

Policy Levers: Price Controls

EC 201: Principles of Microeconomics

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Prologue

Policy Levers

Price controls

Policies that impose legal limits on the market prices of particular goods or services.

Why do governments impose price controls?

1. Help disadvantaged groups.
2. Manage affordability of certain goods.
3. Curry favor with important interest groups.

Price Controls

Price floor

Establishes a legal **minimum** price.

- Prices below the floor are illegal.
- **Examples:** Agricultural price supports, minimum wages laws, *etc.*

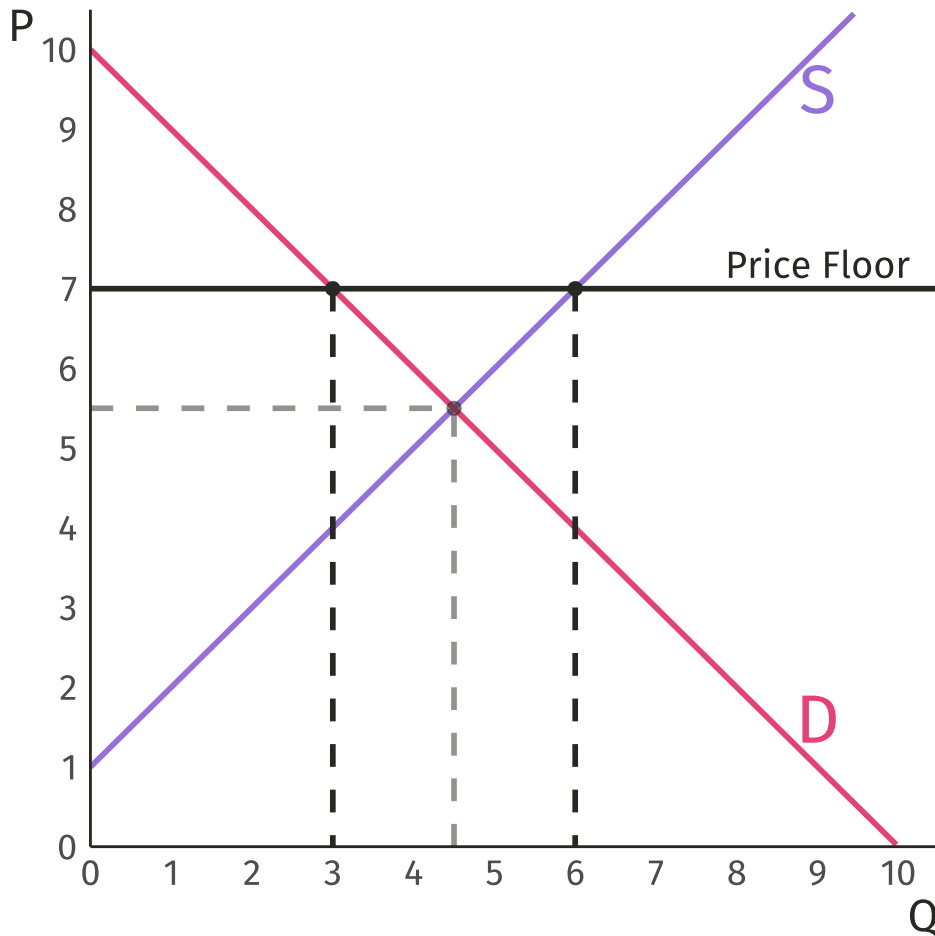
Price ceiling

Establishes a legal **maximum** price.

- Prices above the ceiling are illegal.
- **Examples:** Price-gouging laws, rent control, *etc.*

Price Floors

Price Floor

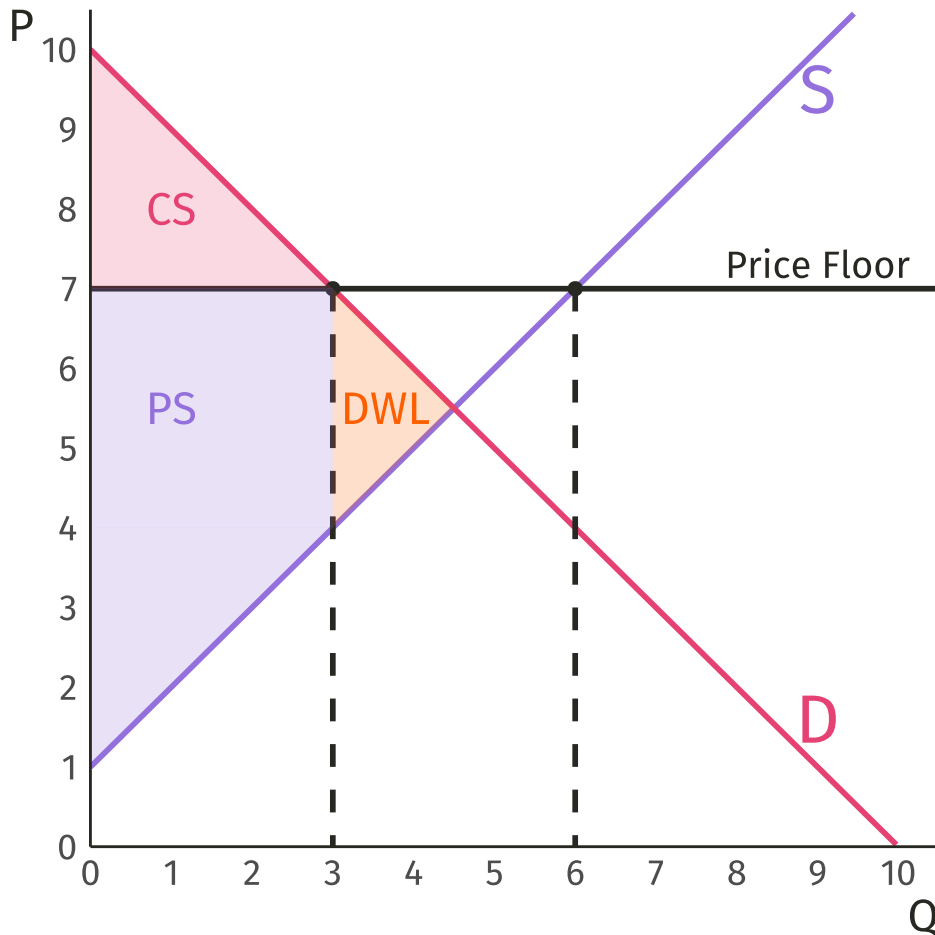


Q: How does a binding[†] price floor affect the market price and quantity?

Price Floor	None	\$7.00
Q_D	4.5	3
Q_S	4.5	6
P_{Market}	\$5.50	\$7.00

[†]: For price floors, *binding* = set above the equilibrium price.

Price Floor

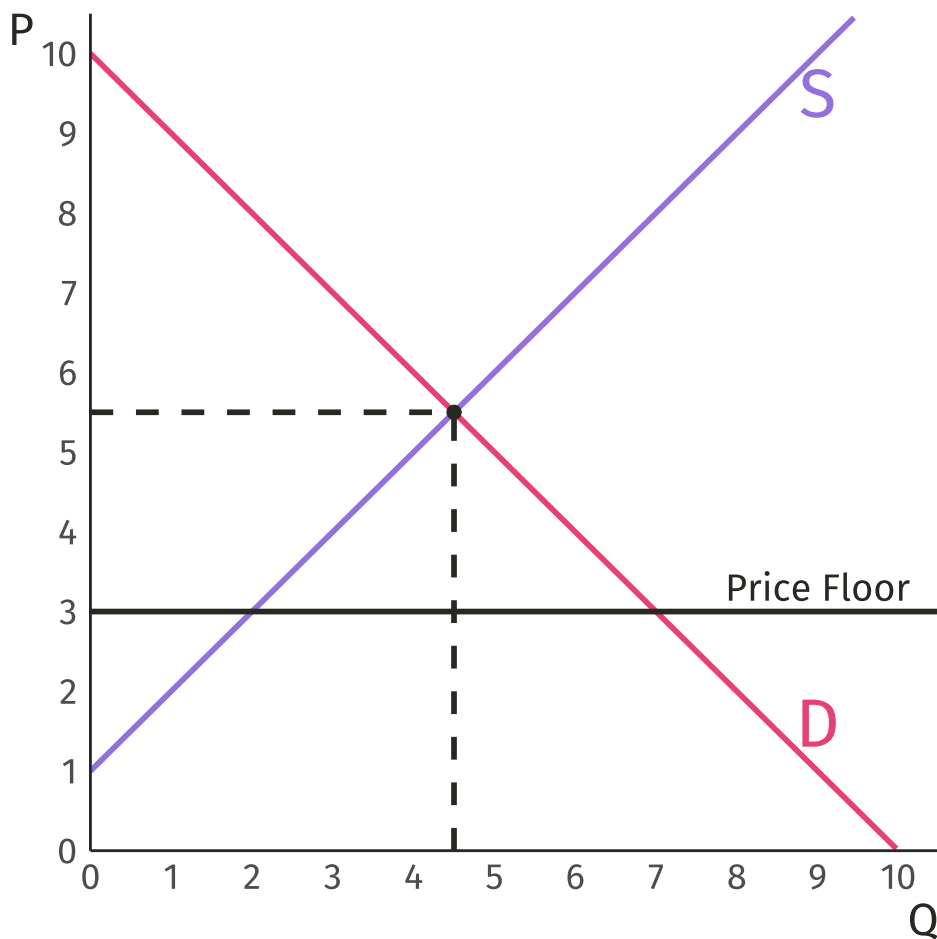


Q: How does a binding[†] price floor affect total surplus in an efficient market?

Price Floor	None	\$7.00
CS	\$10.125	\$4.50
PS	\$10.125	\$13.50
TS	\$20.25	\$18.00
DWL	\$0.00	\$2.25

[†]: For price floors, *binding* = set above the equilibrium price.

Price Floor

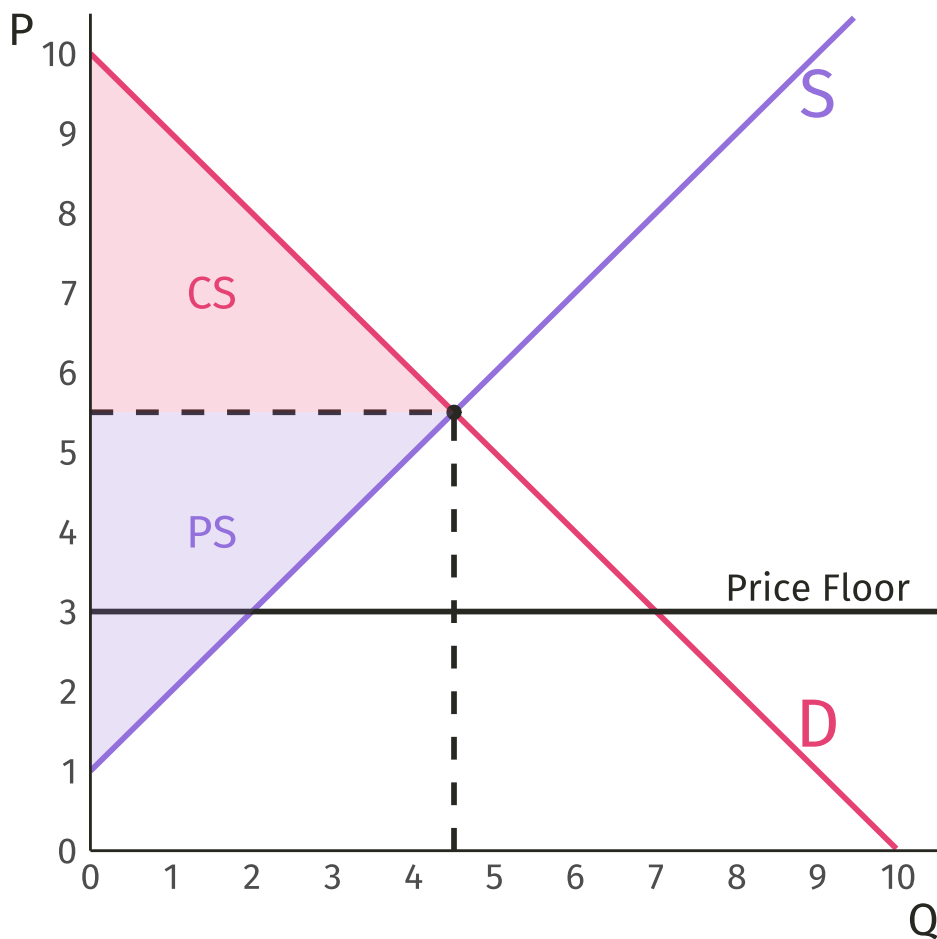


Q: How does a non-binding[†] price floor affect the market price and quantity?

Price Floor	None	\$3.00
Q_D	4.5	4.5
Q_S	4.5	4.5
P_{Market}	\$5.50	\$5.50

[†]: For price floors, *non-binding* = set below the equilibrium price.

Price Floor

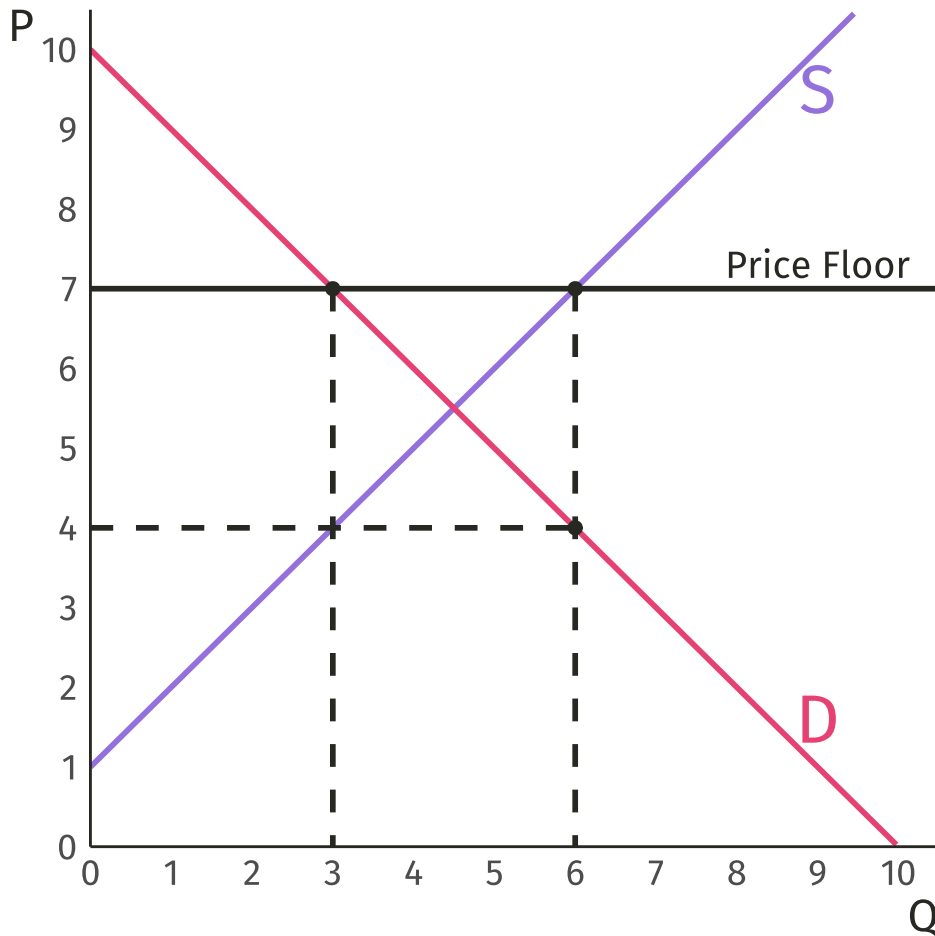


Q: How does a non-binding[†] price floor affect total surplus in an efficient market?

Price Floor	None	\$3.00
CS	\$10.125	\$10.125
PS	\$10.125	\$10.125
TS	\$20.25	\$20.25
DWL	\$0.00	\$0.00

[†]: For price floors, *non-binding* = set below the equilibrium price.

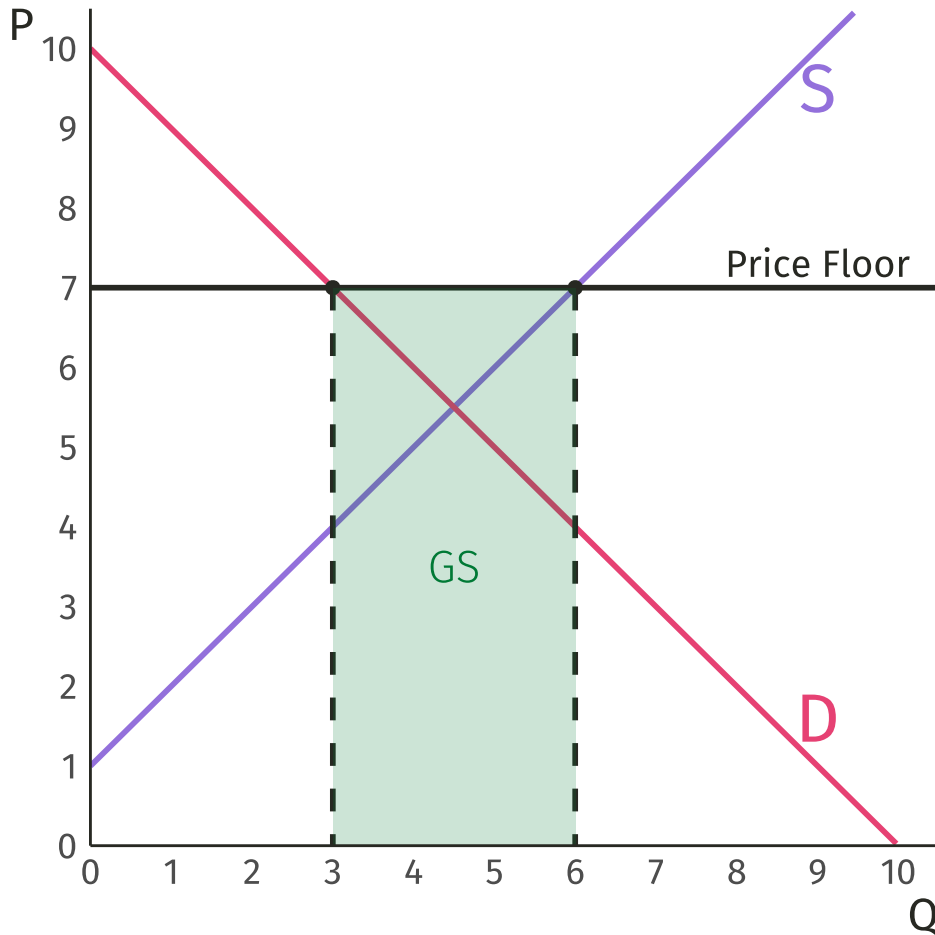
Price Floor



Q: How can sellers eliminate the surplus of goods?

A: Sell the surplus goods on the black market for \$4 per unit.

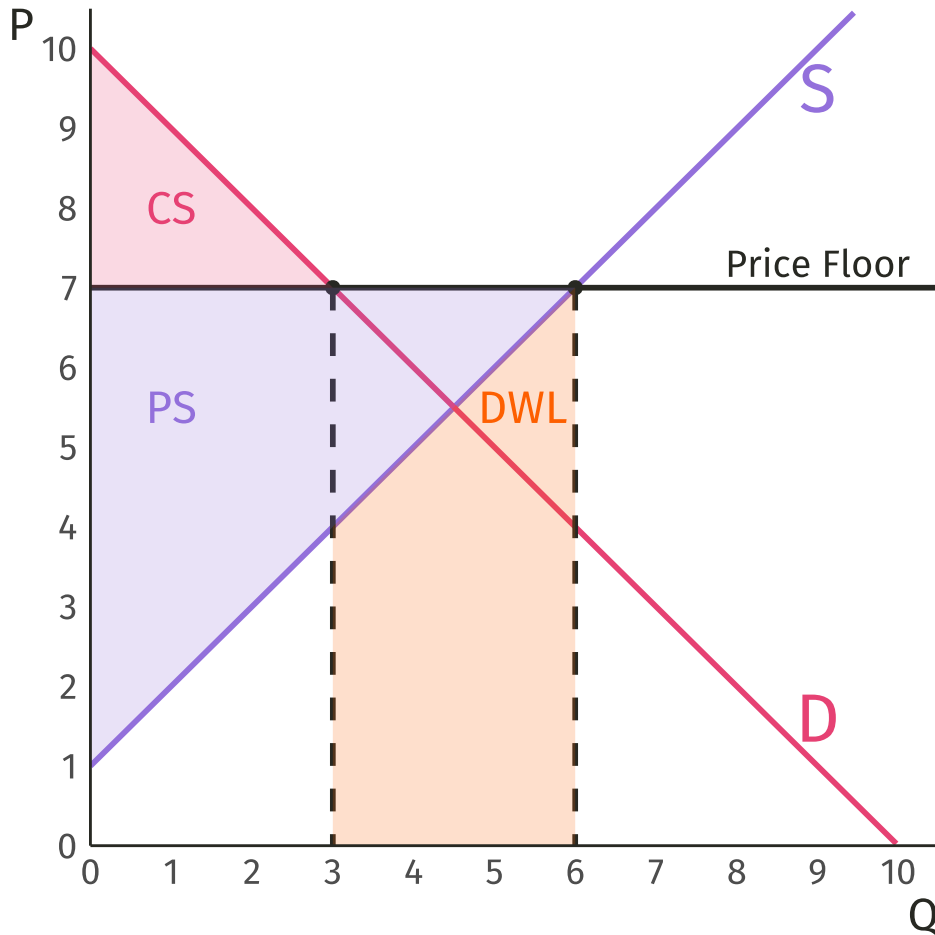
US Dairy Price Supports



Historically, the US government set binding price floors for milk.

Twist: The government bought the surplus of milk.

US Dairy Price Supports



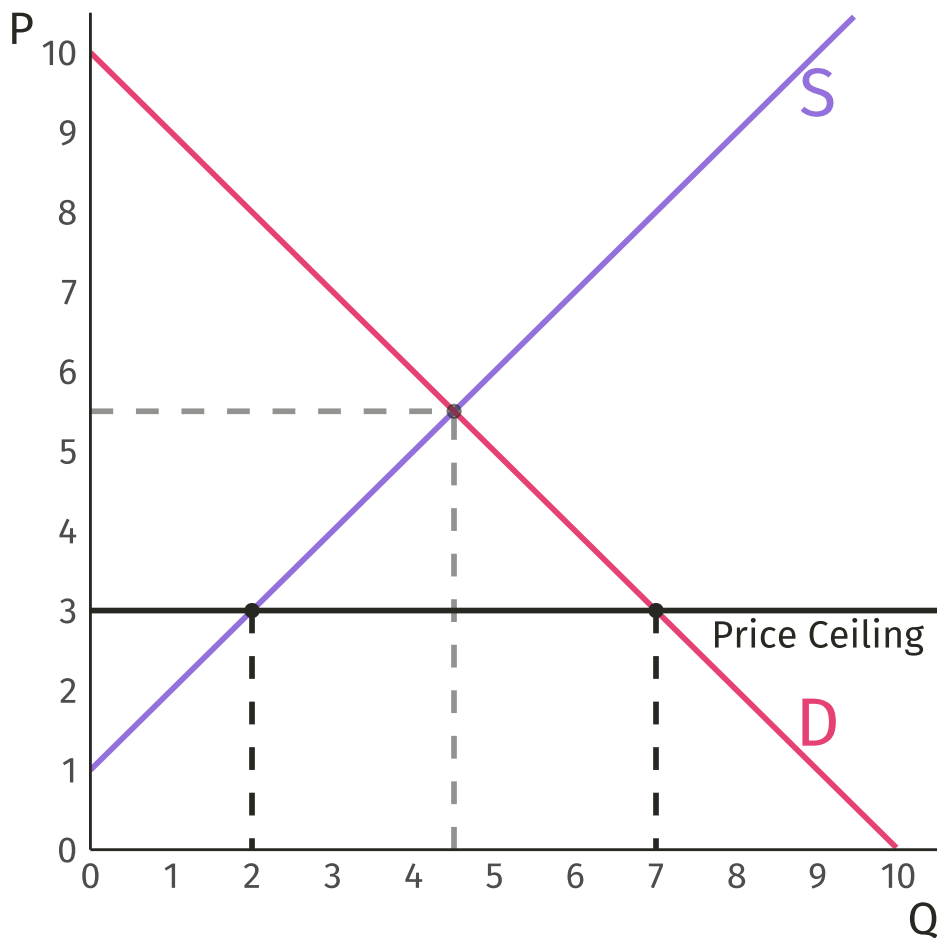
Historically, the US government set binding price floors for milk.

Twist: The government bought the surplus of milk.

Consequence: Additional deadweight loss (e.g., government cheese).

Price Ceilings

Price Ceiling

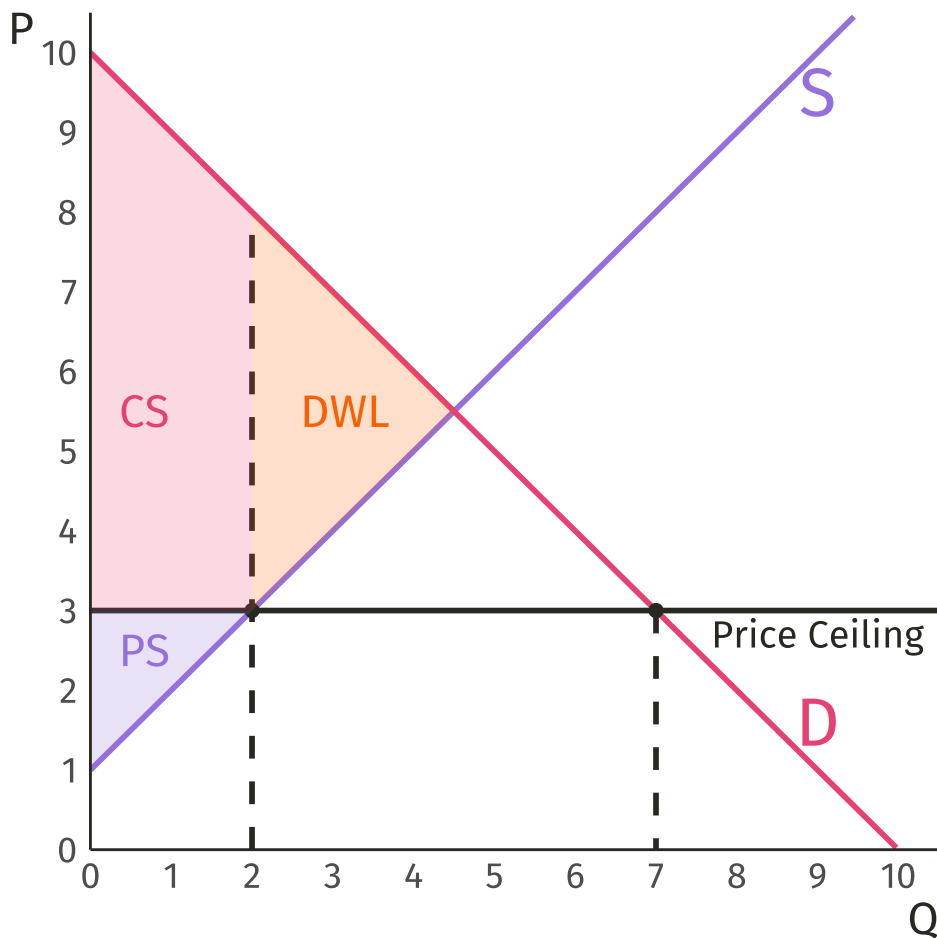


Q: How does a binding[†] price ceiling affect the market price and quantity?

Price ceiling	None	\$3.00
Q_D	4.5	7
Q_S	4.5	2
P_{Market}	\$5.50	\$3.00

[†]: For price ceilings, *binding* = set below the equilibrium price.

Price Ceiling

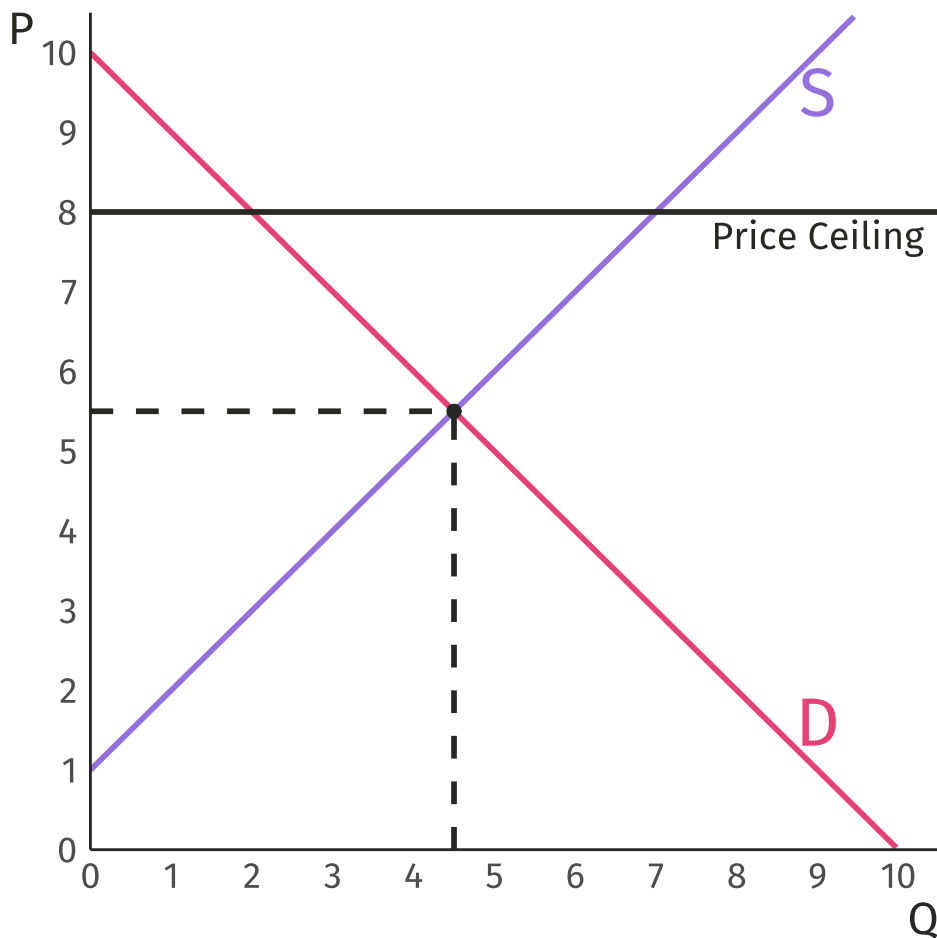


Q: How does a binding[†] price ceiling affect total surplus in an efficient market?

Price ceiling	None	\$3.00
CS	\$10.125	\$12.00
PS	\$10.125	\$2.00
TS	\$20.25	\$14.00
DWL	\$0.00	\$6.25

[†]: For price ceilings, *binding* = set below the equilibrium price.

Price Ceiling

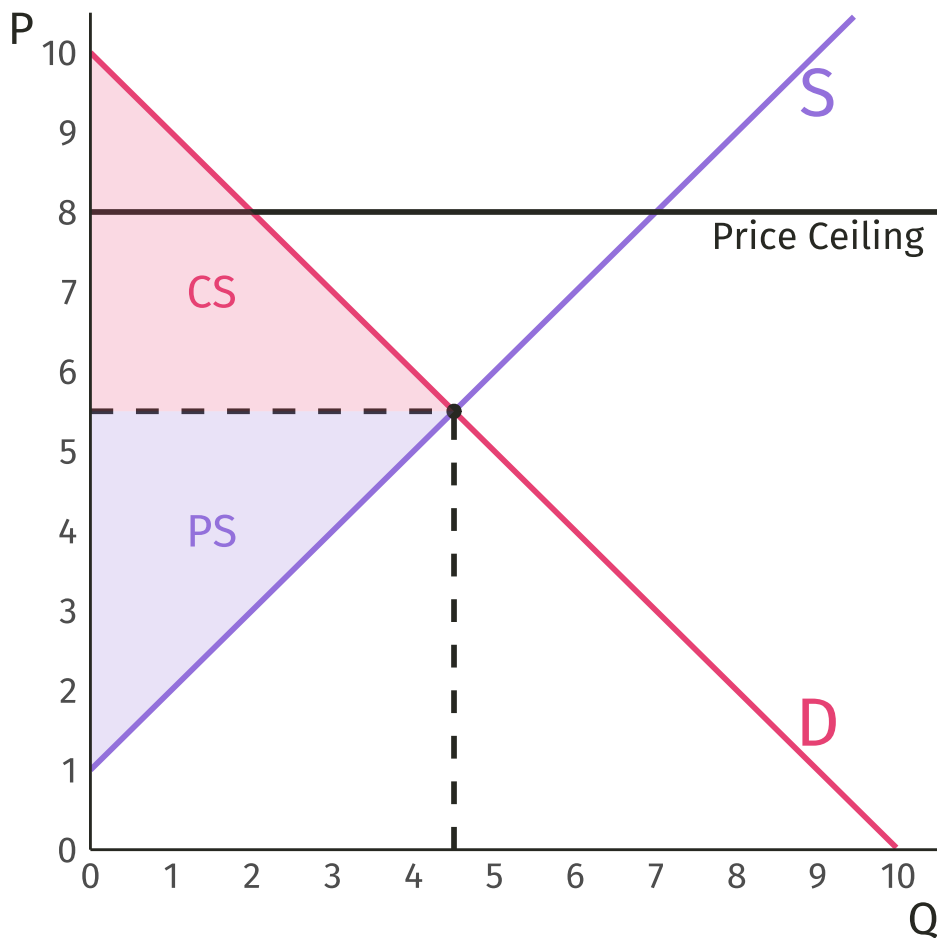


Q: How does a non-binding[†] price ceiling affect the market price and quantity?

Price ceiling	None	\$8.00
Q_D	4.5	4.5
Q_S	4.5	4.5
P_{Market}	\$5.50	\$5.50

[†]: For price ceilings, *non-binding* = set above the equilibrium price.

Price Ceiling

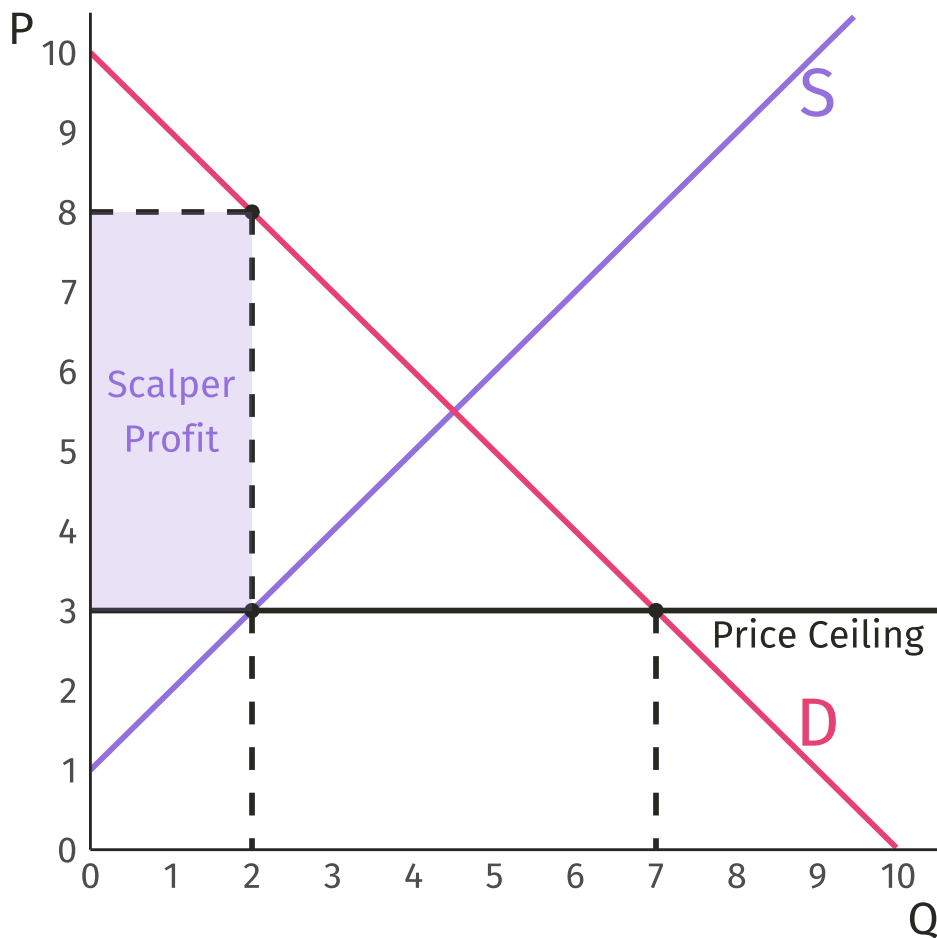


Q: How does a non-binding[†] price ceiling affect total surplus in an efficient market?

Price ceiling	None	\$8.00
CS	\$10.125	\$10.125
PS	\$10.125	\$10.125
TS	\$20.25	\$20.25
DWL	\$0.00	\$0.00

[†]: For price ceilings, *non-binding* = set above the equilibrium price.

Price Ceiling



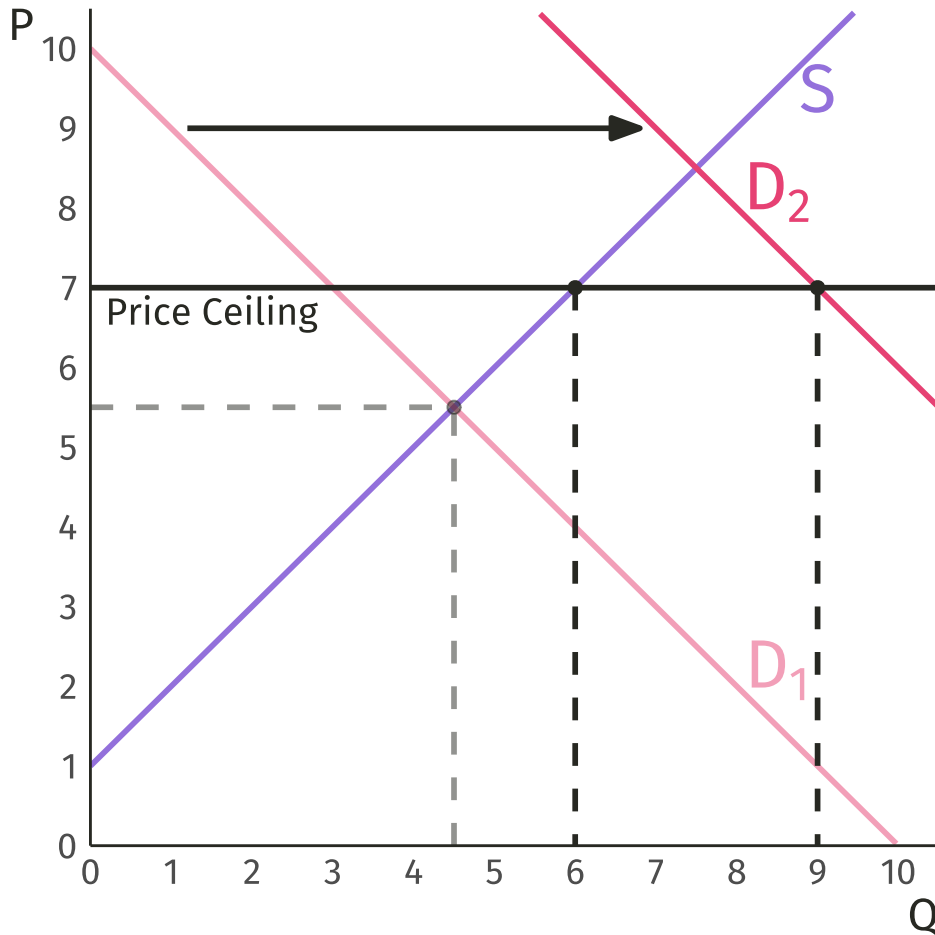
Q: How can buyers cope with the shortage?

A₁: Wait.

A₂: Buy goods on the black market for \$8 per unit

→ Only those with relatively high marginal values will pay the black market price.

Price-Gouging Laws



Objective: Keep necessities and survival goods affordable during times of crisis.

Policy: 35 US states have price ceilings that bind only in times of crisis.

Consequence: Shortage of survival goods during disasters.

Housing

Podcast Question: According to Jenny Schuetz, which of the following is the main cause of the housing affordability crisis?

A. Policy failure.

B. Market failure.

A Tale of Two Prosperous Cities

San Francisco

- Median home price (metro): \$860,000.

Houston

- Median home price (metro): \$178,000.

Q: What explains the difference?

- Climate? Geography? Amenities? Architecture?

A: Many factors contribute, but a growing body of evidence suggests that differences in policy explain a significant part of the difference.

- The Bay Area has some of the strictest zoning regulations in the country; Houston literally has none.

Zoning

Zoning policies restrict the type and intensity of development in certain areas.

Examples

- Minimum and maximum lot sizes.
- Height restrictions.
- Historical preservation
- Urban growth boundaries.
- Industrial zones away from residential areas.

Zoning

Q: Why do cities adopt zoning policies?

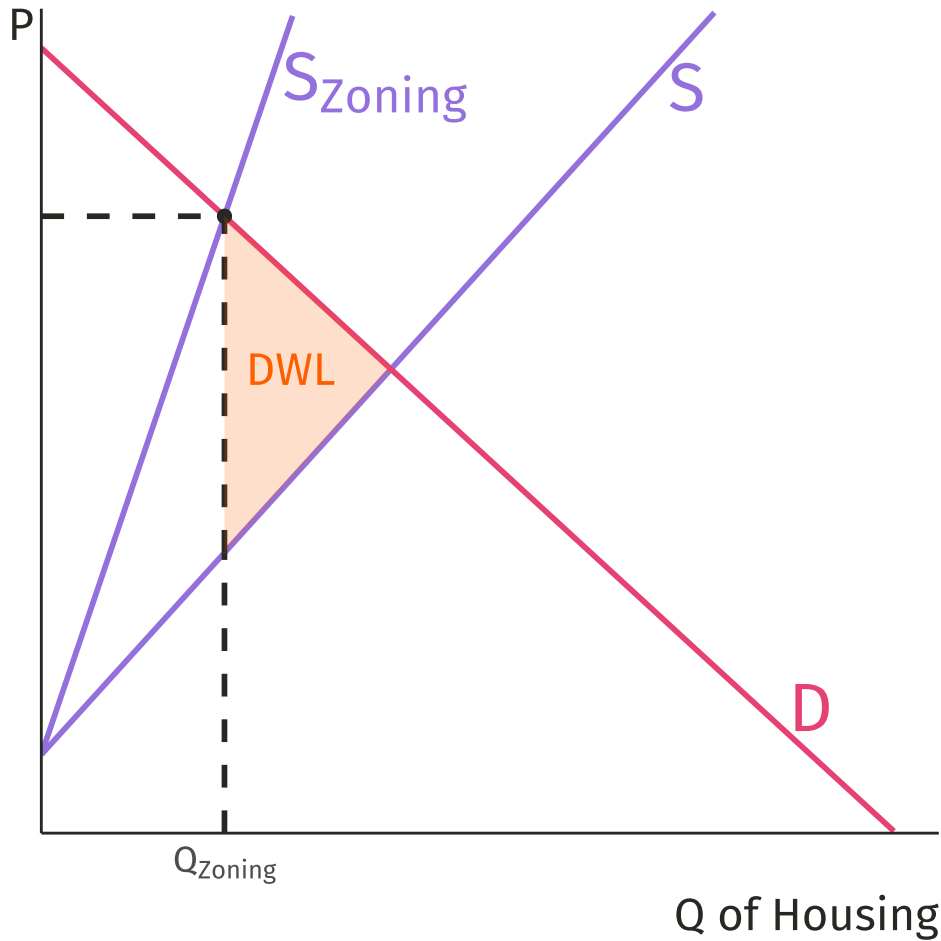
A₁: Reduce or prevent disamenities.

- Some types of development impose external costs on neighbors.
- Suburban sprawl can worsen air quality and increase the cost of providing public services.

A₂: Appease neighborhood activists.

- Many homeowners desire to "preserve the character" of their neighborhoods.
- Development restrictions can increase home prices → wealth transfer to homeowners.

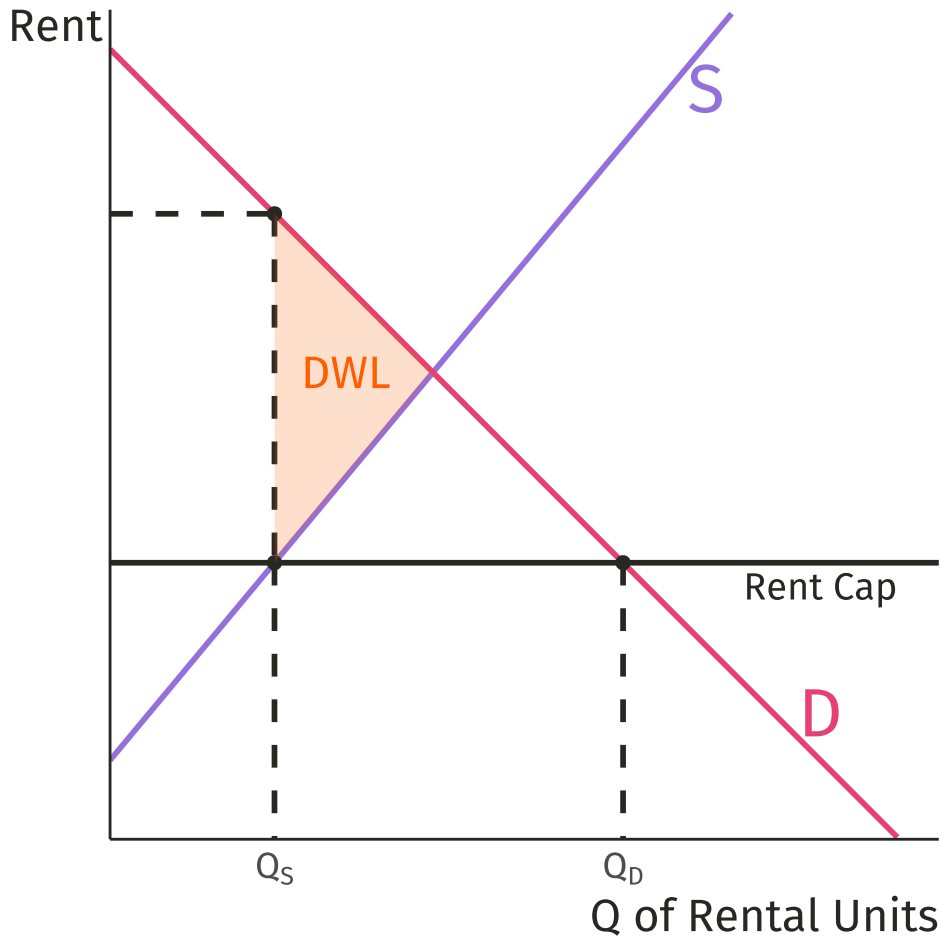
Zoning



Consequences

1. Higher prices and less housing.
2. In the absence of externalities, deadweight loss.

Rent Control



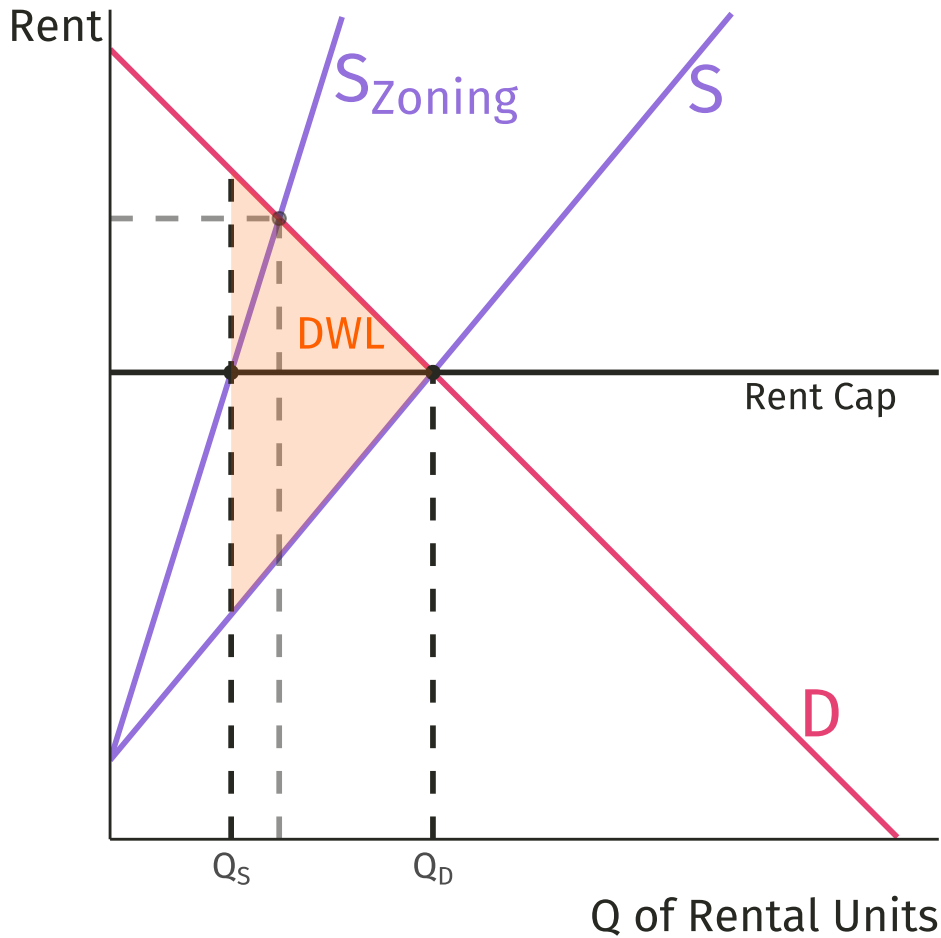
Objective: Make rent more affordable.

Policy: Price ceiling for rental units.

Consequences

1. Rental shortage.
2. Deadweight loss.

Rent Control



Q: Can rent control remedy zoning inefficiencies?

A: No. Deadweight loss increases!

Rent Control

Consequences

1. Fewer available rental units.

- Less new construction
- Landlords convert some existing units to condos.
- Current tenants move less frequently.

2. Illegal subletting.

- Units rationed based on willingness to pay, not need.
- Black market prices exceed both regulated and free market prices.

3. Other unintended consequences.

- *e.g.*, quality downgrading.

Rent Control

Consensus

Assar Lindbeck, Swedish economist and ardent socialist:

In many cases rent control appears to be the most efficient technique presently known to destroy a city—except for bombing.

Why such consensus?

- Binding rent control policies intend to help impoverished tenants, but do the opposite! → inefficient and poorly targeted.

Impossible to change just one price



Impossible to change just one behavior!

Q: In 2019, the Oregon Legislature passed statewide rent control that limited rent increases to 7% per year. How will this policy affect the availability of rental housing in Portland?

- A.** It will reduce the number of available rental units.
- B.** It will have no effect on the number of available rental units.
- C.** If the unregulated price increases by less than 7%, it will reduce the number of available rental units.
- D.** If the unregulated price increases by more than 7%, it will have no effect on the number of available rental units.
- E.** None of the above.

Q: All else being equal, how would a binding rent control policy affect the market for rental housing in the long run?[†]

- A.** The rental housing shortage would decrease.
- B.** The rental housing shortage would increase.
- C.** The rental housing shortage would not change.

[†]: *Long run* = period of time that allows consumers and producers to fully adjust their behavior.

Podcast Question: Which of the following best describes the likely outcome of a subsidy for renters in relatively affluent metro areas?

- A.** Renters would absorb most of the subsidy and the rent they pay would increase.
- B.** Renters would absorb most of the subsidy and the rent they pay would decrease.
- C.** Landlords would absorb most of the subsidy and the rent they receive would increase.
- D.** Landlords would absorb most of the subsidy and the rent they receive would decrease.

Minimum Wage

Minimum Wage

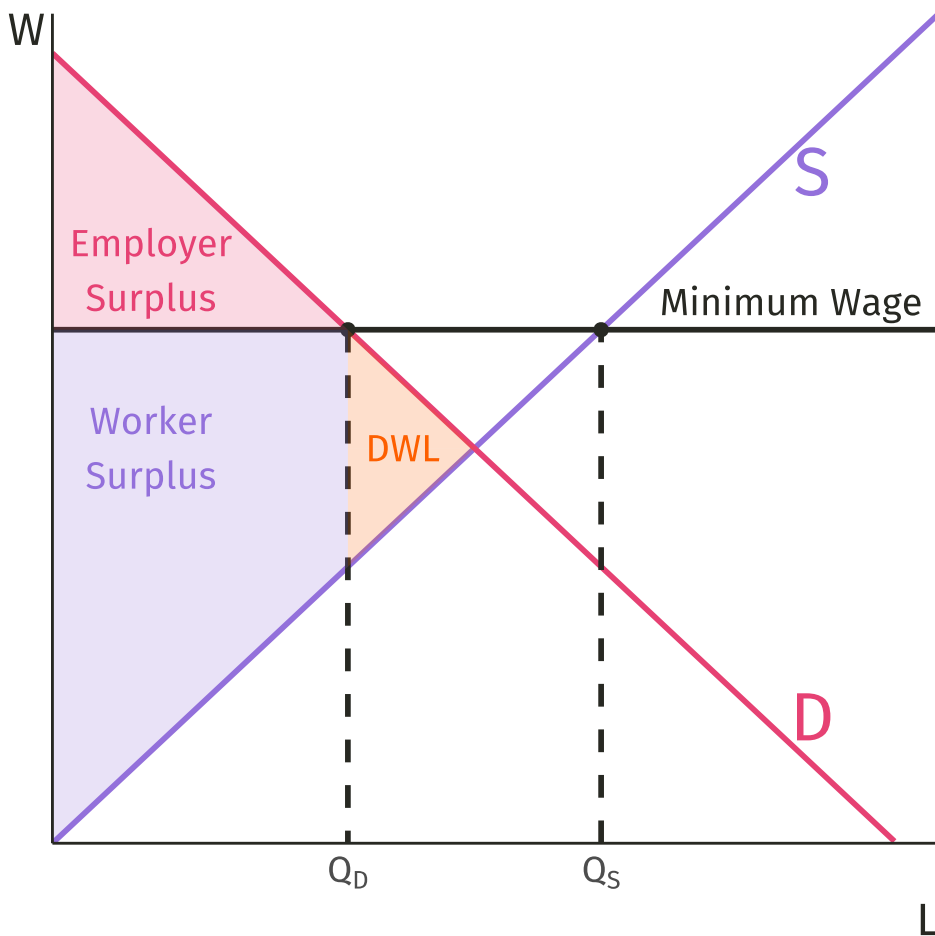
Objective: Increase the living standards of the working poor.

Policy: Price floor for wage labor.

Examples

- Federal minimum wage: \$7.25 per hour.
- As of 2018, Oregon has a tiered minimum wage:
 - Portland metro counties: \$12.50 per hour.
 - Other urban counties: \$11.25 per hour.
 - Rural counties: \$11.00 per hour.
- Seattle minimum wage: up to \$16.39 per hour.

Minimum Wage



Predictions

1. Unemployment.
2. Workers who keep job better off.
3. Workers who lose job worse off.

Minimum Wage

Evidence

Q: Do binding minimum wages lead to job losses?

A: No consensus, but employment effects appear small.

- Most studies: no effect or small negative effect on employment.
- **Seattle:** Small reduction in hours, but not jobs.

Minimum Wage

Evidence

Q: How do businesses respond to increases in binding minimum wages?

A: In addition to reducing hours, they often increase prices.

- **Seattle:** Self-reported price increases by business owners, observed increase in price of child care, but no observed change in prices or quality of supermarket food.

Minimum Wage

Evidence

Q: Do binding minimum wages improve the livelihoods of low-skilled workers?

A: No consensus, but recent evidence suggests...yes?

- **Seattle:** Increase in wage either outweighs or offsets reduction in hours
→ increase or no change in earnings.