Introduction to Economics

Demand & Supply Continued

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The Control of Prices

- At the equilibrium price there will be no shortage or surplus.
- May not be the most desired price - Government intervention

- Government sets a minimum price above the equilibrium there will be a surplus
- Government sets a maximum price below the equilibrium there will be a shortage

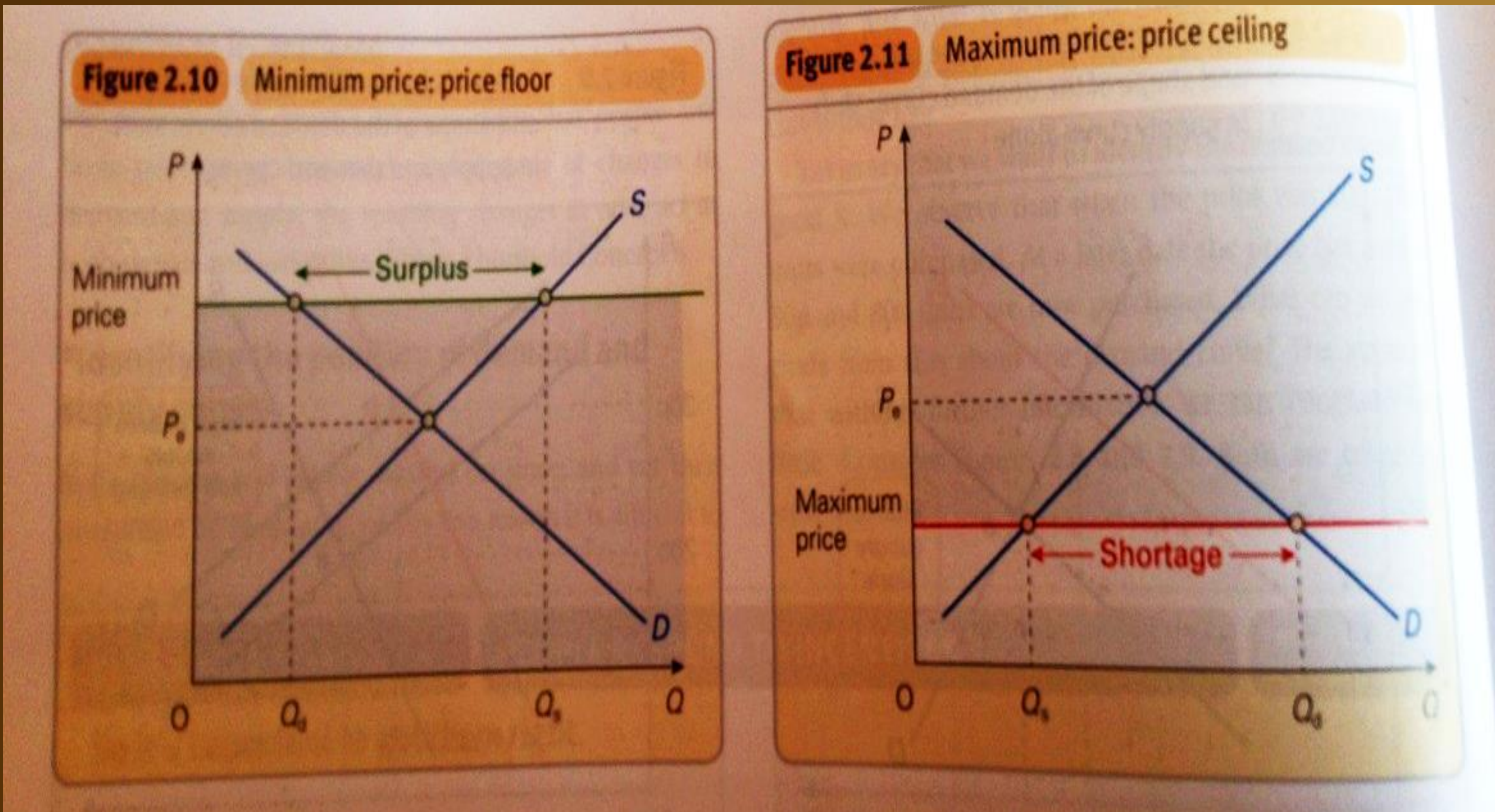
Figure 2.10
Minimum price: price floor
P
S
Minimum price
Surplus
P_e
D
O
Q_d
Q_s
Q
Figure 2.11
Maximum price: price ceiling
P
S
P_e
Maximum price
Shortage
D
O
Q_s
Q_d

Minimum price

- A price floor set by government or some other agency

- The price is not allowed to fall below this level (although it is allowed to rise above it)

Maximum Price

- A price ceiling set by the government or some other agency.

- The price is not allowed to rise above this level (although it is allowed to fall below it)

Setting a minimum (high) price

- To protect producers incomes (industries subject to fluctuations)
- To create a surplus (to be stored for future shortages)
- In the case of wages to prevent workers wages falling below a certain level (gnvt policy on poverty and inequality)

How do Gnvts deal with Surpluses associated with minimum prices?

- Buy & store, destroy, sell abroad
- Artificially reduce supply by restricting producers – introducing quotas
- Raise demand - ^ advertising, alternative uses - impose taxes or subsidies on substitutes

- Problems – evasion, inefficiency

Setting a Maximum (low) price

- Fairness, famine, war

- Associated problems “first come first served”
- Preference to regular customers
- May lead to underground markets – ignoring price and selling illegally

- Rationing – gnvt restricts amount people allowed to buy

Underground Markets

- Traditionally referred to as black markets
- Government prices and controls are ignored and people illegally sell at whatever price illegal demand and supply create

Activities

- Listen to the podcast
  http://www.bbc.co.uk/programmes/b06yn9zv

- Read the article and answer the questions

http://pearsonblog.campaignserver.co.uk/?p=19578