chapter:
5

>> Price Controls and Quotas: Meddling with Markets

Krugman/Wells
Economics

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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.

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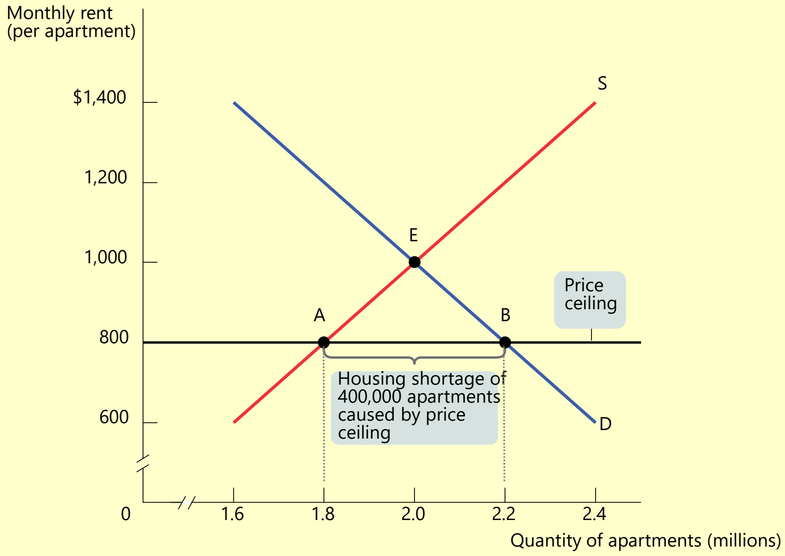
Why Governments Control Prices

- 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



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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

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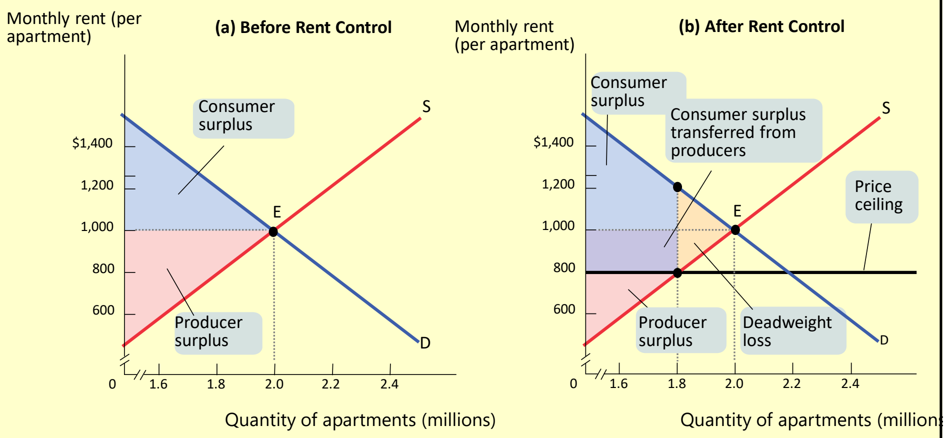
Winners and Losers from Rent Control



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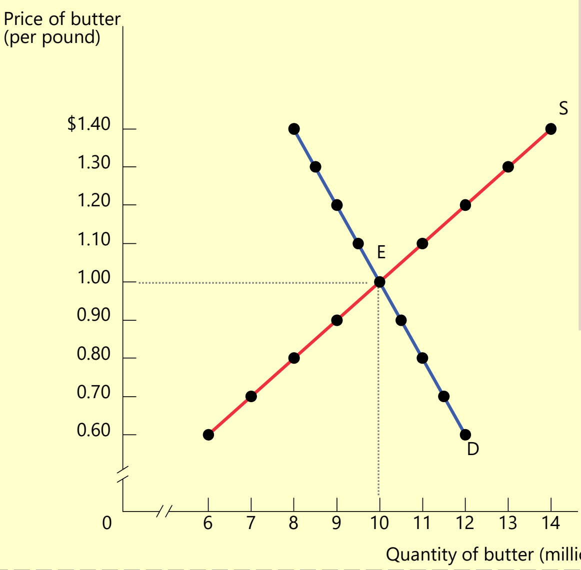
The Market for Butter in the Absence of Government Controls



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

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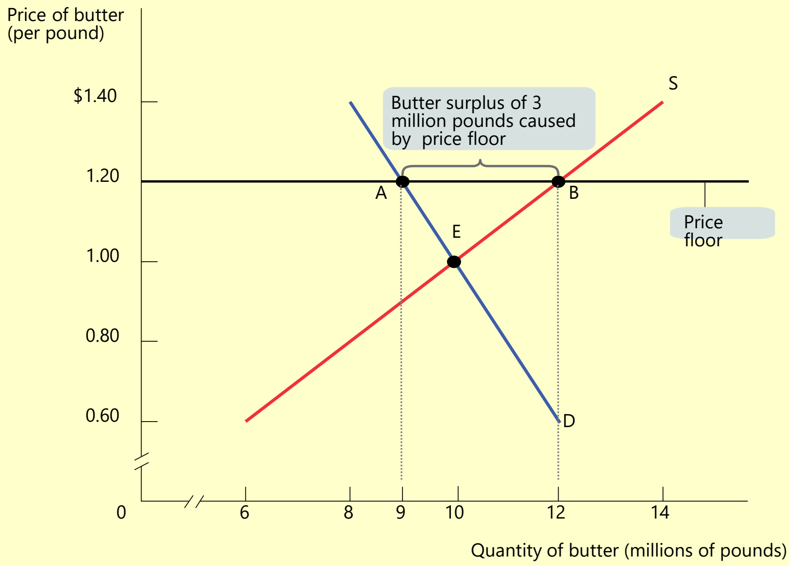
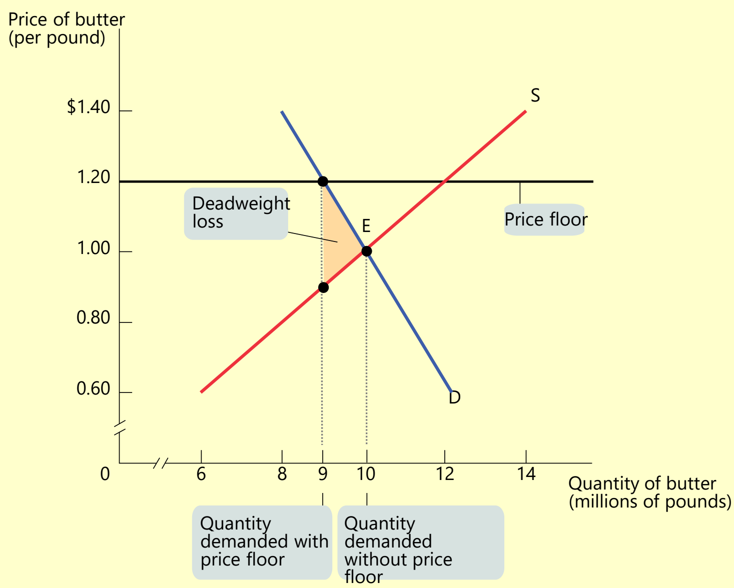
The Effects of a Price Floor



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



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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.

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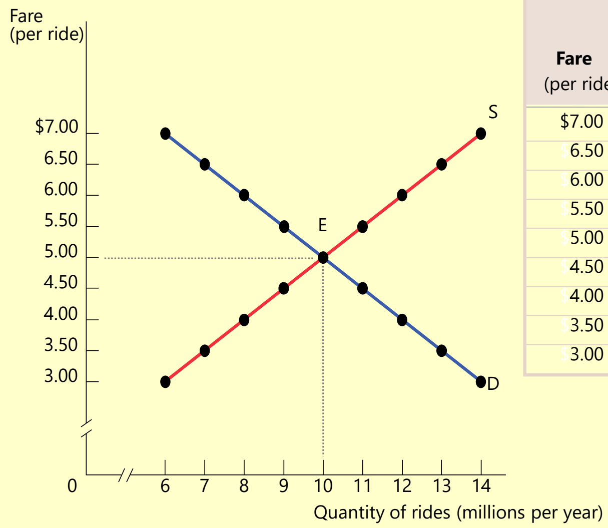
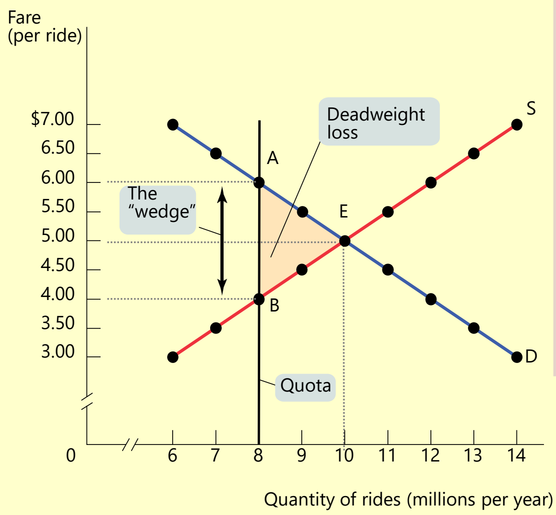
The Market for Taxi Rides in the Absence of Government Controls



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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5.00	10	10
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