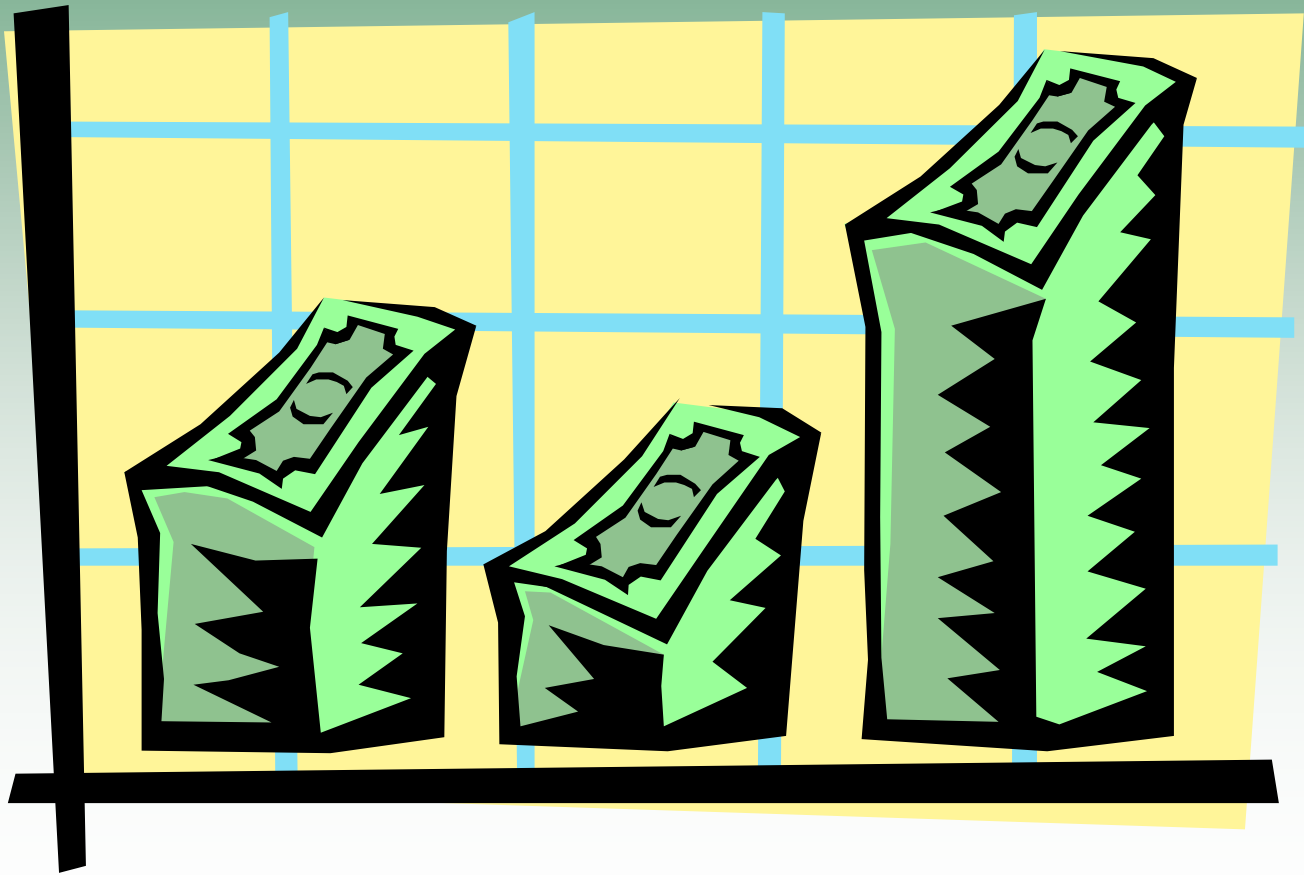


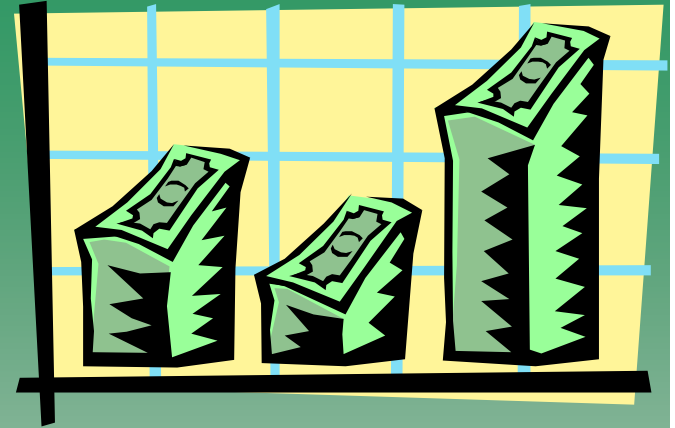
# *HOW THE MARKETS WORK*

## *THE EFFECTS OF PRICES*



# ***PRICES***

## ***CHAPTER CONTENTS***



***É WHAT IS “PRICE” ?***

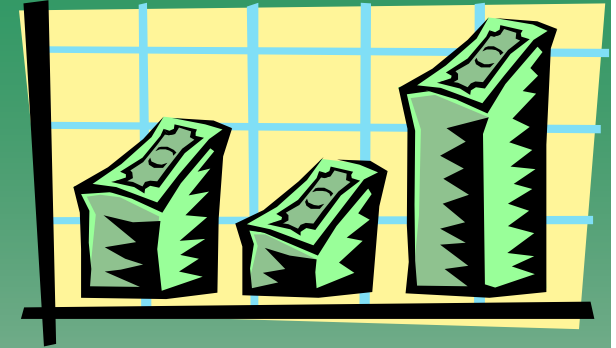
***É EFFECTS ON SUPPLY AND DEMAND >  
WHAT IS “DISEQUILIBRIUM” ?***

***É GOVERNMENTAL ROLES IN CONTROL -  
LING PRICES AND RATIONING = BAD  
IDEAS !!***

***É THE ROLE OF PRICES IN A FREE  
MARKET > ADVANTAGES AND BENEFITS  
OF A PRICE - BASED SYSTEM***

# *PRICES*

*WHAT IS “PRICE” ?*



*IT IS A TOOL FOR DISTRIBUTING AND  
RATIONING GOODS AND RESOURCES  
THROUGHOUT THE ECONOMY > PRICES  
ARE SIGNALS TO PRODUCERS AND  
CONSUMERS*

*WHY DID I USE THE TERM “RATIONING”  
HERE ? BECAUSE ALL GOODS AND RE -  
SOURCES ARE SCARCE AND HAVE TO BE  
ALLOCATED BY SOME METHOD > PRICES  
DO IT BEST !!*

# *PRICES*

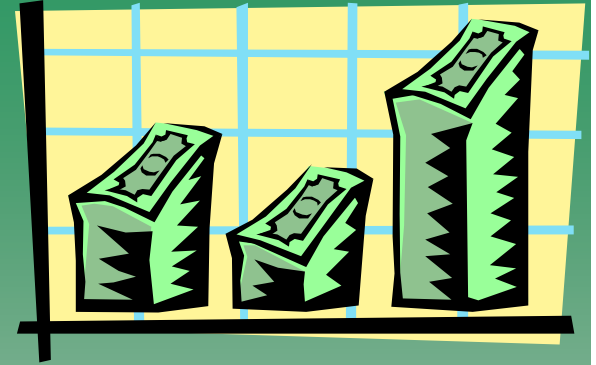


*WHAT IS “DISEQUILIBRIUM” ?*

*IT OCCURS WHEN THE QUANTITY SUPPLIED IS NOT EQUAL TO THE QUANTITY DEMANDED*

*THIS MAY OCCUR WHEN YOU HAVE EITHER EXCESS DEMAND OR SUPPLY - HOW CAN THAT HAPPEN ?? IT IS TEMPORARY, BUT IT DOES*

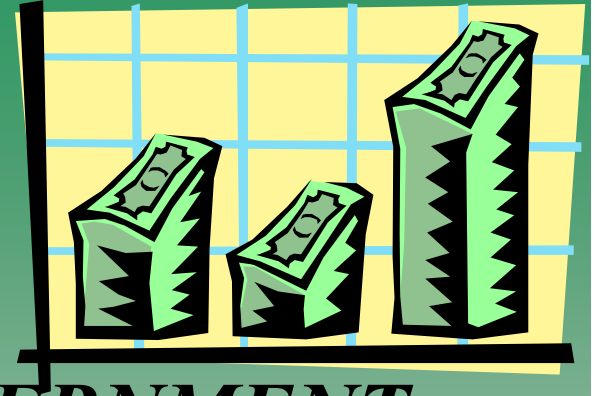
# *PRICES*



*HOW DOES THE MARKET FIX  
THE DISEQUILIBRIUM PROBLEM ?*

*AS LONG AS PRICES ARE FLEXIBLE ,  
MARKET FORCES WILL NATURALLY PUSH  
THE MARKET TOWARD THE EQUILIBRIUM  
POINT ( PRICES ARE A KEY TOOL OF  
ADAM SMITH'S “INVISIBLE HAND ”)*

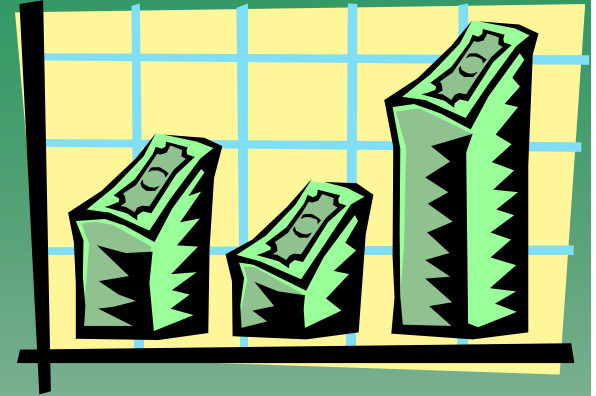
# *PRICES*



*HOWEVER, SOMETIMES GOVERNMENT OFFICIALS THINK THAT PRICE MANAGEMENT FOR OR ANOTHER FORM OF **RATIONING** IS NEEDED - DIVIDING UP GOODS AND SERVICES USING CRITERIA OTHER THAN PRICE*

***WHY WOULD THEY BELIEVE THIS ??***

# *PRICES*



*THE 2 MOST COMMON  
REASONS GIVEN FOR  
GOVERNMENT INTERVENTION TO  
CONTROL THE PRICE SYSTEM*

*É ~~CITIZENS~~ ~~OR~~ ~~BUSINESSES~~ ~~ARE~~ ~~BEING~~  
~~TAKING~~ ~~ADVANTAGE~~ ~~OF~~ ~~PROTECT~~ ~~SOME~~  
É ~~CITIZENS~~ ~~OR~~ ~~BUSINESSES~~ ~~CAN~~ ~~NOT~~  
~~SURVIVE~~ ~~POLITICAL~~ ~~REASONS~~ !!*

*WITH THE EXCEPTION OF A VERY FEW UNIQUE  
SITUATIONS PRICE CONTROLS OR RATIONING DO  
NOT WORK BECAUSE THEY FAIL THE TESTS OF  
EQUITY AND EFFICIENCY !!*

# PRICES

*Essential > Adjective . Basic , indispensable , or fundamental .*

Synonym

*Necessary*

Related

*Critical*

Antonym

*Worthless*

*Her participation was essential to the success of the team .*

ó RENT

**SOUNDS GREAT**

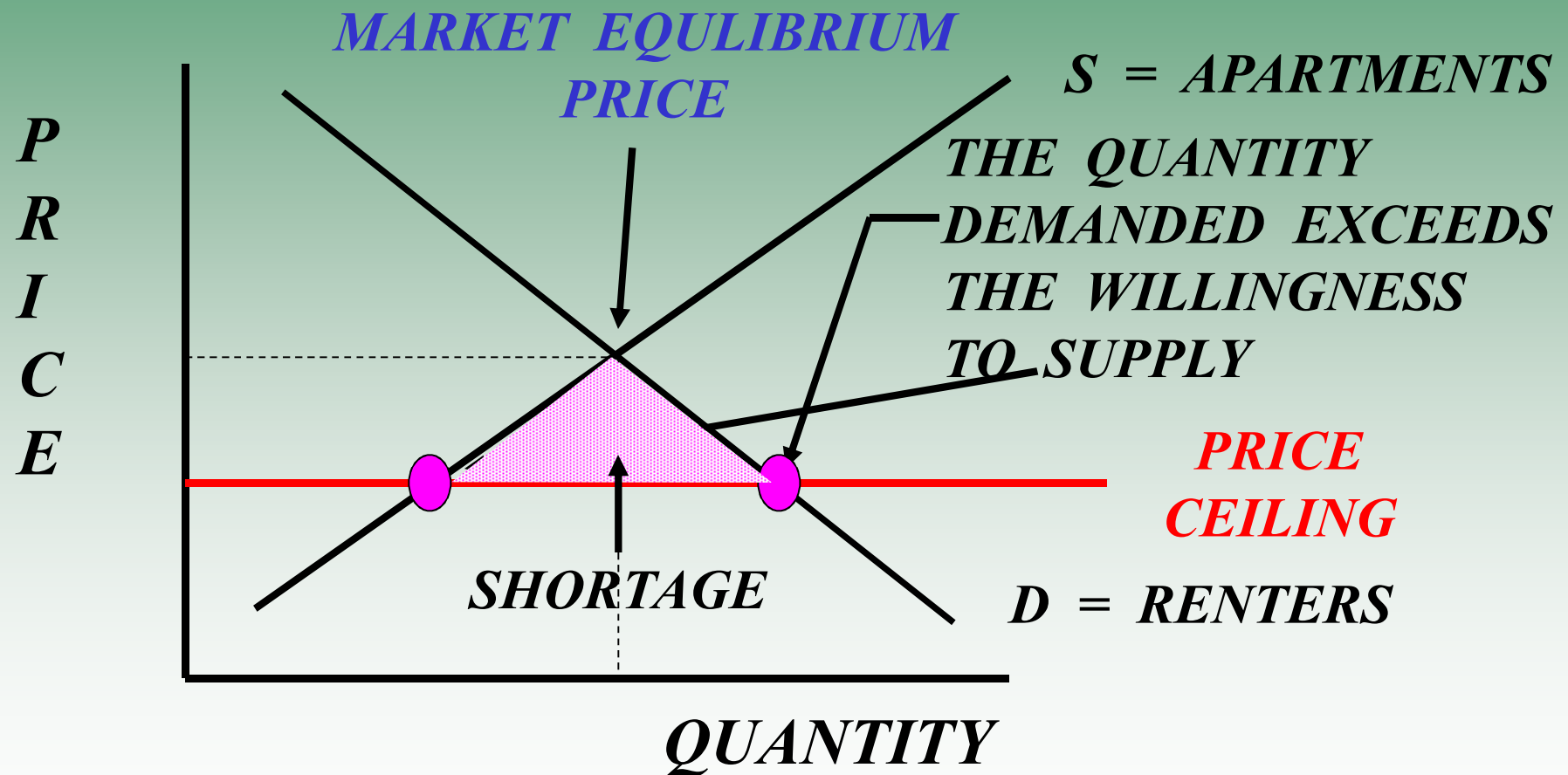
ó CREDIT CARD INTEREST





# **PRICES** *WHY DO POLITICANS DO THIS ?? THEY TRULY BELIEVE YOU ARE STUPID !!*

## **WHY PRICE CEILINGS DO NOT WORK**



**MARKET > RENTAL HOUSING**

# *PRICES*



*Stifle > Verb . To hold or kill off by preventing respiration .*

*Synonym*

*Suffocate*

*Smother*

*Related*

*Thwart*

*Antonym*

*Breathe*

*Refresh*

*Without oxygen the flame was stifled .*

*É PROMOTES DISCRIMINATION*

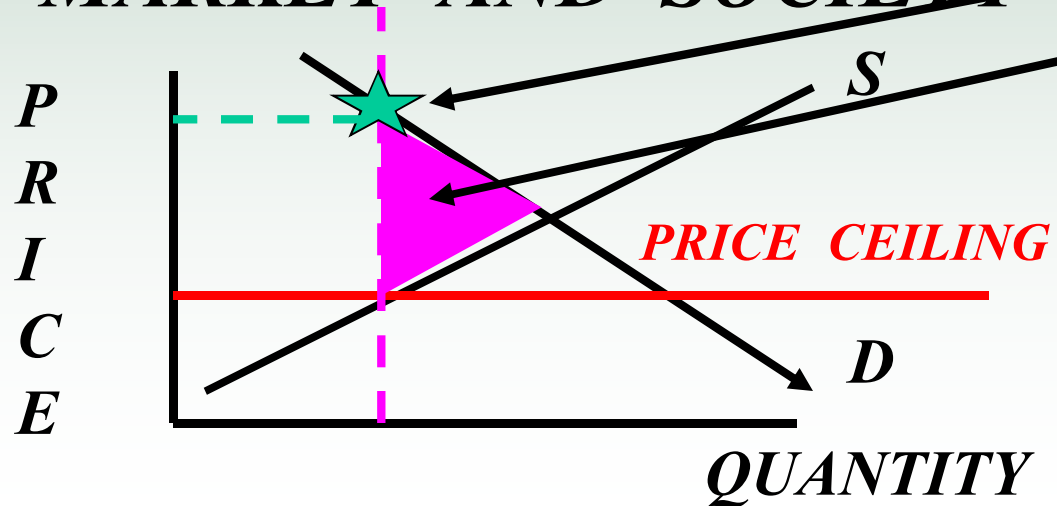
*É PROMOTES A **BLACK MARKET** - WHEN  
BUSINESS IS CONDUCTED WITHOUT ....*

# *PRICES*

*DAMAGE DONE BY PRICE  
CEILINGS > RENT CONTROL*

*EXAMPLE > 4 CONSIDERATIONS :*

*É .... REGARD FOR GOVERNMENT  
CONTROLS ON PRICE , QUANTITY , OR  
QUALITY = VERY DAMAGING TO THE  
MARKET AND SOCIETY*



*BLACK MARKET PRICE  
SOCIAL COST OF THE  
BLACK MARKET*



# ***PRICES***

## ***GOVERNMENT INTERVENTION***

### ***TO CONTROL PRICES - 2 CATEGORIES :***

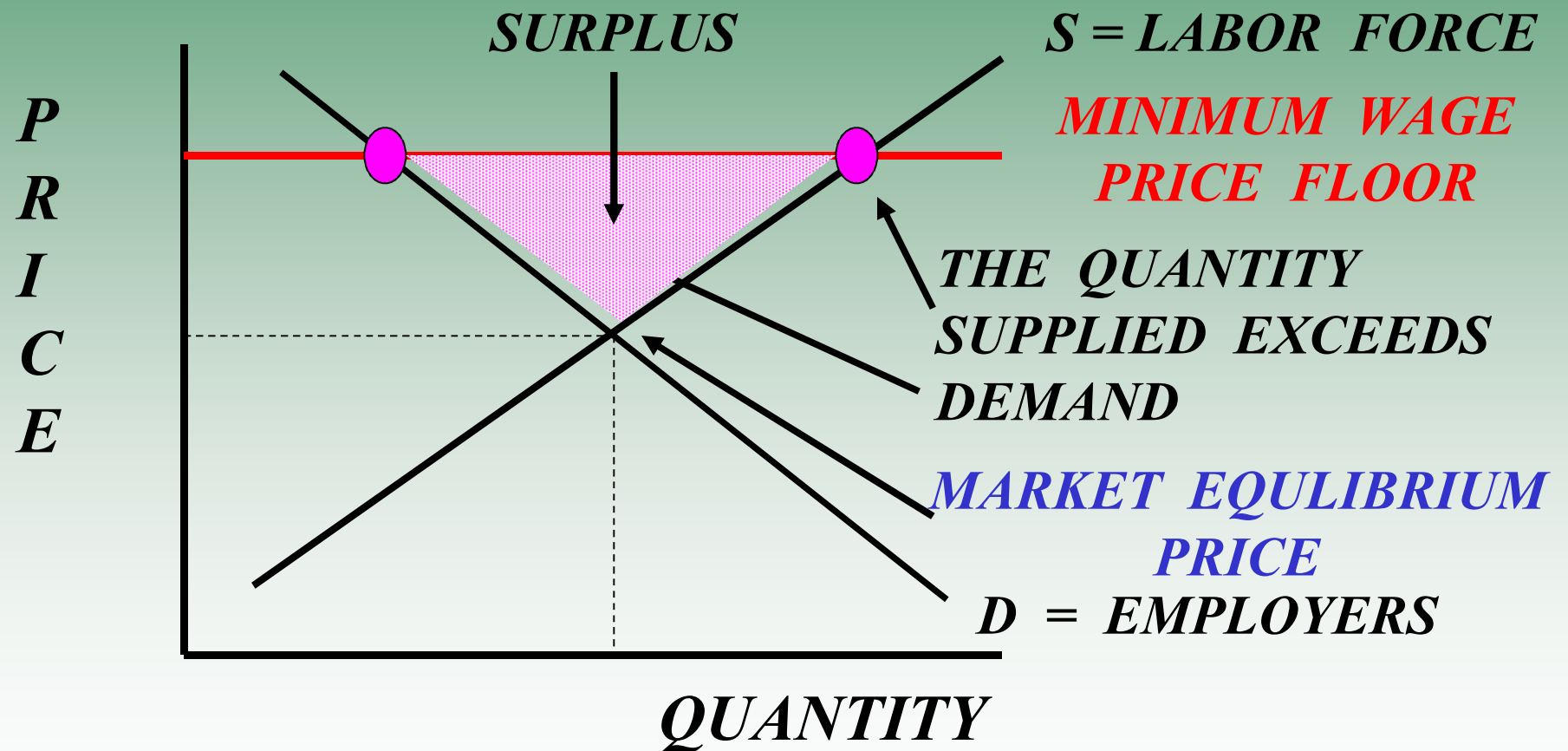


***É # 2 PRICE FLOOR - MINIMUM PRICE FOR  
A GOOD OR SERVICE > 2 EXAMPLES :***

***ó # 1 - MINIMUM WAGE - THE  
MINIMUM PRICE THAT AN EMPLOYER  
CAN PAY A WORKER FOR AN HOUR  
OF LABOR > ITS PURPOSE IS TO  
SUPPORT LOW SKILLED AND INEX -  
PERIENCED WORKERS ..... BUT  
DOES IT ??***

**PRICES** *WHY DO POLITICANS DO THIS ?? YES,  
THEY TRULY BELIEVE YOU ARE STUPID !*

*WHY PRICE FLOORS DO NOT WORK*



*MARKET > LOW SKILLED LABOR*

# ***PRICES***

***DAMAGE DONE BY PRICE  
FLOORS > MINIMUM WAGE***

***EXAMPLE > 5 CONSIDERATIONS :***

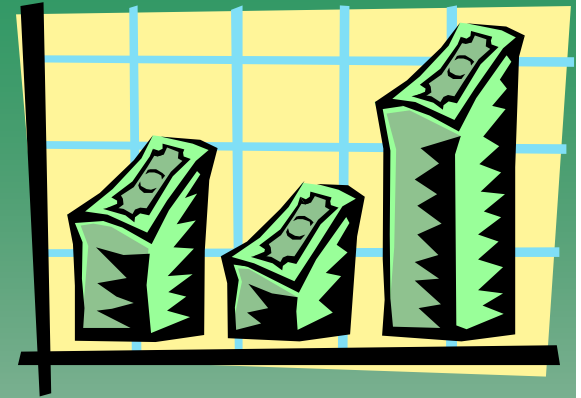
***É DISCOURAGES BUSINESS INVESTMENT  
AND GROWTH BY ADDING COSTS***

***É CREATES ILLEGAL WORKER PROBLEMS***

***É LEADS TO HIGHER UNEMPLOYMENT***

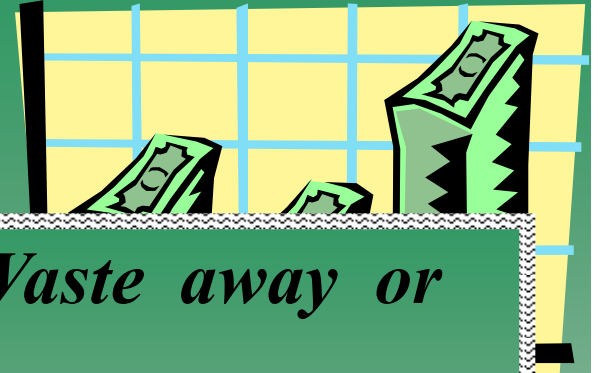
***FOR YOUNG ADULTS AND  
LOW SKILLED WORKERS***

***É PROMOTES  
DISCRIMINATION***





# PRICES



*Deteriorate / Deterioration > Verb . Waste away or let fall apart .*

## Synonym

*Atrophy*

*Degrade*

## Related

*Destroy*

*Spoil*

## Antonym

*Build*

*Grow*

*The building deteriorated over time without maintenance .*

# ***PRICES***

***GOVERNMENT INTERVENTION  
TO CONTROL PRICES - 2 CATEGORIES :  
É # 2 PRICE FLOOR > 2 EXAMPLES :***

***ó AGRICULTURE PRICE SUPPORTS  
( SUBSIDIES ) - PAID TO FARMERS ,THE  
DIFFERENCE BETWEEN THE MARKET  
EQUILIBRIUM PRICE ( WORLD  
MARKET PRICE ) AND THE PRICE  
NEEDED TO MAKE A SPECIFIC  
PROFIT .... BUT WHY ?? FARMERS ON  
AVERAGE MAKE 30 % MORE INCOME  
THAN THE AVERAGE AMERICAN !!***



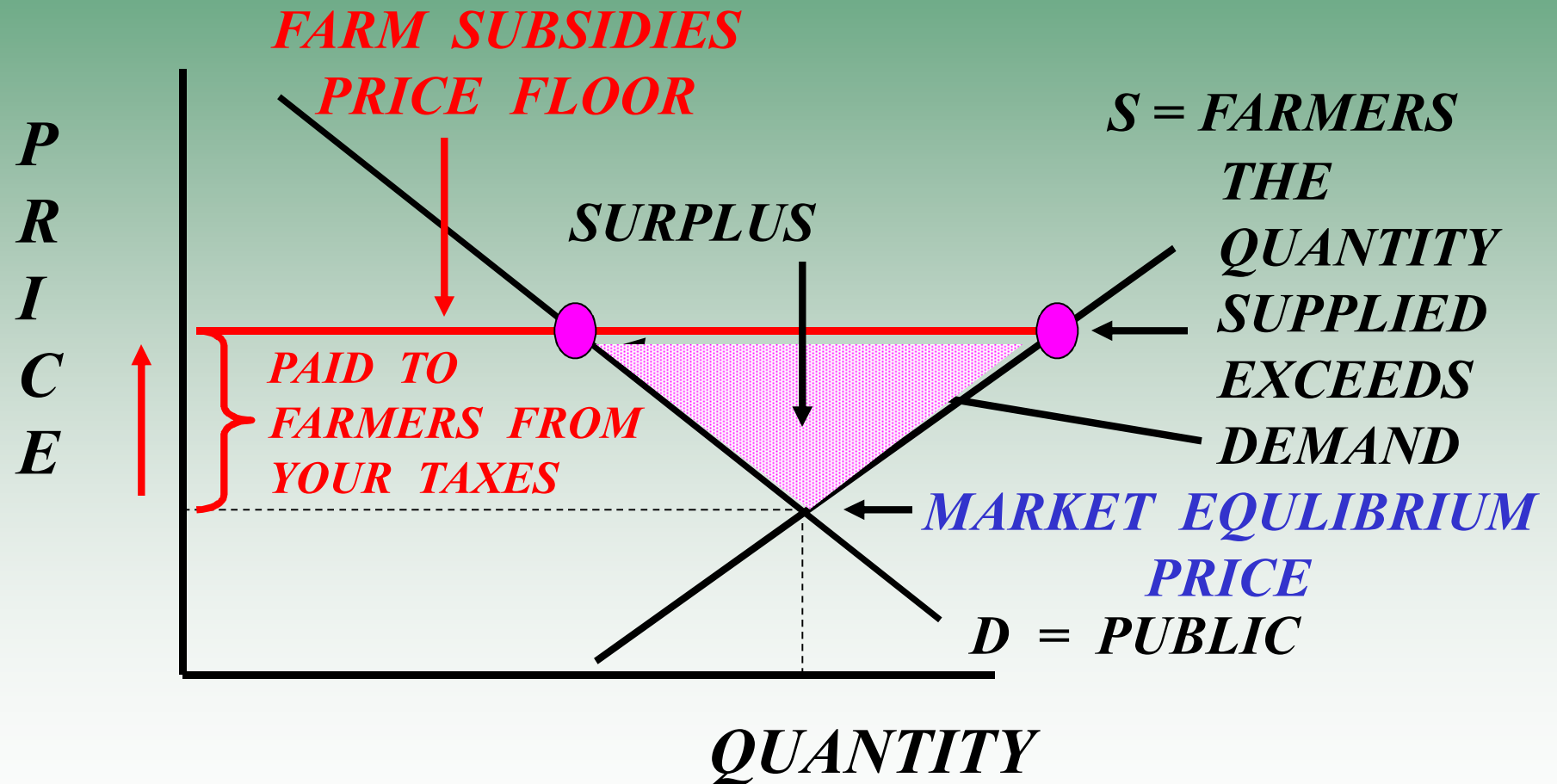


Rank	Program	Number of Recipients	1995-2006 Subsidy Total
<b><i>OVER 200 BILLION DOLLARS IN TEN YEARS !!</i></b>			
1.	<u>Corn Subsidies</u>	1,568,095	\$56,170,875,257
2.	<u>Wheat Subsidies</u>	1,308,268	\$22,051,566,200
3.	<u>Cotton Subsidies</u>	247,879	\$21,329,862,262
4.	<u>Conservation Reserve Program</u>	768,180	\$20,337,282,263
5	<u>Disaster Payments</u>	1,246,432	\$15,114,518,393
6	<u>Soybean Subsidies</u>	985,712	\$14,239,702,740
7	<u>Rice Subsidies</u>	65,533	\$11,043,795,298
8	<u>Sorghum Subsidies</u>	586,766	\$4,569,912,363
9	<u>Dairy Program Subsidies</u>	151,737	\$3,560,356,847
10	<u>Livestock Subsidies</u>	754,842	\$2,908,502,988
11	<u>Peanut Subsidies</u>	89,463	\$2,609,286,072
12	<u>Barley Subsidies</u>	337,812	\$1,962,025,270
13	<u>Env. Quality Incentive Program</u>	115,206	\$943,955,199
14	<u>Tobacco Subsidies</u>	383,889	\$530,488,022
15	<u>Sunflower Subsidies</u>	57,976	\$461,135,751
16	<u>Apple Subsidies</u>	8,586	\$261,540,987
17	<u>Sugar Beet Subsidies</u>	9,071	\$242,064,005
18	<u>Canola Subsidies</u>	19,390	\$200,281,433
19	<u>Oat Subsidies</u>	620,641	\$198,255,252
20	<u>Wool Subsidies</u>	73,277	\$185,590,080

***SOURCE : 2009 , ENVIRONMENTAL WORKING GROUP AND UNITED STATES FEDERAL GOVERNMENT PUBLIC RECORDS***

# PRICES

## WHY PRICE FLOORS DO NOT WORK



*MARKET > COTTON*

# *PRICES*



*Ironic / Irony > Noun . The use of words to convey the opposite of their literal meaning .*

*Synonym*

*Cynical*

*Related*

*Biting*

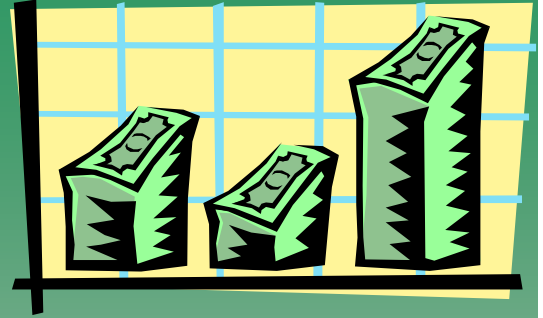
*Antonym*

*Straightforward*

*It is ironic that the minimum wage hurts the people it is supposed to help the most .*

***POVERTY BY DISCOURAGING  
DEVELOPMENT IN THIRD WORLD  
COUNTRIES***

# ***PRICES***



***SUMMARY > 3 REASONS WHY  
GOVERNMENT PRICE CONTROLS AND  
RATIONING NEVER WORKS :***

***É LEADS TO MARKET INEFFICIENCY AND  
UNPRODUCTIVE RESOURCES BY :***

***ó LIMITING CHOICES***

***ó ELIMINATING INCENTIVES***

***É LEADS TO INEQUITY BY PROMOTING  
DISCRIMINATION***

***É STIFLES GROWTH AND REDUCES THE  
STANDARD OF LIVING***

# ***PRICES***

## ***THE 6 ADVANTAGES OF AN UNREGULATED PRICE BASED SYSTEM :***



***É PRICES PROVIDE A COMMON  
LANGUAGE FOR BUYERS AND SELLERS***

***É PRICES PROVIDE REAL TIME  
INFORMATION REGARDING SUPPLY  
AND DEMAND FOR A GOOD OR  
SERVICE***

***É FLEXIBLE PRICES PROVIDE A CONVEN -  
IENT TOOL FOR SOLVING PROBLEMS  
OF EXCESS SUPPLY AND DEMAND***

# PRICES



*Theory / Theoretical > Noun / Adverb . Organized knowledge applicable in a relatively wide variety of circumstances , a system of assumptions or accepted principles .*

## Synonym

*Hypothesis*

*Conjecture*

## Related

*Guess*

*Speculation*

## Antonym

*Certainty*

*Knowledge*

*It is theoretical that there is life on other planets in the universe .*

***TARGET THE AUDIENCE THEY WANT***

# ***PRICES***

***THREE OCCASIONAL FREE MARKET PROBLEMS > USUALLY CALLED MARKET FAILURES :***

***É IMPERFECT COMPETITION - SOMETIMES THERE IS NOT ENOUGH COMPETITION AMONG SELLERS TO LOWER THE MARKET PRICE = MONOPOLY***

***É IMPERFECT INFORMATION - BUYERS DO NOT HAVE ENOUGH INFORMATION TO MAKE AN INFORMED DECISION > .....***



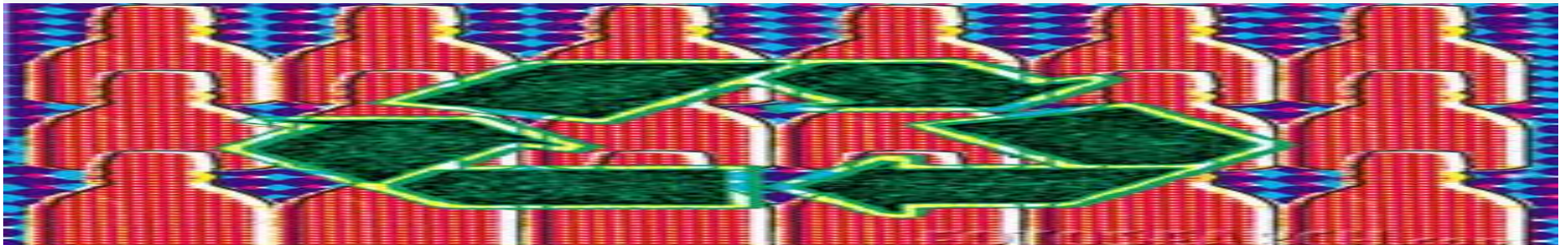


# *PRICES*

*THREE OCCASIONAL FREE MARKET PROBLEMS > USUALLY CALLED MARKET FAILURES :*

*É ... TECHNOLOGY HAS BECOME  
A TWO EDGED SWORD*

*É **SPILLOVER COSTS** - COSTS PASSED ON  
TO THE CONSUMER IN THE FORM OF  
HIGHER PRICES AS THE RESULT OF  
GOVERNMENT REGULATIONS*





# ***PRICES***

## ***SUMMARY :***

***É WHAT IS PRICE ?***

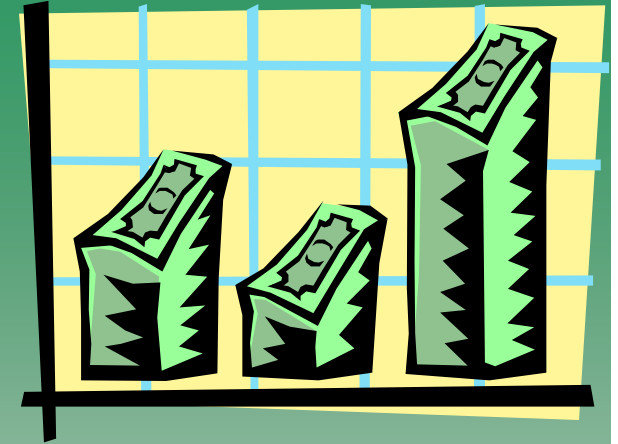
***É WHAT IS EQUILIBRIUM ?***

***É WHAT IS DISEQUILIBRIUM ?***

***É HOW IS THE DISEQUILIBRIUM  
PROBLEM FIXED ?***

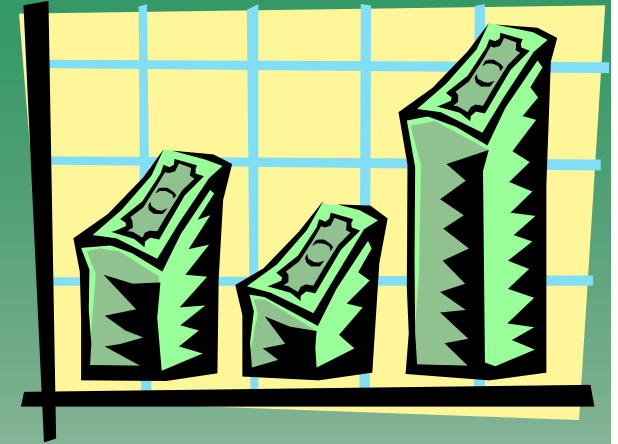
***É WHAT TYPES OF GOVERNMENT  
INTERVENTION ARE USED ?***

***É WHAT ARE THE 6 ADVANTAGES OF  
A PRICE BASED SYSTEM ?***



# ***PRICES***

## ***SUMMARY :***

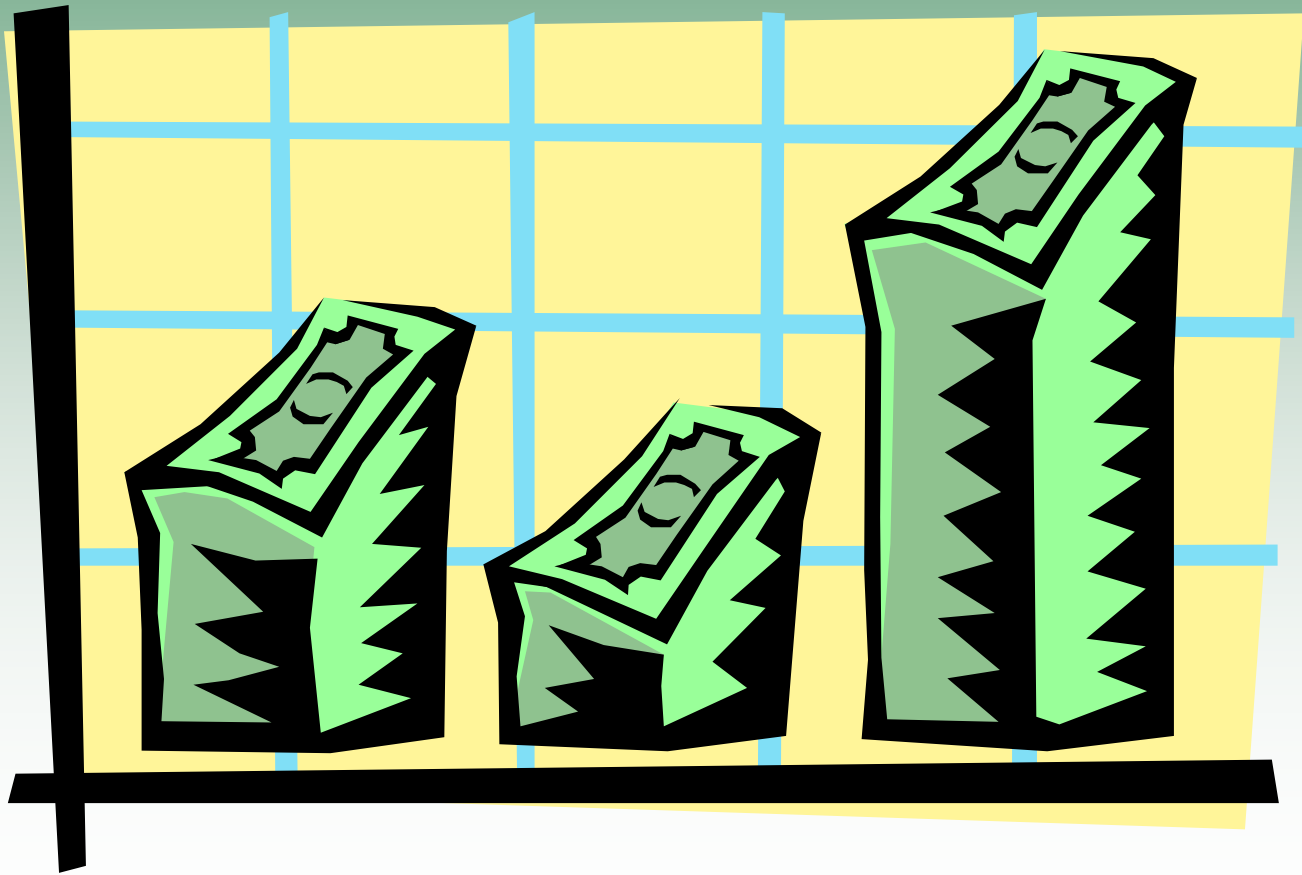


***É WHAT MARKET PROBLEMS OCCUR  
RELATED TO PRICES ?***

***É WHAT ARE RATIONING AND THE  
BLACK MARKET ?***



# *A DEEPER LOOK AT PRICE CEILINGS AND FLOORS*



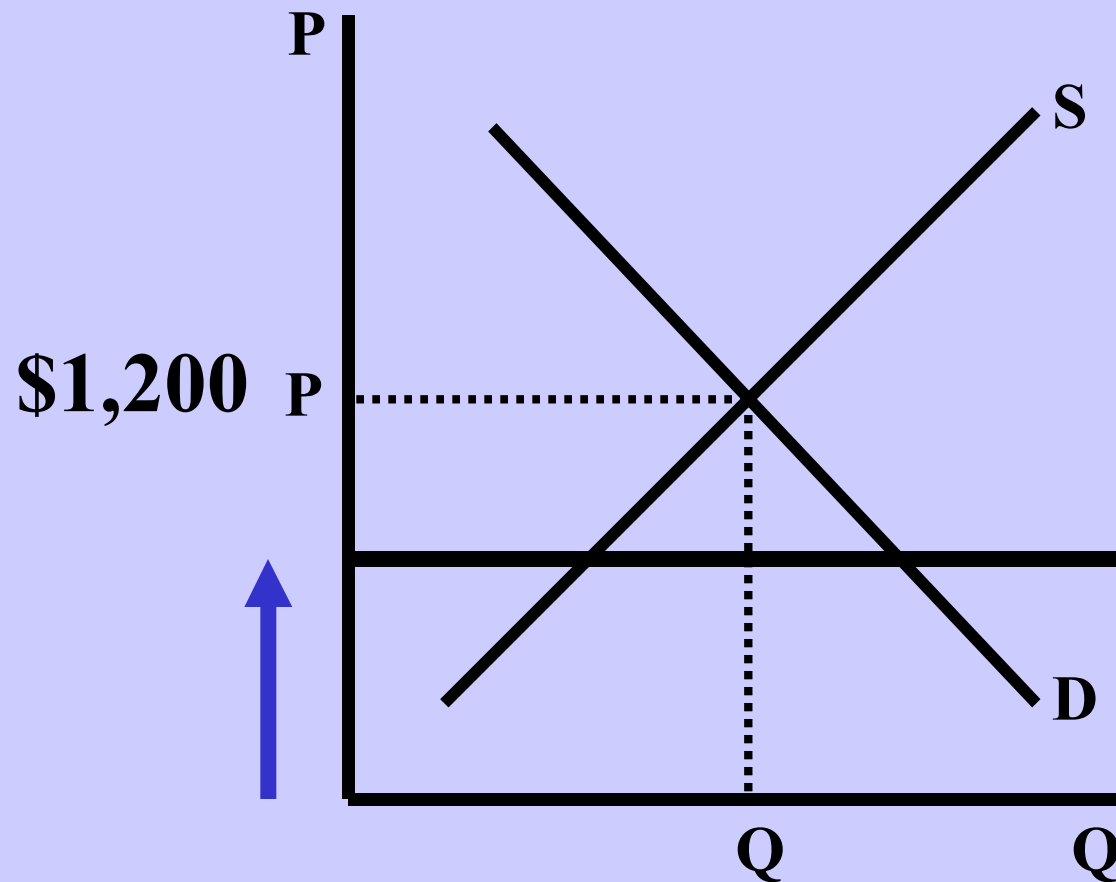
# *PRICE CEILINGS*

*NEW YORK CITY*

*RENT CONTROL*

*CASE STUDY*

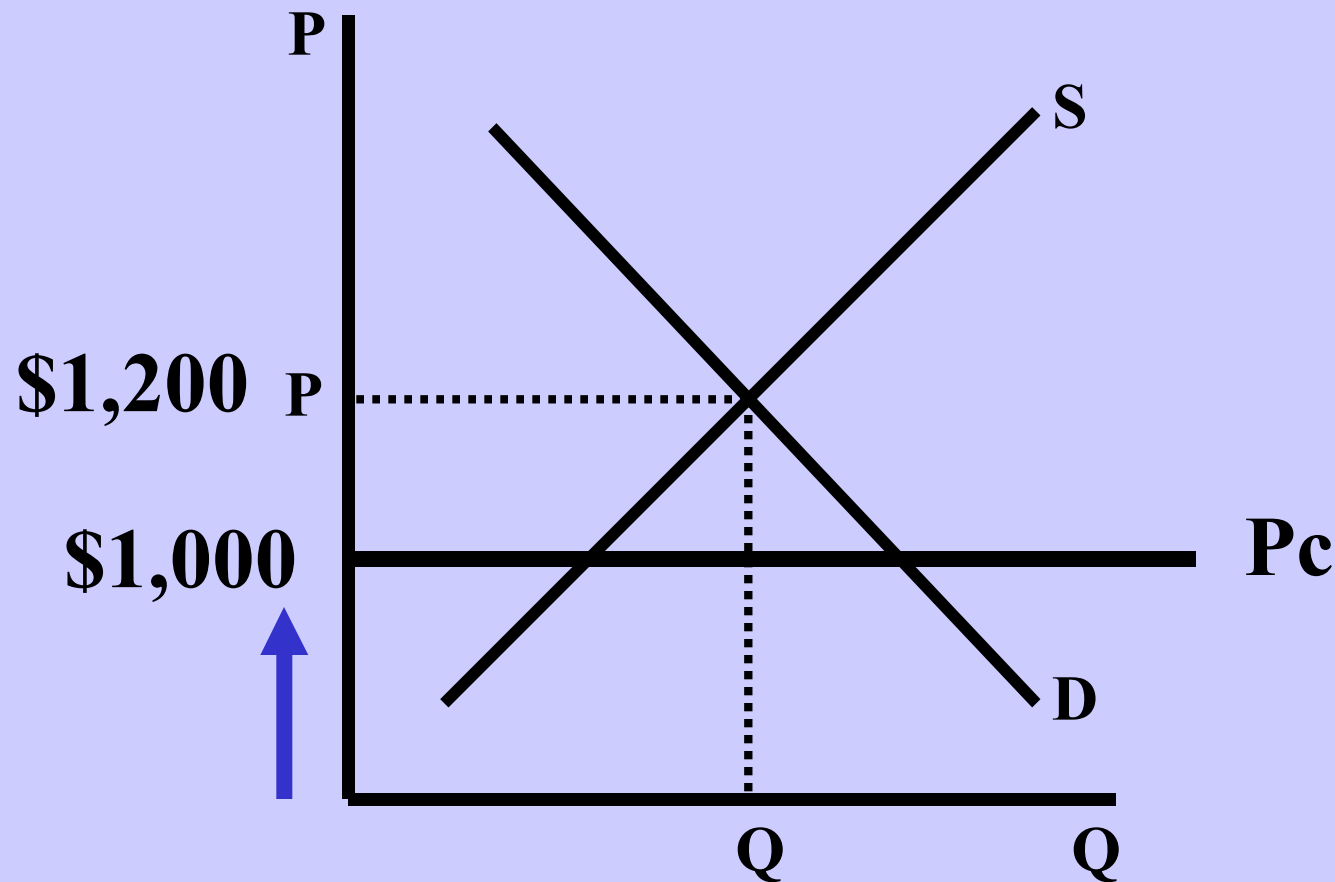




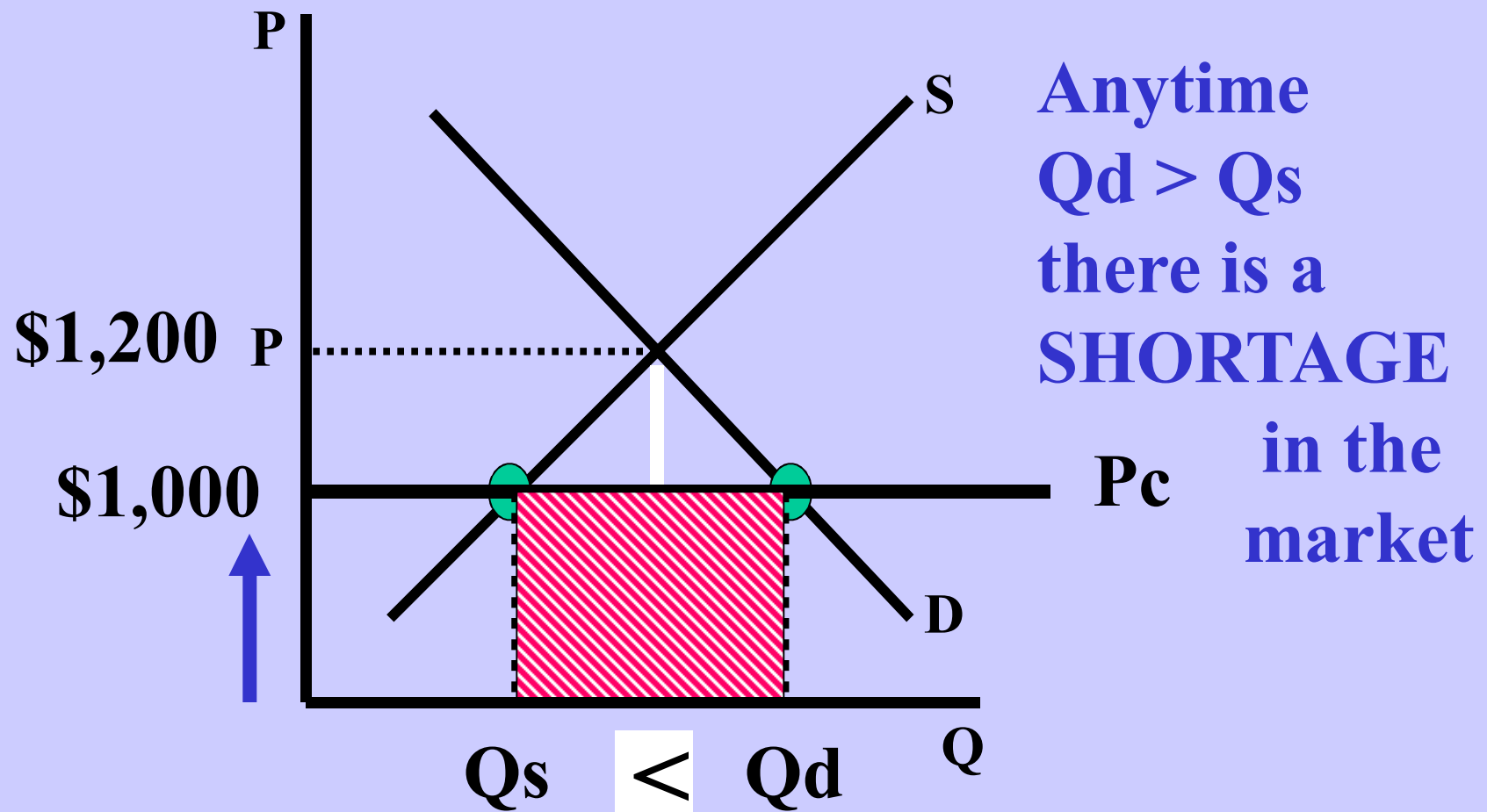
$P_c$  are set  
**BELOW** the  
equilibrium  
price

$P_c$  is the  
highest price  
that can be  
charged in the  
market

**Fair market price of apartments in NYC is \$1,200**  
**NYC has rent controls which are price ceilings .**  
**Where do you think price CEILINGS are set ?**  
**Below or ABOVE the market price ?**



**Rent controls are a price set by the government to keep prices of apartments down . In NYC the government sets the **HIGHEST PRICE** that can be charged for a one-bedroom apartment .**

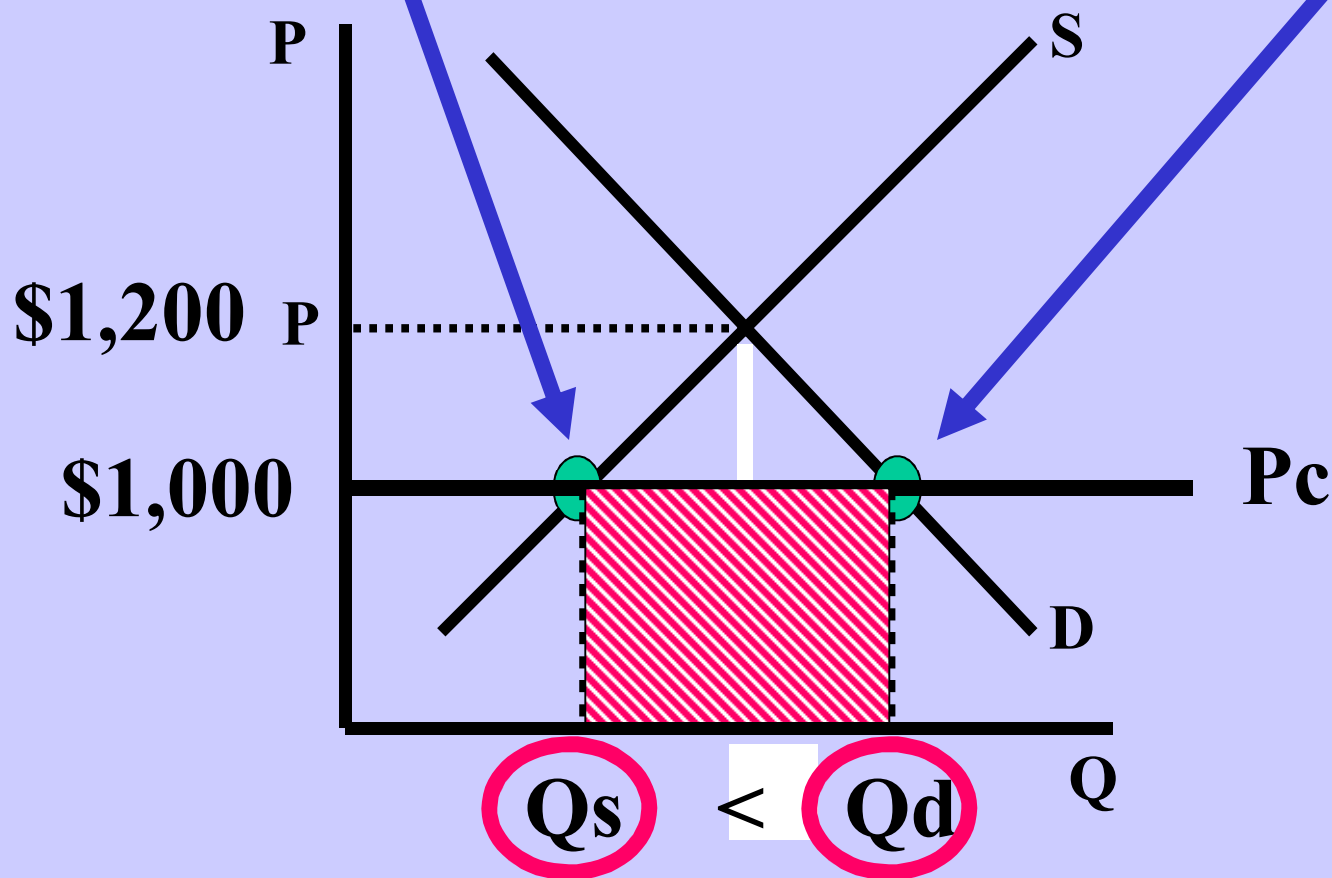


Looking at the graph, what occurs when the price is set **BELOW** the equilibrium price  $>$  when a **PRICE CEILING** is set ?

The Quantity Demanded  $>$  the Quantity Supplied

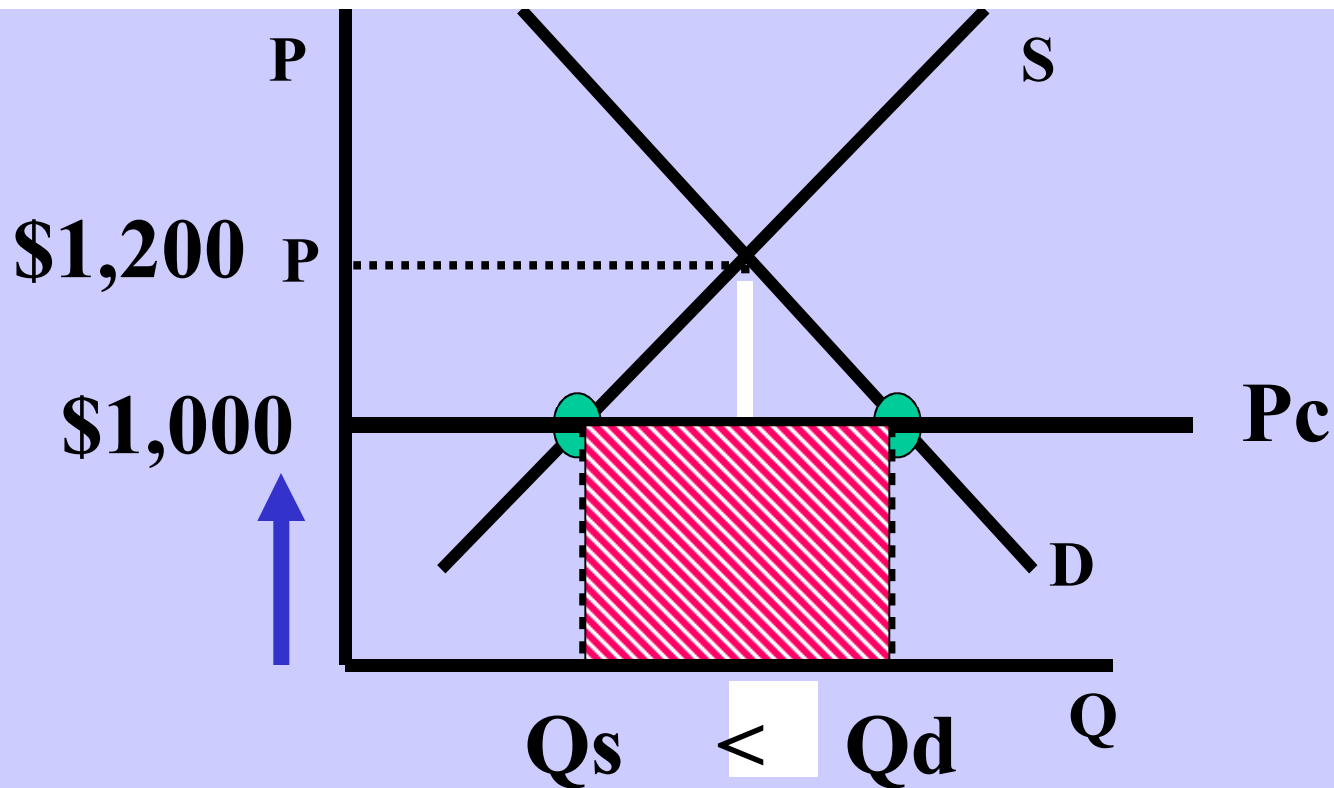
This is the number of apartments landlords are willing to supply at this price ( $Q_s$ ).

This is the number of people willing to rent apartments at this price ( $Q_d$ ).

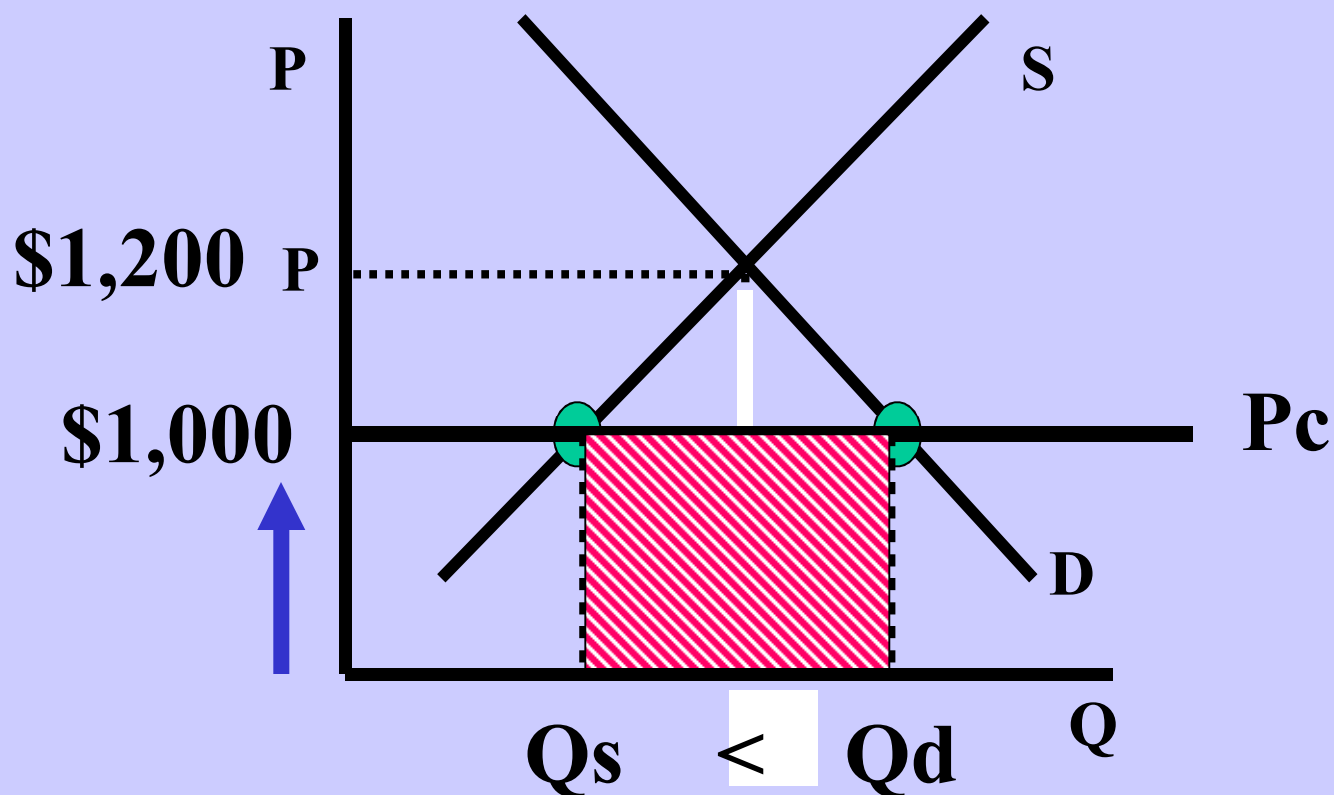


This is a **SHORTAGE**.

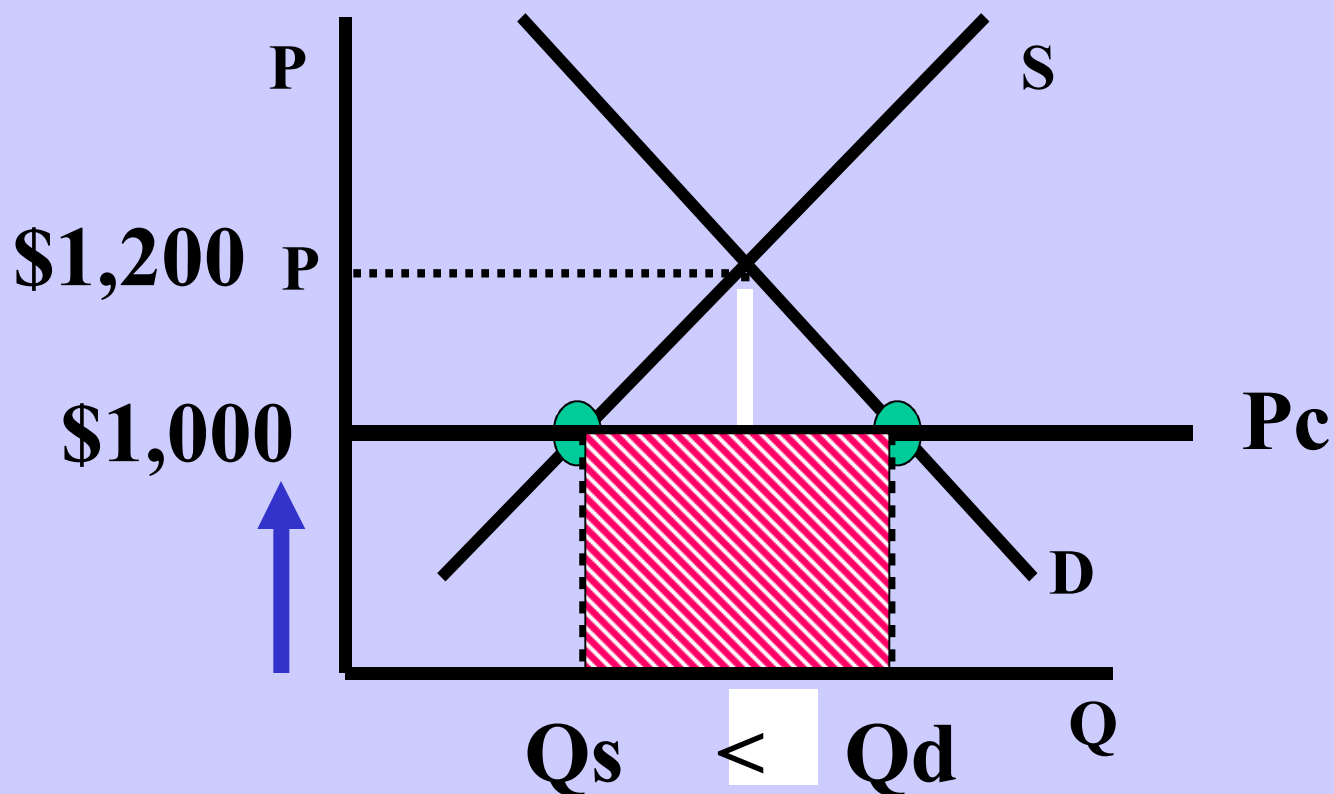




In a *good* year New York's housing stock loses 14,000 to 19,000 dwelling units each year . At the same time , unlike other large eastern and Midwestern cities, New York's household population is actually growing—by 2,000 to 5,000 households per year or more .

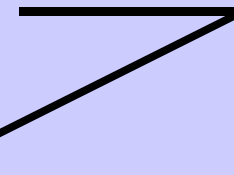


**Since 1970 , rent control has allowed a landlord to raise an apartment's rent by 7.5 percent a year until hitting a “maximum base rent” well below the market price .**



**The consulting firm Arthur D. Little Associates estimated in 1986 that rent regulation in New York amounted to an annual subsidy of \$754 million .**

***CAN YOU BELIEVE THIS ????***



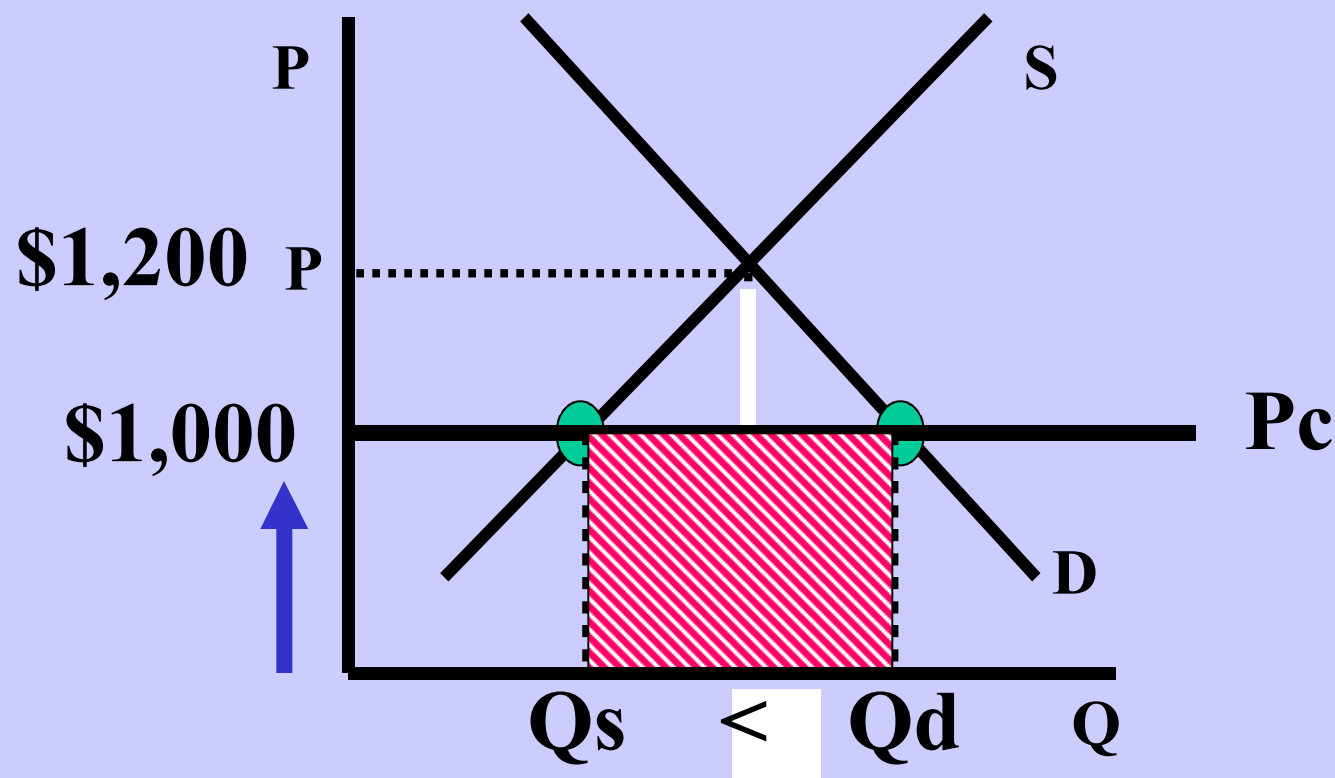
**Even more valuable than the limits on rent hikes ,  
is the right of tenants *and their relatives* to occupy  
their apartments for as long as they wish , whether  
their landlords want them to stay or not .**

***THEREFORE IT SHOULD BE NO SURPRISE  
THAT***



**There's only one avenue open to disgruntled  
landlords who want to get out of the housing  
business : abandonment -- which explains why New  
York City has come to own 40,000 apartments and  
inherits an additional 5,000 to 10,000 units a year .**

In 1994 just 4,010 private residential building permits were issued in New York City, a city with nearly three million dwelling units .



***PRICE CEILING - THE HIGHEST PRICE THE SELLER CAN SELL THE PRODUCT***



# *PRICE FLOORS*

*AIRLINE INDUSTRY*

*CASE STUDY*

**In 1975**

**To fly from Chicago to  
Minneapolis it cost**

**Minneapolis**

**\$169**

**Chicago**

**San  
Fran.**

**\$69**

**Los Angeles**

**To fly from Los Angeles  
to San Francisco it cost**

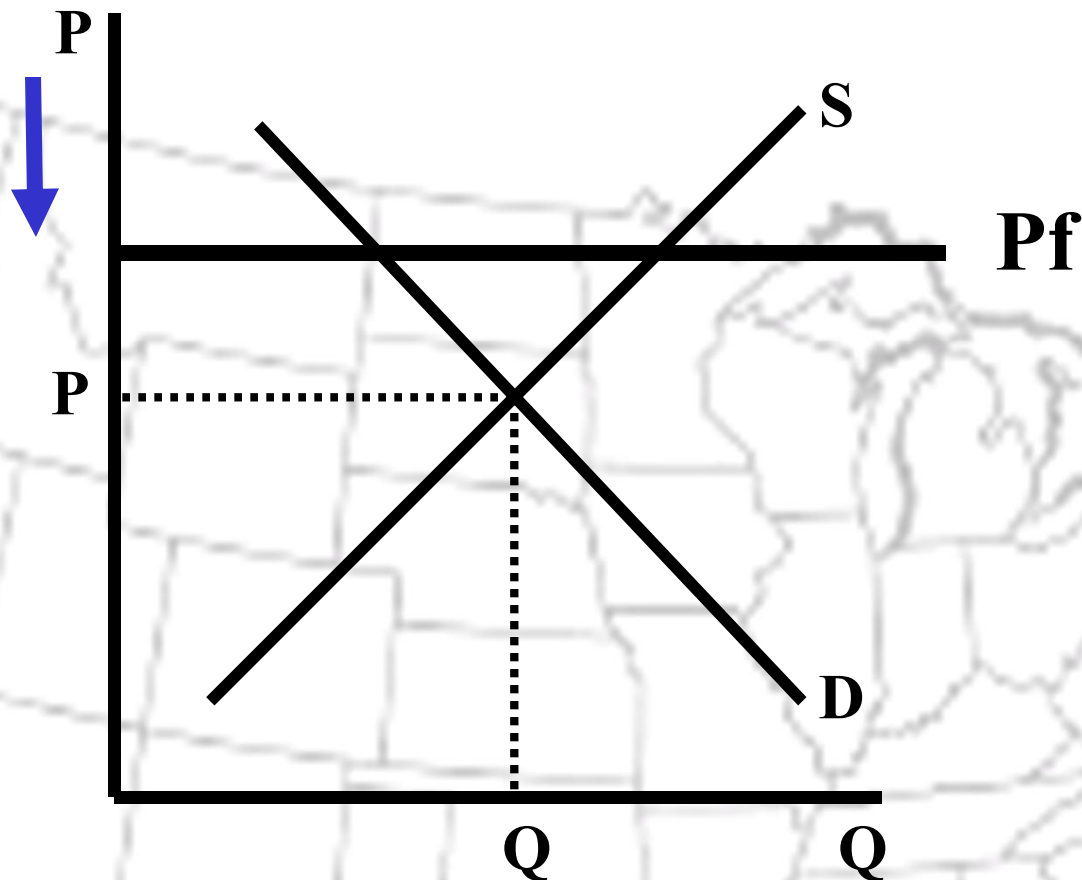
**WHY?**



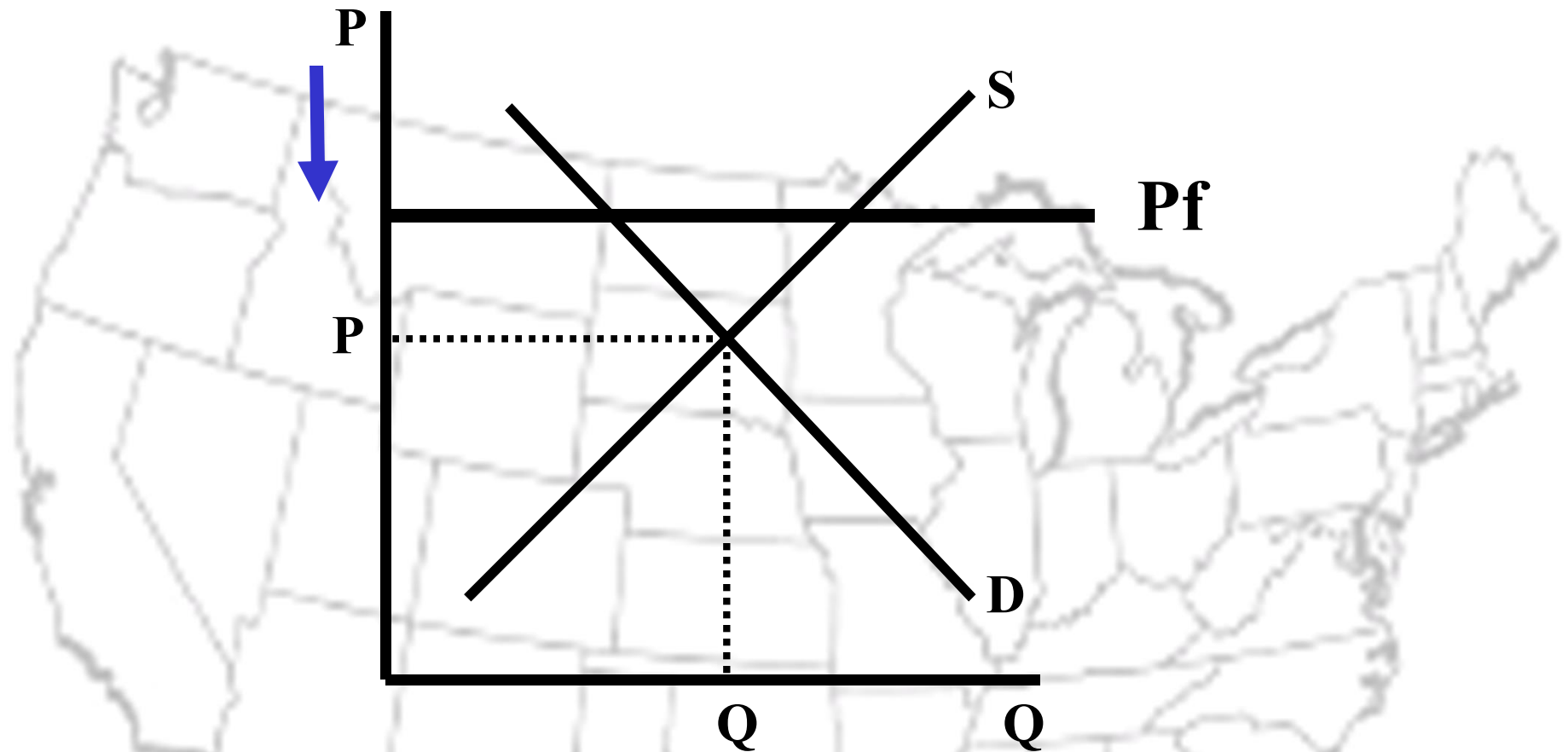


**Roughly the same number of people were flying between these two destinations and roughly the same number of airplanes were flying these two routes. So why such a difference in the prices of these airfares? What is different between these two routes?**



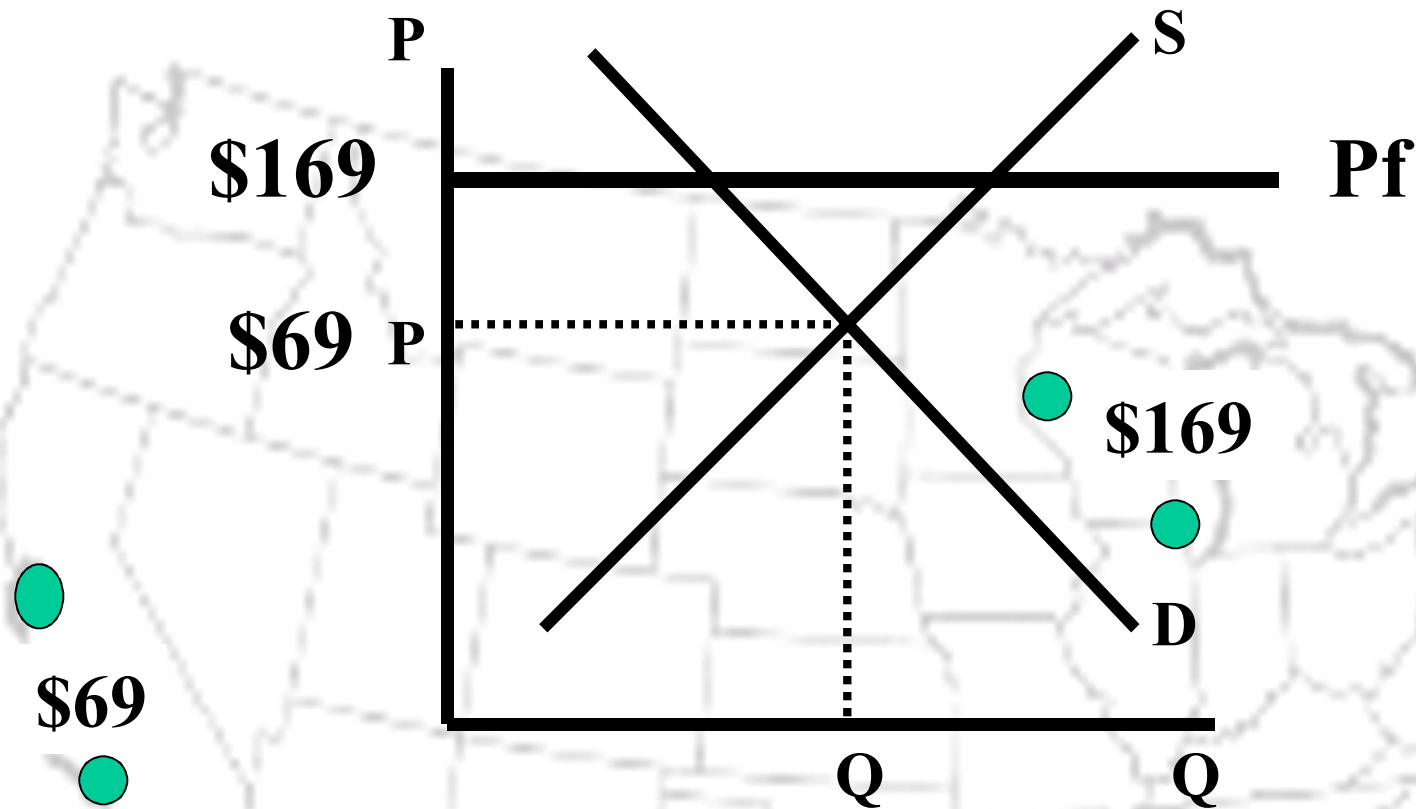


**Interstate travel was regulated by the Civil Aeronautics Board. It set the prices for flights traveling across state lines. It set a PRICE FLOOR. Where is a PRICE FLOOR set? Above or BELOW the equilibrium price? ABOVE.**



**Why is it called a price FLOOR if it is set ABOVE the equilibrium/market price?**

**Because it is the LOWEST price that can be charged by law.**

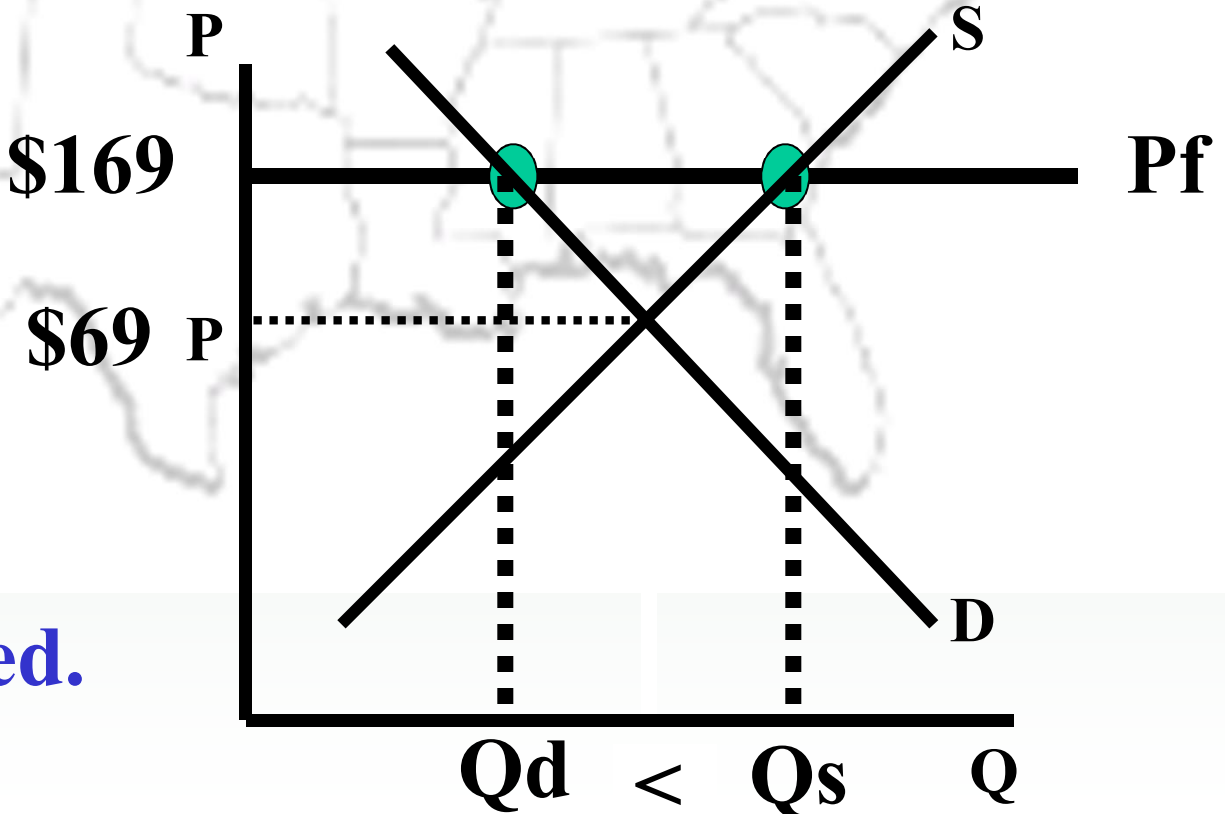


**Which route is the market price and which route is the PRICE FLOOR?**

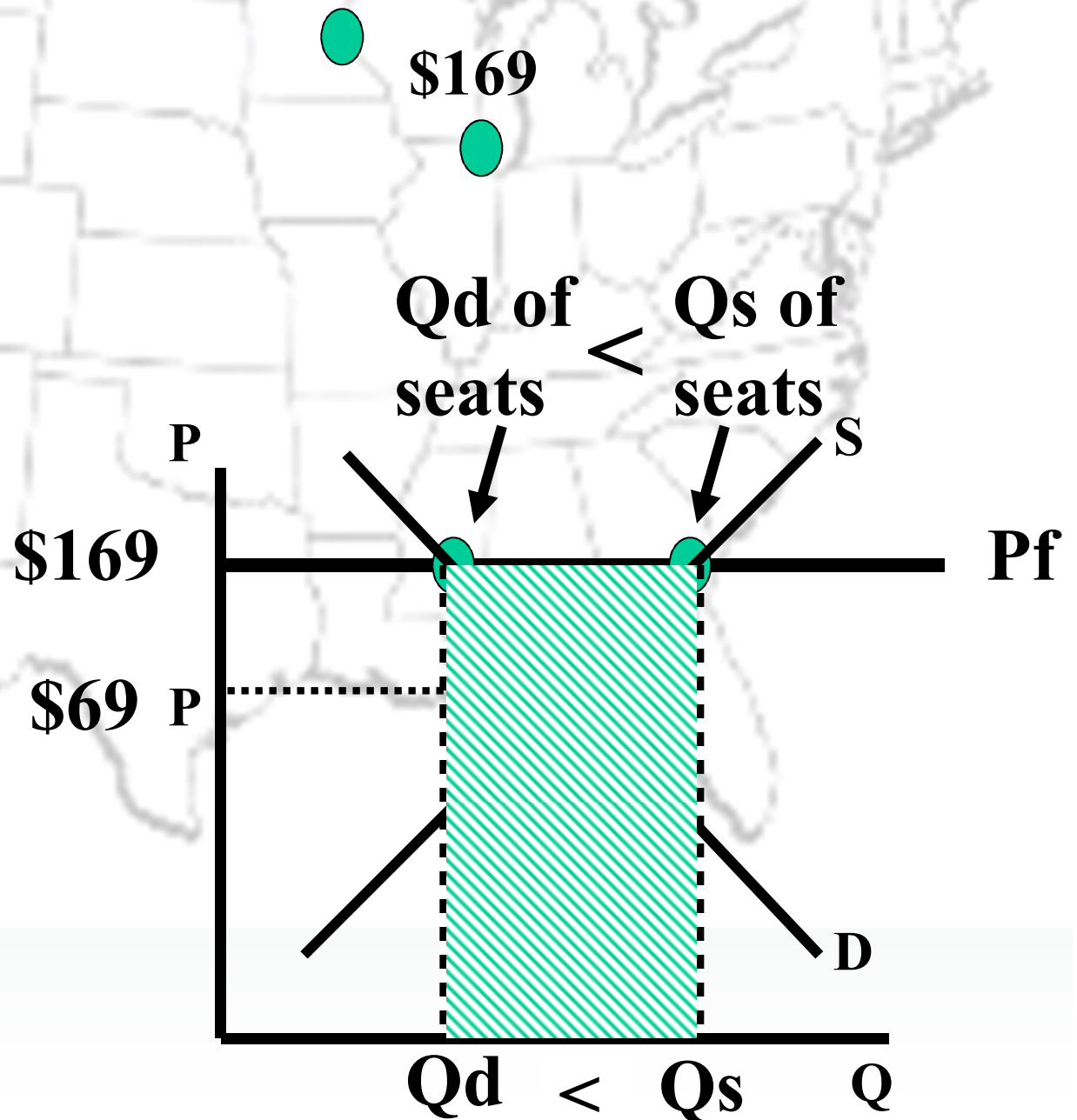
**The market price is \$69, the price charged between Los Angeles and San Francisco.**

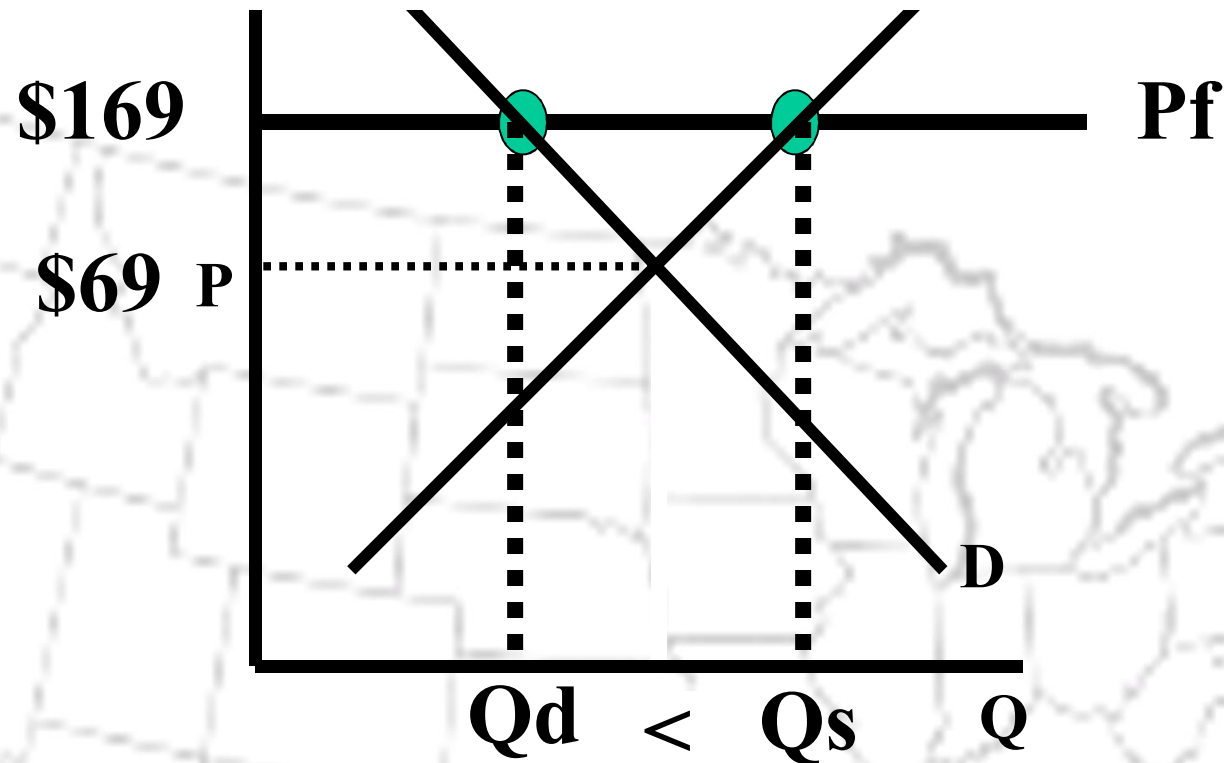
**The PRICE FLOOR is \$169, the price charged between Chicago and Minneapolis.**

**Whenever there is a PRICE FLOOR the Quantity Supplied is greater than the Quantity Demanded.**



**A price floor  
causes a  
SURPLUS  
in the market.**





What price did the airlines charge customer flying from Chicago to Minneapolis ? **\$169**

If airlines couldn't compete by price since they all charged the same price, how did airlines compete ?

**Service: Best food, bigger seats, prettiest flight attendants**





**Surplus of seats  
available because  
of the price floor**

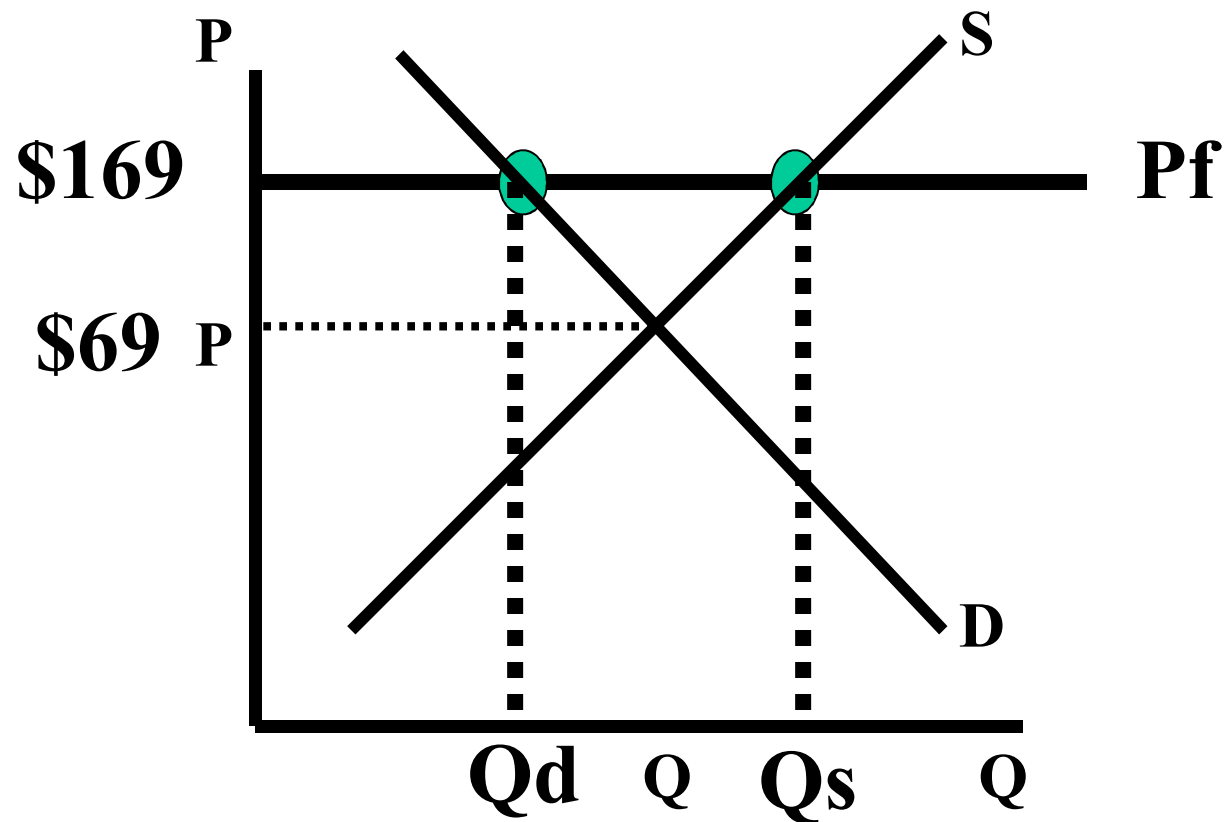


**Airlines competed by  
serving better food**



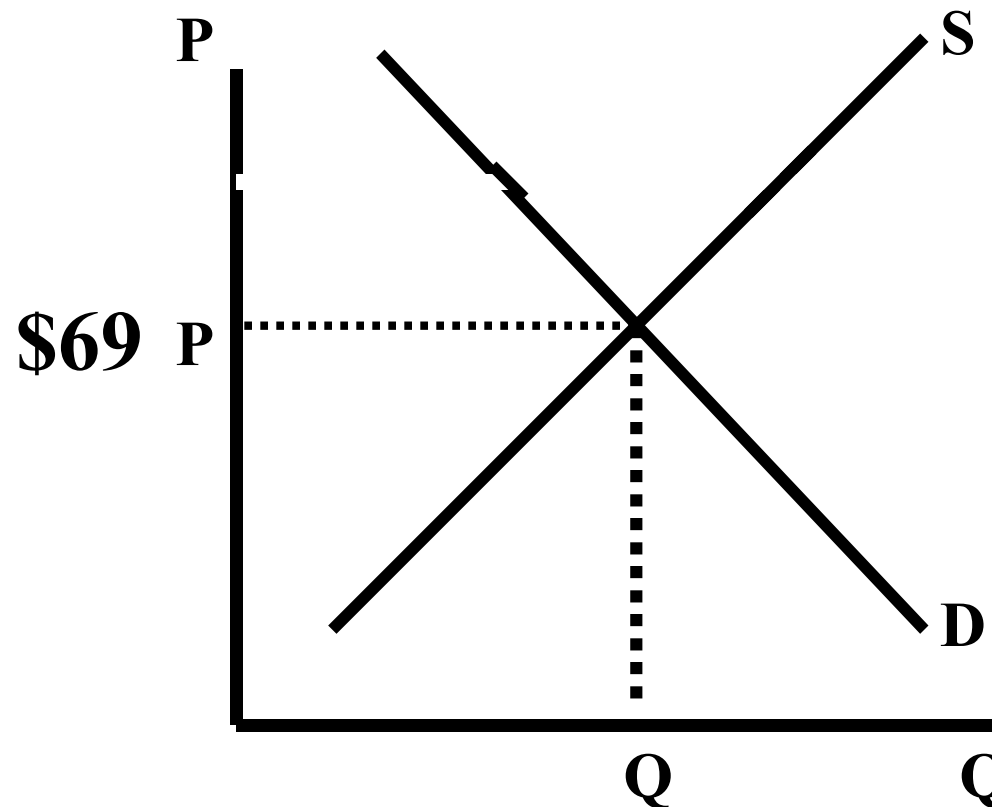
**Prettiest stewardess**

As deregulation of the airline industry took place in 1978, what happened to the price floor ?





As deregulation of the airline industry took place in 1978, what happened to the price floor ?



The price floor is eliminated, lowering the price to the market price. This gets rid of the surplus. People get to fly for lower prices, but the airplanes are now more crowded.