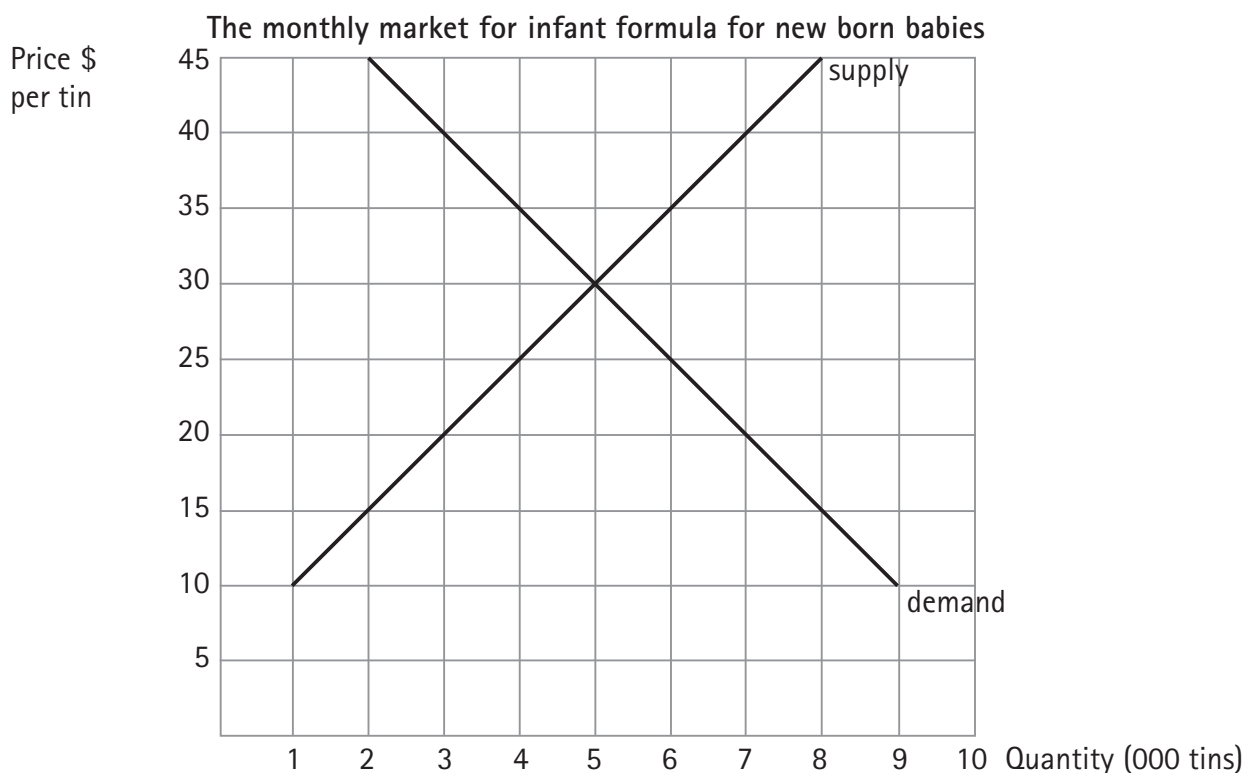


eLearneconomics: Price Controls – Maximum Price (1)

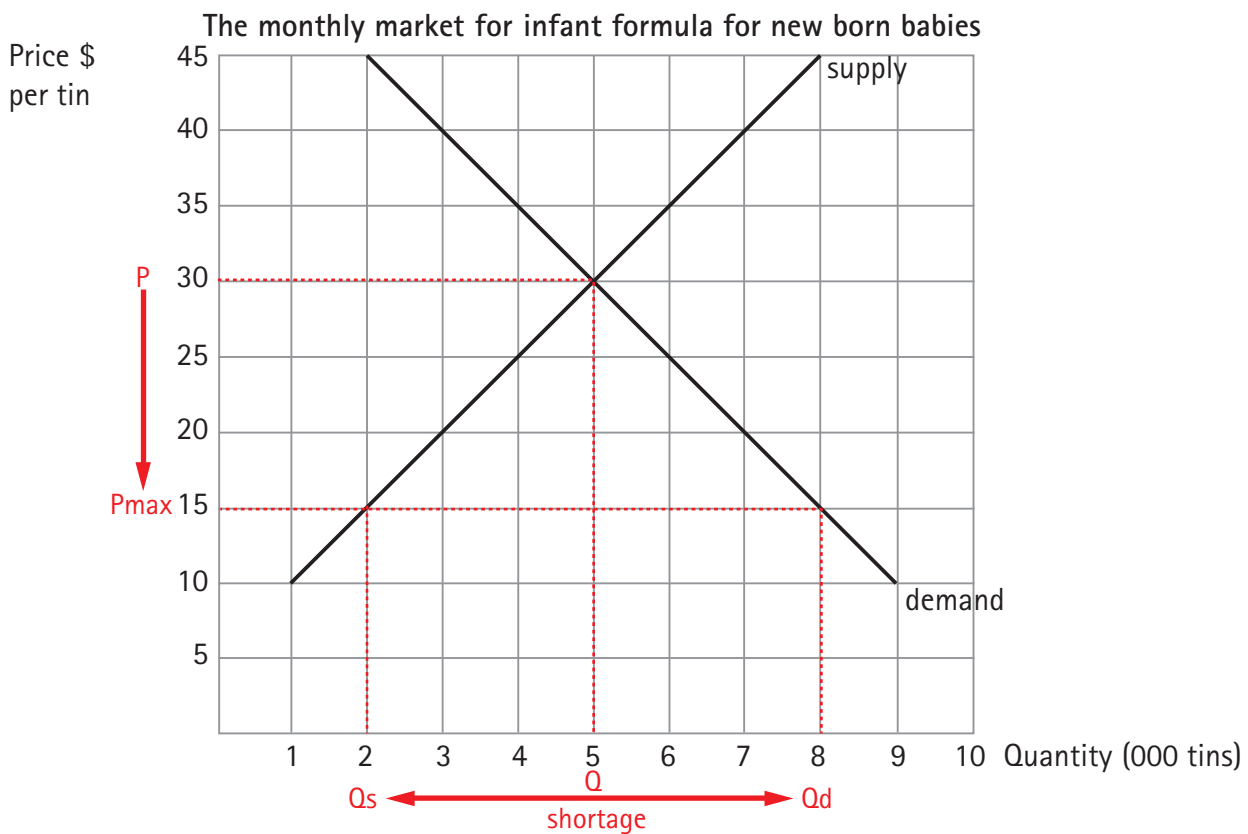
Student response



- a On the monthly market for infant formula for new born babies graph above, show the effect of a maximum price control that reduces the price by 50%. You must label the maximum price (P_{max}), the quantity demanded (QD) and quantity supplied (QS).
- b Referring to the graph in a, fully explain the consequences of a maximum price control on this market. Include the following in your explanation:
- quantity demanded before and after the maximum price control
 - quantity supplied before and after the maximum price control
 - a problem the maximum price control might create
 - a possible solution for the above problem.

eLearneconomics: Price Controls – Maximum Price (1a)

Solutions



Quantity demanded increases from 5 000 tins to 8 000 tins (Q to Q_d).

Quantity supplied decreases from 5 000 tins to 2 000 tins (Q to Q_s).

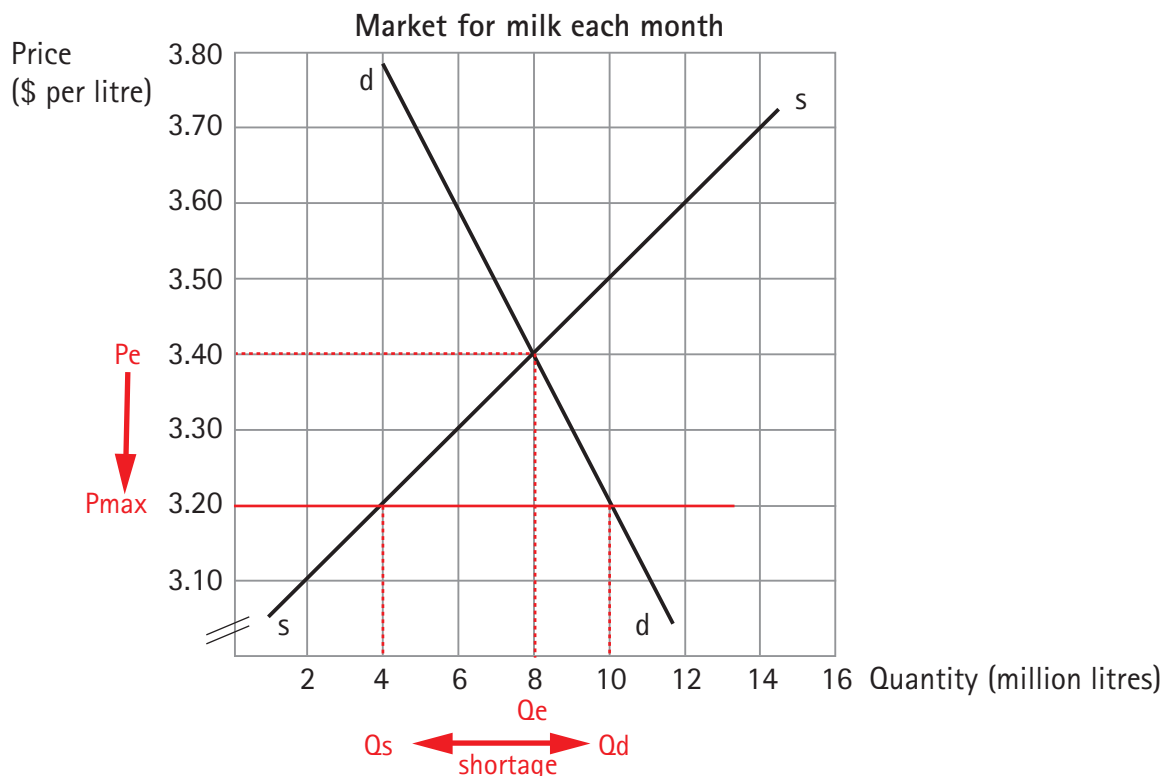
There will be a shortage of 6 000 tins of milk formula for babies, which is a problem. Some consumers will be willing to pay more than the \$15.00 per tin which is illegal and creates a black market.

Solutions to the shortage problem could include rationing, first-in-first-served or providing producers with a subsidy in order to increase supply.

Student response

eLearneconomics: Price Controls – Maximum Price (2a)

Solutions



b Referring to the graph, identify:

- the price that consumers pay before and after: before: \$3.40 per litre (Pe) after: \$3.20 per litre (Pmax)
- the price that producers receive before and after: before: \$3.40 per litre (Pe) after: \$3.20 per litre (Pmax)
- the value of sales before and after: before: \$3.40 x 8 million equals \$27.2m after: \$3.20 x 4 million equals \$12.8m

A maximum price (Pmax) is a price control set by government, prohibiting the charging of a price higher than a certain level, in this case \$3.20 per litre on milk. As the price of milk falls the quantity demanded increases from 8 million litres (Qe) to 10 million litres (Qe').

The change in consumer spending on milk falls from \$27.2m to \$12.8m.

Several flow-on effects include that consumers desire 10 million litres but can only purchase (legally) 4 million litres, that is, there is a shortage of 6 million litres of milk monthly, which is a problem. A black market may arise because some consumers who can afford to pay higher prices might offer to pay more than the legally set price. Some consumers may miss out, others may switch to a substitute good (e.g., milk powder).

Explains maximum price in depth. Values (figures) stated. Uses appropriate economic terms. Explains flow-on effects.