chapter:

5

>> Price Controls and Quotas: Meddling with Markets

Krugman/Wells
Economics

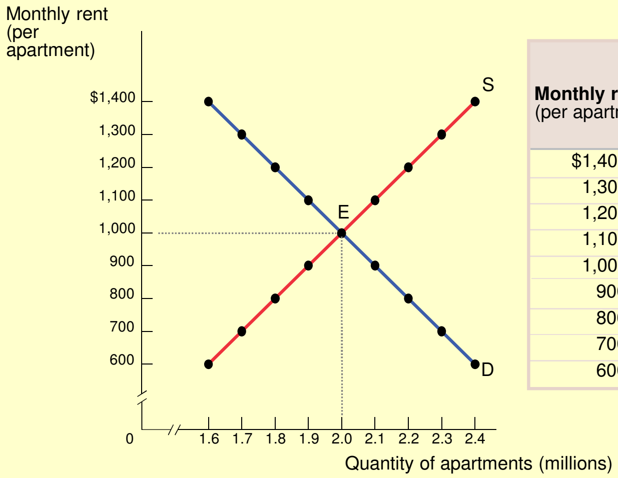
WHAT YOU WILL LEARN IN THIS CHAPTER:

- 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.

Why Governments Control Prices

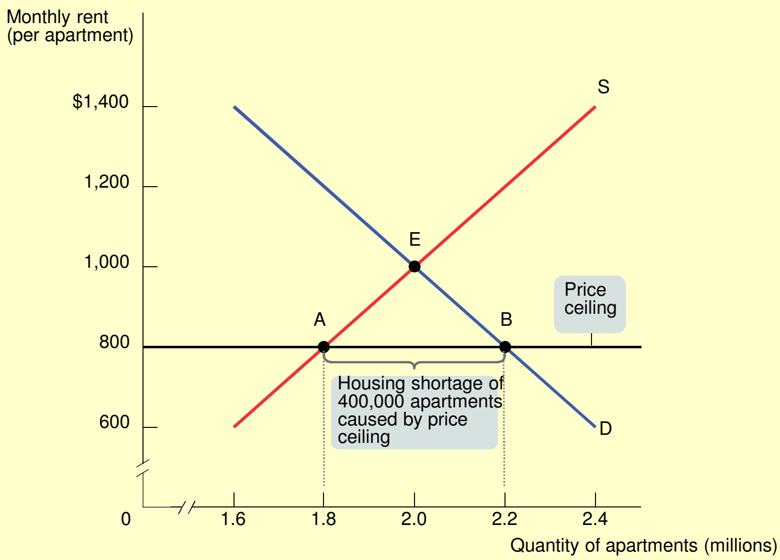
- The market price moves to the level at which the quantity supplied equals the quantity demanded. BUT this equilibrium price does not necessarily please either buyers or sellers.
- Therefore, the government intervenes to regulate prices by imposing **price controls**, which are legal restrictions on how high or low a market price may go.
- **Price ceiling** is the maximum price sellers are allowed to charge for a good or service.
- **Price floor** is the minimum price buyers are required to pay for a good or service.

The Market for Apartments in the Absence of Government Controls



Monthly rent (per apartment)	**Quantity of apartments** (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

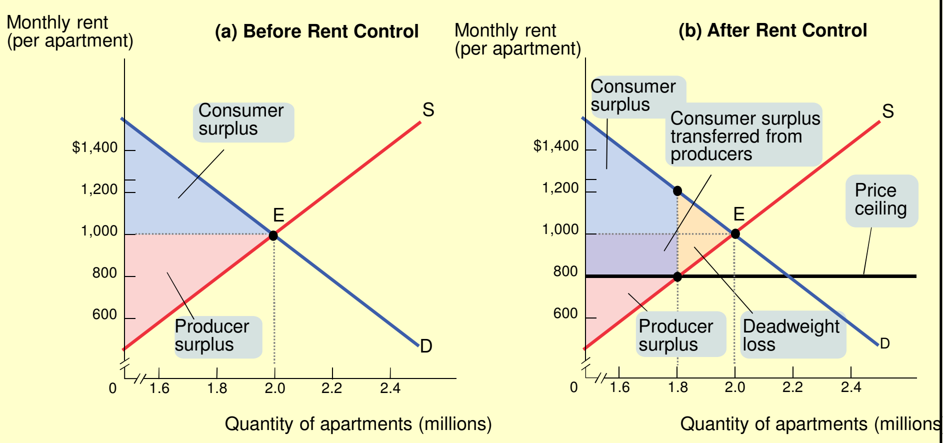
The Effects of a Price Ceiling



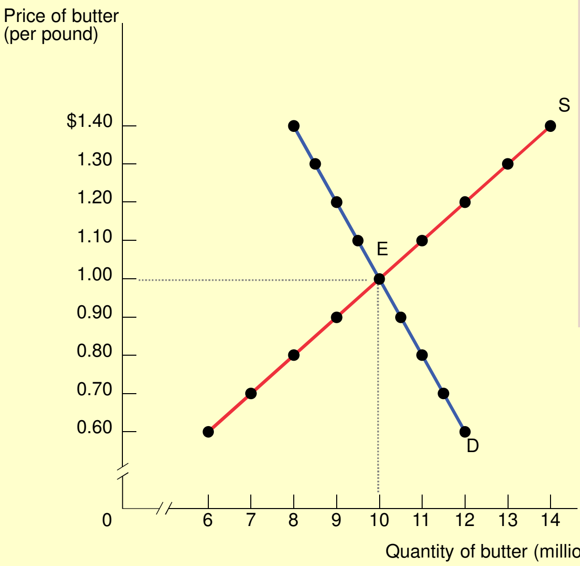
How Price Ceilings Cause Inefficiency

- Inefficiently Low Quantity
  - Deadweight loss is the loss in total surplus that occurs whenever an action or a policy reduces the quantity transacted below the efficient market equilibrium quantity
- Inefficient Allocation to Customers
- Wasted Resources
- Inefficiently Low Quality
- Black Markets

Winners and Losers from Rent Control

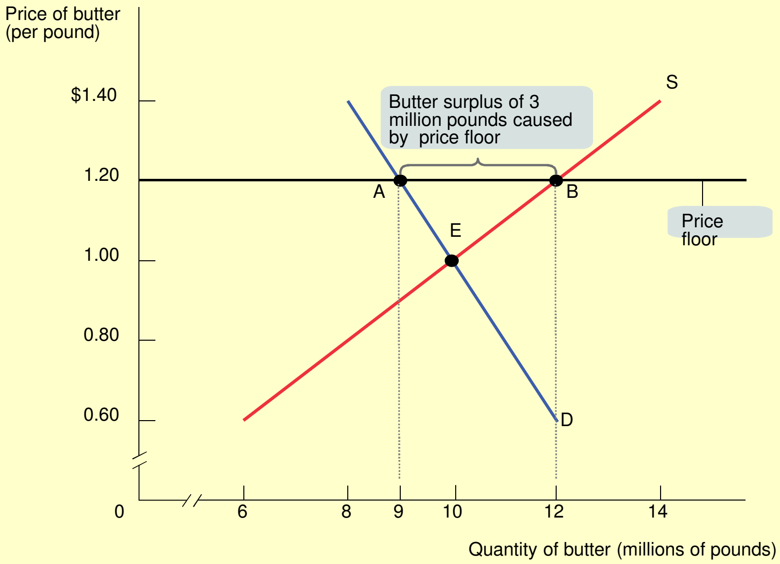


The Market for Butter in the Absence of Government Controls



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

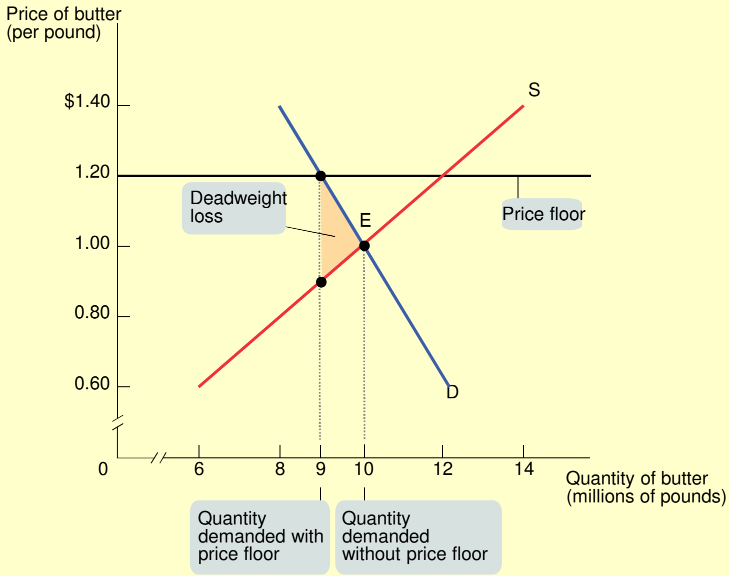
The Effects of a Price Floor



How a Price Floor Causes Inefficiency

- The persistent surplus that results from a price floor creates missed opportunities—inefficiencies—that resemble those created by the shortage that results from a price ceiling. These include:
  - 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

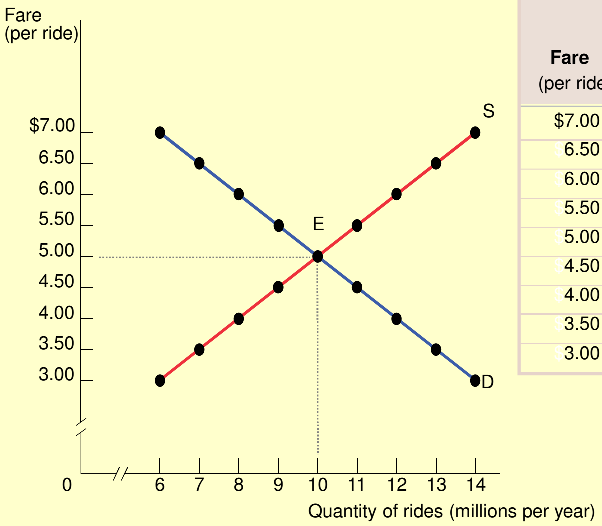
A Price Floor Causes Inefficiently Low Quantity



Controlling Quantities

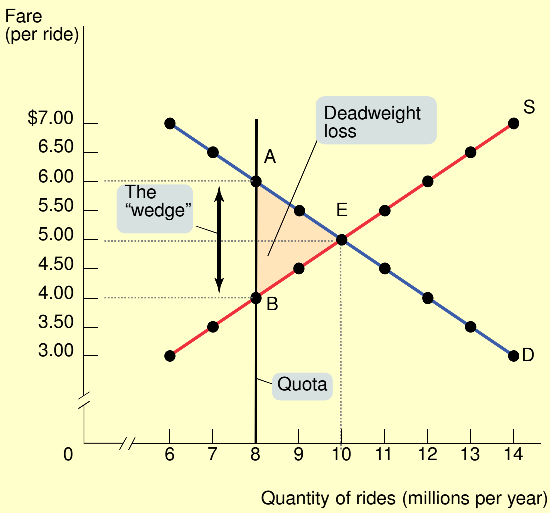
- A **quantity control**, or **quota**, is an upper limit on the quantity of some good that can be bought or sold. The total amount of the good that can be legally transacted is the **quota limit**. An example is the taxi medallion system in New York.
- A **license** gives its owner the right to supply a good.
- The **demand price** of a given quantity is the price at which consumers will demand that quantity.
- The **supply price** of a given quantity is the price at which producers will supply that quantity.

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



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4.50	11	9
4.00	12	8
3.50	13	7
3.00	14	6

The End of Chapter 5

Coming attraction:

Chapter 6:
Elasticity