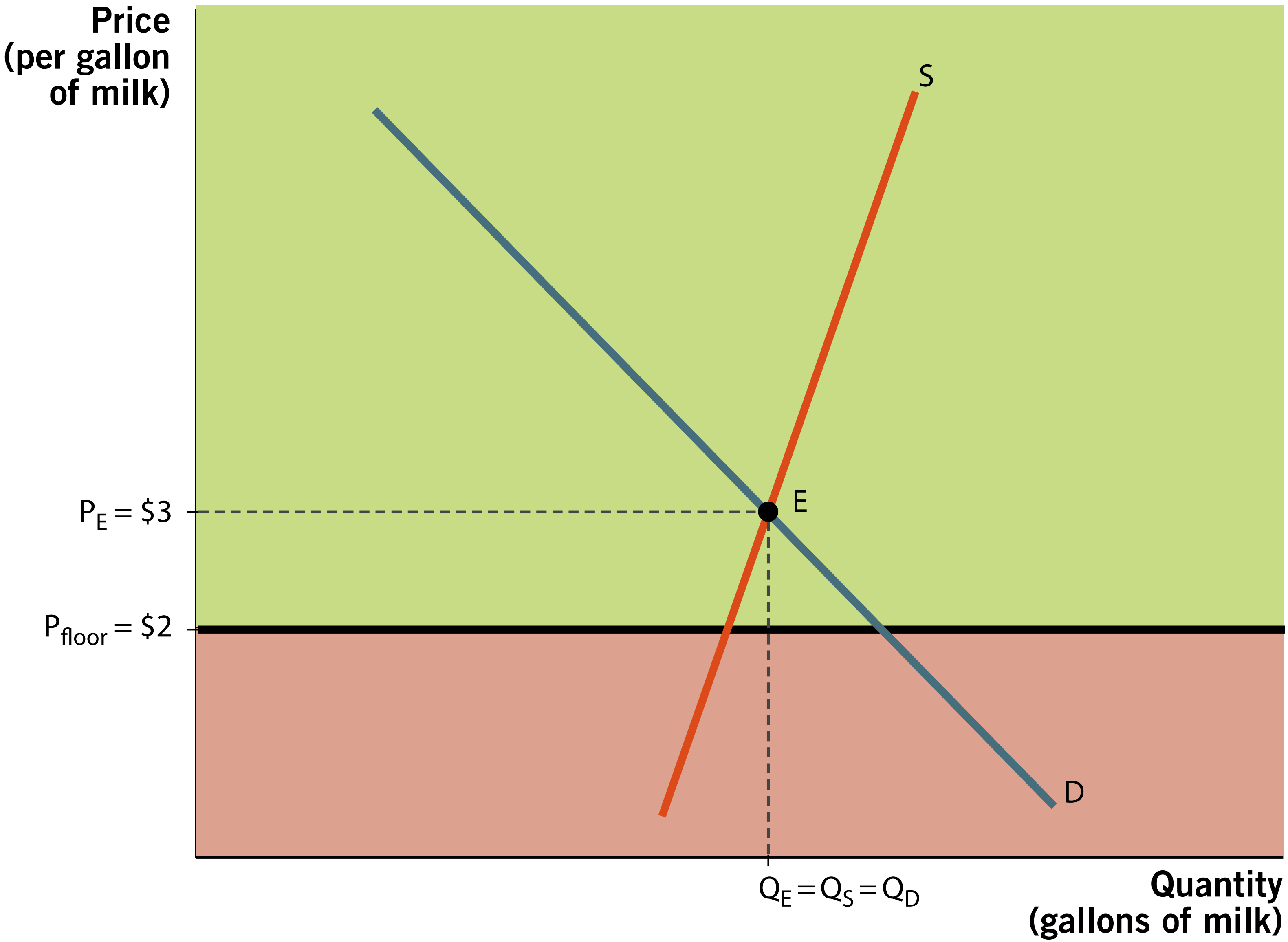
Practice What You Know—2

- In the event of a binding price ceiling, what is one function that a black market serves?
  A. reduces the shortage caused by the price ceiling
  B. decreases the price even further
  C. creates a monopoly
  D. causes a surplus of the good

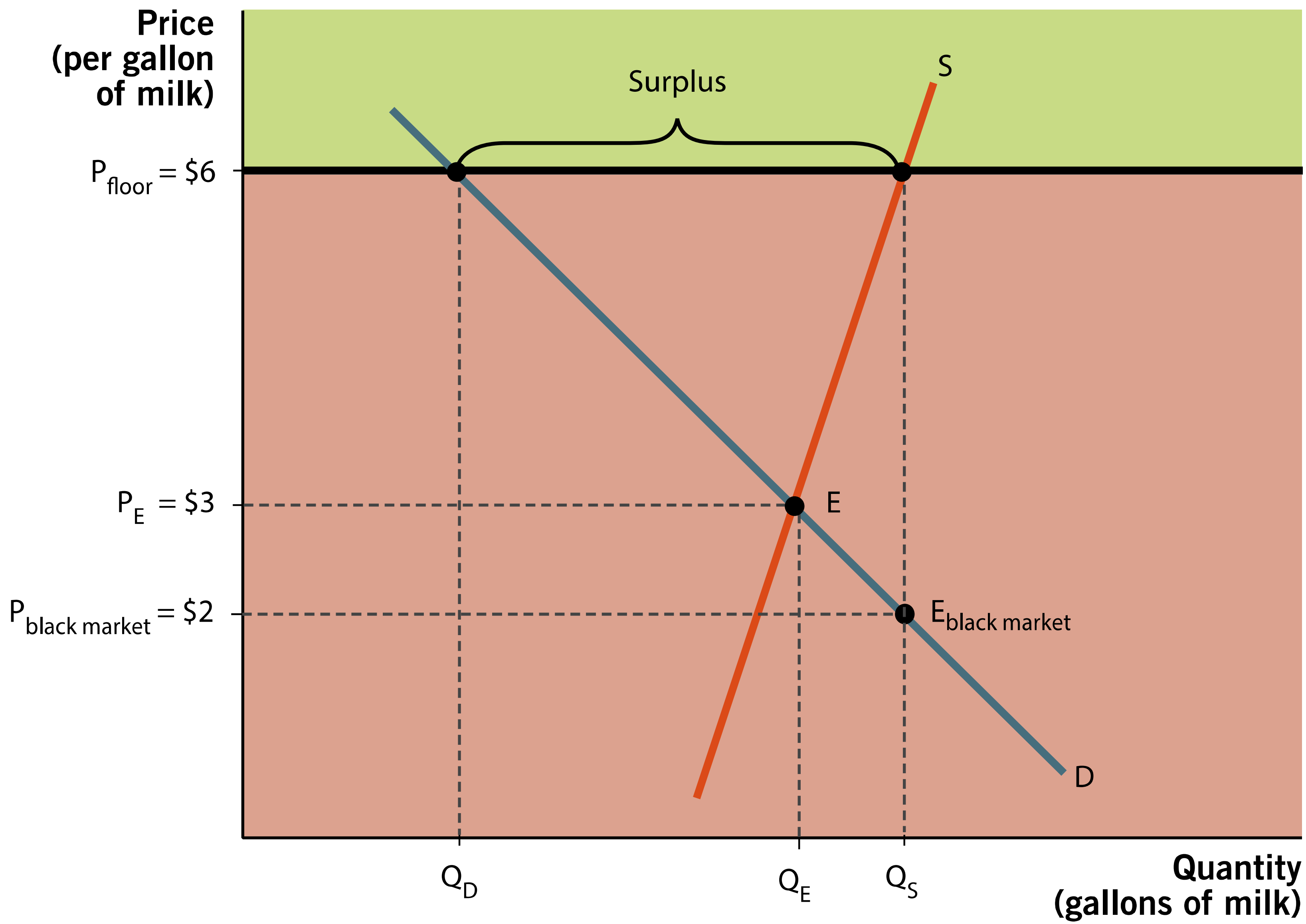
Price Floors

- Recall that a price floor is
  - A <u>minimum</u> legal price
- Who do you think lobbies for price floors?
  - Producers of the product

Nonbinding Price Floor



Binding Price Floor



Minimum Wage

- Minimum wage
  - The lowest hourly wage rate that firms may legally pay their workers; it functions as a price floor.
- Rationale for minimum wage:
  - Provide a "living wage"
  - Help the working poor who are often unskilled

Labor Markets

- In the supply and demand framework for <u>goods and services</u>:
  - Consumers (all of you) are the demanders of goods
  - Firms (the businesses) are the suppliers (producers) of the goods

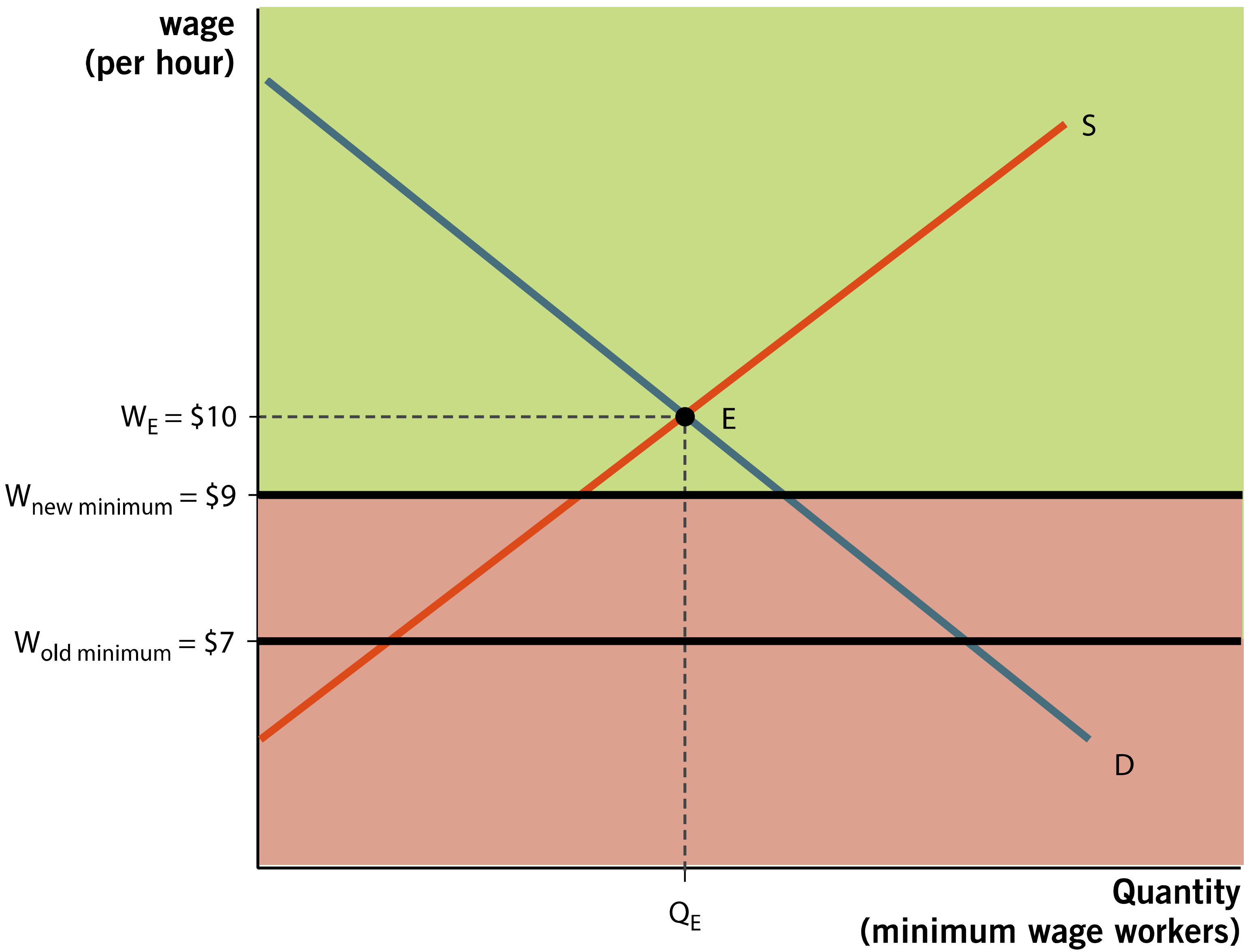
Labor Markets

- In the supply and demand framework for *labor*:
  - Consumers (all of you) are the suppliers of labor.
  - Firms (the businesses) are the demanders of labor.
- The axes on a graph of a labor market
  - Wage (W) is the vertical axis. This is the price of labor.
  - Labor (L) is the horizontal axis. This is the number of workers.

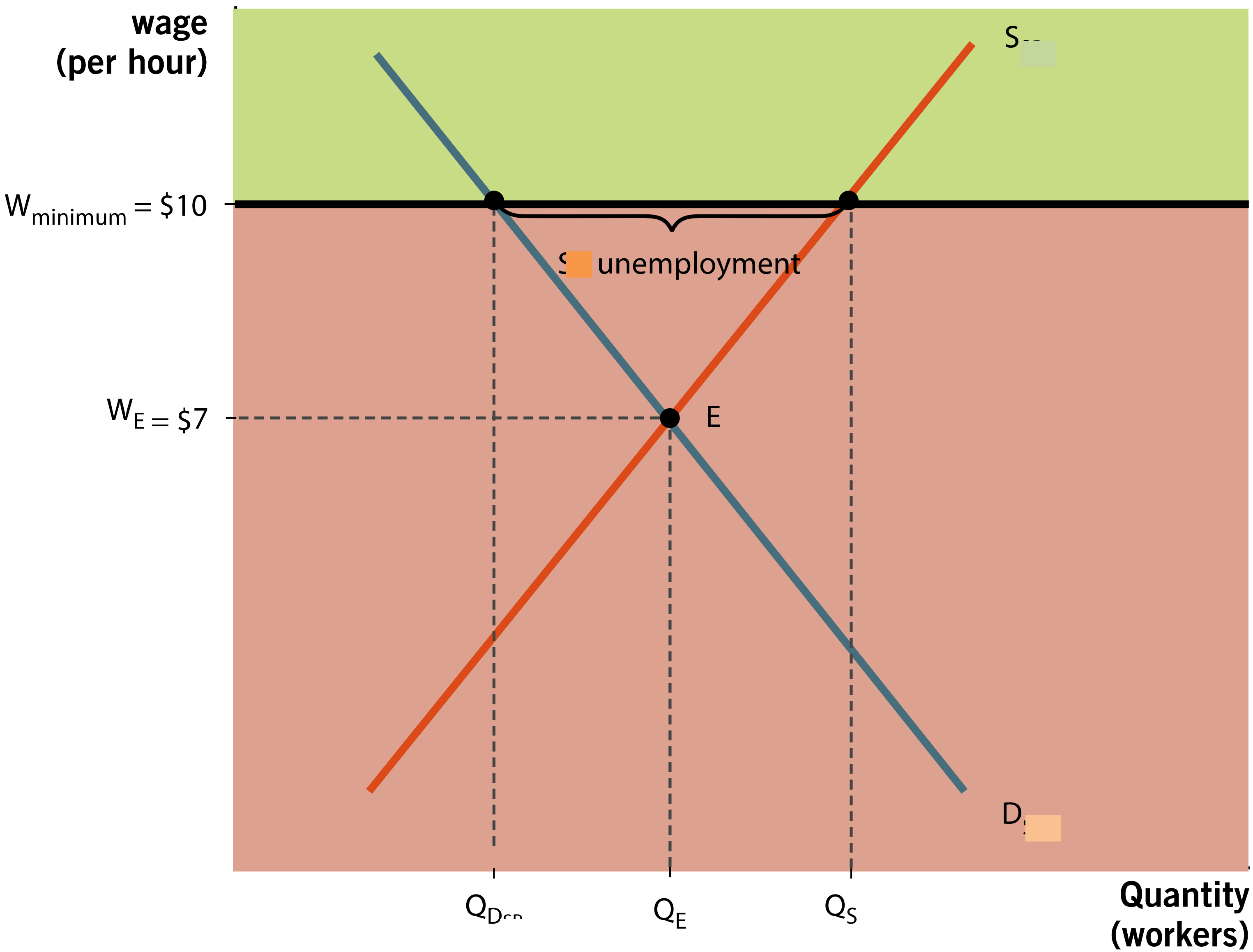
Labor Markets

- The demand curve for labor is downward-sloping. Firms are willing to buy:
  - More labor at low wages
  - Less labor at high wages
- A simple supply curve for labor is upward-sloping. Individuals are willing to supply:
  - More labor at higher wages
  - Less labor at lower wages

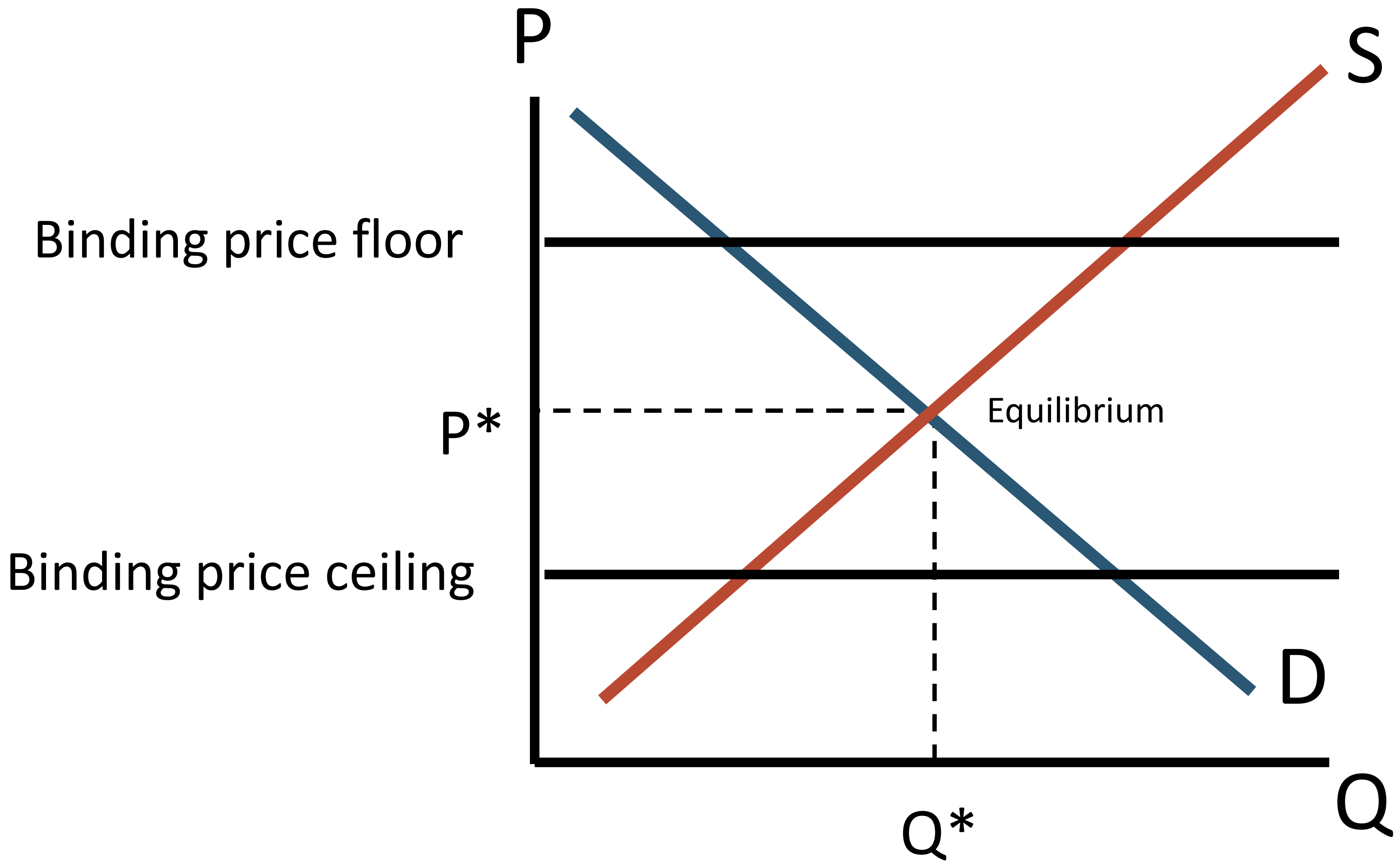
Non-binding Minimum Wage



Binding Minimum Wage



Remembering Price Controls



Summary

- A price ceiling is a legally imposed maximum price.
  - The resulting shortage is problematic.
  - Two unintended consequences: a smaller supply of the good (Q_s) and a higher price for those who turn to the black market.
- A price floor is a legally imposed minimum price.
  - The minimum wage is an example of a price floor.
  - Usually help producers and are common in agriculture.