

Ch 4: Price and Quantity Controls

What are We Talking About

- Price Ceilings and Floors
 - *Legal* minimum or maximum price
 - Minimum wage (Legal Min)
 - Rent control (Legal Max)
- Quantity Ceilings and Floors
 - Legal minimum and maximum purchase or sale
 - Tricky because it can be per purchase or in aggregate.
 - Minimum purchase or sale (Auto Insurance)
 - Maximum purchase quantity (See local ganja store for example)

A Few Warnings

- This is about messing with well functioning, perfectly competitive markets.
- You generally don't want to touch those.

But ...

We Should if They are Not

- Markets that are non-competitive in some way
 - Low skill - low wage labor, minimum wage laws (Economists are split on this but evidence is coming in)
 - Labor markets in general (There may be few buyers and buyers may have more information)
 - Monopoly power, internet service etc.
- When there are externalities
 - Pollution, congestion and the like, but other mechanisms often work better
 - Common resource like fishing. Again, different approaches may be better.

We Do Mess with Markets for Other Reasons

- Critical industry (Argument currently in use for auto tariffs and price floors on milk)
- Infant industry (Just let it grow so we don't have to import)
- Protect the poor (Cheap food)
- Ensure quality (UK had a minimum price of gin)

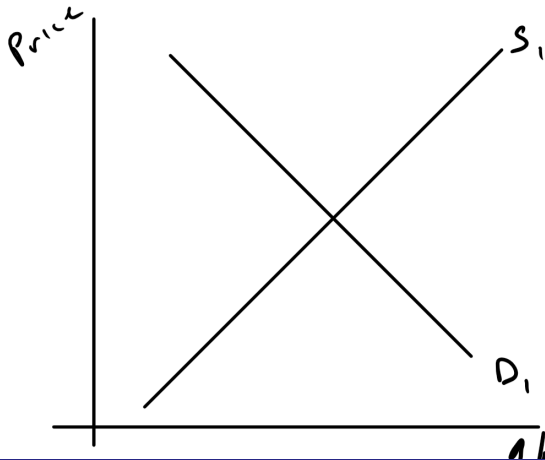
Why We Care in Macro, your next course?

- We do this on vast scales.
 - Quotas on large industries (autos, oil)
 - Tariffs
- The vast scales don't restrict themselves to a single industry they have macro, unemployment, growth, and inflation, effects.

Warnings

- The analysis that follows assumes that we are constraining well functioning markets.
- You can improve the functioning of *some* markets with constraints, but not all.
- The constraints break prices ability to allocate, so other non-price allocation mechanisms, like discrimination, kick in.

Price Ceiling



Summary of Price Ceiling

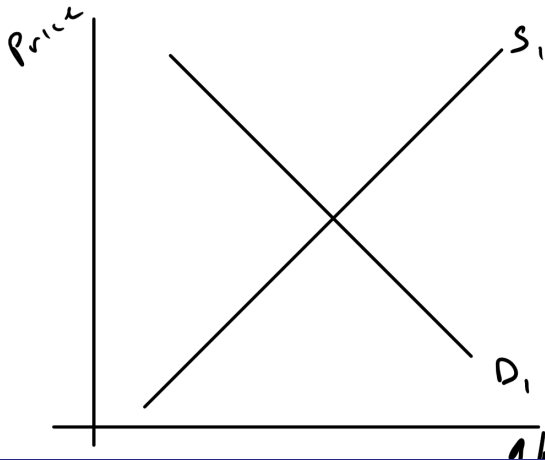
- Quantity demanded is larger than quantity supplied – a shortage.
- The usual equilibrium mechanism, bidding up price, can't work.
- Those that can buy at the low price get a lot of benefits.
- Those that can't end up either:
 - Not getting the goods
 - Buying a close substitute
 - Waiting for a non-price allocation mechanism to kick in.

Real Example: Rent Control

Anne was trying to move to Berkeley and I tried to help.

- Many don't get to buy
- Some get imperfect substitutes – Oakland.
- Information becomes valuable, since prices no longer transmit information
- Discrimination
- Queues
- Connections to other markets arise
- Administrative Allocation
- Lottery

Price Floor



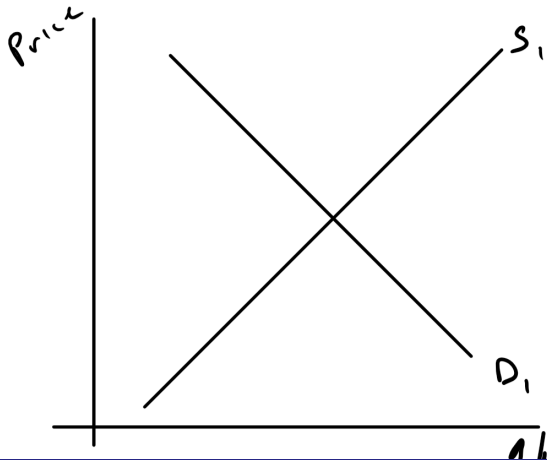
Summary of Price Floor

- Quantity Supplied is larger than quantity demanded – a surplus.
- The usual equilibrium mechanism, bidding down price, can't work.
- Those that can sell at the high price get a lot of benefits.
- Those that can't end up either:
 - Not selling
 - Selling a close substitute
 - Waiting for a non-price allocation mechanism to kick in.

Real Example: Airlines Before Deregulation (1978)

- Many don't get to sell
- Some get imperfect substitutes – Bus and car.
- Information becomes valuable, since prices no longer transmit information
- Discrimination
- Queues
- Connections to other markets arise
- Administrative Allocation
- Lottery

Quantity Floor

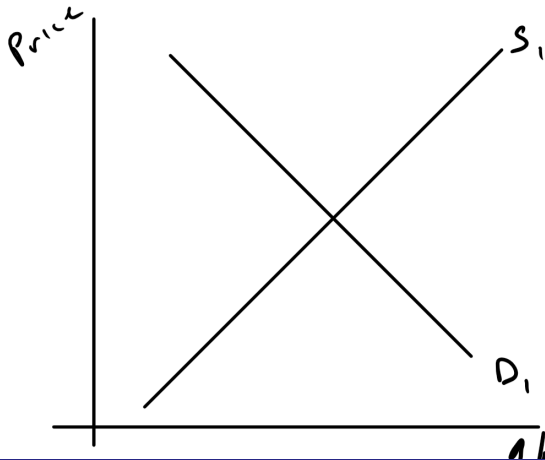


Summary of Quantity Floor

- Price could be high or low depending on who is constrained, who must buy or sell.
 - If buyers must buy, price is high
 - If sellers must sell, price is low

In short, the unconstrained party, buyer or seller, bids the price up or down.

Quantity Ceiling



Next

Welfare Analysis, i.e., how well off you we are, and taxes.