Thursday, September 08, 2011
10:02 AM

Price ceiling
Price Floor: 2 cases
Price support

DEMAND, SUPPLY, AND APPLICATIONS (CONT.)

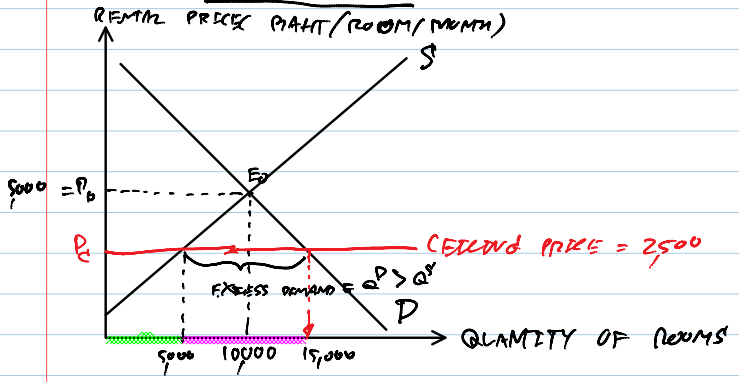
- PRICE CEILING
- PRICE FLOOR
- PRICE SUPPORT

• PRICE CEILING

- SOMETIMES GOVTS ADOPT POLICIES THAT ARE DESIGN TO LOWER PRICES
  - TO IMPROVE THE WELL-BEING OF BUYERS
  - EXAMPLE: RENT CONTROL

• PRICE CEILING: LEGALLY MAXIMUM PRICE THAT SELLERS CAN CHARGE FROM BUYERS.

Ex: RENT CONTROL



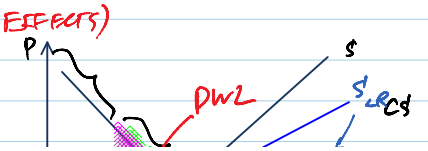
RESULT #1 AS $Q_D = 15{,}000 > Q_S = 5000$ AT THE $P_c = 2500$, SHORTAGES RESULT.

RESULT #2 HOW TO ALLOCATE THE 5000 UNITS OF ROOM?

NON-PRICE MECHANISM
- FIRST COME - FIRST SERVED → LONG WAITING LINES
- LUCKY DRAW

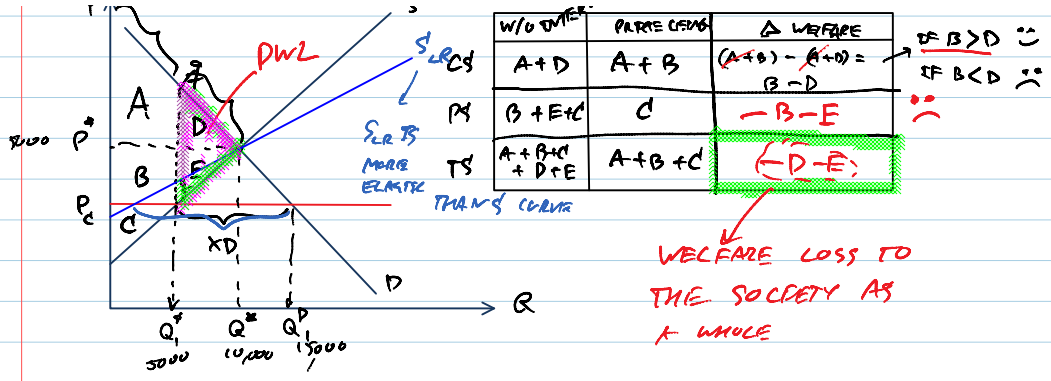
RESULT #3 (WHO GAIN / WHO LOSE) (WASTEFUL RESOURCES)

(ON WELFARE EFFECTS)



W/O INTERVENTION	PRICE CEILING	Δ WELFARE
A+D	A+B	(A+B) − (A+D) = B − D

IF B > D ☺
IF B < D ☹



W/O DWL	PRICE CEILING	Δ WELFARE
A+D	A+B	(A+B) − (A+D) = B − D
B+E+C	C	−B−E
A+B+C+D+E	A+B+C	−D−E

IF B > D ☺
IF B < D ☹ ☹

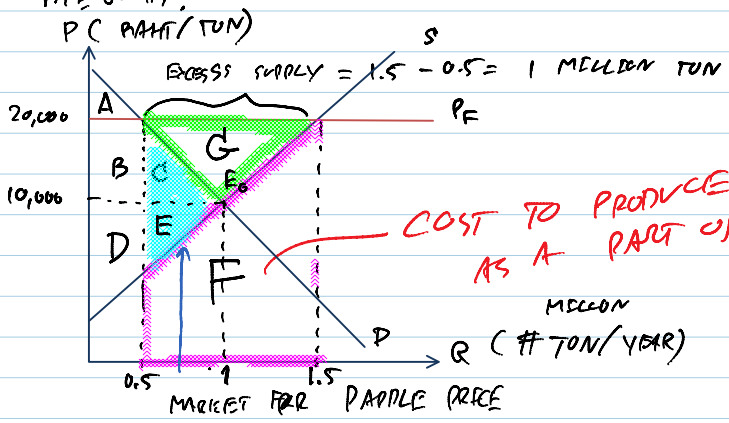
WELFARE LOSS TO THE SOCIETY AS A WHOLE

- IN THE LONG RUN, WHEN SUPPLY BECOMES MORE ELASTIC, SHORTAGES BECOME MORE SEVERE.
- ON QUALITY ASPECTS, QUALITY OF ROOMS WILL BE WORSEN AS LANDLORDS HAVE NO INCENTIVE TO MAINTAIN THEIR ROOM IN A GOOD CONDITION.
- BLACK MARKET MAY ARISES.
  - MARKETS WHERE GOODS ARE TRANSACTED ILLEGALLY.

OR: MARKETS WHERE GOODS ARE TRANSACTED AT THE PRICE HIGHER THAN THE REGULATED PRICE. ($2500 = P_C)

- PRICE FLOORS

PRICE FLOOR ESTABLISHES A (LEGALLY) MINIMUM PRICE THAT SELLER RECEIVE WHEN THEY SELL THE GOODS.



COST TO PRODUCE UNSOLD QUANTITY AS A PART OF DWL.

CASE 1 WHEN SELLERS KNOW THAT THEY COULD SELL ONLY 0.5 MIL TON THEY PRODUCE ONLY 0.5 MILLION TON. (PERFECT FORESIGHT)

	PERFECT COMPETITION	PRICE FLOOR	Δ
CS	A+B+C'	A	−B−C'
PS	D+E	B+D	B−E
TS	A+B+C'+D+E	A+B+D	−C'−E

CONSUMERS ARE WORSE OFF.

PRODUCERS ARE BETTER OFF. (ASSUMING THAT B > E)

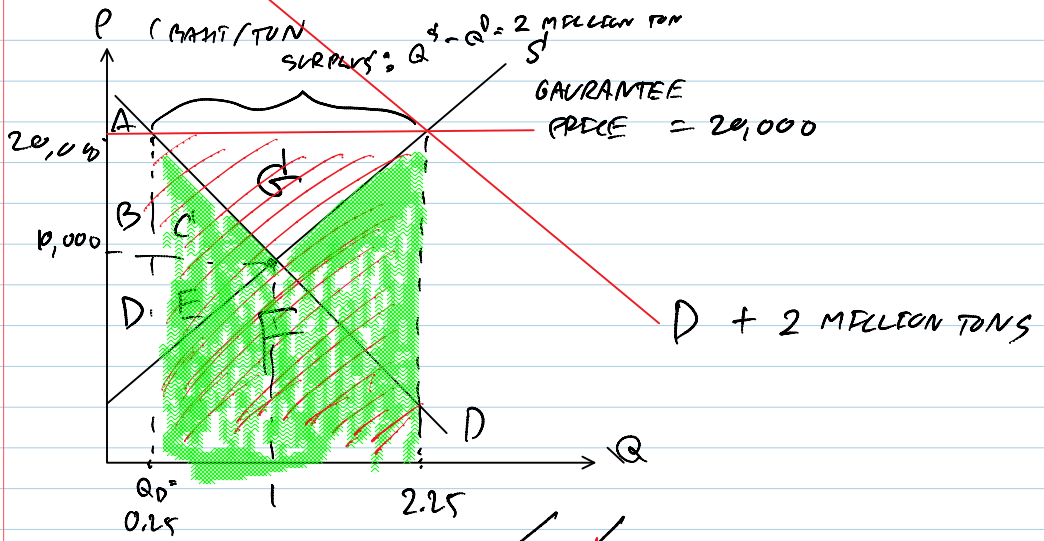
CASE 2 WHEN PRODUCERS PRODUCE AT Q = 1.5.

	PERFECT COMPETITION	PRICE FLOOR	Δ
CS	A+B+C'	A	−B−C
PS	D+E	B+D−F	B−E−F
TS	A+B+C'+D+E	A+B+D−F	−C'−E−F

DWL

PRICE SUPPORTS (VERTICAL)

- VERY MUCH LIKE PRICE FLOOR
- HOWEVER, NO LAW BEING IMPOSED
- GOVT WILL HELP BUYING UNSOLD QUANTITY.



$\Delta CS = -B - C$

$\Delta PS = +B + C' + G$ [= NEW PS − OLD PS = B C G D E − D E]

GOVT $= -C - E - F$

$\Delta TS = \Delta CS + \Delta PS + \Delta GOVT. = -C - E - F$

$\Delta TS = \Delta CS + \Delta PS + \Delta GOVT. = -C - E - F$

DEADWEIGHT LOSS

DIRECT TRANSFER IS MORE EFFECTIVE