

Test Yourself: The Price System



If all economists were laid end to end, they
would still not reach a conclusion.

GB Shaw



What is the price system?



The price system is a mechanism that uses the forces of supply and demand to create an equilibrium through rising and falling prices.



What are the two types of price controls?



The two types of price controls are:

- **price ceilings** – a legally established *maximum* price a seller can charge ... for example, rent control, wage and price controls, usury laws
- **price floors** – a legally established *minimum* price a seller can be paid ... for example, minimum wage law, agricultural price supports



What is the purpose of price ceilings on rent (rent control)?

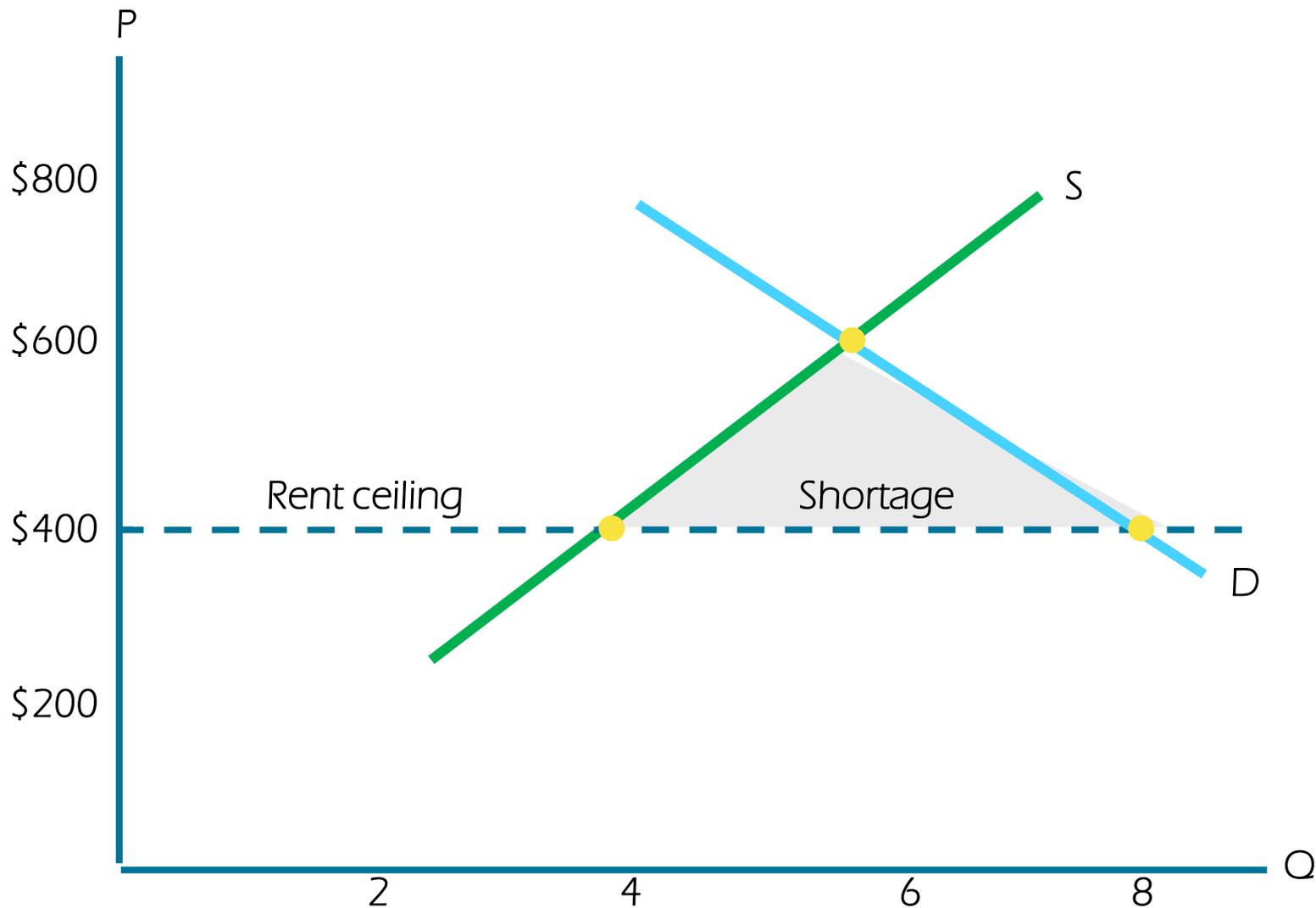


The purpose of price ceilings on rent (rent control) is to provide a lower rent than the equilibrium rent so poor people can afford to pay it.

Unfortunately, rent control leads to a shortage of rental units, illegal markets, less maintenance and discrimination, and so may be counterproductive.



Chart: Rent Control Results in a Shortage of Rental Units





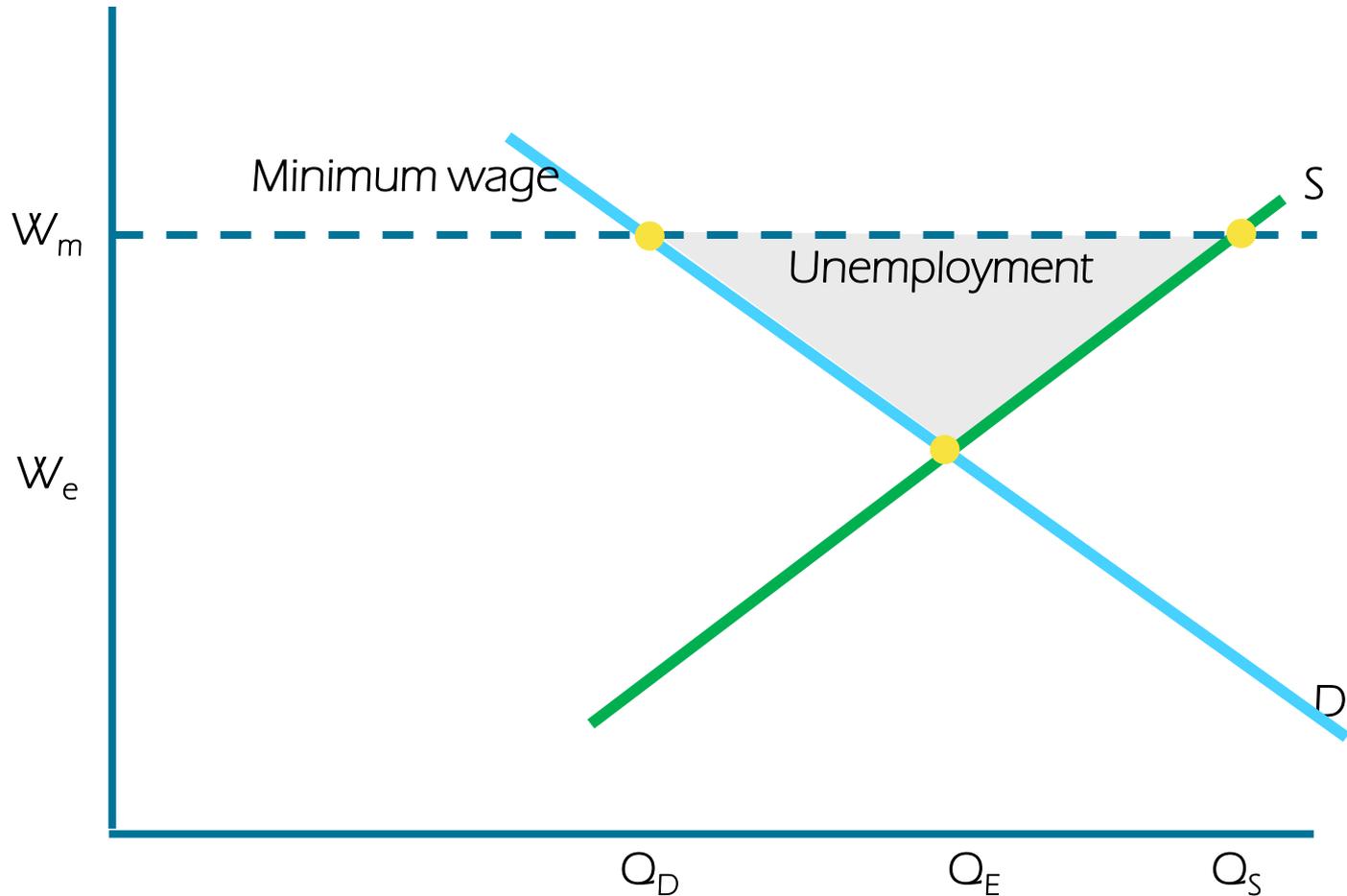
What is the result of a price floor on wages paid to labor (minimum wage)?



The result of a price floor on wages paid to labor (minimum wage) is a surplus of labor ... employers cannot afford to hire as many workers.



Chart: A Minimum Wage Results in a Surplus of Labor





Why do we have price ceilings
and price floors?



We have price ceilings and price floors because of failures in the free market.

A **market failure** is a situation in which the price system creates a problem for society or fails to achieve society's goals.

Market failure happens when competition is lacking.

Two examples of market failure are *income inequality* and *externalities*.



How did you do?! If you didn't do as well as you'd like, review the margin notes and presentations and test yourself again.



**CONTINUED IN TEST YOURSELF:
GOVERNMENT FUNCTIONS**