

Answer on Question #38868 – Economics – Microeconomics

Illustrate the effect of price controls when:

- (a) The imposed price is above the market-clearing price

Solution

Price ceilings are not the only sort of price controls governments have imposed. There have also been many laws that establish *minimum* prices, or **price floors**. The graph below illustrates a price floor with price **Pf**. At this price, buyers are in equilibrium, but sellers are not. They would like to sell quantity **Q2**, but buyers are only willing to take **Q3**. To prevent the adjustment process from causing price to fall, government may buy the surplus, as the U.S. government has done in agriculture and in precious metals. If it does not buy the surplus, government must penalize either buyers or sellers or both who transact below the price floor, or else price will fall. Because there is no one else to absorb the surplus, sellers will.



Rationing is necessary to deal with scarcity. When an item is scarce, people must sacrifice something in order to get as much of the item as they would like to have. There are some goods that are not scarce. Air is an example--it is free to all who want to breathe it. Ice is not scarce in Greenland. But almost all other goods are scarce. Price is a way to ration goods. It deprives those who do not have enough income or desire for a product. The function of price as a rationer is most clearly seen when price is prohibited from acting as a rationer, so that some other method of rationing (such as queuing or coupon rationing) must emerge or be developed.