

Ch. 5 The Market Strikes Back

- The meaning of **price controls** and **quantity controls**, two kinds of government interventions in markets.
- How price and quantity controls create problems and can make a market inefficient.
- What **deadweight** loss is.
- Why the predictable side effects of intervention in markets often lead economists to be skeptical of its usefulness.
- Who benefits and who loses from market interventions, and why they are used despite their well-known problems.

Examples of Price Controls

- **Price floor** is the minimum price buyers are required to pay for a good or service.



- **Price ceiling** is the maximum price sellers are allowed to charge for a good or service.



Price Ceilings

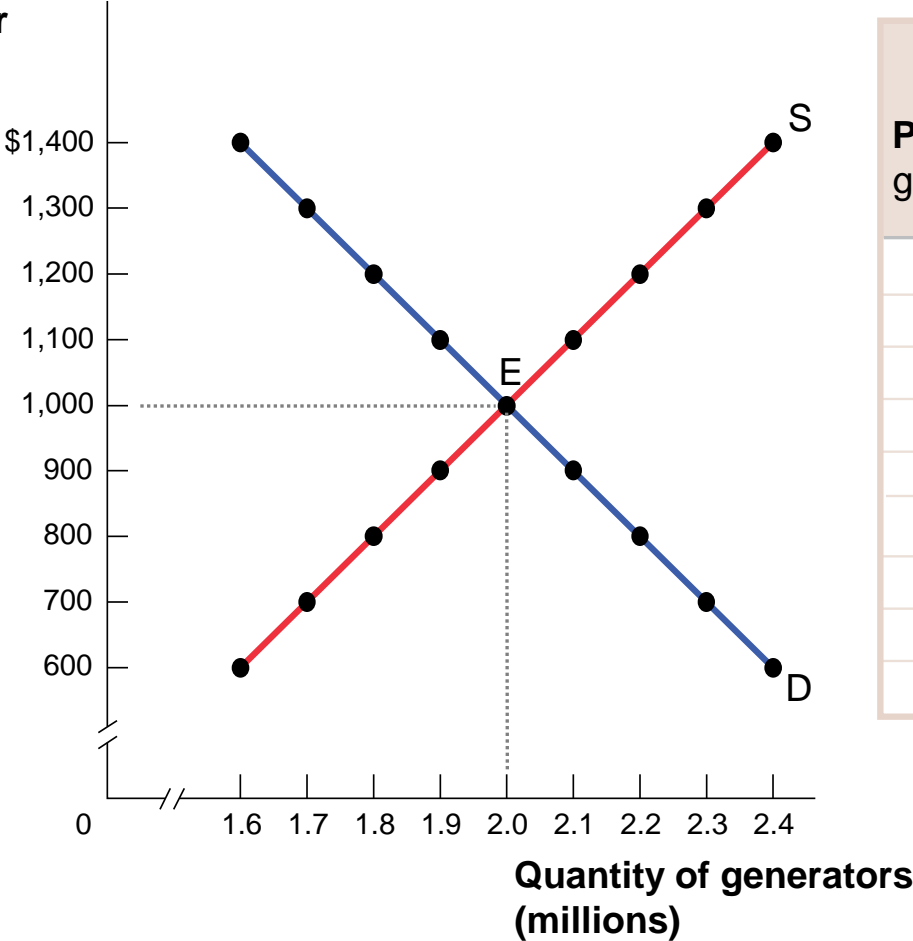
- Price ceilings are typically imposed during crises—wars, harvest failures, natural disasters—because these events often lead to sudden price increases that hurt many people but produce big gains for a lucky few.



- Examples:
 - U.S. Government imposed ceilings on aluminum and steel during World War II
 - Anti-Price Gauging Legislation

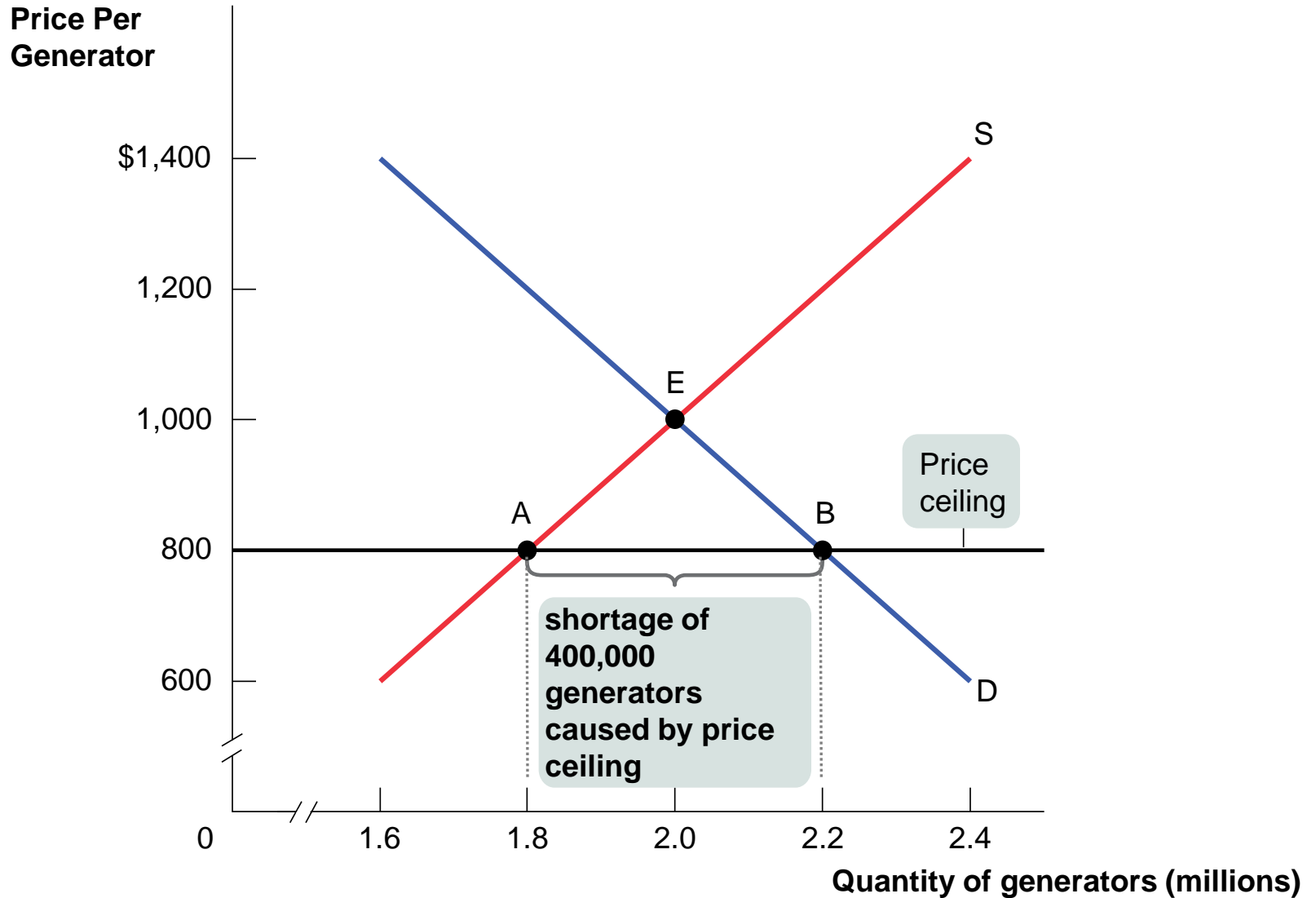
The Market for Generators in the Absence of Government Controls

Price per generator



Price (per generator)	Quantity of generators (millions)	
	Quantity demanded	Quantity supplied
\$1,400	1.6	2.4
1,300	1.7	2.3
1,200	1.8	2.2
1,100	1.9	2.1
1,000	2.0	2.0
900	2.1	1.9
800	2.2	1.8
700	2.3	1.7
600	2.4	1.6

The Effects of a Price Ceiling



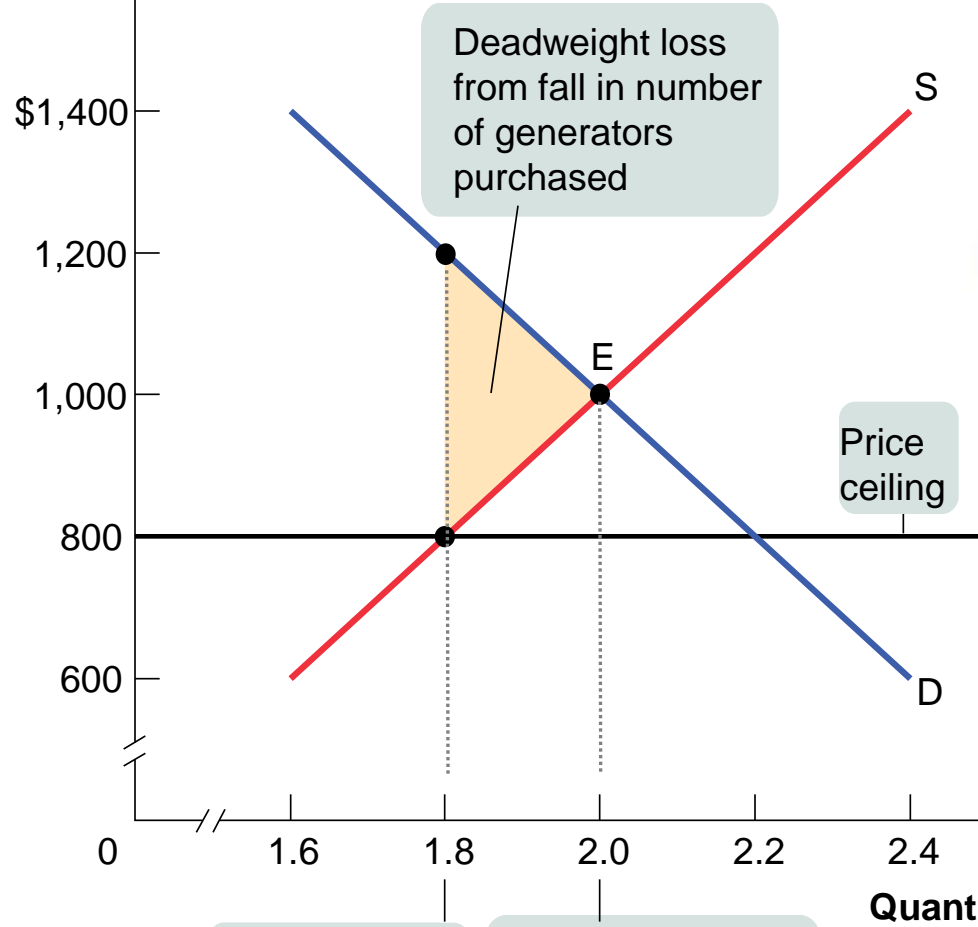
How Price Ceilings Cause Inefficiency

- Inefficiently Low Quantity
 - Deadweight loss: loss in total surplus that occurs with the quantity transacted below the equilibrium
- Inefficient Allocation to Customers
- Wasted Resources
- Inefficiently Low Quality
- Black Markets



A Price Ceiling Causes Inefficiently Low Quantity

Price
(per generator)



Quantity
supplied with
government
intervention

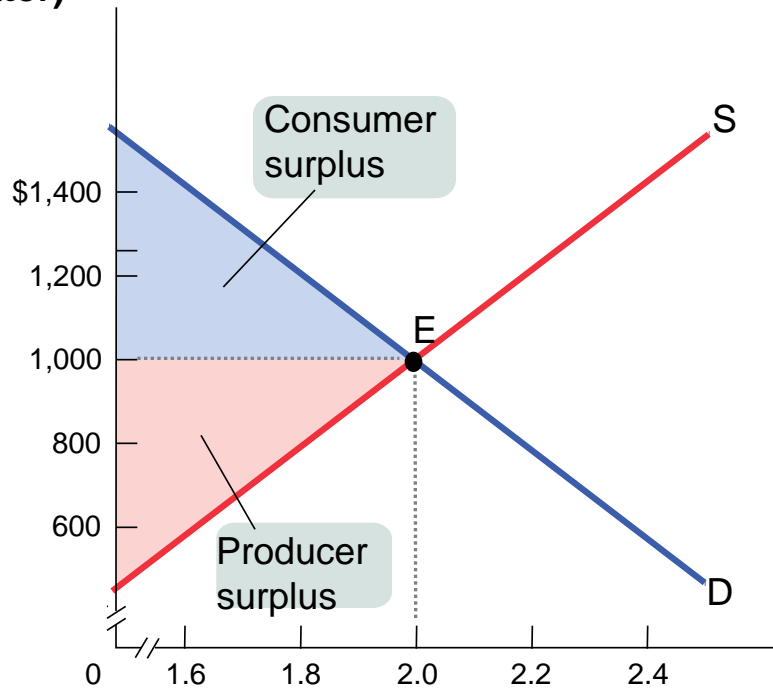
Quantity supplied
without government
intervention

Quantity of generators (millions)

Winners and Losers from Rent Control

Price (per generator)

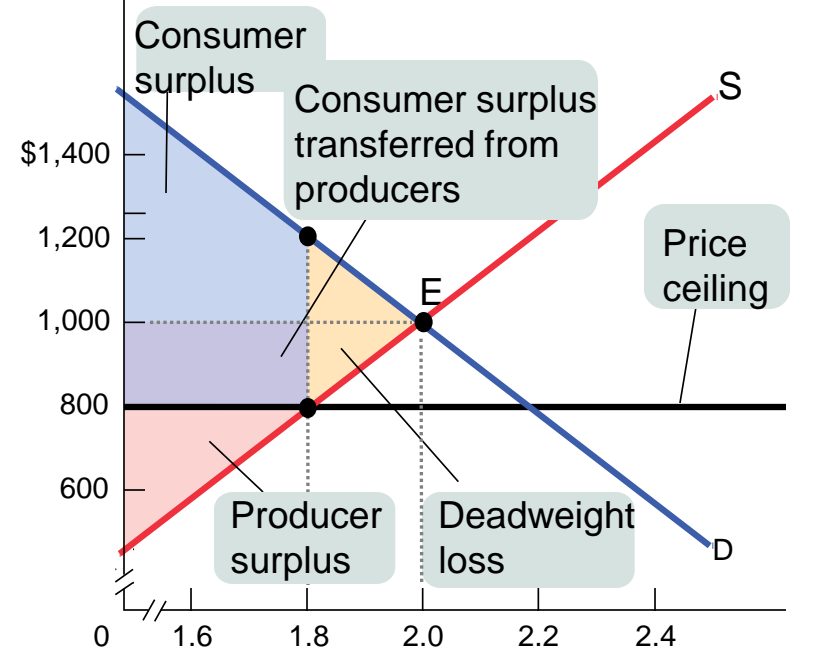
(a) Before Rent Control



Quantity of generators (millions)

Price (per generator)

(b) After Government Action



Quantity of generators (millions)

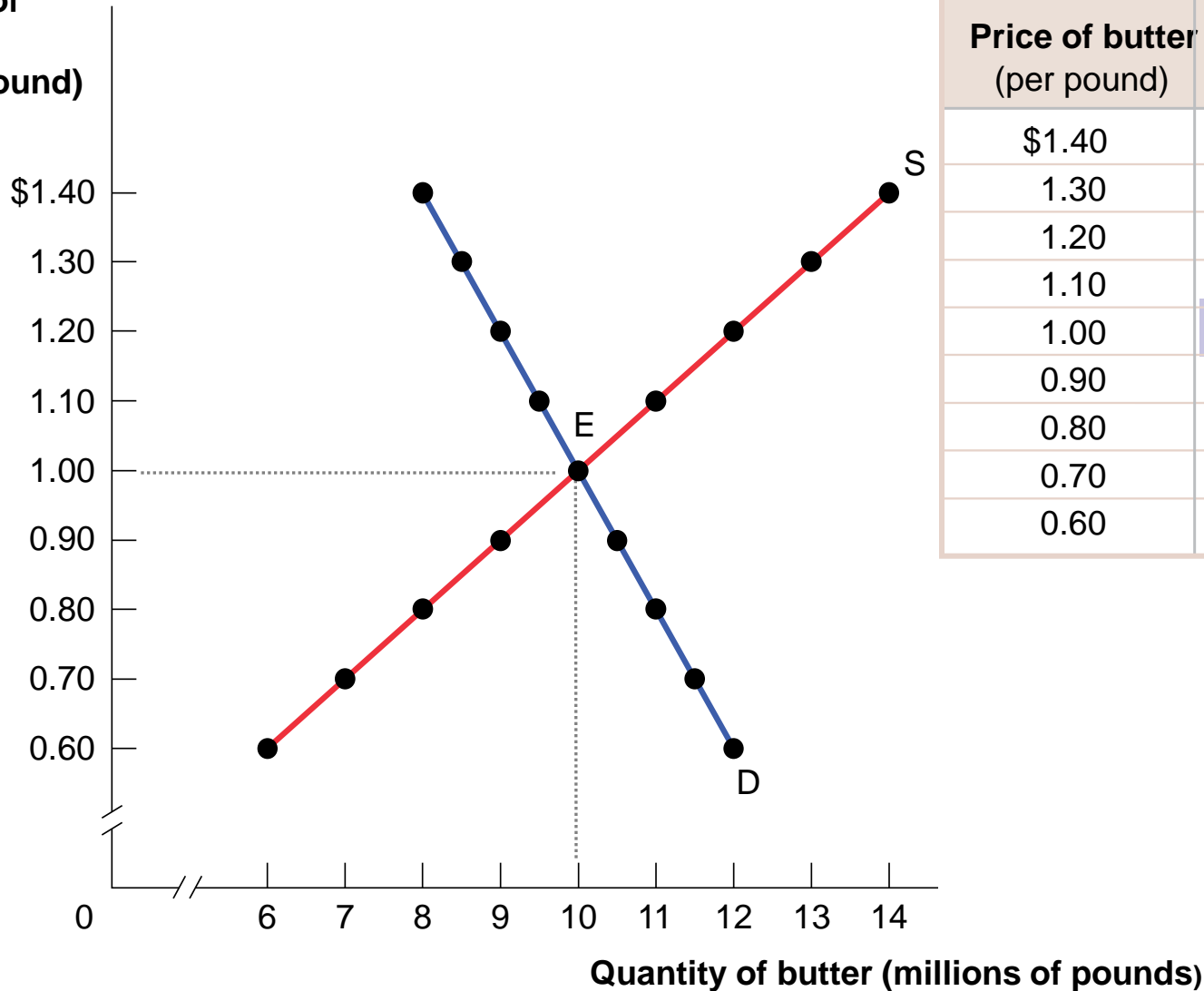
So Why Are There Price Ceilings?

Case: Rent Control in New York

- Price ceilings hurt most residents but give a small minority of renters much cheaper housing than they would get in an unregulated market (those who benefit from the controls are typically better organized and more influential than those who are harmed by them).
- When price ceilings have been in effect for a long time, buyers may not have a realistic idea of what would happen without them.
- Government officials often do not understand supply and demand analysis!

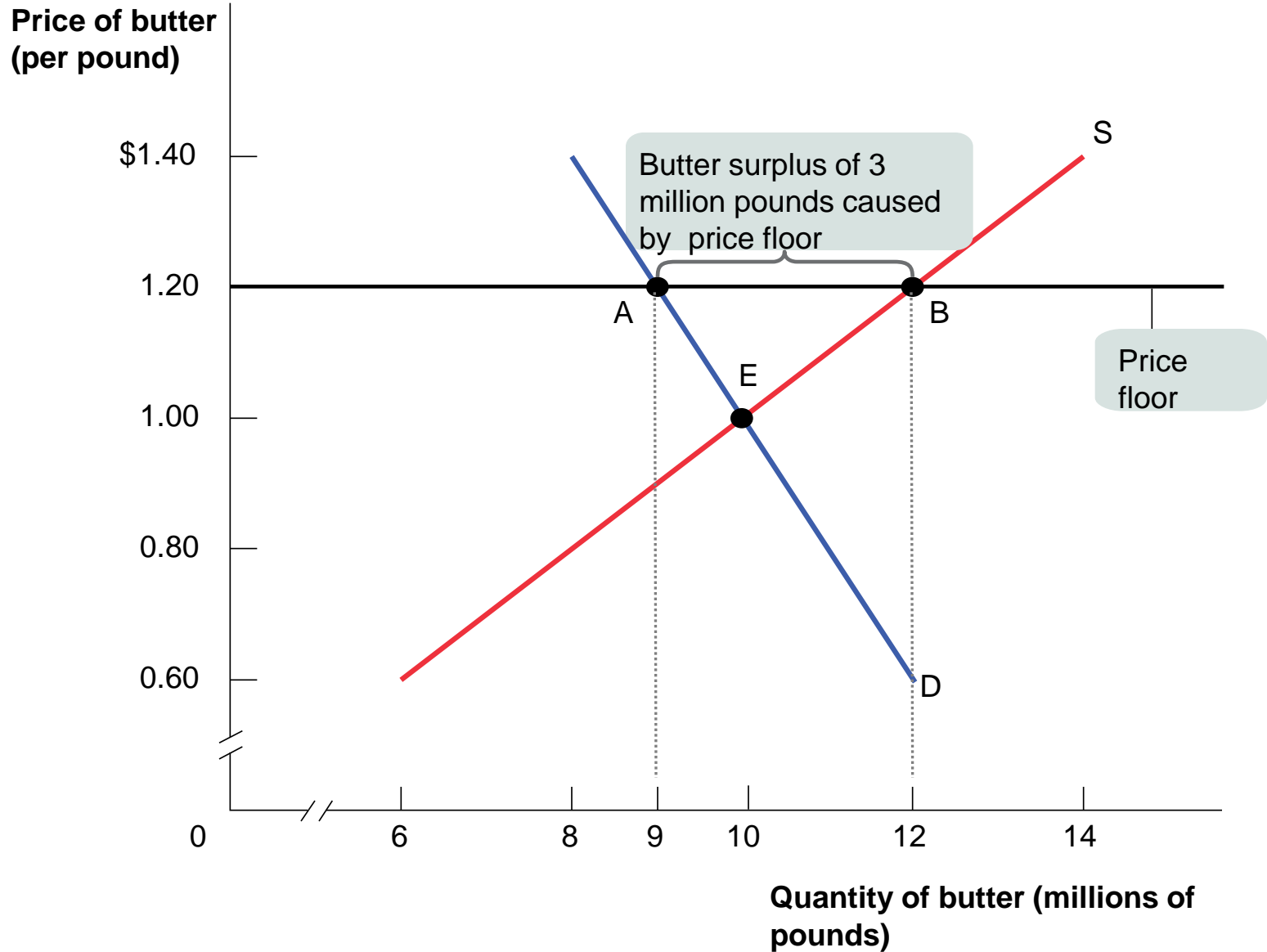
The Market for Butter in the Absence of Government Controls

Price of butter (per pound)



Price of butter (per pound)	Quantity of butter (millions of pounds)	
	Quantity demanded	Quantity supplied
\$1.40	8.0	14.0
1.30	8.5	13.0
1.20	9.0	12.0
1.10	9.5	11.0
1.00	10.0	10.0
0.90	10.5	9.0
0.80	11.0	8.0
0.70	11.5	7.0
0.60	12.0	6.0

The Effects of a Price Floor



Price Floors and School Lunches

- When you were in grade school, did your school offer free or very cheap lunches? If so, you were probably a beneficiary of price floors.
- During the 1930s, when the U.S. economy was going through the Great Depression, prices were low and farmers were suffering. To aid, the U.S. government imposed price floors on agricultural products like beef, sugar, pork, etc.
- Price floors are meant to **create a surplus**. Government reduces supply by paying farmers not to grow crops and also buys the surplus, thus taking excess surplus off the market.
- The government then gives away this excess surplus to schools as free or cheap lunches.



How a Price Floor Causes Inefficiency

- Deadweight loss from inefficiently low quantity
- Inefficient allocation of sales among sellers
- Wasted resources
- Inefficiently high quality
- Temptation to break the law by selling below the legal price

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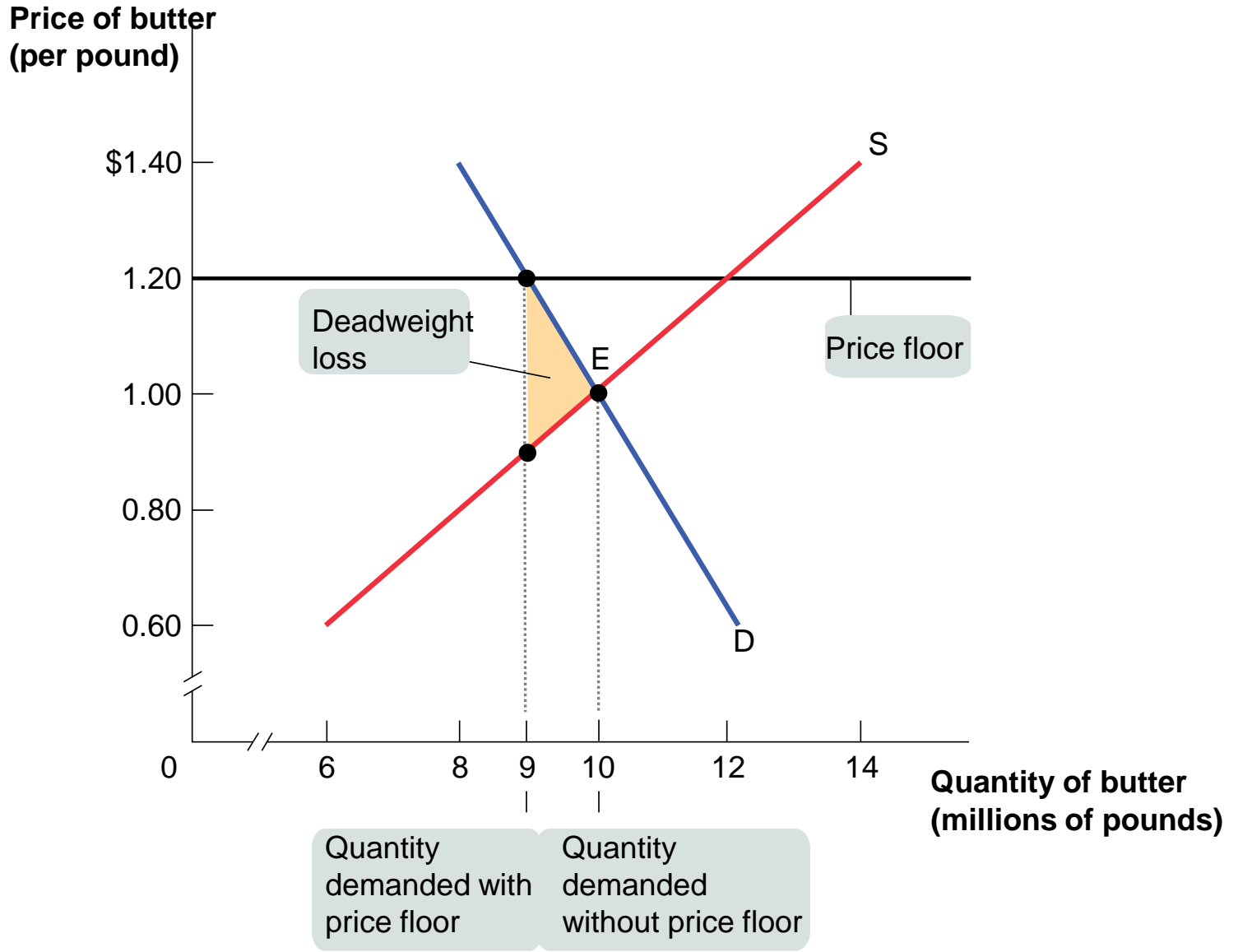


"They hiked the minimum wage
again — now I'm out of an even
better job!"

POLITICALLY CORRECT by Jim Huber



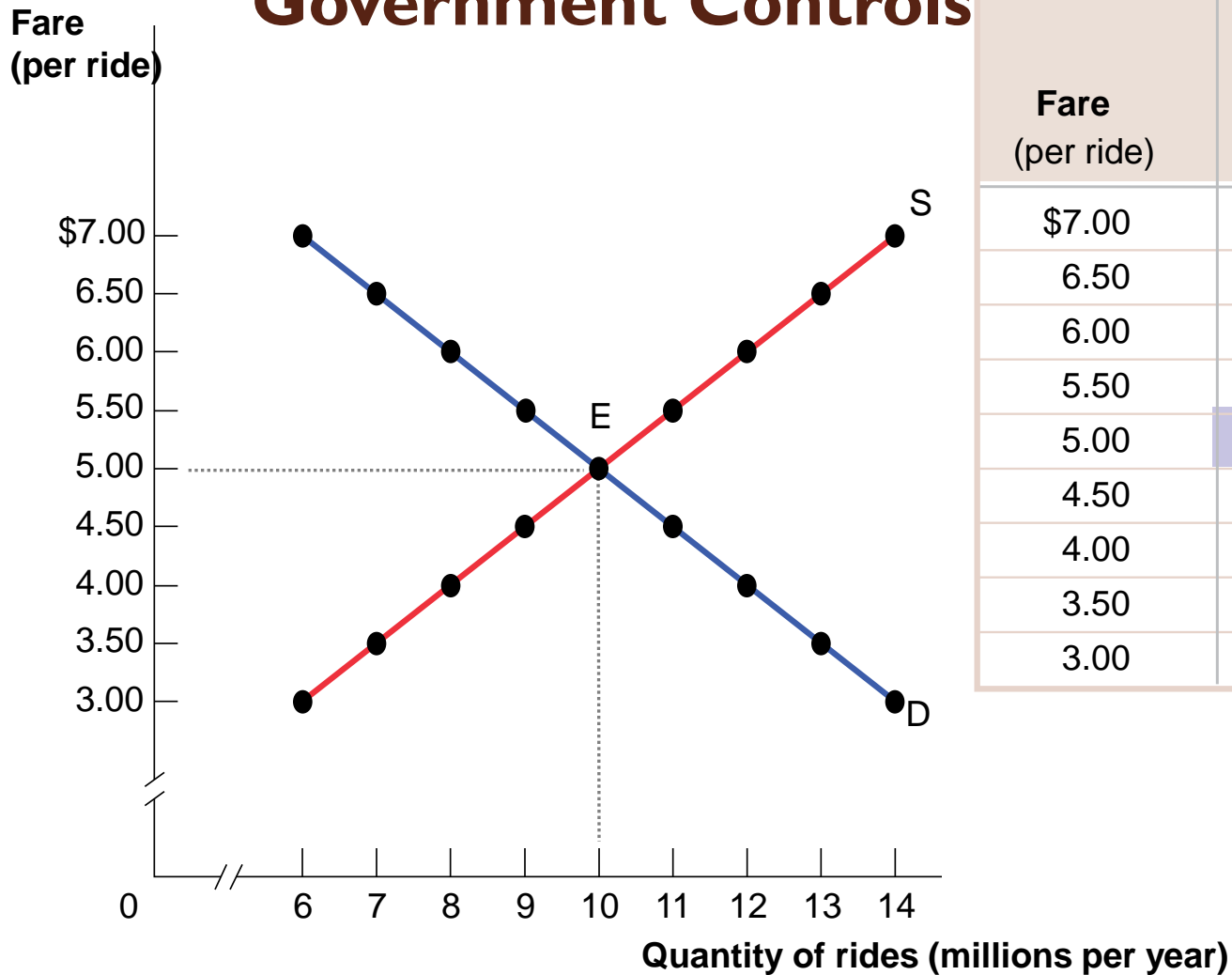
A Price Floor Causes Inefficiently Low Quantity



Controlling Quantities

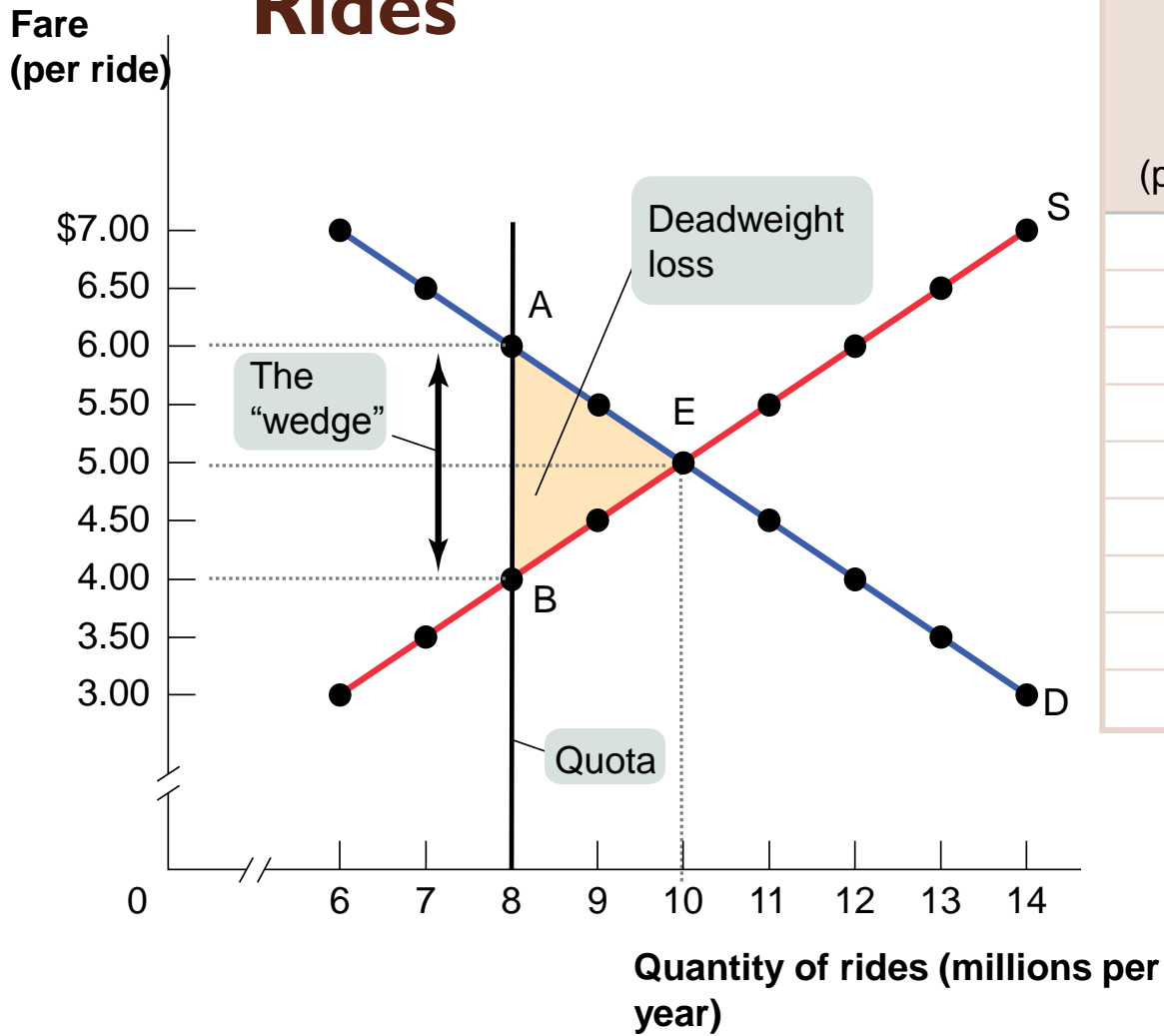
- A **quantity control**, or **quota**, is an upper limit on the quantity of some good that can be bought or sold. The total amount of the good that can be legally transacted is the **quota limit**.
- A **license** gives its owner the right to supply a good.

The Market for Taxi Rides in the Absence of Government Controls



Fare (per ride)	Quantity of rides (millions per year)	
	Quantity demanded	Quantity supplied
\$7.00	6	14
6.50	7	13
6.00	8	12
5.50	9	11
5.00	10	10
4.50	11	9
4.00	12	8
3.50	13	7
3.00	14	6

Effect of a Quota on the Market for Taxi Rides



Fare (per ride)	Quantity of rides (millions per year)	
	Quantity demanded	Quantity supplied
\$7.00	6	14
6.50	7	13
6.00	8	12
5.50	9	11
5.00	10	10
4.50	11	9
4.00	12	8
3.50	13	7
3.00	14	6

Pitfalls of Ceilings, Floors and Quantities

- A price ceiling pushes the price of a good down.
- A price floor pushes the price of a good up.
- Both floors and ceilings reduce the quantity bought and sold.
- If sellers don't want to sell as much as buyers want to buy, it's the sellers who determine the actual quantity sold, because buyers can't force unwilling sellers to sell and vice versa.