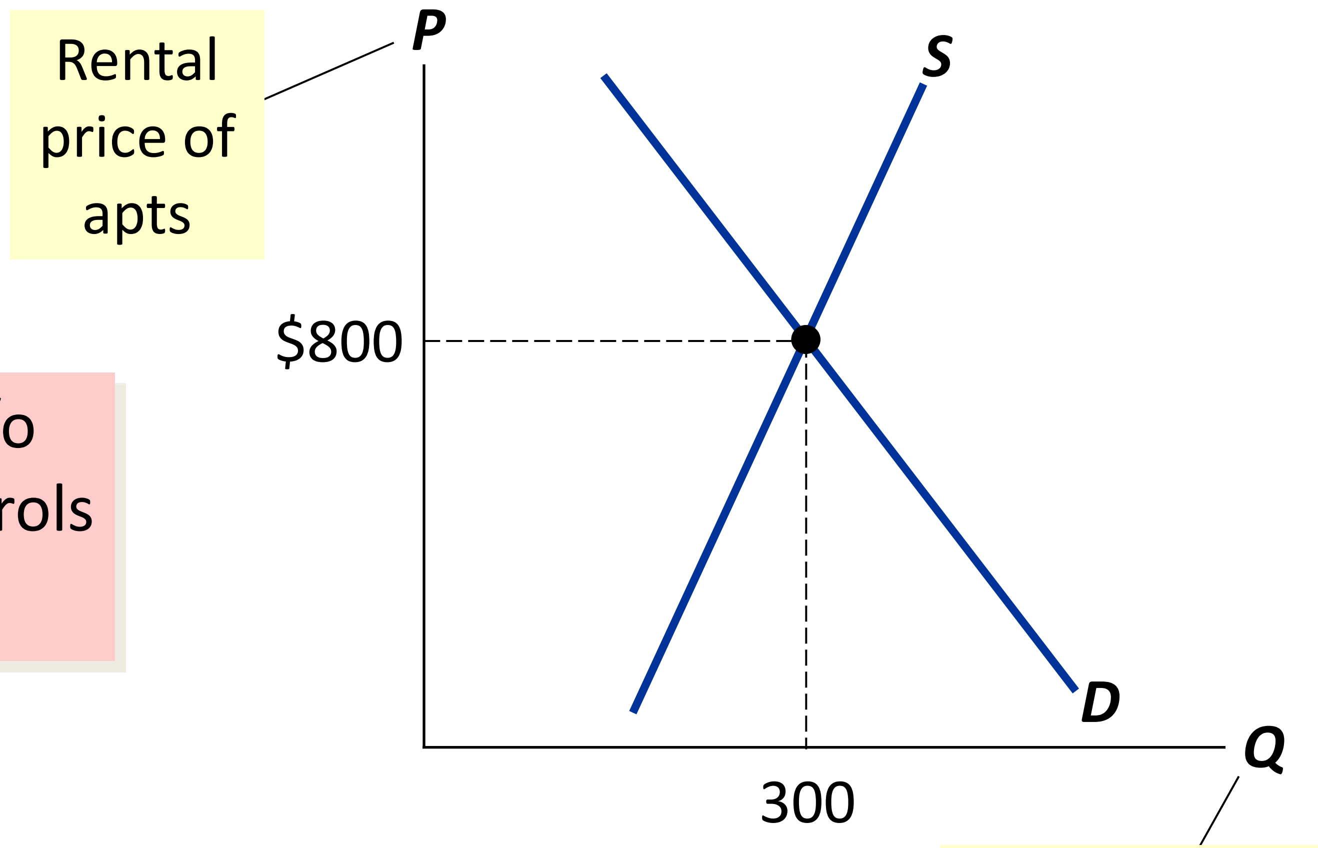
- Price controls
  - **Price ceiling**: a legal maximum on the price of a good or service *Example: rent control*
  - **Price floor**: a legal minimum on the price of a good or service *Example: minimum wage*

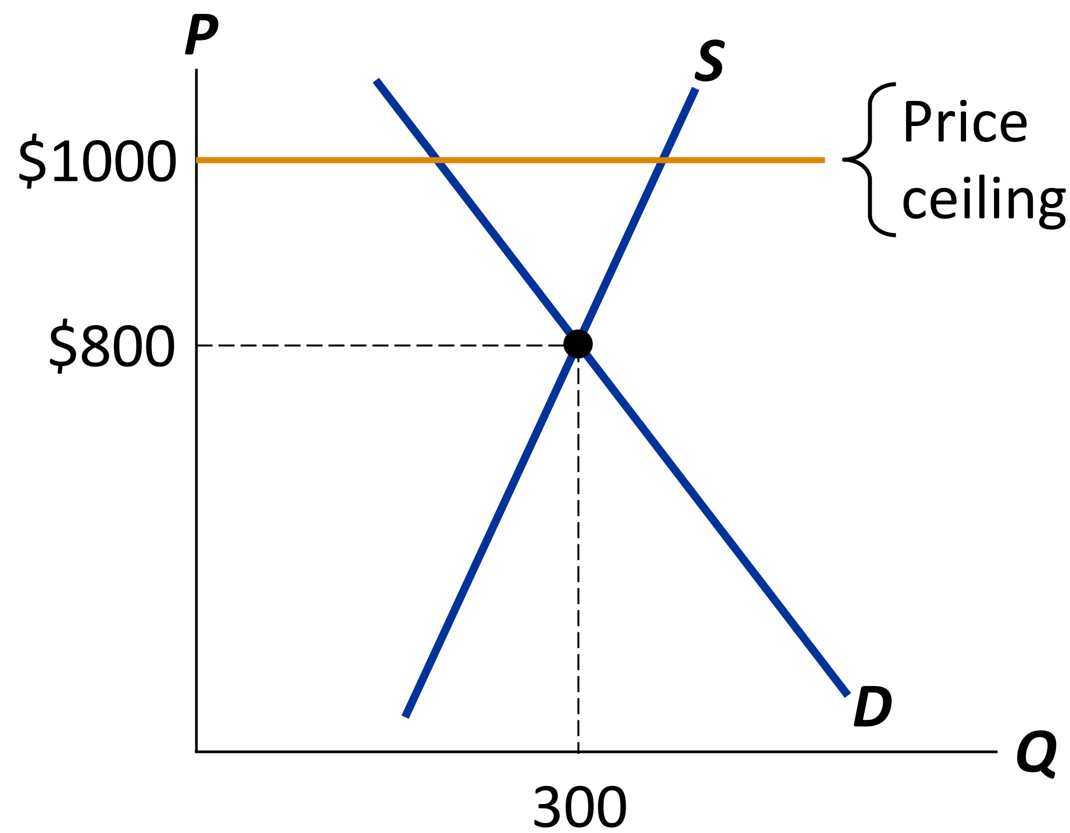
EXAMPLE 1: The Market for Apartments



Eq'm w/o price controls

How Price Ceilings Affect Market Outcomes

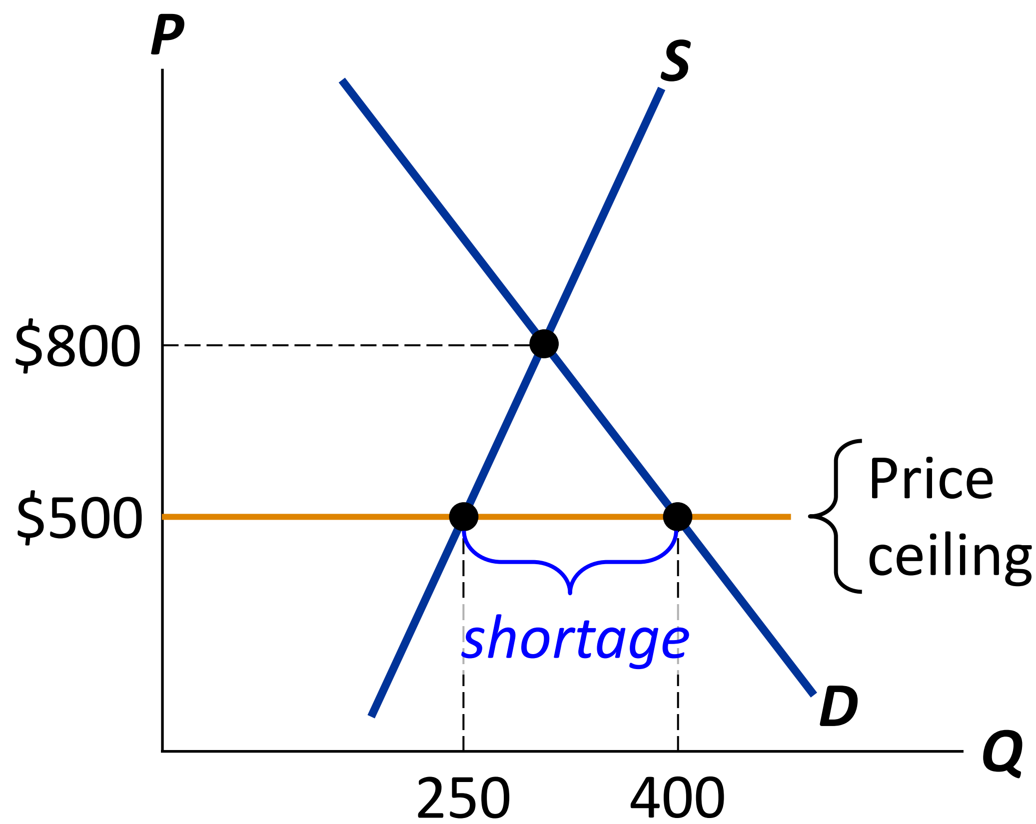
A price ceiling above the eq'm price is **not binding** – has no effect on the market outcome.



How Price Ceilings Affect Market Outcomes

The eq'm price ($800) is above the ceiling and therefore illegal.

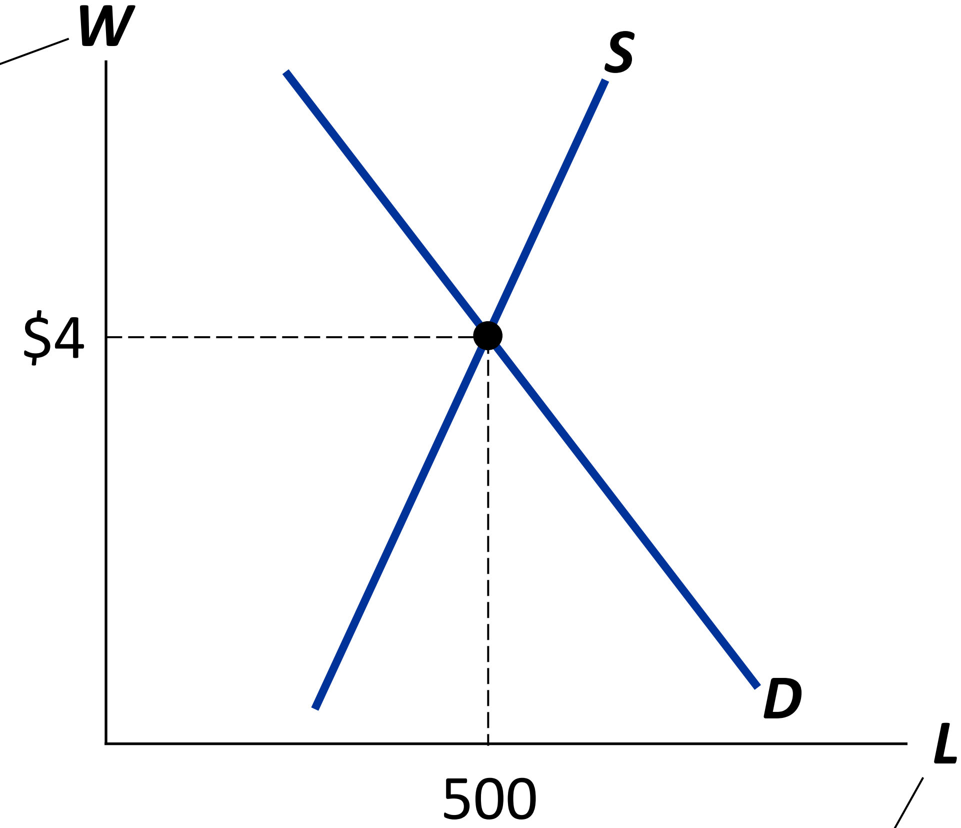
The ceiling is a **binding constraint** on the price, causes a shortage.



EXAMPLE 2: The Market for Unskilled Labor

Wage paid to unskilled workers

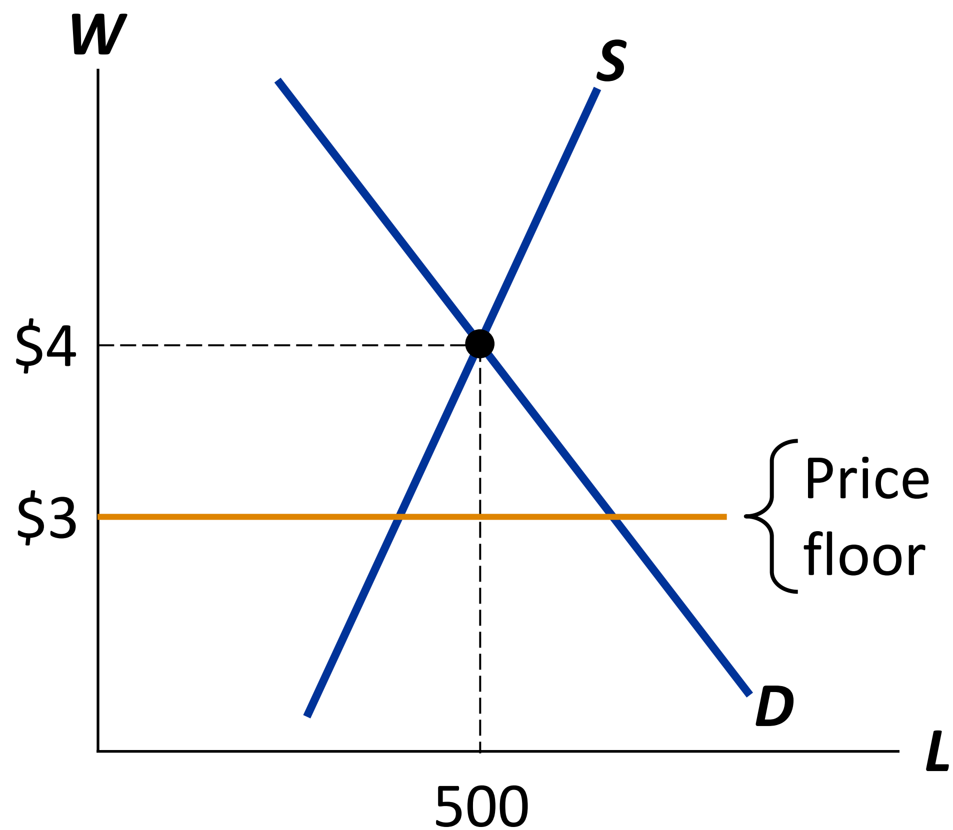
Eq'm w/o price controls



Quantity of unskilled workers

How Price Floors Affect Market Outcomes

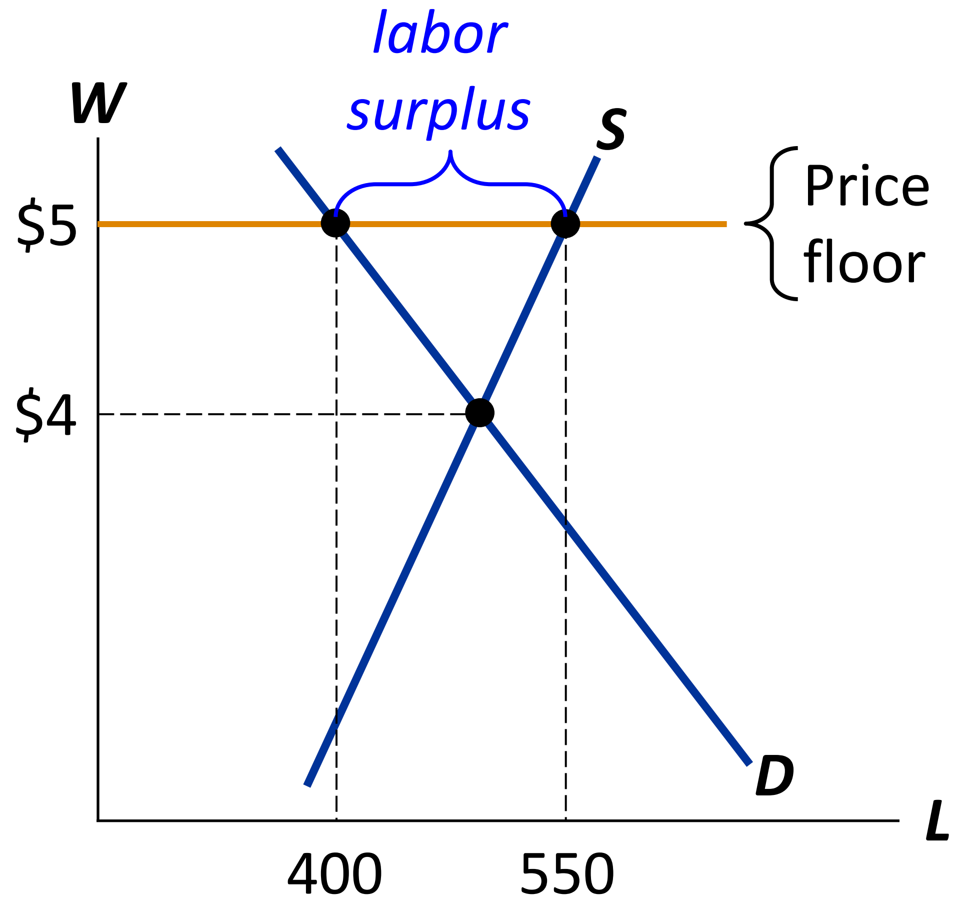
A price floor below the eq'm price is **not binding** – has no effect on the market outcome.



How Price Floors Affect Market Outcomes

The eq'm wage ($4) is below the floor and therefore illegal.

The floor is a **binding constraint** on the wage, causes a surplus (*i.e.*, unemployment).

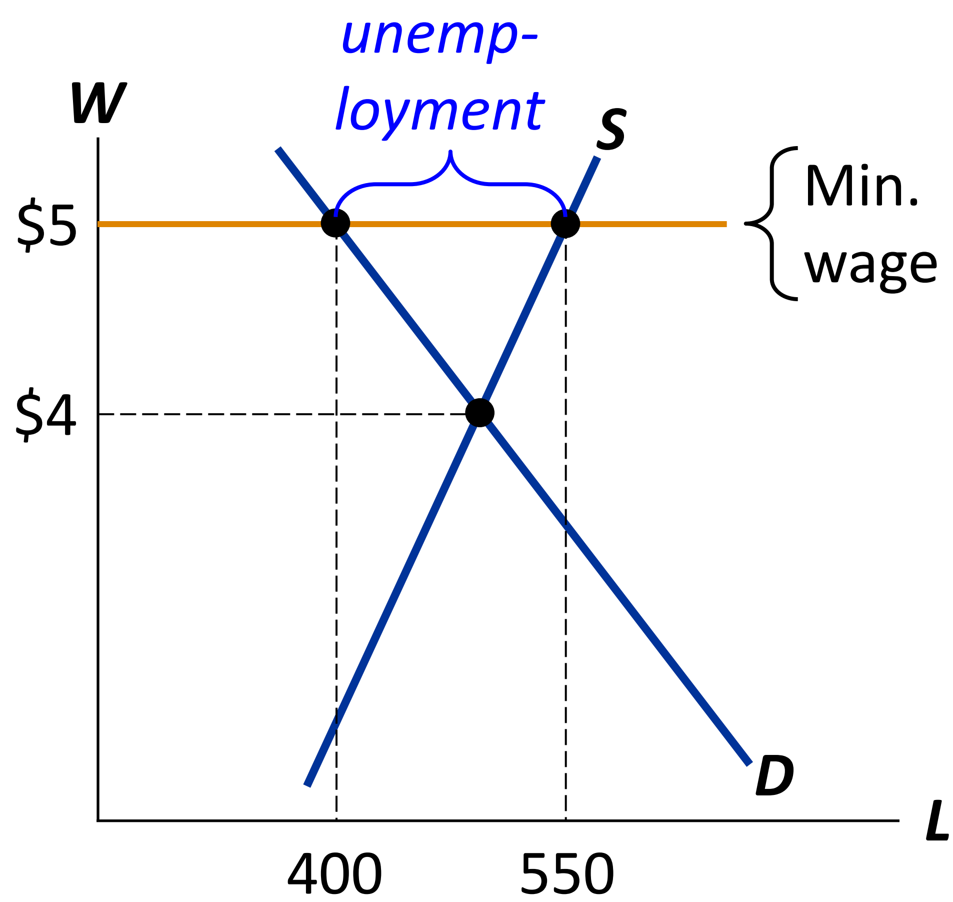


The Minimum Wage

Min wage laws do not affect highly skilled workers.

They do affect teen workers.

Studies:
A 10% increase in the min wage raises teen unemployment by 1-3%.



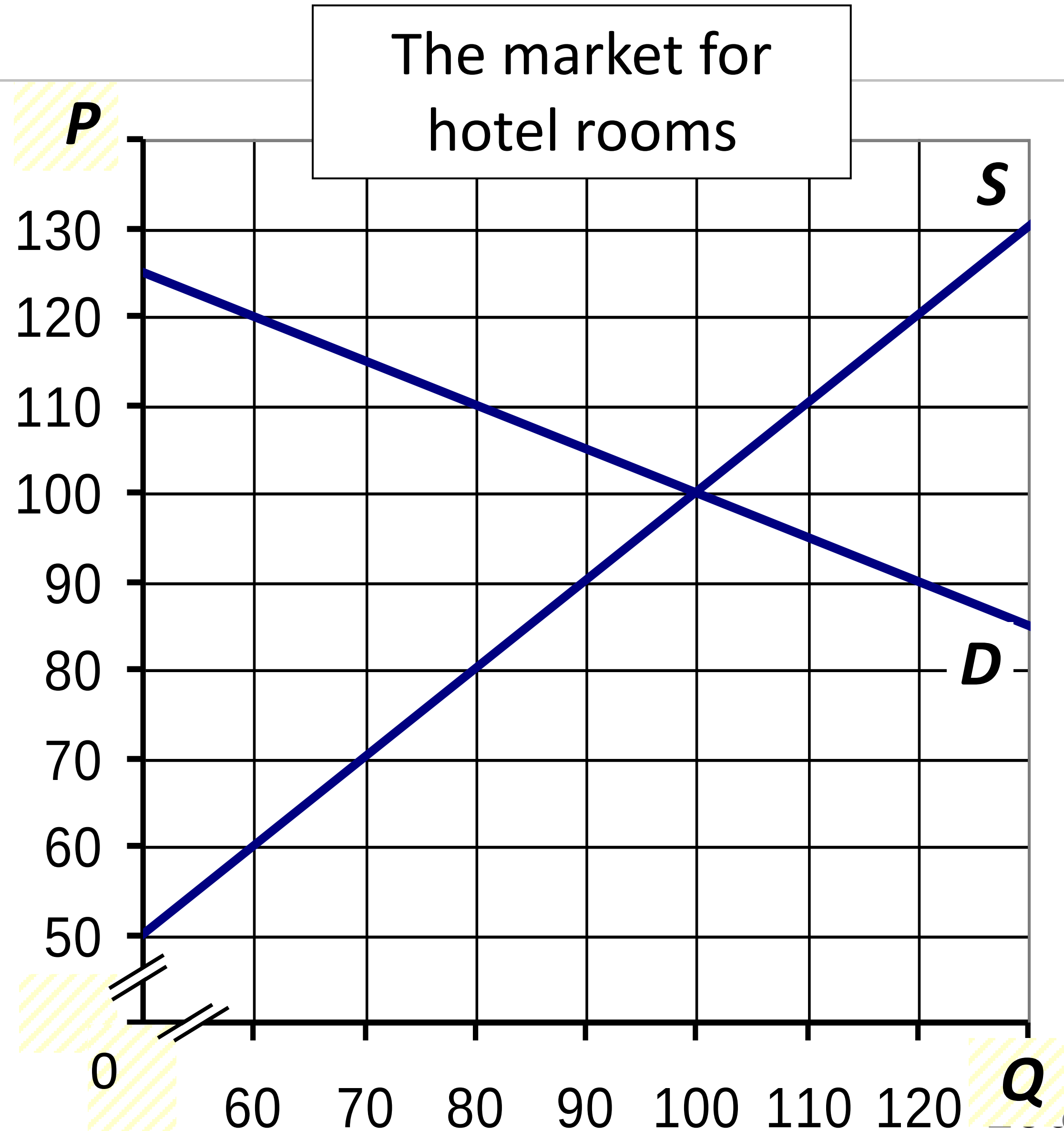
ACTIVE LEARNING *1*
Price controls

Determine effects of:

A. \$90 price ceiling

B. \$90 price floor

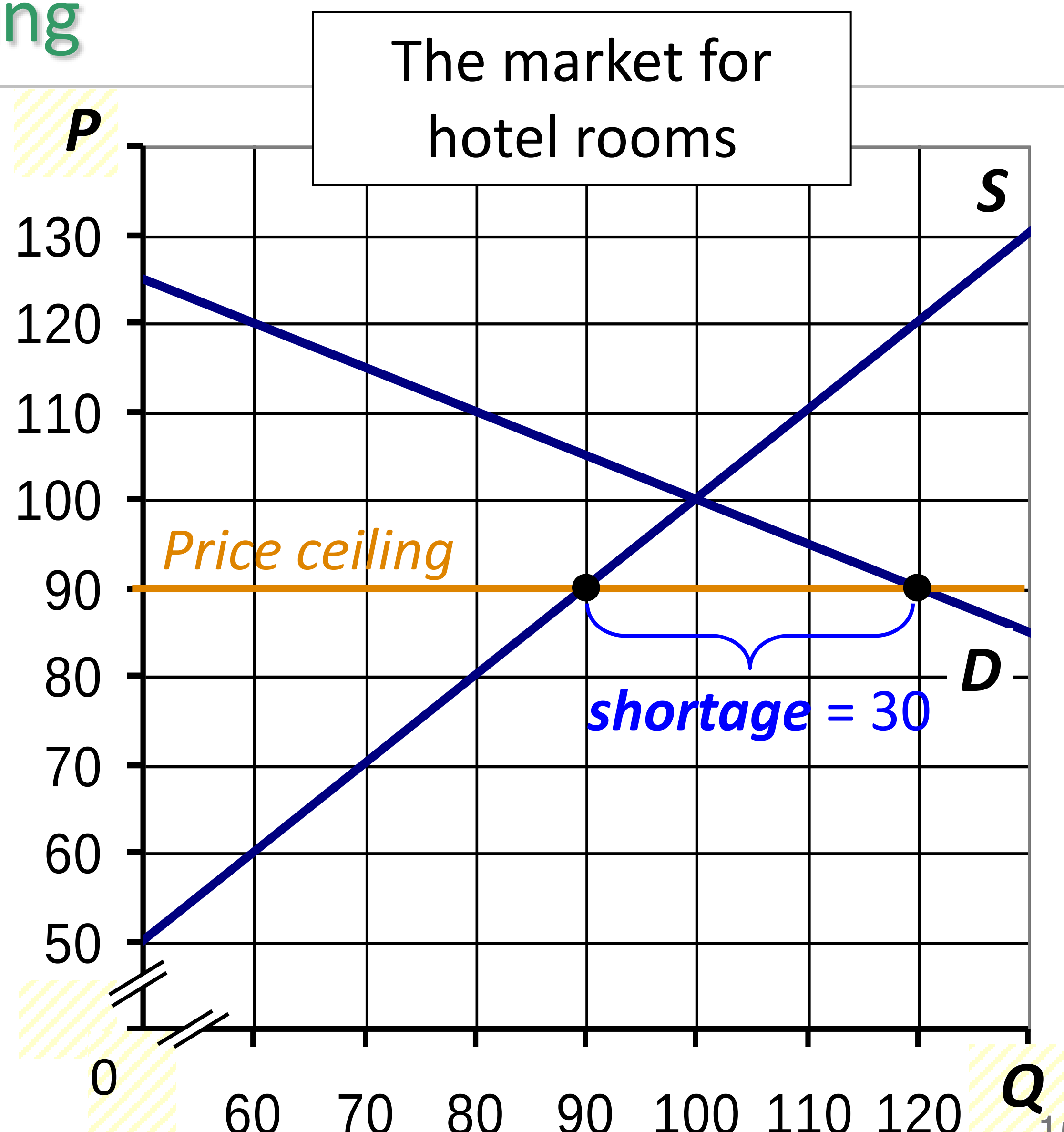
C. \$120 price floor



ACTIVE LEARNING *1*
A. $90 price ceiling

The price falls to $90.

Buyers demand 120 rooms, sellers supply 90, leaving a shortage.



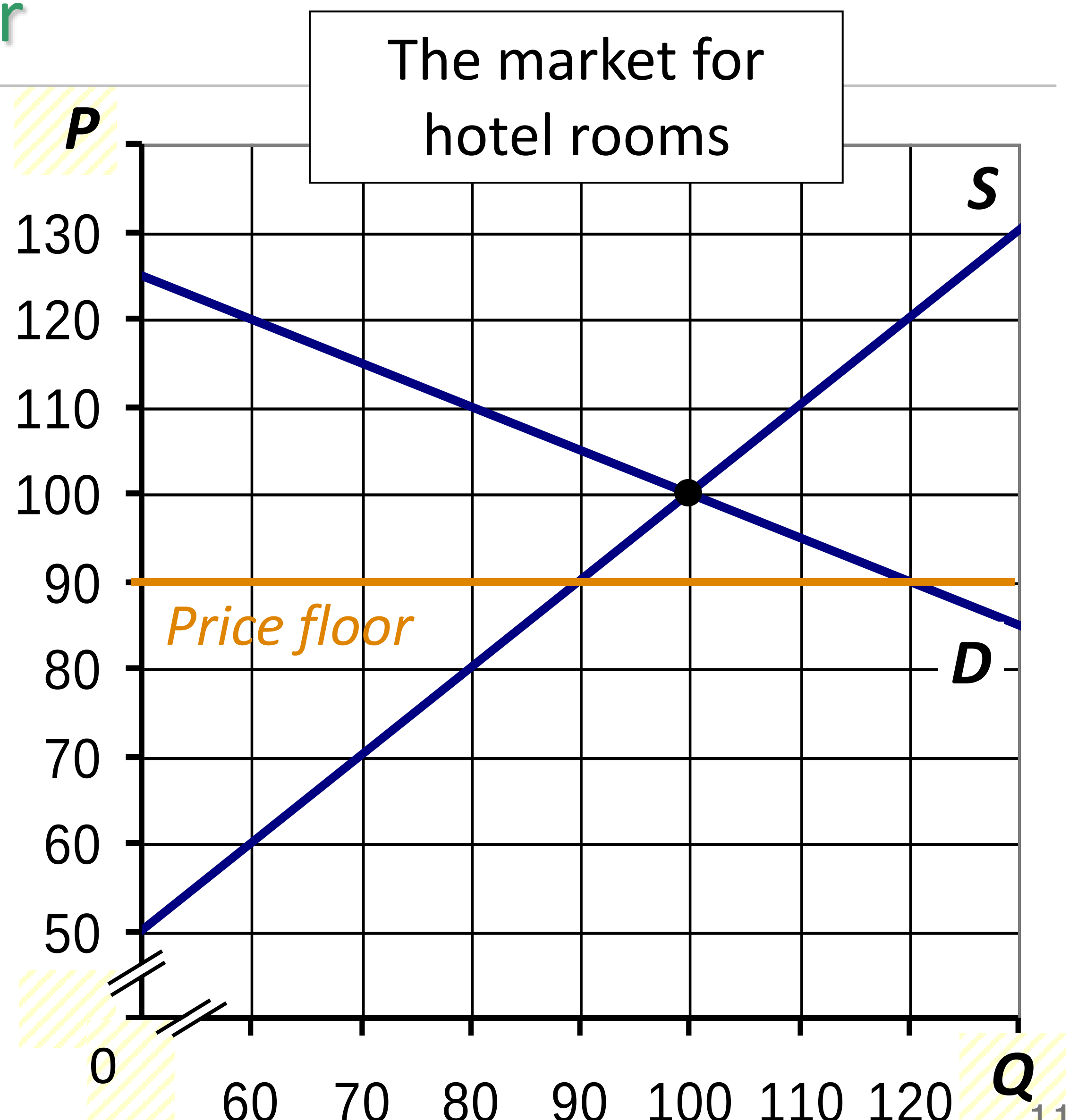
ACTIVE LEARNING *1*

B. $90 price floor

Eq'm price is above the floor, so floor is not binding.

P = $100,

Q = 100 rooms.

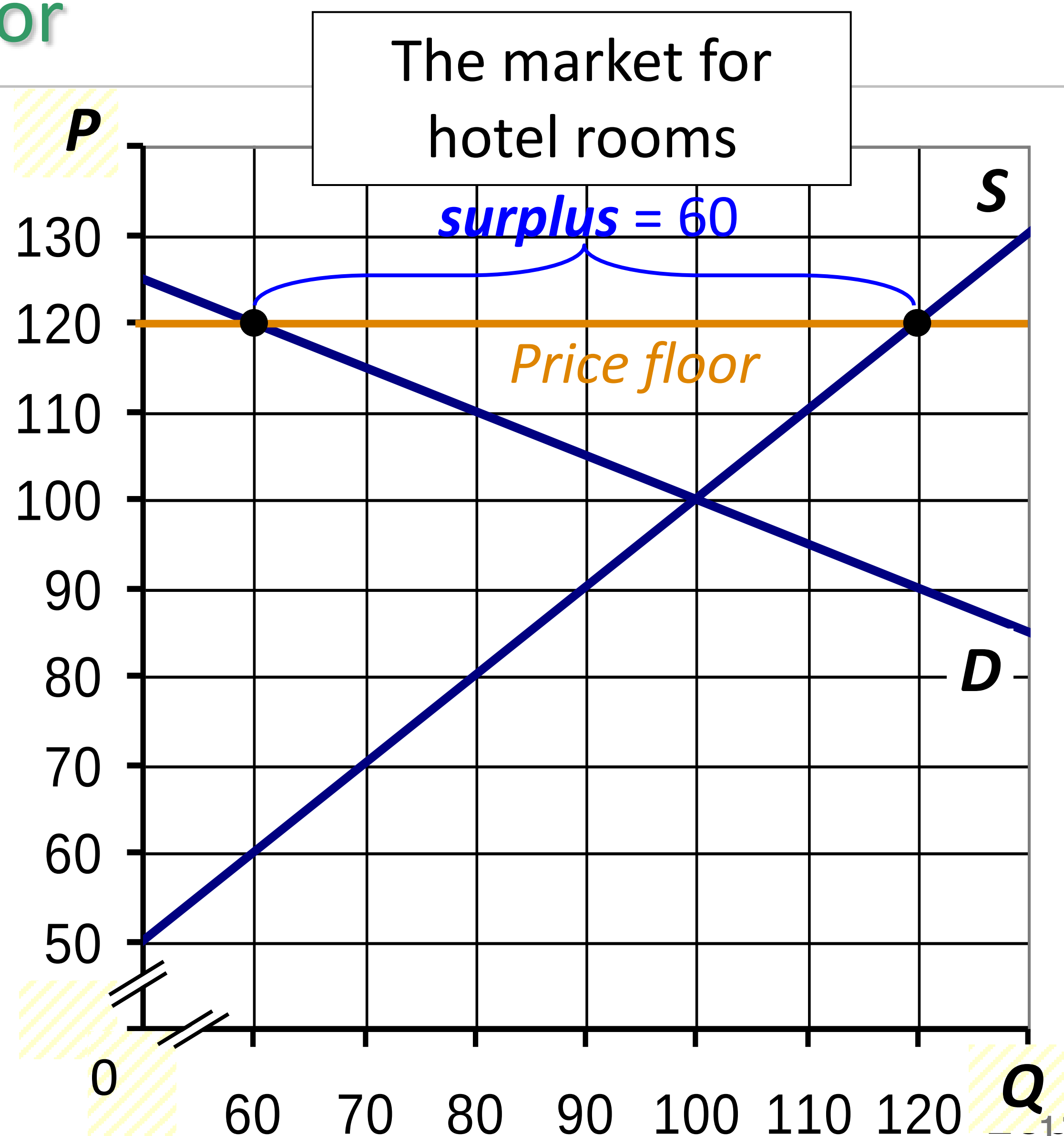


ACTIVE LEARNING *1*

C. $120 price floor

The price rises to $120.

Buyers demand 60 rooms, sellers supply 120, causing a surplus.



Evaluating Price Controls

- Recall one of the Ten Principles from Chapter 1:

  Markets are usually a good way to organize economic activity.

- Prices are the signals that guide the allocation of society's resources. This allocation is altered when policymakers restrict prices.
- Price controls often intended to help the poor, but often hurt more than help.