

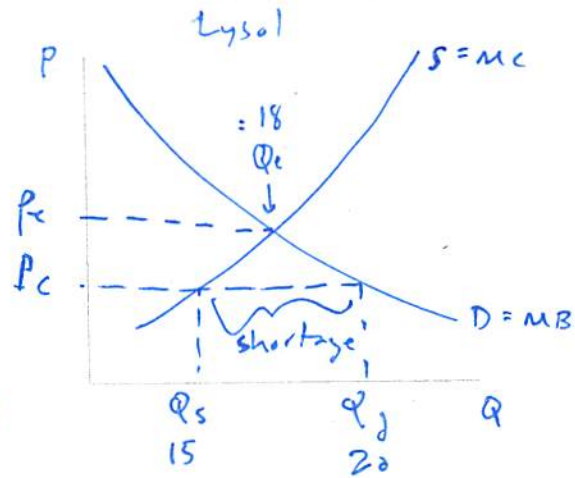
Instructions: After you've done the required readings for Lecture G, on price controls, complete these practice problems. We can discuss these problems when we return on **Tues., March 24.**

1. Draw a graph that illustrates a price ceiling. Make sure you label your axes and curves. Indicate the effect of the price ceiling on the graph. Make up some numbers of Q_d and Q_s , and illustrate how many transactions occur in the market when the price ceiling is in effect.

Without the price ceiling, at P_e , there'd be 18 transactions ($Q_e = 18$)

The price ceiling causes a shortage, and the Q of transactions falls to 15.

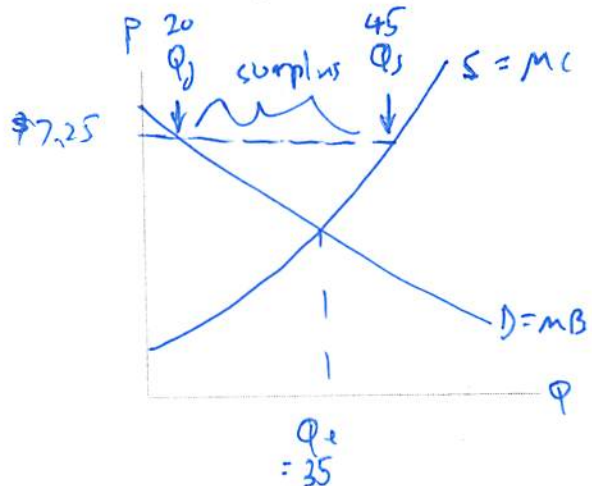
There's a shortage of 3 units.



2. Draw a graph that illustrates a price floor. Make sure you label your axes and curves. Indicate the effect of the price ceiling on the graph. Make up some numbers of Q_d and Q_s , and illustrate how many transactions occur in the market when the price ceiling is in effect.

Here the price floor causes a surplus ($Q_s > Q_d$), of 25 units at the P of \$7.25. The number of transactions is 20.

At P_e the number of transactions would have been 35.



3. What type of price control is each? Circle PF for price floor, and PC for ceiling.

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|------------------|-----------|-----------|----------------------------|-----------|-----------|
| Rent control | PF | <u>PC</u> | Agricultural price support | <u>PF</u> | PC |
| Minimum wage law | <u>PF</u> | PC | Anti-price gouging law | PF | <u>PC</u> |

4. Price controls make certain voluntary, mutually beneficial transactions illegal. By imposing price controls, government is preventing prices from serving their allocative function. Explain some of the other criteria that may replace prices in allocating scarce resources, in the cases of:

a. rent controls – who will end up getting rent controlled apartments, from among all the applicants for them?

People who can prove high income; credit/background checks; no pets; no college students; and there may be discrimination by race, religion, etc., even though that's illegal.

b. minimum wage laws – who will end up getting the minimum wage jobs, from among all the applicants?

Those workers with more experience, skills, and education are more likely than those who will get the jobs. The people without these are less likely to be employed at all.

c. anti-price gouging laws – who will end up getting lumber to rebuild, from among all the consumers who would like to buy lumber after a hurricane?

Whoever's in line first; friends of Lowe's employees, etc.
Not necessarily the people who 'need' it most.

5. Given price controls must reduce the number of transactions that will occur in the price controlled market (which must make society worse off), what do you think is the motivation for politicians to impose price controls? Who lobbies for them? Who lobbies against?

It's political. Anti-price gouging laws sound good, since it seems to address the problem.

Think about ag. price supports. Farmers stand to gain big \$, but consumers only bear a small share of the cost. So farmers lobby for, and consumers don't lobby against.