Price Ceiling

Thursday, February 21, 2019 09:30 AM

CH6 : Supply, Demand, and Government Policies

Main question: What will happen to a market if govt intervene?

- Price?
- quantity?
- welfare gain/loss to buyers and to sellers?

Tools used:

- Supply & Demand (Ch. 4)
- Elasticity (Ch. 5)
- CS / PS / TS (Ch. 7)

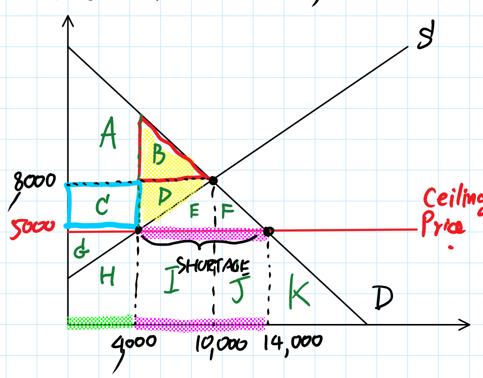
3 Applications

1. Price ceiling
2. Price Floor

} Price Controls

3. Taxes

Price ceiling : A legally maximum price sellers can charge to buyers.



Consider market for Apartments

Demand → students

Supply → landlords / apartment owners

w/o govt intervention, P = 8000 Q = 10,000

Fact#1 Effective price ceiling creates "shortage" as $Q^D > Q^S$.

Fact#2 4,000 limited amounts of rooms will be allocated by ...

- Luck draws
- First come First serve
- Discrimination

} "non-price mechanisms" → creates wasted resources. (Time, Energy, Resources)

Fact#3 Quality of housing gets worse in the long run as landlords have no incentive to provide proper maintainence!

Fact#4 Who gain / Who lose?

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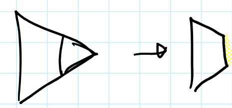
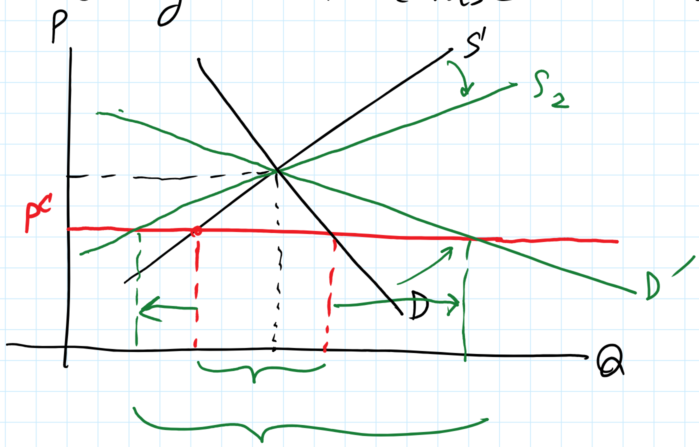
	Free Market	Price Ceiling	Δ
CS	$A+B$	$A+C$	$(A+C)-(A+B) = -B+C$; $>0 \to CS\uparrow$; $<0 \to CS\downarrow$
PS	$C+D+G$	G	$-C-D$ worse off
TS	$\cancel{A}+B+\cancel{C}+D+\cancel{G}$	$\cancel{A}+\cancel{C}+\cancel{G} \to$	$-B-D$

- Consumers may be better off or worse off, depending on size of $(-B+C)$
- Producers are worse off
- For society as a whole, economic pie reduces by $B+D$

We call this as "Dead weight loss"



Fact#5 in the long run, if D and S becomes more elastic, price ceiling will cause a severe shortage.



Fact#6 What happens if Demand is inelastic?

Are buyers better off or worse off?