

Maximum and Minimum Price Controls

Prices send signals and provide incentives to buyers and sellers. When supply or demand changes, market prices adjust, affecting incentives. High prices induce extra production while they discourage consumption.

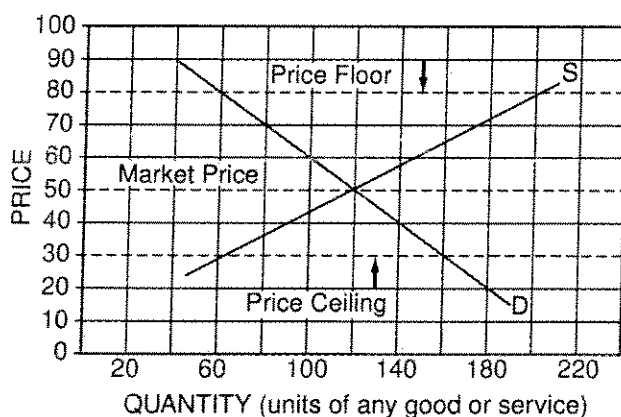
In this exercise, we discover how the imposition of price controls (maximum or minimum prices) interrupts the process that matches production with consumption. *Price ceilings* (maximum prices) sometimes appear in the form of rent control, utility prices and other caps on upward price pressure. *Price floors* (minimum prices) also occur in the form of prevailing wages and minimum wages.

When government imposes price controls, citizens should understand that some people gain and some people lose from every policy change. By understanding the consequences of legal price regulations, citizens are able to weigh the costs and benefits of the change.

As a general rule, price floors create a *surplus* of goods or services, or *excess supply*, since the quantity demanded of goods is less than the quantity supplied. Conversely, price ceilings generate *excess quantity demanded*, causing shortages.



Figure 22.1
Price Floors and Ceilings



Price floors and ceilings can be plotted with supply and demand curves. Use Figure 22.1 to answer the questions. Fill in the answer blanks or underline the correct words in parentheses.

- What is the market price? _____
- What quantity is demanded and what quantity is supplied at the market price?
 - Quantity demanded _____
 - Quantity supplied _____

Adapted from *Capstone Student Activities* (New York: National Council on Economic Education, 1989), p. 57.

3. What quantity is demanded and what quantity is supplied if the government passes a law requiring the price to be no higher than \$30? This is called a *price ceiling*.
 - (A) Quantity demanded _____
 - (B) Quantity supplied _____
 - (C) There is a (*shortage / surplus*) of _____.

4. What quantity is demanded and what quantity is supplied if the government passes a law requiring the price to be no lower than \$80? This is called a *price floor*.
 - (A) Quantity demanded _____
 - (B) Quantity supplied _____
 - (C) There is a (*shortage / surplus*) of _____.
 - (D) What happens to total consumer or producer surplus? _____
 - (E) Is society better or worse off after the price floor is imposed? _____
 - (F) Who gains from the price floor? _____

Pricing Problems

Write answers to the following questions. Be sure to support your answers with sound economic reasoning and draw graphs where appropriate to illustrate your answers.

1. "Gold is valuable because so many people hunt for it." True, false or uncertain, and why?
2. A consumer group believes the prices of necessities such as food, housing, energy and medical care should be controlled by the government. "People can afford higher prices for luxuries," they reason, "but all of us, and especially the poor, suffer when the prices of necessities rise." Evaluate the effects of this plan.
3. State Representative Smith feels that New York can raise revenue 500 percent by increasing license-plate and registration fees by 500 percent. Will the government increase its revenue by 500 percent? Why or why not?
4. Make the assumption that one day you will be a college graduate. Would you support a law to raise the legal minimum wage of college graduates to \$50,000?

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5. Recently the price of beef rose. Use graphs to show that the increase in price could be consistent with the following. (Be sure to draw a graph and provide a brief explanation for each situation.)

(A) The quantity of beef consumed falls.

(B) The quantity of beef consumed rises.

(C) The quantity of beef consumed stays the same.

6. You stumble across a heated debate in the cafeteria. It seems that a bunch of friends just bought concert tickets from Ticketmaster, a ticket-handling agency, and paid a \$4.00 surcharge for each ticket. "It's outrageous! It's not like they actually do anything worth \$4.00," complains a friend. Comment on her complaint.

7. You learn that a prominent economist is going to give a lecture, and you rush to get tickets. The economist says, "We economists don't know much, but we know how to create shortages and surpluses."
 - (A) How can government create a shortage in a competitive market? Illustrate this with a graph. Can you provide examples of this?

 - (B) How can government produce a surplus in a competitive market? Illustrate this with a graph. Can you provide examples of this?