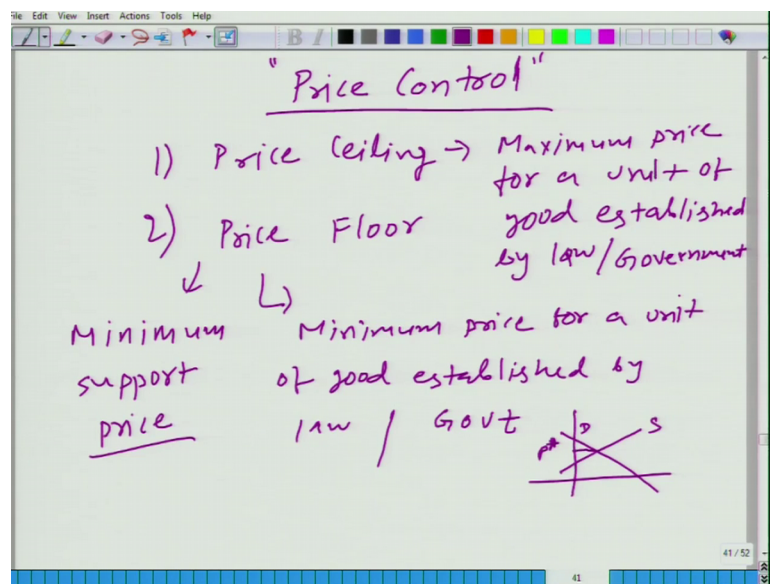


An Introduction to Microeconomics
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Lecture – 17
Application: Price Control

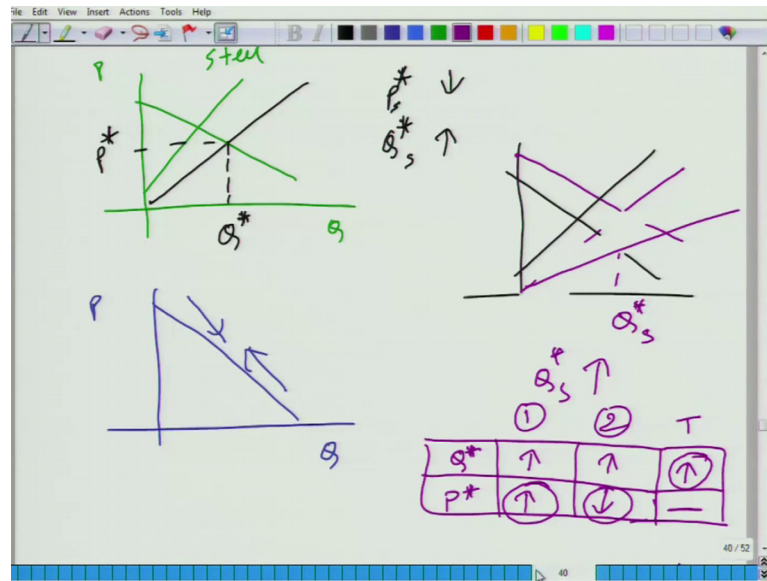
Now, let us talk about. I said that in this chapter we will discuss two applications one price control and second taxation, so right. Yes.

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Student: Sir, does this slope of this graph denote anything price demand upon, some price upon some quantity.

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It does denote. So, wait little later we will talk about that that topic, right now we are not we are just talking about movement and shifts, the direction of movement and shifts we are not talking about the slope. Slope is also very important very good question, but little later we you have to wait little bit to get the idea about the slope. We will talk about the slope.

So, right now we are talking about one application another application taxation we will talk little later. So, what is price control what do we mean by price control.

Student: Sir, how we can regulate the prices of the goods in the market.

See typically what happens in the market that if there is imagine that there is no control then what happens the as we have seen in the potato market the price and quantity bought and sold in the market they adjust on their own, it is not that someone is adjust making that adjustment because of individual behaviors that there is an automatic adjustment and eventually the market reaches to equilibrium price and at that price quantity and bought and sold would be the equilibrium quantity.

But now there is a possibility that government says that because there is a legislation or there is a law that you cannot buy or sell the product now there are two possibilities that above this particular price or below this particular price. So, government can come up with a regulation to fix price ceiling or price floor and we can define price ceiling as

maximum price for a unit of good established by law or by government and similarly price floor is the minimum price tell me an example.

Student: Sir, petrol petrol or petroleum.

What do we have price floor or.

Student: Price ceiling.

Student: Price ceiling and price floor into in case of farmers like.

Minimum support.

Student: Minimum support.

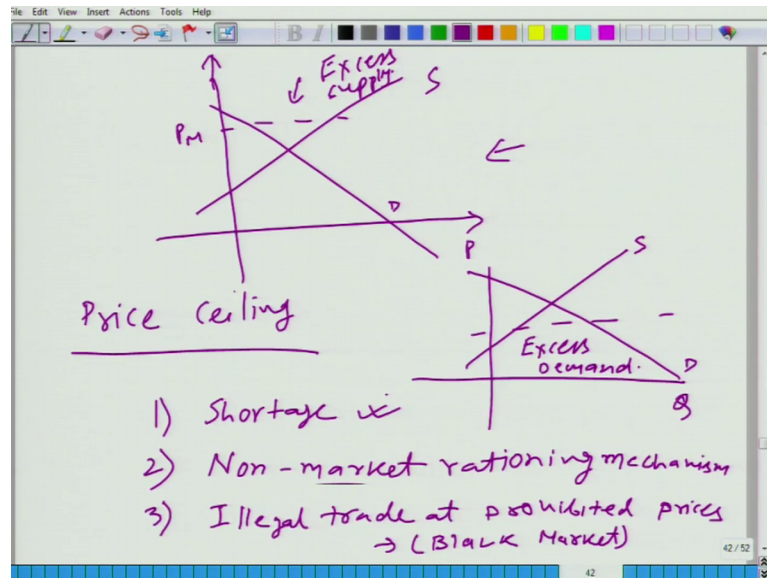
So, price floor typically is minimum support price. What happens typically, let me also add government does not only say in the case of price floor that this is the minimum price two ways to do it one way is that government says you cannot you know this is the price below which you cannot buy yourself this is the one way to do it or the second way to do it is that government says that we are the government is willing to buy the product at this particular price.

Now, consider a scenario let us look at the demand and supply this is supply this is the demand if government says that the minimum support price and let us say this is the equilibrium price P^* . If government says that the minimum support price is less than the government would not say government fixes the minimum support price which is lower than the market equilibrium price what would happen. Let us say that in the market on its own wheat can be bought or sold at 5 rupees per unit 5 rupees per kg or government says that the minimum support price for wheat is 4 rupees per kg.

Student: Nothing will change.

Nothing will change this will only influence the market if it is above the market equilibrium price. So, what is happening in that case let us look at it.

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Minimum support price is above market equilibrium this is demand this is supply and this is minimum support price what will happen; what you can see immediately is.

Student: Excess supply.

Excess supply.

Student: Excess supply.

Excess supply it means there will be a downward pressure.

Student: (Refer Time: 06:08).

On the sellers to decrease their price of per unit of good, but if government wants to support them then what does the government say.

Student: It will.

That you bring the goods.

Student: It will buy by itself.

We will buy it at this particular price. So, what government does that it artificially jacks up the their demand in a way that we will buy, but you have seen again I am moving out

of economics you have seen that every year Government of India buys lot of grains and what happens to the that that grain.

Student: It get wasted.

It gets wasted because not only if you let us say when market can support 5 rupees per kg and you promise that you will pay 6 rupees per kg you are producing more than what is required in the market. So, people would even supplier they could they could use their resources to produce something else, but this just because there is a support price for wheat they would devote their resources to produce wheat. So, supply of which would increase even further it may increase even further you understand. So, this may be a result of price, that the price floor. Now, let us look at the price ceiling. Where do we get the price ceiling typically?

Student: Petrol.

Petrol or even in the range.

Student: Maximum rent.

Maximum rent that you can charge is given by the government. You cannot increase the rate beyond a particular level, you cannot increase the rate beyond particular level. So, in that case what happens? Now, there are two possibilities if that level is above the market equilibrium price.

Student: Nothing will change.

Nothing will change if that level is above. So, you can go up to that level, but market itself is operating at the lower level. So, there is no problem it would not change the market, but we get into problem when the price ceiling is below the market equilibrium level and this is the price ceiling. Now in this case what is happened what do we get excess.

Student: Demand.

Excess demand supply demand price quantity we get excess demand and when we have excess demand what happens there.

Student: Upward pressure.

There is an upward pressure, but by law sellers cannot increase the rent or buyers cannot pay more. So, then what do we observe in the market.

Student: Role of government.

Ah.

Student: Black marketing.

Black market you know under the table payment, what else. So, let me let me write it that first thing it gives rise to shortage that is the very basic thing to say fine. Now, second what we observe is something I can call non market.

Student: Transaction.

Rationing mechanism what is non market rationing mechanism for example, petrol you were giving the example of petrol the people would like to buy more, but very little amount of petrol is available relatively less amount of petrol is available at that particular price. So, what happens? Typically you see a long line people waiting. This is in a way it is a non market rationing mechanism you have to wait little longer waiting is costly for you. So, you are paying in a different way not as the price of petrol, but in terms of the time, time that you could use to earn some wage.

So, non market mechanism it can give rise to in room rent case what can happen the landlord can demand pagadi, in India we have pagadi system there is and it was it is more prevalent in Bombay because in Bombay we have more we have stringent rent control laws. So, this is non market mechanism that you have to pay right in the beginning as pagadi to rent a room we are talking about the effect of price ceiling on the market and one thing that we saw clearly that whenever we have price ceiling and the price determined by the government or by the law is lower than the what would have been the market equilibrium price.

Then what we get is shortage it means we have excess demand and we have less supply that results into shortage it means that some of the people would like to buy the good at

that particular price, but they are not able to buy because we do not have sufficient amount of goods available in the market at that particular price. So, we get shortage.

Also what we observe again I am not saying all the time, but in some of the cases what we observed is non market rationing mechanism and that is like for one example would be long wait it is not illegal you know it is not illegal. But just because there are so many people who would love to buy a good at that particular price, but there are not enough supply. So, they will have to wait longer like lines that you have seen long queues that you have seen outside petrol station gas station for even the long way to get the gas cylinder people would love to buy more of gas cylinder at that particular price, but there is no, not enough supply to fulfill their demand. So, we get this is something non market rationing mechanism.

Another example is that you have two pagadi. Right now that pagadi is something that security deposit that land the house owner or the apartment owners they take from the person who would like to rent their house or the apartment in name of security. But you can think it is kind of a non market rationing mechanism that they cannot that the landowner or the house owner cannot charge the market equilibrium price that they would like to charge they are forced to charge something less. So, to compensate they charge pagadi in name of security fee and this is in a way when they say that it is a security fee it is not illegal. So, it is non market rationing mechanism.

Now, we can also think about the black market the rise of black market or in other word illegal trade at prohibited prices or in other word this is one kind of black market this is not the black market, but this is one kind of black market.

Student: Sir, actually the pagadi system.

Ha.

Student: We are taking some question.

Ha.

Student: Like you said some security. So, sir is it taken thinking that we would earn interest on that casual money and we would the prices would be rising see or [FL] or on see you compensate there are.

No see.

Student: Common price.

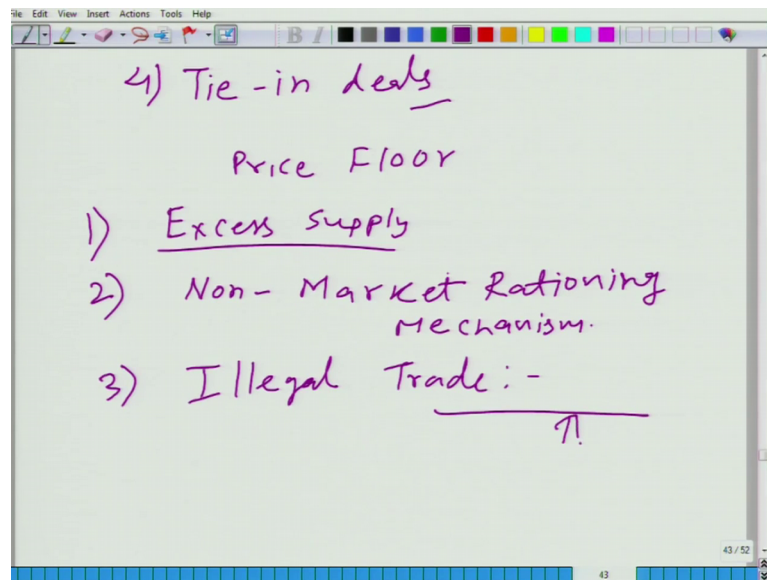
I think from let me tell you this thing little in a different perspective. If market is operating at the equilibrium price and let us say the rent of the room of course, here we are assuming that there we have only one kind of apartment available not very different kind of apartments available and the rent of that apartment is 1000 rupees per month and you know what happens the quantity demanded matches the quantity supplied. So, when apartment owner demands a pagadi you would not go to him go to that person for to renting his apartment you will move to the another apartment owner because that person would be willing to give you you know, the pagadi would vanish from the market and even if it is present if it is really security the causal money or the security money it is going to be very small security money. Just imagine in Bombay you pay almost the price of apartment as security money sometime more than that as security money, although the name is security money, but that is not security money fine.

Now, let us move to the illegal trade at prohibited price. Now, you have here some sort of black market people the sellers are not allowed to sell at price higher than the price determined by the government through some law or some legislation, but it is very very difficult for government to monitor it. So, you will automatically have a black market where you can buy gas cylinder at higher price you can have black market where you can buy diesel at higher price and these are quite common in our country.

Student: Yes, sir we do have agents like who supply.

Supplied I am not trying to say that they do they provide us they of course, provide us a service I am not saying that they are doing the right thing the idea here is not to defend them, but to explain why it is happening and then what we have is some kind of tie in deals.

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Let me explain what is tie in deals. Then time in deals is many people would like to have gas connection let me give you explain this through an example that many people in this country would like to have gas connection, but the suppliers are not cannot afford to give those mini gas connection at the government determined price.

So, what they say you go to, you go for gas connection if it is your turn if somehow you are getting gas connection what the seller would say that you want gas connection you will also have to buy gas burner from me then well you will get the gas connection ok.

Student: Sir.

And that is also quite common. You are not interested in buying gas burner at really at that at the price which is much higher than the price that you will you have to pay in the market for a gas burner. So, this is the tie in deals it is not that you are buying the gas burner here what you have is shortage, there is no not enough match is available in the market between buyers and sellers. So, sellers are just sellers are getting compensated in that particular way. Again I am not defending their position that they do a right or legal thing I am just trying to explain why it happens.

Similarly when you go for apartments in Bombay you the apartment owner they say rent is this much, but also you have to take the furnitures that I have put in the house you also have to rent the refrigerator that I have put in the house, and you will have to pay rent for

these furnitures and refrigerators which is much higher than the rent that you would have to pay if you rent these items from the market. So, these are tie in deals that is what you get fine.

So, let me put a table for price ceiling and what you get although I explained these terms for price ceiling let us look at what happens when we have price floor. Here you get excess supply then you have then you have non market rationing mechanism again here also and can you tell me what is one example of non market rationing mechanism.

Student: (Refer Time: 19:56).

Let us take example of the minimum support price for wheat. Of course, you will have excess supply and also you will have nor market rationing mechanism can you give me one example of non market rationing mechanism in case of excess supply of wheat because of price floor.

Student: Sir, because let the payment is not done at the time of buy it is done after year or after few months.

That can be one, again it is very difficult to discern it is because of some other reason, but that can be one reason.

Student: And one more thing we have to pay a minimum wage to the laborers. So, to escape from that thing we include child labor.

That is stretching too far, again it is difficult to figure out, but one thing that is very very simple to sell their product they have to here it is not the consumer who is waiting, here producer they wait very very that they wait long period to sell their product or when they go to the government unit to sell their product there is a long queue. So, long waiting period is there for loading their products. What you said is ok, but child labour one has to think and really establish that connection it is not that direct.

What else, illegal market you will have to pay bribe, illegal trade instead of writing market illegal trade to offload your wheat at government units you will have to pay bribe to the government officials. So, all these things happen in whenever we have price control. So, you may ask that whatever I have said talks about the problem associated

with price control then why do we have price control. Can you think of a reason that we have price control?

Student: Yes sir, because the farmers like people who are putting in more efforts, but not getting the proper returns of their effort that is.

Student: That is why incentivize the production for a few like for wheat or if we talk if there is a new production of potato and if we put price floor on potato. So, it will incentivize production and they can serve the market better.

But for this example that at least everyday news we hear that so much of grain is rotting in government depots. So, do you think it is important enough to incentivize farmer to produce more wheat or more potato.

Student: Sir, that is also one more reason now that we do not have proper distribution system by which we can distribute like some people with like below poverty line people they are dying because of hunger and we are throwing a lot of grains as surplus. So, we do not have a proper distribution to.

So, let me just again for the argument sake, I am not trying to demonize price control I am just we are looking at the reason and these negative reasons I gave you because we are talking about demand and supply we are not talking about normative properties of imposing price control. But just for the arguments sake from demand and supply perspective you are talking about there are many poor people, if government wants to serve these poor people why cannot government buy grains at the market price and give it to the poors. You understand my point. That if aim is to serve poors why cannot government buy these products at the market price and sell it as you have already said that we do not have proper distribution system.

So, what we are doing basically is that we are buying at the minimum support price and leaving grains to rot in open, in absence of proper distribution system. But even when we have proper distribution why cannot government buy these the items that government needs to provide to poor at the market price and give it to poorest just a point that you should ponder. But I am not saying that price control does not have advantage that when we talk about the welfare economics towards the end we will talk about it. But what I am saying definitely that there are definitely better ways to cater to the welfare of public.