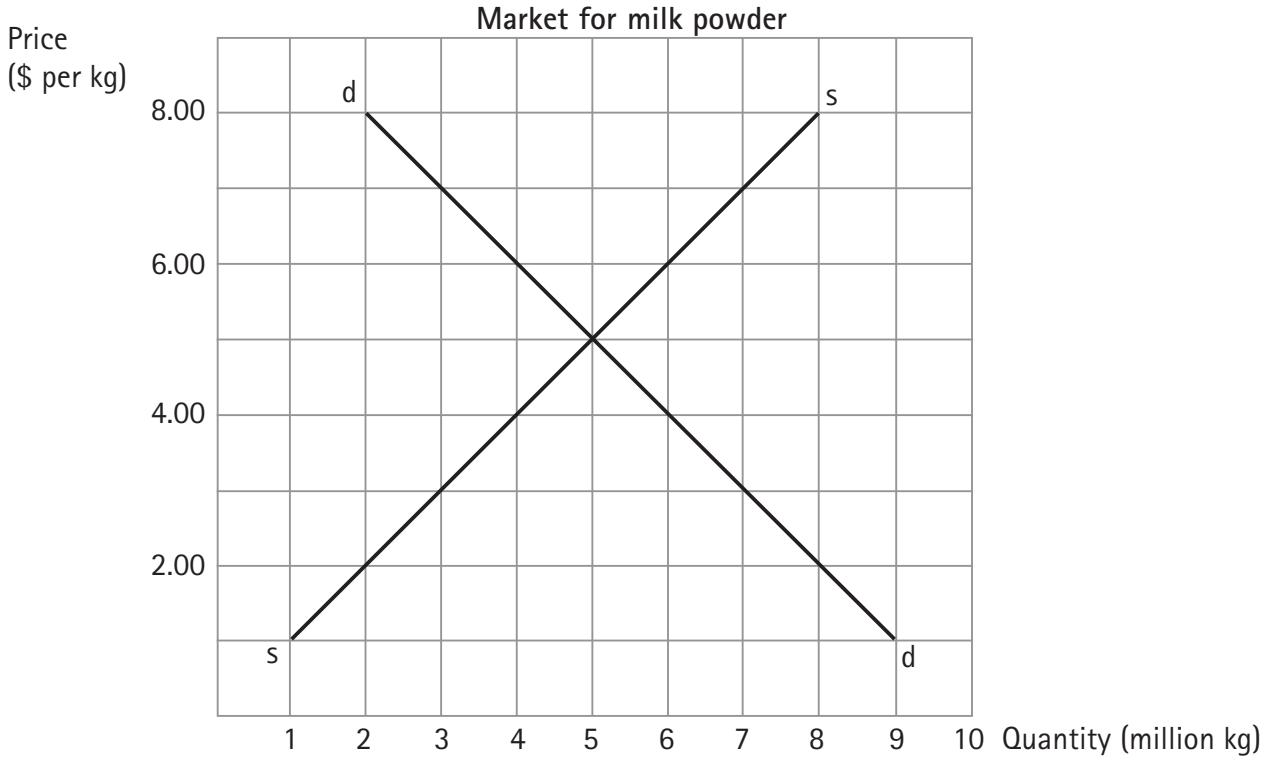
eLearneconomics: Price controls (1)

Student response

Use the diagram below to answer the questions that follow.

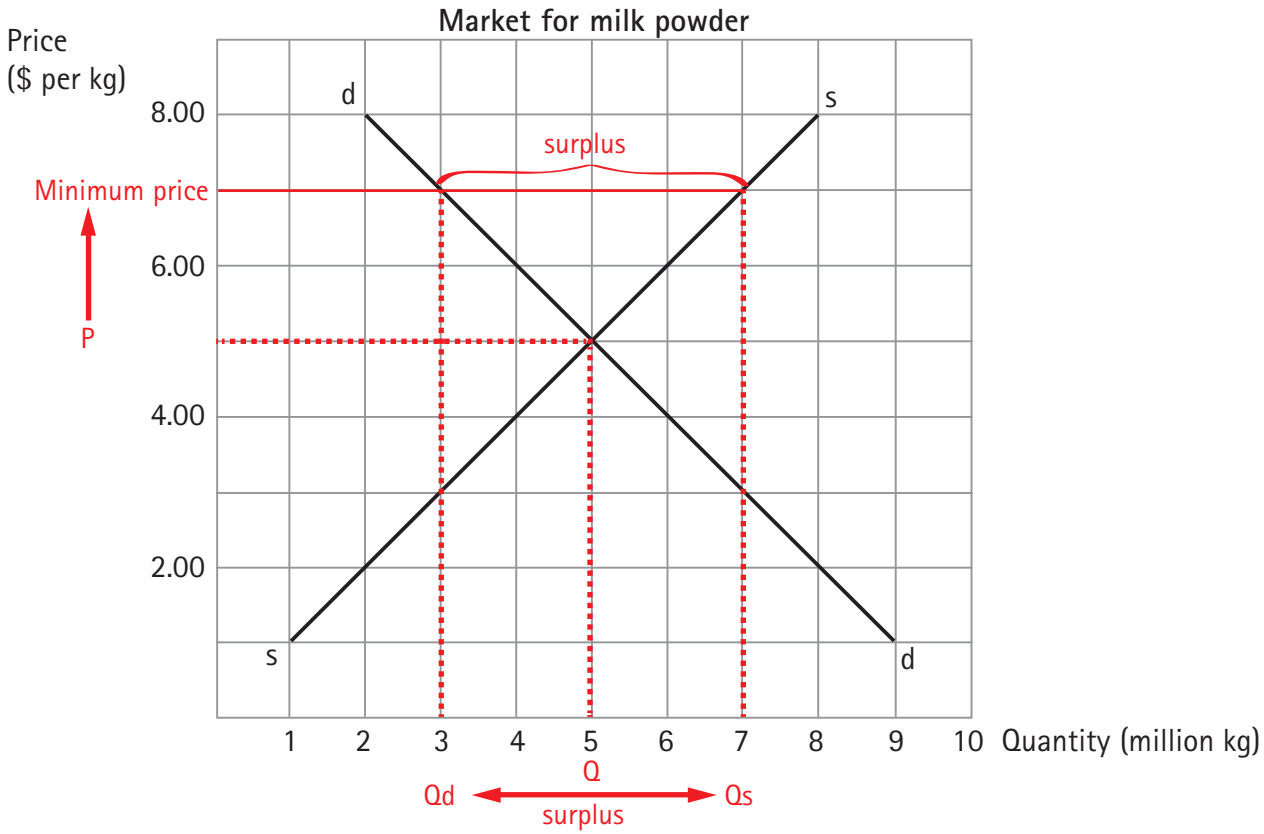


The government wants to protect producers from volatile prices in the world market for milk powder. One option is to impose a price control of $7.50 per kg.

- What is the correct economic term for this option?
- Show the effect on the graph of the government imposing a price control of $7.50 per kg.
- What difficulty does the government face with getting a price control of $7.50 per kg?
- Why might a government impose a minimum price?

eLearneconomics: Price controls (1a)

Solutions



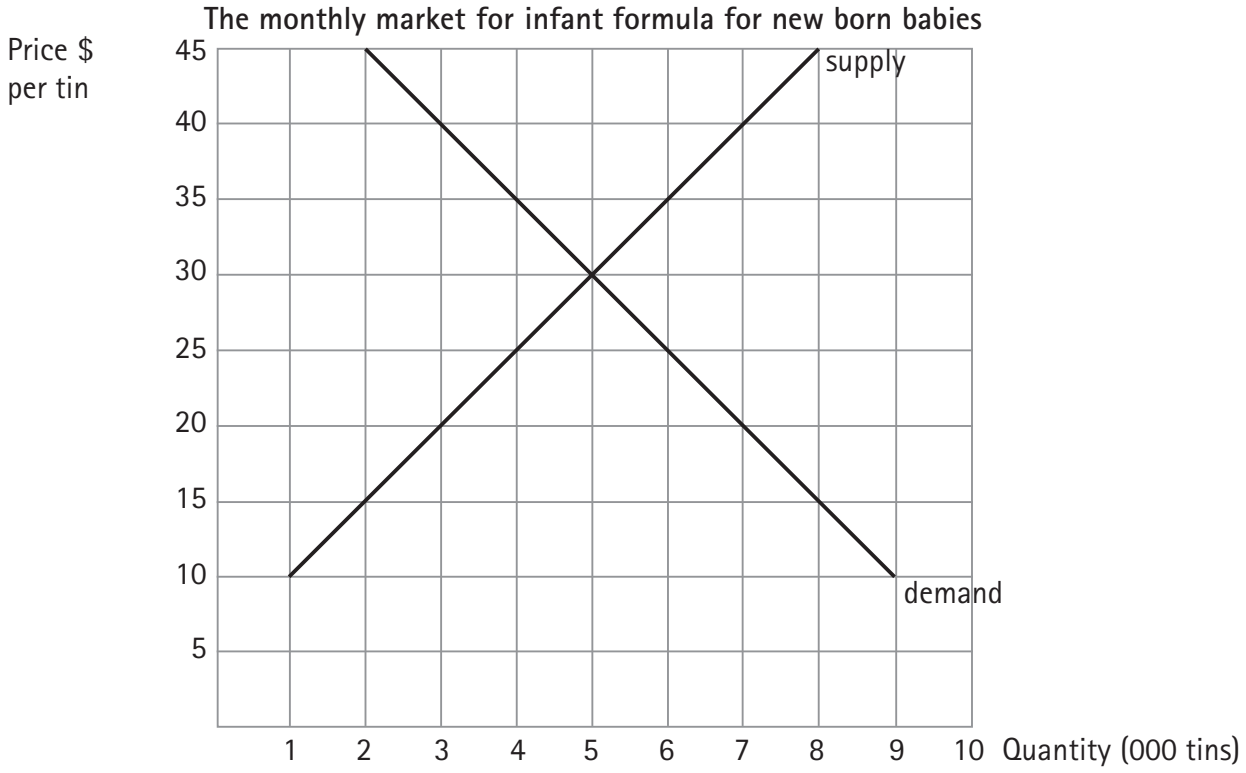
Minimum (floor) price.

The government has to decide what to do with the resulting surplus, usually stockpile it and sell it at a later date.

The government may impose a minimum price to protect producers from receiving unreasonably low prices for their output.

eLearneconomics: Price controls (2)

Student response



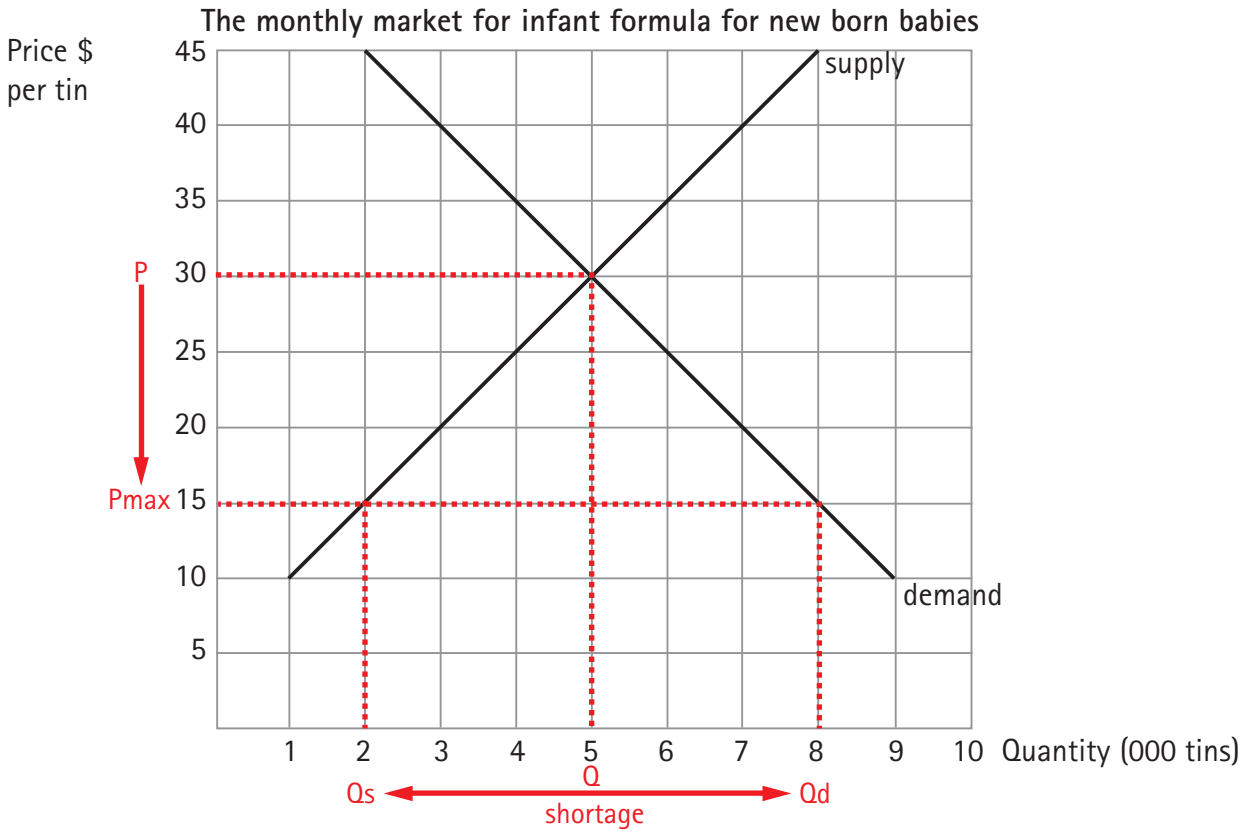
a On the monthly market for infant formula for new born babies graph above, show the effect of a maximum price control that reduces the price by 50%. You must label the maximum price (Pmax), the quantity demanded (QD) and quantity supplied (QS).

b Referring to the graph, 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 (2a)

Solutions



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

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

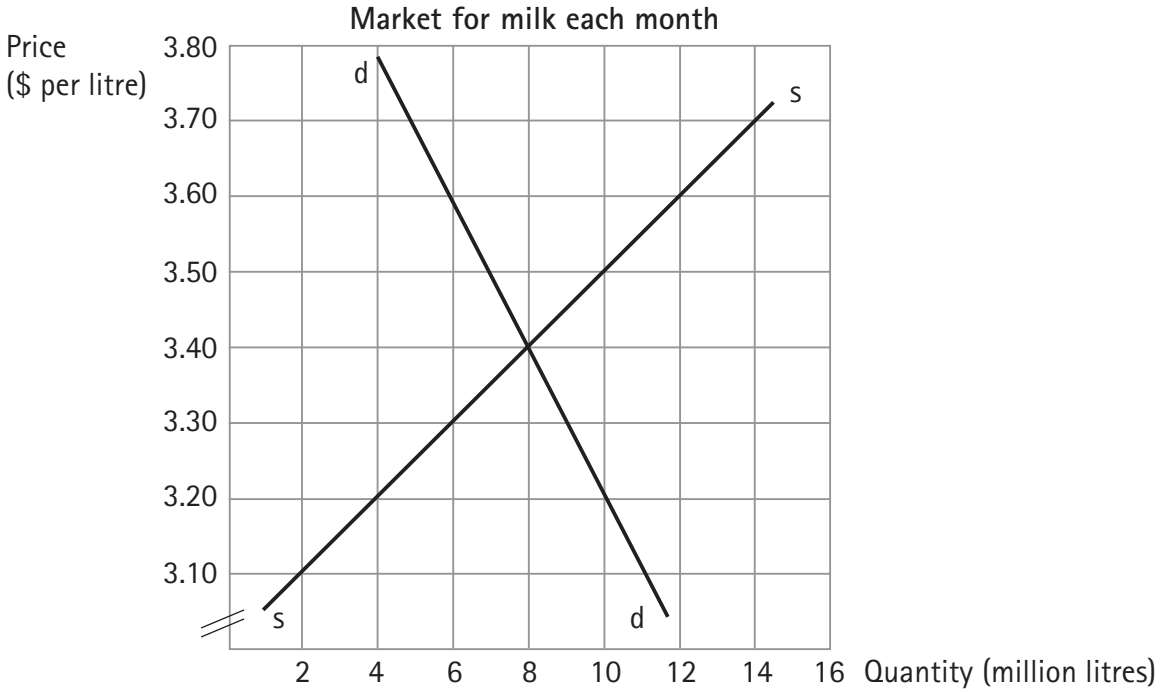
There will be a shortage of 6 000 tins of milk formula for babies, which is a problem. Some consumers will be willing to pay more than the $15.00 per tin which is illegal and creates a black market.

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

eLearneconomics: Price controls (3)

Student response

a Show the effects of a maximum price of $3.20 per litre on the graph below (labelled as Pmax) on the market for milk each month.



b Referring to the graph, identify:

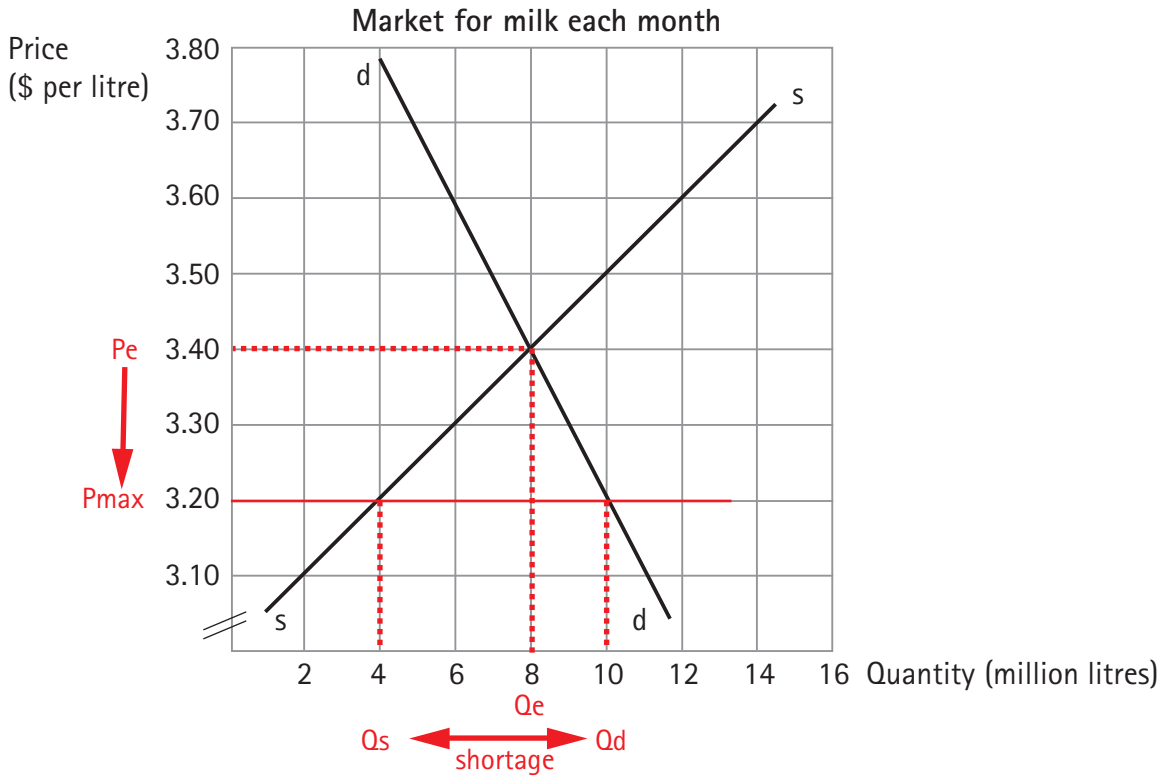
- the price that consumers pay before and after: before: _____ after: _____
- the price that producers receive before and after: before: _____ after: _____
- the value of sales before and after: before: _____ after: _____

c Fully explain the effects of introducing a maximum price on milk consumers. In your answer you should:

- explain the change in price, the change in the quantity demanded and in consumer spending on milk
- explain two flow-on effects on society in general
- refer to the data above.

eLearneconomics: Price controls (3a)

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.

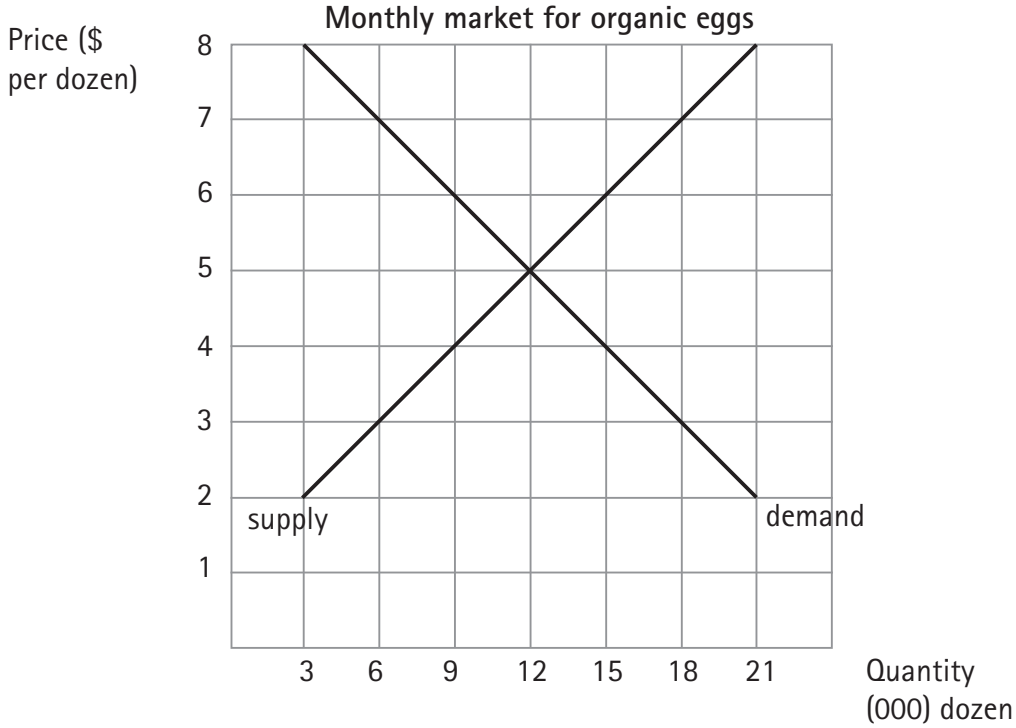
Several flow-on effects include that consumers desire 10 million litres but can only purchase (legally) 4 million litres, that is, there is a shortage of 6 million litres of milk monthly, which is a problem. A black market may arise because some consumers who can afford to pay higher prices might offer 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.

eLearneconomics: Price controls (4)

Student response

a On the graph of the Monthly market for organic eggs below, show the effect of a minimum price of $7 per dozen (labelled as Pmin).



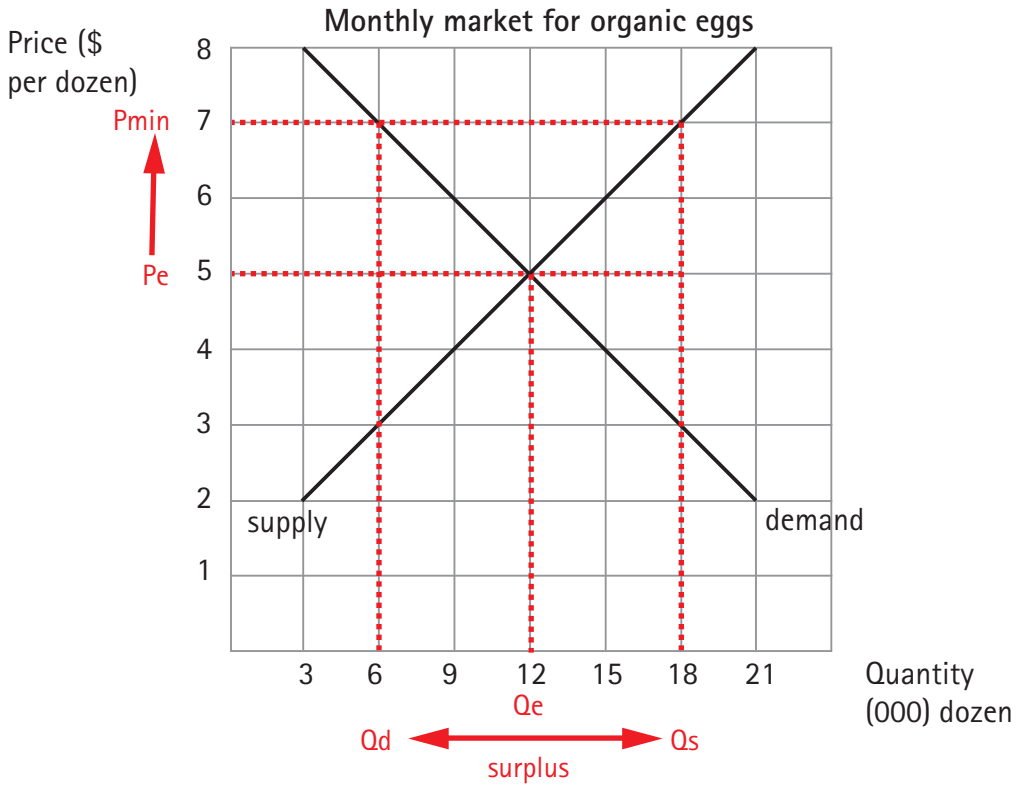
b Fully explain the effects of introducing a minimum price for organic eggs on egg producers.

In your answer you should:

- explain the change in price, the change in quantity demanded and quantity supplied
- explain the effect on organic egg producers. Refer to the data.

eLearneconomics: Price controls (4a)

Solutions



A minimum price control is a price control set by government when the market price is not allowed to fall below a minimum (floor) level, in this case $7 per dozen for organic eggs.

The quantity demanded by consumers falls from Qe (12 000 dozen) to Qd (6 000 dozen). The quantity supplied of organic eggs increases from Qe (12 000 dozen) to Qs (18 000 dozen).

Organic egg producers' revenue increases from $60 000 to $126 000. Organic egg producers will switch resources into organic egg production because it is relatively more profitable. Egg producers now receive Pmin ($7 per dozen) instead of Pe ($5 per dozen).

Explains minimum price in depth. Shows the change on the graph and uses appropriate economic terms.