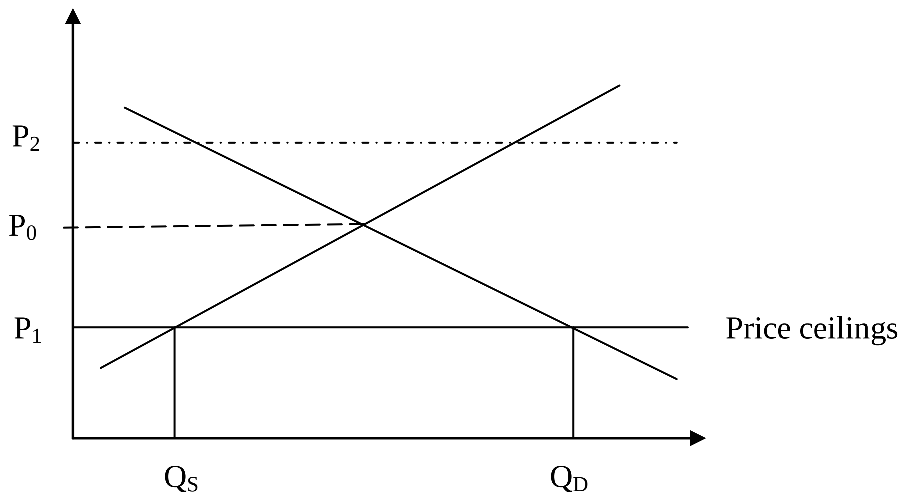
Price Ceiling

In a free market system, prices are set by the market forces namely; demand and supply sides. However, the government may feel that the price set by the market forces is unattainable by most consumers. This usually applies to the demand for essential goods such as food stuffs. In this case, governments impose price ceilings in order to ensure that all consumers in a country have access to these basic and essential goods. Morton and Goodman point out that price ceiling is a legal upper limit price set by legislators that stipulate what suppliers should charge consumers for a specific good (106). For example, a government in a developing nation may decide to impose price ceiling on the price of bread, which it feels is above the reach of many yet a necessity. There are two types of price ceilings namely; non-binding and binding price ceilings. Non-binding price ceilings are inconsequential since they are set above the equilibrium price. However, binding price ceilings cause economic mess since they are set below the equilibrium price.

Price ceiling set below the equilibrium price are responsible for long queues since suppliers are unwilling to sell their goods at prices below the price set by the market forces. At equilibrium price, there is a match of quantity supplied and quantity demanded, hence eliminating queues. In this case buyers willing and able to buy bread in a country implementing price ceiling, which is below equilibrium price have to queue for long, and in the process lose a lot of working hours, which is detrimental to an economy. According to Gwartney, Stroup, Sobel and Macpherson at P_1 suppliers will be willing to sell to the market quantity Q_S against quantity demanded Q_D (85). The shortage Q_D- Q_S can only be resolved by long queuing. In this case buyers of bread will be required to queue for long in order to purchase bread since the demand outstrips supply by the stated margin, Q_D- Q_S.

Figure 1. Graphical representation of effects of price ceilings



Source: Gwartney, James, Richard, Stroup, Russell, Sobel and David Macpherson. Economics: Private and Public Choice. Ohio, OH: Cengage Learning, 2008.

Works Cited

Gwartney, James, Richard, Stroup, Russell, Sobel and David Macpherson. Economics: Private and Public Choice. Ohio, OH: Cengage Learning, 2008.

Morton, John, and Rae, Jean, Goodman. Advanced Placement Economics Teacher Resource Manual, New York, NY: National Council of Economic Education, 2003.