Price Controls... 

- Are usually enacted when policymakers believe the market price is unfair to buyers or sellers. 
- Result in government-created price ceilings and floors.

Price Ceilings & Price Floors

**Price Ceiling** 
- A legally established *maximum* price at which a good can be sold.

**Price Floor** 
- A legally established *minimum* price at which a good can be sold.

Price Ceilings

Two outcomes are possible when the government imposes a price ceiling:

- The price ceiling is *not* binding if set *above* the equilibrium price. 
- The price ceiling is *binding* if set *below* the equilibrium price, leading to a shortage.
**Effects of Price Ceilings**

A binding price ceiling creates ...  
... shortages because $Q_D > Q_S$.  

- Example: Gasoline shortage of the 1970s  
- Examples: Long lines, Discrimination by sellers

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**Lines at the Gas Pump**

In 1973 OPEC raised the price of crude oil in world markets. Because crude oil is the major input used to make gasoline, the higher oil prices reduced the supply of gasoline.

What was responsible for the long gas lines?  
Economists blame government regulations that limited the price oil companies could charge for gasoline.
Rent Control

- Rent controls are ceilings placed on the rents that landlords may charge their tenants.
- The goal of rent control policy is to help the poor by making housing more affordable.
- One economist called rent control “the best way to destroy a city, other than bombing.”
Rent Control in the Long Run...

Price Floors

When the government imposes a price floor, two outcomes are possible.
- The price floor is not binding if set below the equilibrium price.
- The price floor is binding if set above the equilibrium price, leading to a surplus.

A Price Floor That Is Not Binding...

A Price Floor That Is Binding...
Effects of a Price Floor

- A price floor prevents supply and demand from moving toward the equilibrium price and quantity.
- When the market price hits the floor, it can fall no further, and the market price equals the floor price.

A binding price floor causes ... 
... a surplus because $Q_S > Q_D$.
... nonprice rationing is an alternative mechanism for rationing the good, using discrimination criteria.
- Examples: The minimum wage, Agricultural price supports

The Minimum Wage

An important example of a price floor is the minimum wage. Minimum wage laws dictate the lowest price possible for labor that any employer may pay.

The Minimum Wage

A Free Labor Market

![Diagram of labor market with minimum wage]
**The Minimum Wage**

A Labor Market with a Minimum Wage

- Labor surplus (unemployment)
- Labor supply
- Labor demand

**Minimum wage**

0

Quantity demanded

Quantity supplied

Quantity of Labor

**Taxes**

Governments levy taxes to raise revenue for public projects.

**Taxes**

- Tax incidence refers to who bears the burden of a tax.
- Taxes result in a change in market equilibrium.
- Buyers pay more and sellers receive less, regardless of whom the tax is levied on.

**Impact of a 50¢ Tax Levied on Buyers...**

- Price of Ice-Cream Cone
- Supply, S
- Demand, D
- A tax on buyers shifts the demand curve downward by the size of the tax ($0.50).
Impact of a 50¢ Tax Levied on Buyers...

Impact of a 50¢ Tax on Sellers...

The Incidence of Tax

- In what proportions is the burden of the tax divided?
- How do the effects of taxes on sellers compare to those levied on buyers?

The answers to these questions depend on the elasticity of demand and the elasticity of supply.
So, how is the burden of the tax divided?

The burden of a tax falls more heavily on the side of the market that is less elastic.