Microeconomics

3. Government Intervention

Price Ceilings

- **Price ceiling (maximum price):** a price above which it is illegal for a producer to charge
- Must be set **below** the equilibrium price
- e.g. rented accommodation in New York

REASONS FOR IMPOSING PRICE CEILINGS

- ↓ price of merit/necessity goods
- ↑ affordability + ∴ ↑ overall living standard

ECONOMIC CONSEQUENCES

- Shortages + ∴ inefficient resource allocation
- Underground/parallel markets emerge
- Non-price rationing mechanisms

CONSEQUENCES OF PRICE CEILING ON STAKEHOLDERS

<u>Consumers</u>

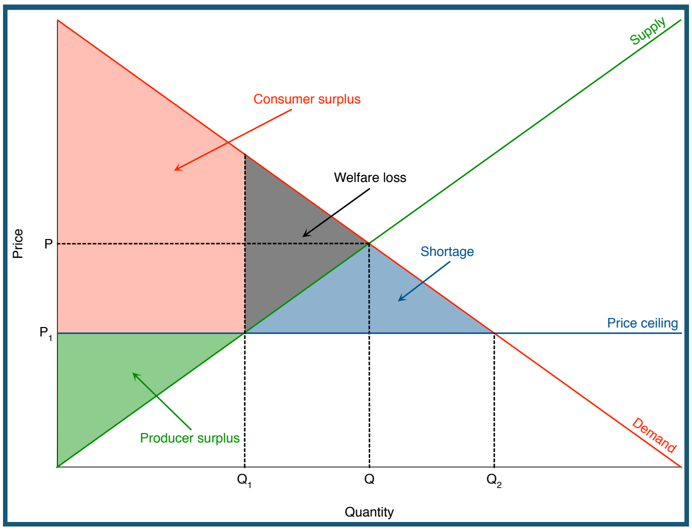
- **Price ↓ ∴ ↑ affordability**
- Excess demand/shortage
- Lower quality goods as less investment
- **Consumer surplus ↓**

<u>Producers</u>

- Revenues ↓ ∴ may lay off workers → unemp.
- Profits ↓ ∴ lack of funds for R&D
- **Producer surplus ↓**

<u>Governments</u>

- Enforcement costs
- ↓ tax revenue from corporation tax
- **Welfare loss ↑**



Price Floors

- **Price floor (minimum price):** a price below which it is illegal for a producer to charge
- Must be set **above** the equilibrium price
- e.g. demerit goods (alcohol), minimum wage

REASONS FOR IMPOSING PRICE CEILINGS

- Protect incomes of producers
- Ensure "liveable wage" for those on low incomes ∴ ↑ incentive for unemp. to work
- ↑ price of demerit goods

ECONOMIC CONSEQUENCES

- Surplus + ∴ inefficient resource allocation

CONSEQUENCES OF PRICE CEILING ON STAKEHOLDERS

<u>Consumers</u>

- **Price ↑ ∴ ↓ affordability**
- Health ↑ as ↓ consumption of demerit goods
- **Consumer surplus**

<u>Producers</u>

- **Revenues ↑**
- **Profits ↑ ∴ ↑ funds for R&D**
- Inefficient producers may enter industry
- **Producer surplus ↓**

<u>Governments</u>

- Fitter workforce ∴ ↓ spending on healthcare
- **Protects industries through ↑ revenues**
- Opportunity cost of buying up surplus
- **Welfare loss ↑**