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Price Controls:
Price Ceilings

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.

What Are Price Controls?

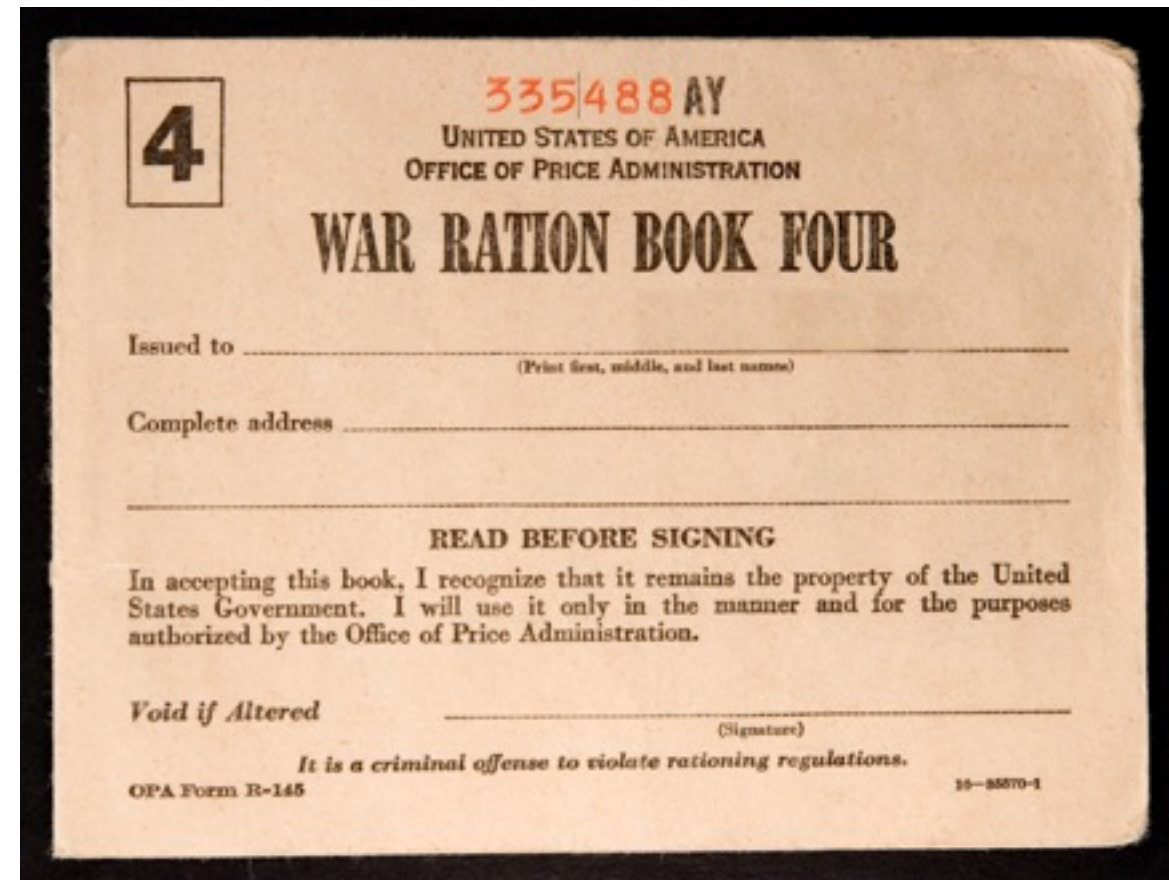
- Price controls
 - Attempt to set, or manipulate, prices through government involvement in the market
 - Meant to ease perceived burdens on the population
- Price ceiling
 - Legally established maximum price for a good or service
- Price floor
 - Legally established minimum price for a good or service

Price Controls, Historically

- Price controls in ancient Egypt
 - Farmers revolted and economy collapsed
- Price ceiling on grain in ancient Greece
 - Supply of grain disappeared
- Throughout history, price controls
 - Disrupt the normal functions of the market
 - Prevent the market from clearing

More Recent Price Controls

- 1941: U.S. Office of Price Administration
 - Price controls after WWII resulted in black markets.
- Black markets
 - Illegal markets that arise when price controls are in place.
 - Best known example is Prohibition
- Other ways to circumvent price controls
 - Reducing size or quality of product



Thought Experiment

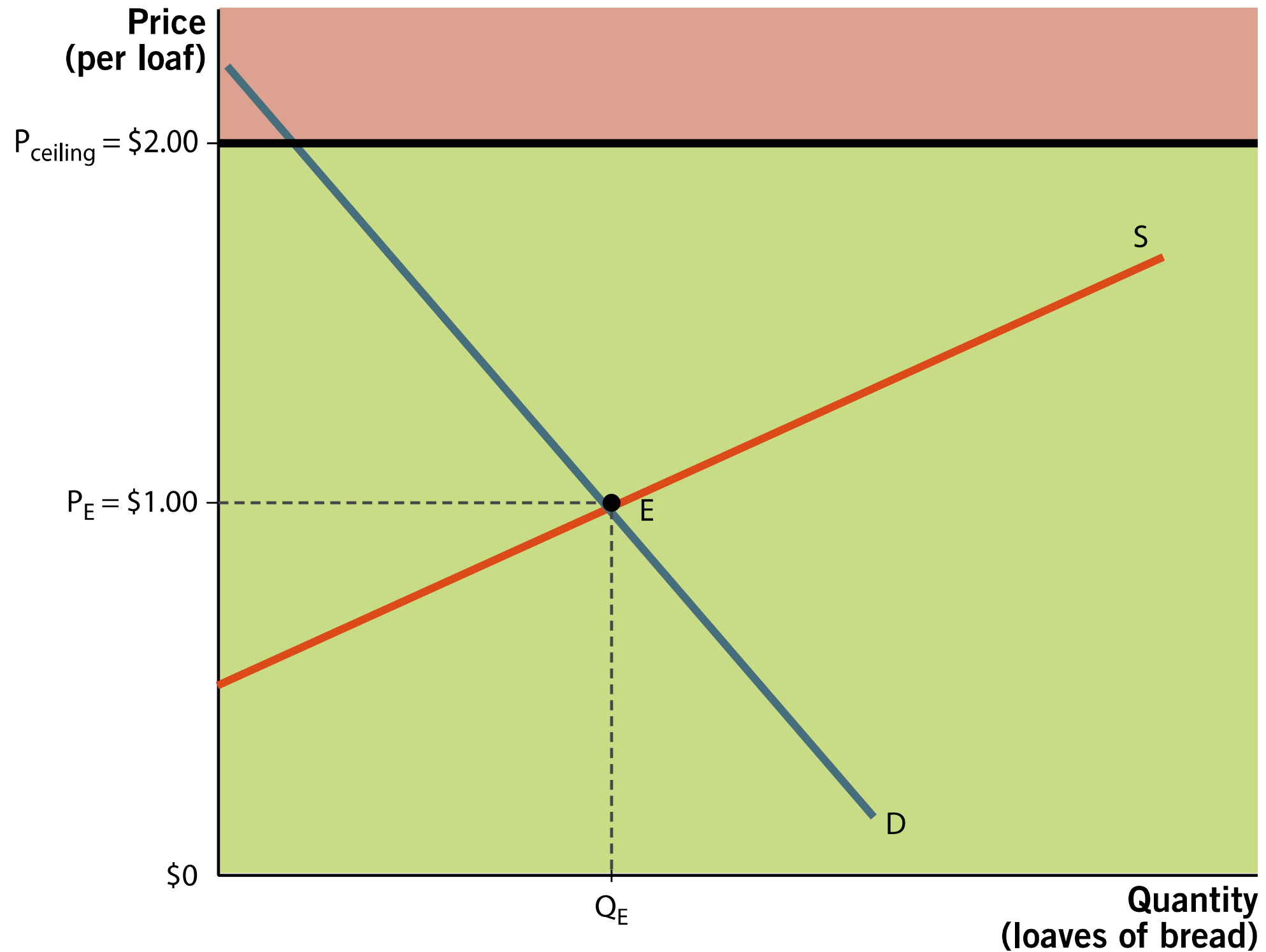
\$0.50 Price Ceiling on Bread

<u>Question</u>	<u>Explanation</u>	<u>In pictures</u>
Will there be more or less bread for sale?		
Will the size of a typical loaf change?		
Will the quality change?		
Will the opportunity cost of finding bread change?		
Would you buy illegal bread if you could?		

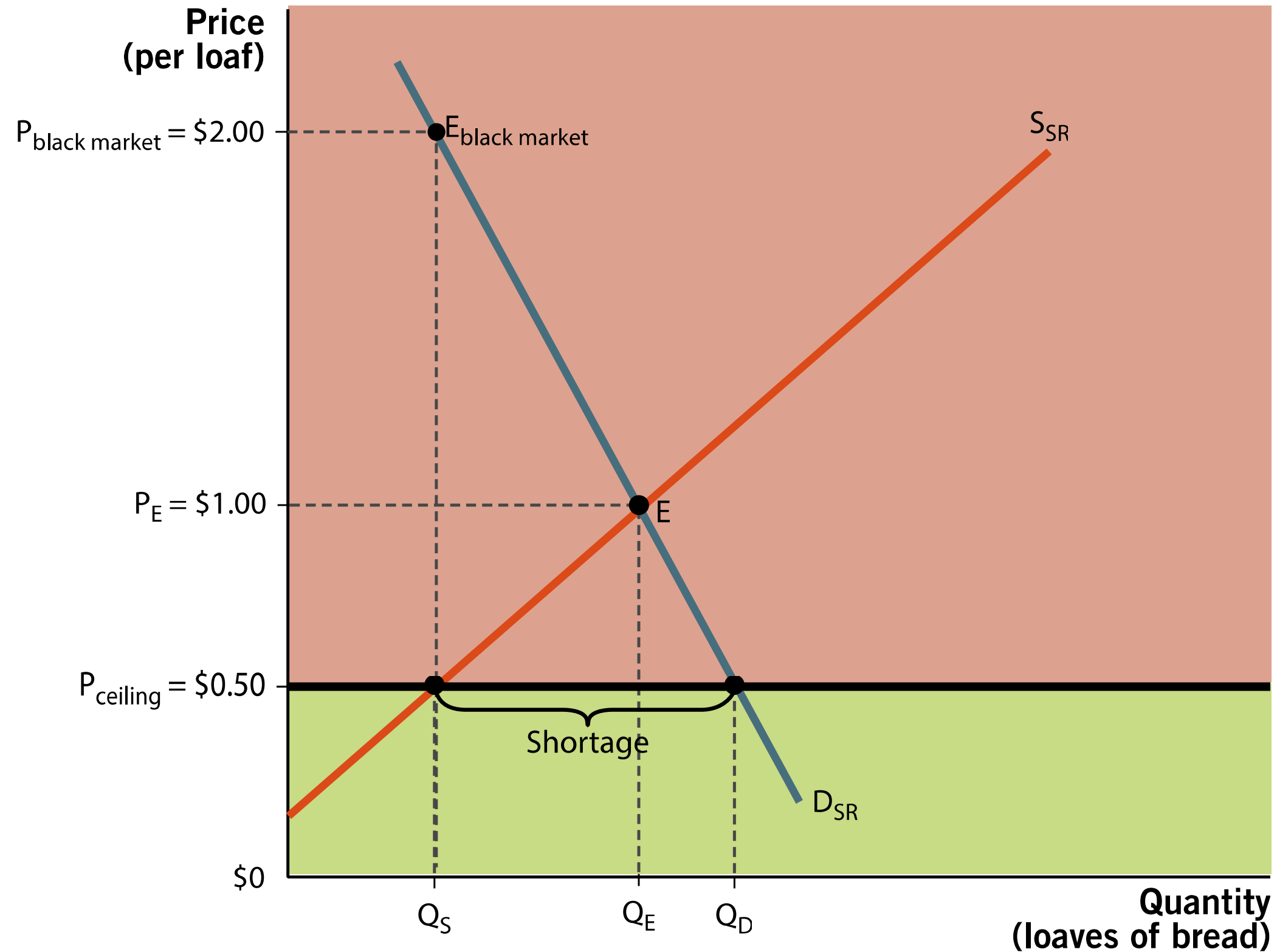
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Price Controls:
Graphing Price
Ceilings

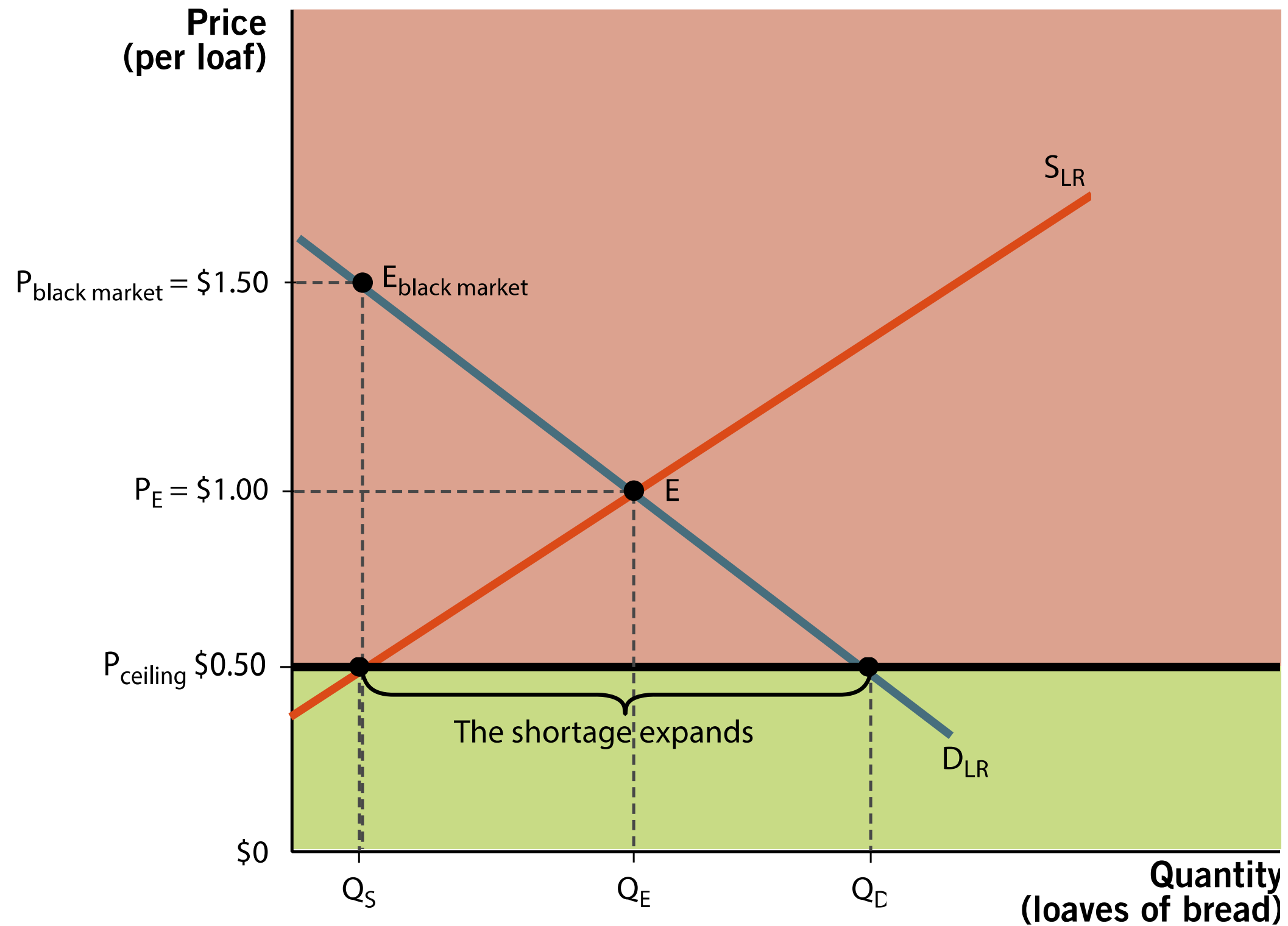
Non-binding Price Ceiling



Binding Price Ceiling



Price Ceilings in the Long Run



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Price Controls:

Price Ceiling

Example -

Rent Control

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
 - Landlords “nickel and diming” tenants with fees to increase revenues



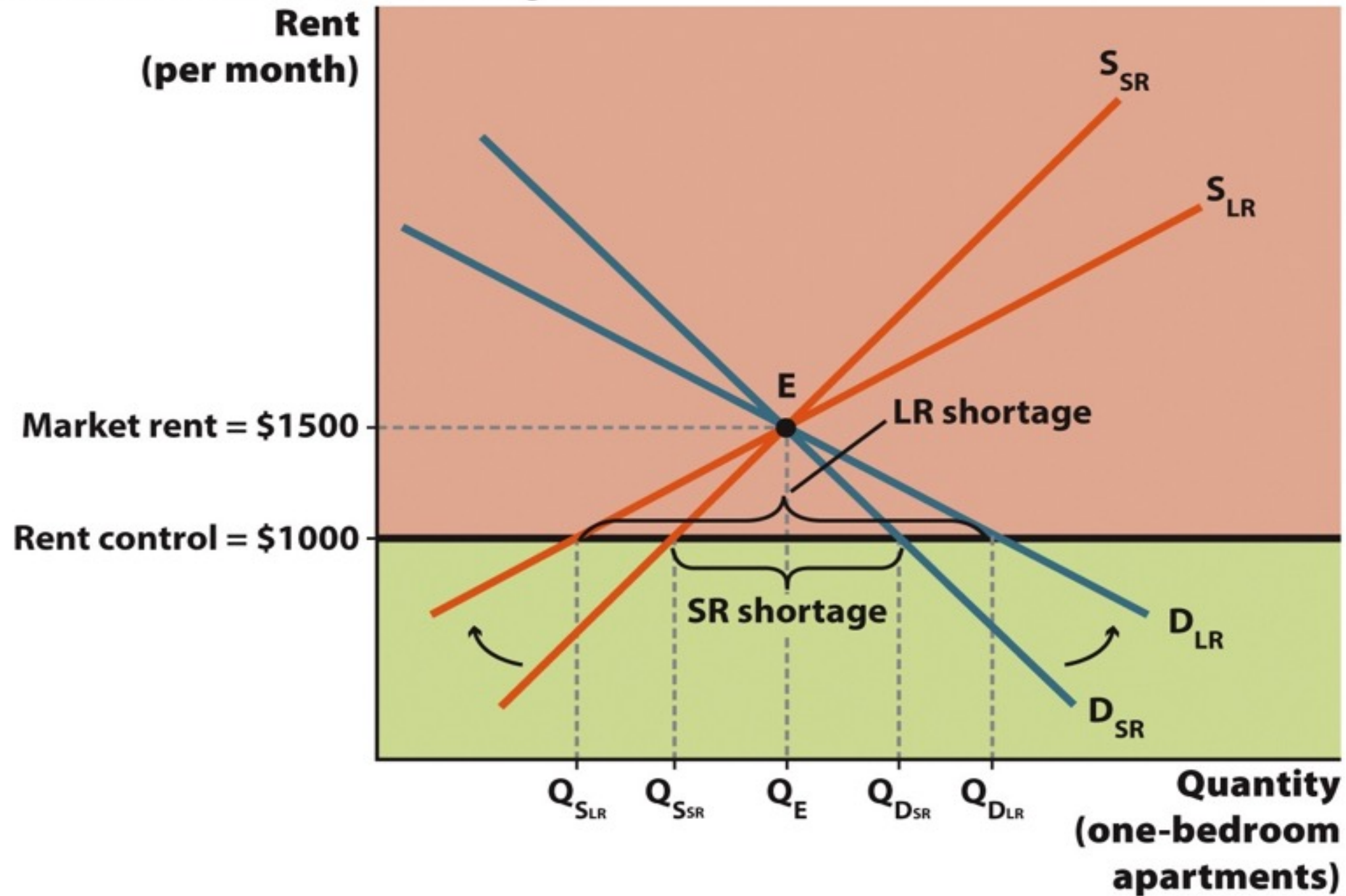
Rent Control

- Unintended consequences of rent control
 - “Housing gridlock”
 - Units are actually harder to find.
 - Policy often ends up hurting the very people it was supposed to help.



Rent Control in the Short Run and Long Run

Rent Control in the Short Run and Long Run



Rent Control and the Rich

- The rich and rent control
 - Massachusetts decided to end rent control in part because only 6% of people in rent-controlled units were poor.
 - Actresses Mia Farrow and Faye Dunaway lived in rent-controlled units for years.
 - Ask: Best allocation of resources?
- Long-term development issues
 - Cities without rent controls (Dallas, Phoenix) have vacancy rates above 15%.
 - Rent-controlled cities (New York) have vacancy rates around 5%.

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Price Controls:

Price Ceiling

Example -

Price Gouging

Price Gouging

- Price gouging laws
 - Laws that place a temporary ceiling on prices
 - Usually after a natural disaster or emergency

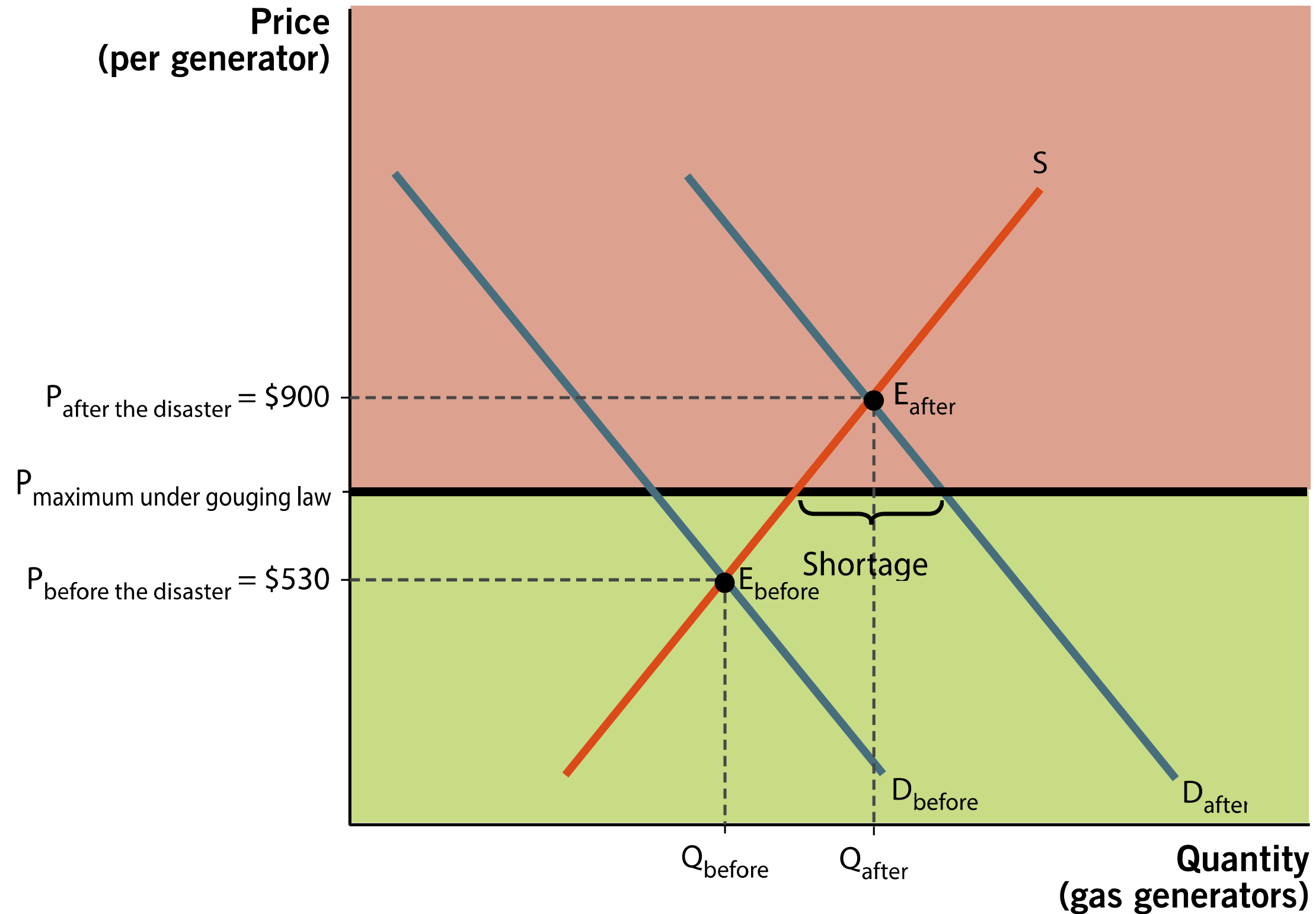


Price Gouging

- Consequences
 - Restricted prices can't ration efficiently.
 - Resources may not go where they are needed the most.
 - Goods that people need disappear due to severe shortages.



Price Gouging



Economics in *Stossel in the Classroom*

- Is price gouging bad?



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Price Controls: Price Floors and Graphing Them

Price Floors

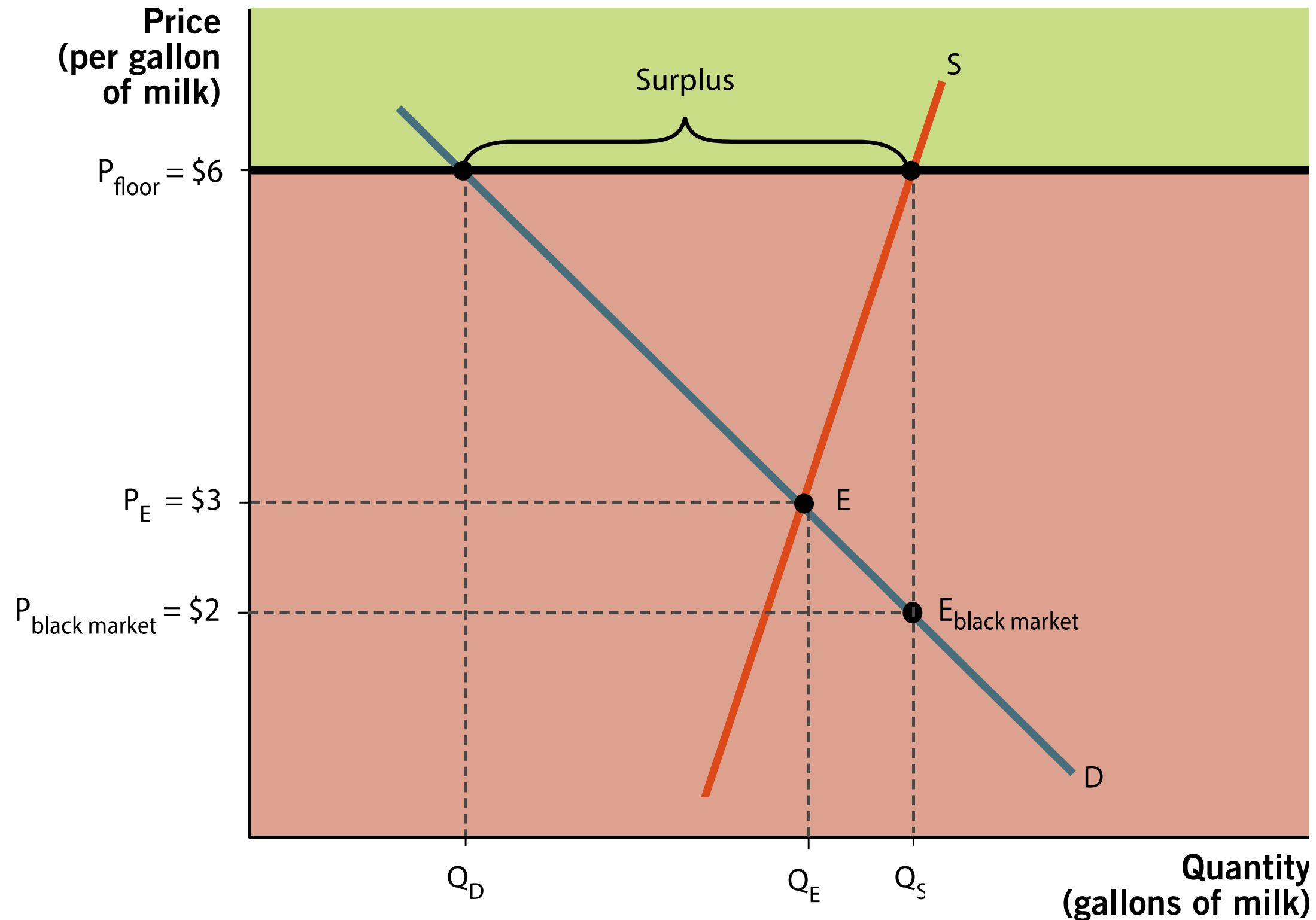
- Recall that a price floor is
 - A minimum legal price
- Who do you think lobbies for price floors?
 - Producers of the product

Thought Experiment

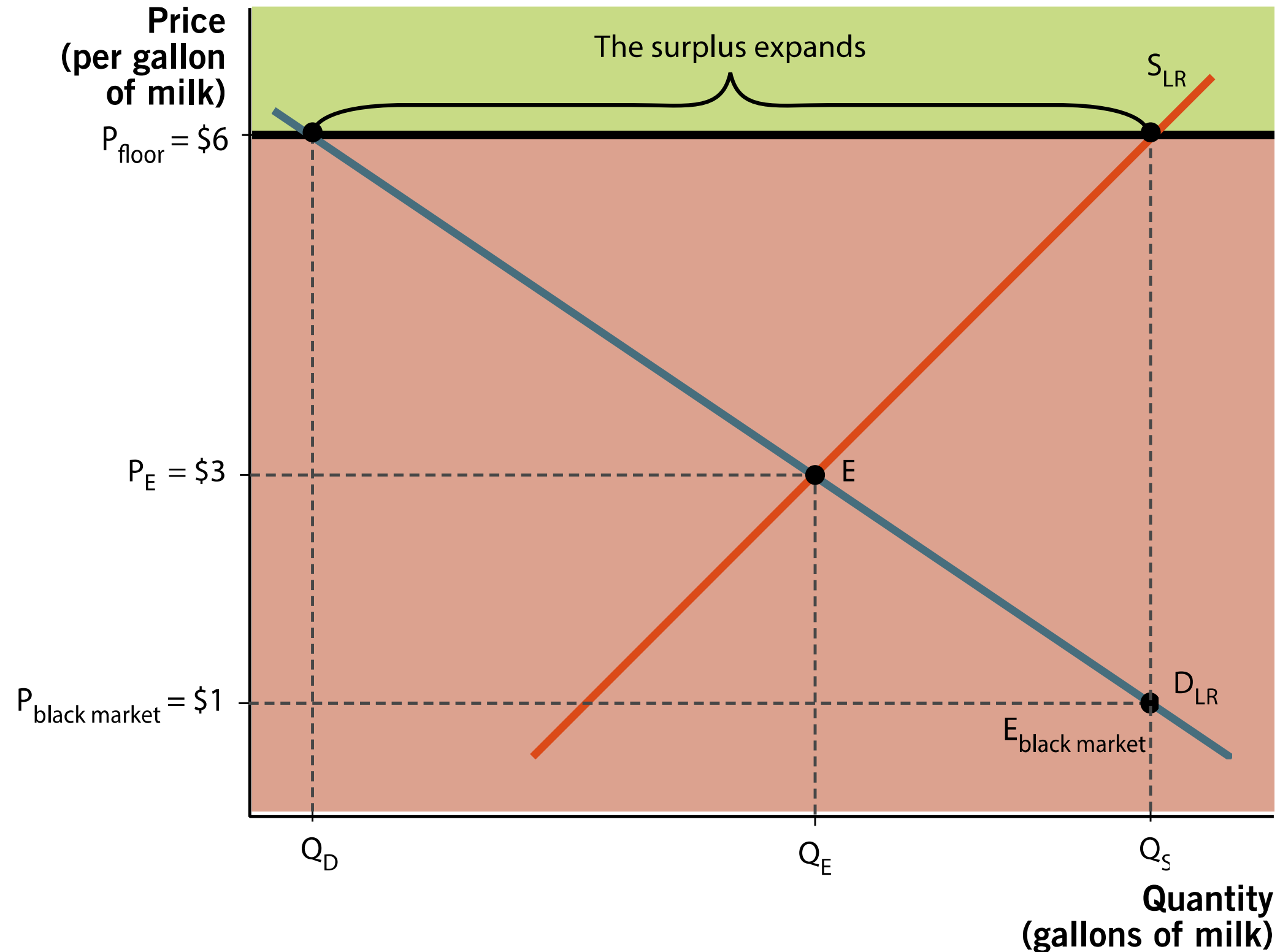
\$6 Price Floor on Milk

<u>Question</u>	<u>Explanation</u>	<u>In pictures</u>
Will the quantity of milk for sale change?		
Will the size of a typical container change?		
Would producers sell below the price floor?		
Are milk producers better off?		

Binding Price Floor



Binding Price Floor



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Price Controls:
Price Floor
Example -
Minimum Wage

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



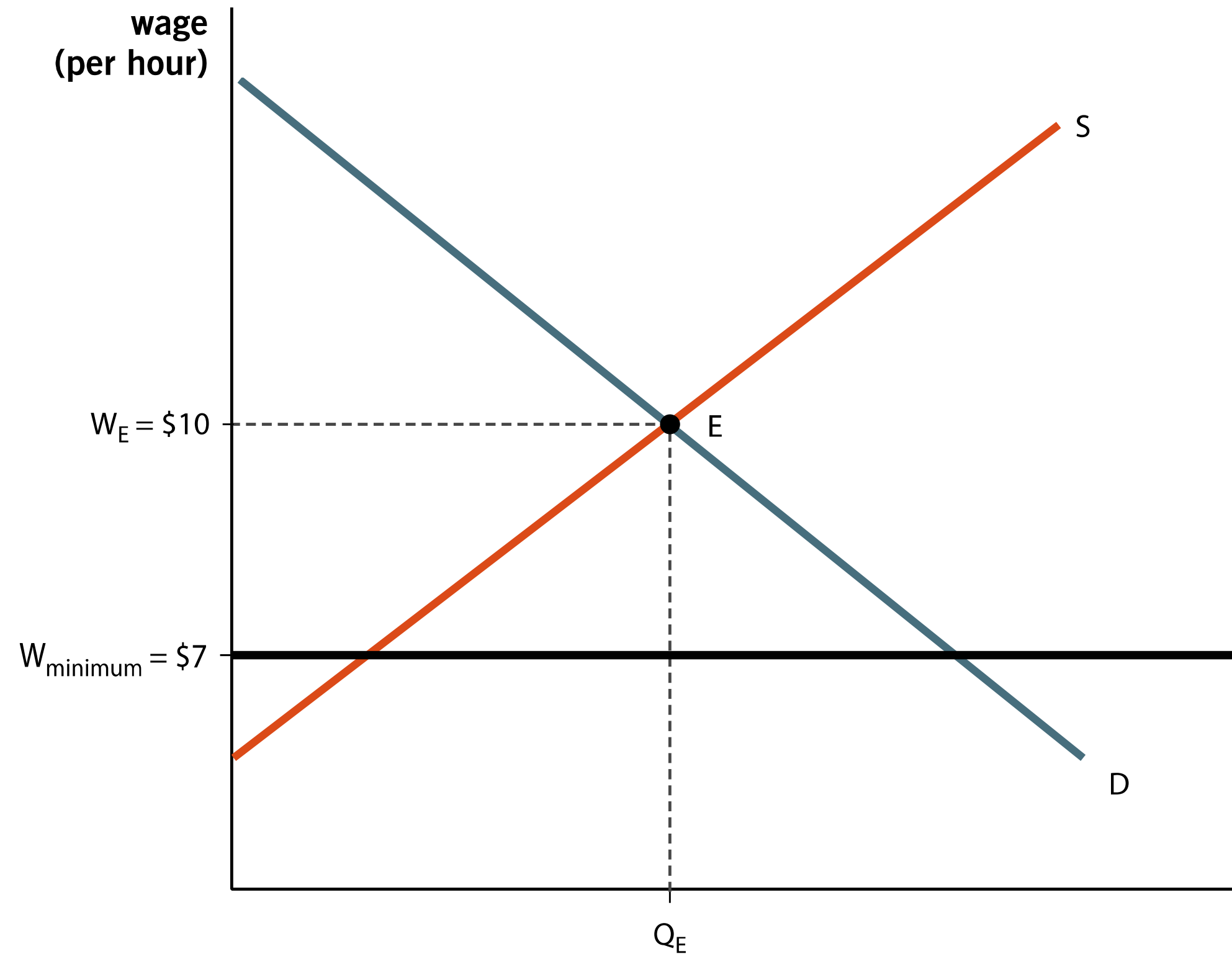
Labor Markets

- In the supply and demand framework for goods and services:
 - 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.
 - Quantity of Labor (Q) is the horizontal axis. This is the number of workers.

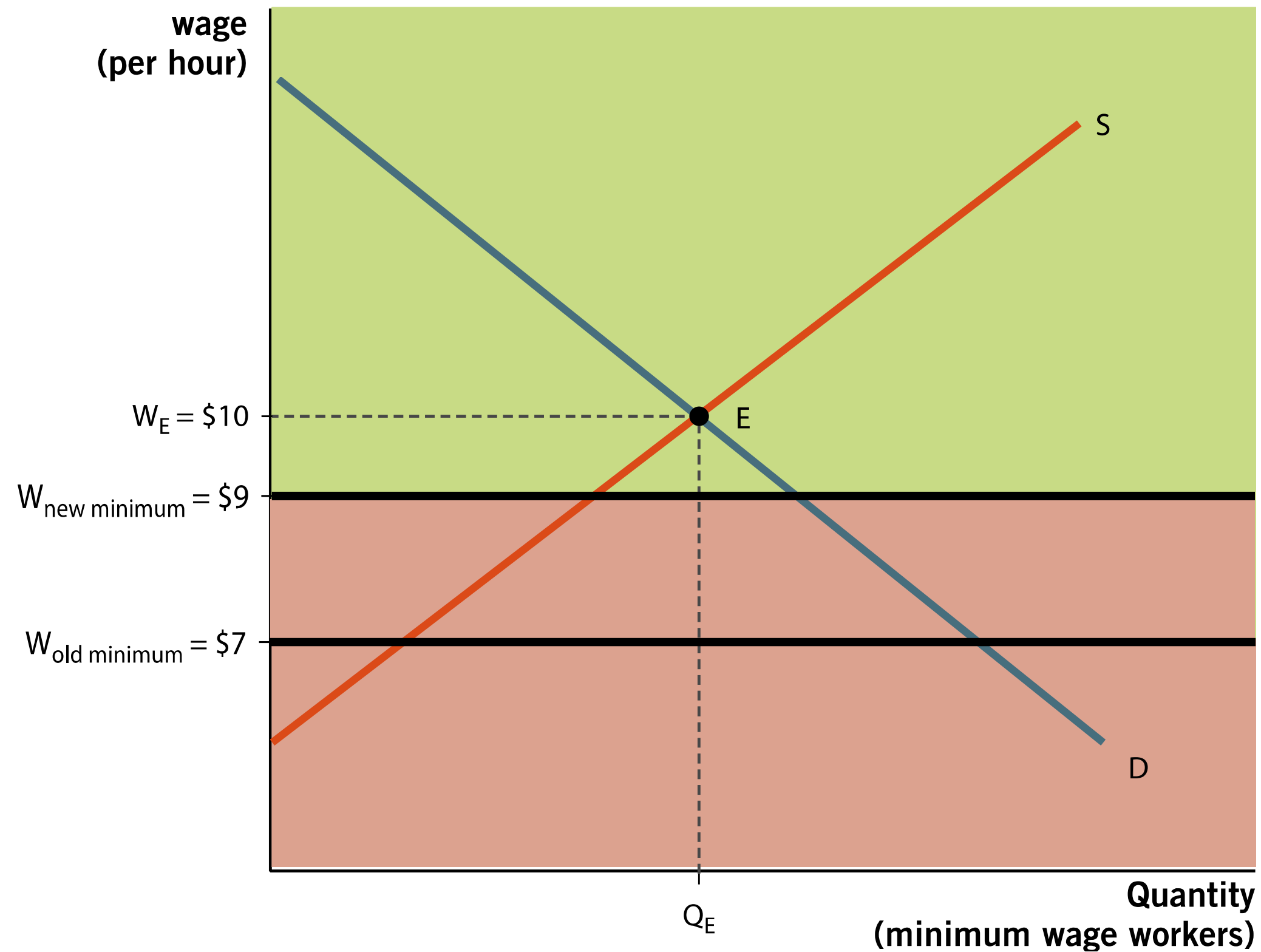
Labor Market



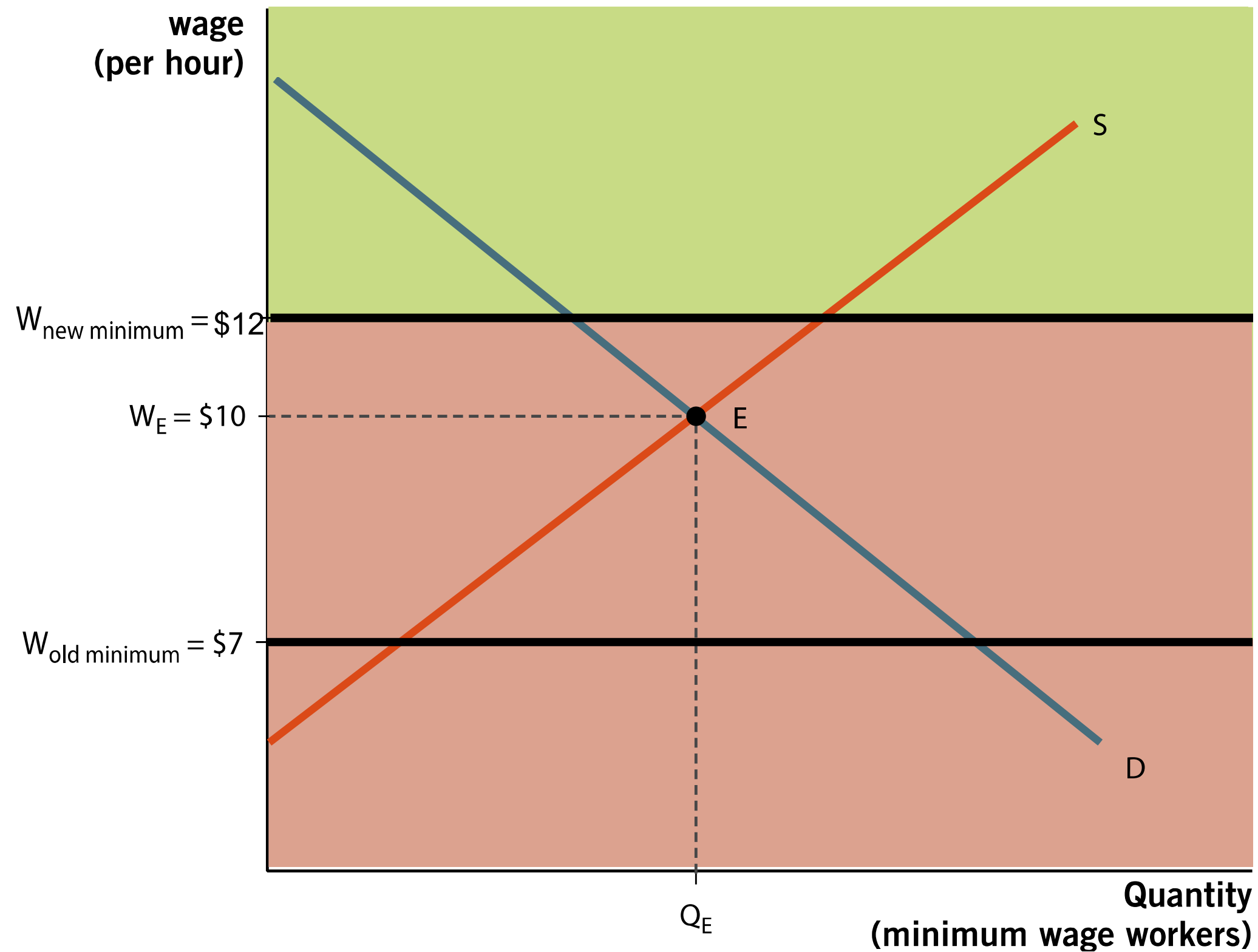
Labor Markets

- 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

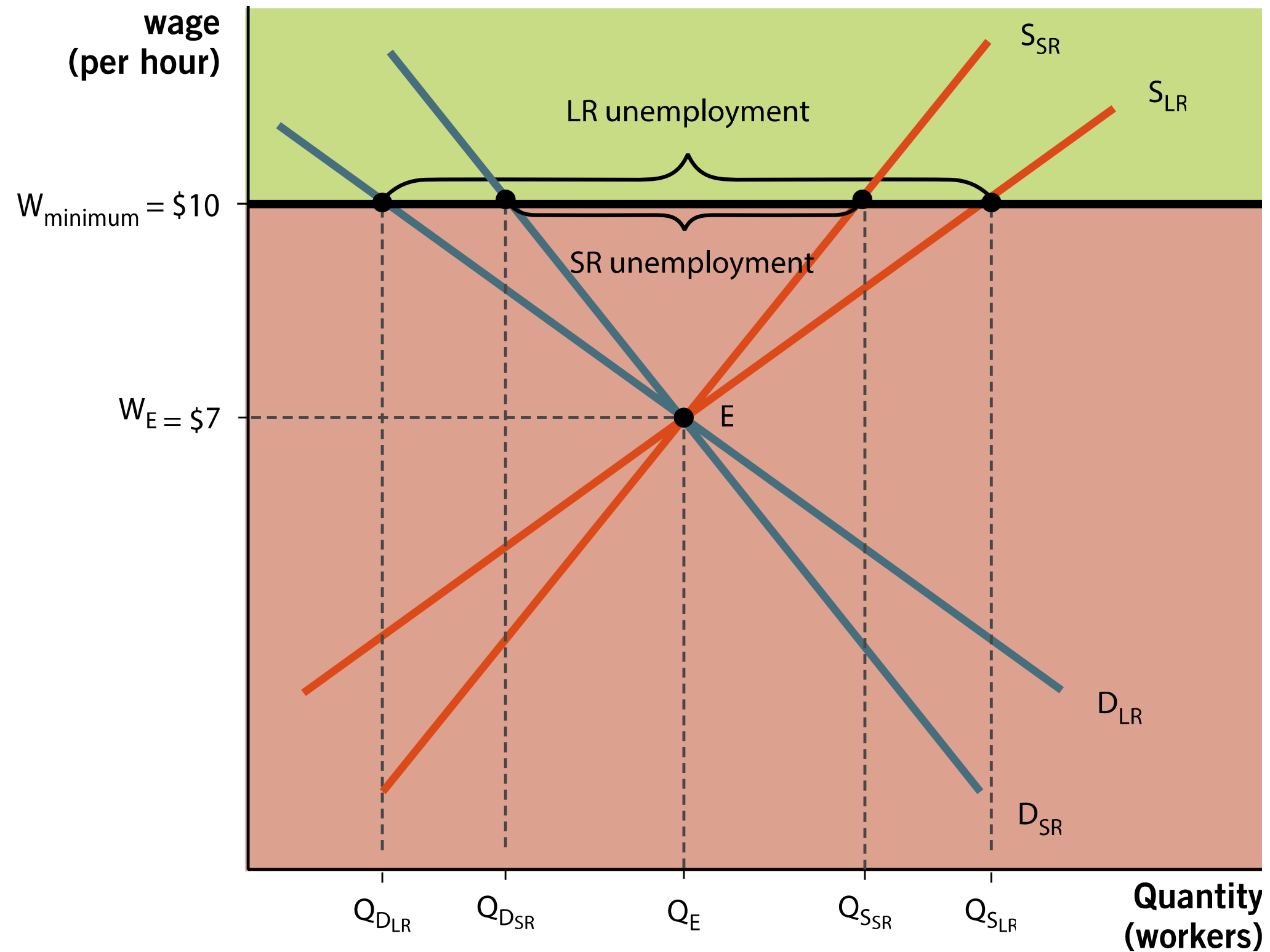
Non-Binding Minimum Wage



Binding Minimum Wage



Binding Minimum Wage in the Long Run



Minimum Wage

- The unintended consequence of a binding minimum wage is unemployment. Caused by:
 - Decrease in quantity demanded for labor
 - Increase in quantity supplied of labor
 - Firms replacing low-skilled jobs with capital, if possible
 - Firm relocation to countries without wage laws
 - Shortening hours for workers
- Proponents of minimum wage also advocate
 - Training, education, job programs

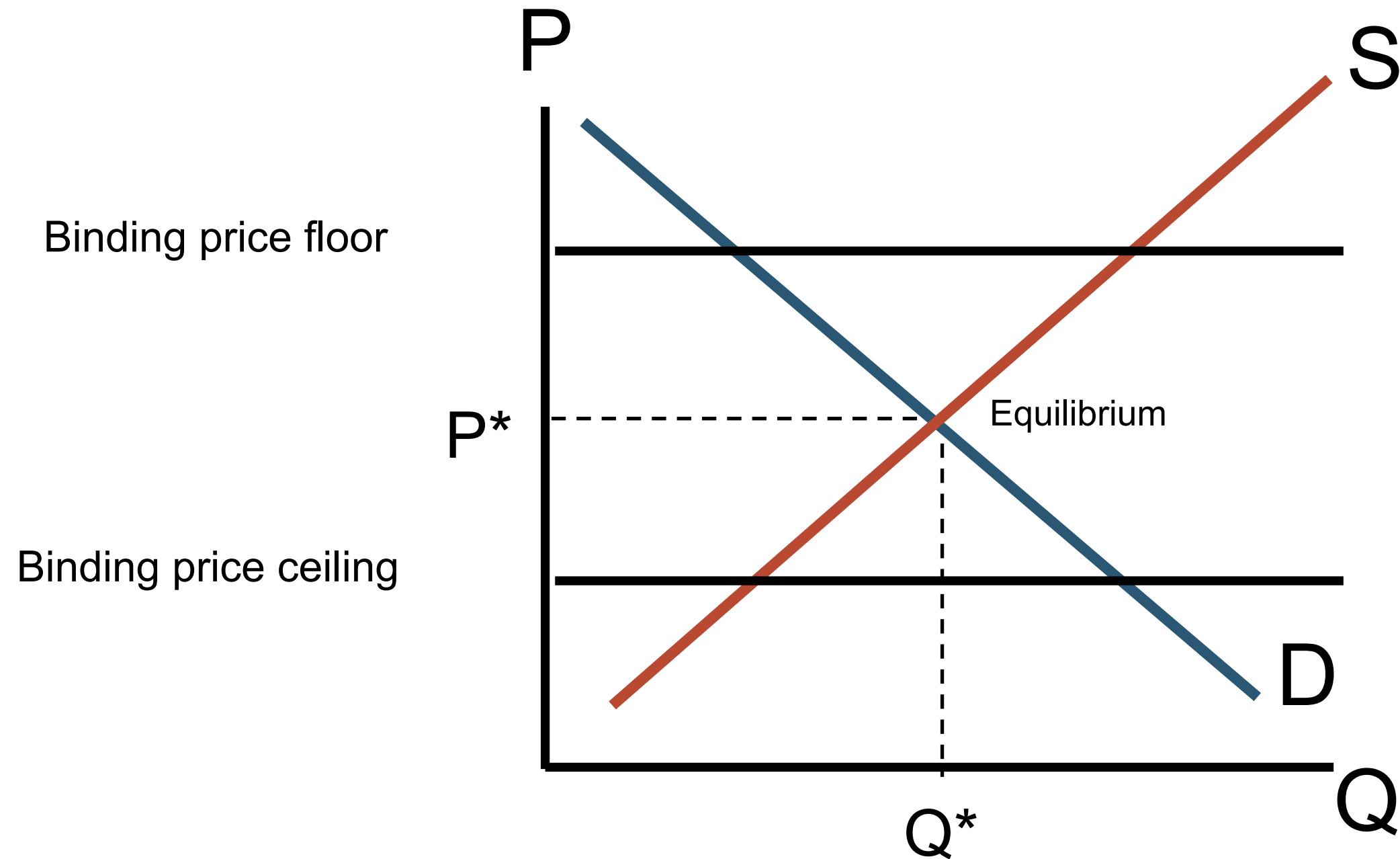
Politics and Minimum Wage

- Politically
 - Raising a non-binding wage floor will seem caring and benevolent.
- Economically
 - Raising a non-binding wage floor will have no effect, as long as the new floor is still below the equilibrium wage.
- Locally
 - States with the highest (binding) minimum wages also have some of the highest unemployment.
 - Washington, Oregon, California

Empirical Evidence and the Minimum Wage

- It is true that States with the highest (binding) minimum wages also have some of the highest unemployment.
 - Washington, Oregon, California
- Most of the empirical tests of the effect of minimum wage on unemployment show small or no effect.
 - The minimum wage changes in the U.S. are usually small compared to fluctuations in other input prices.

Remembering Price Controls



Conclusion

- Prices act as signals and give information to consumers and producers.
- Price controls can distort the signals.
- Price control policy should be done with caution.