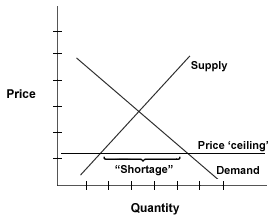
**Price Controls: Price Ceilings and Floors**

Sometimes the general public and/or governments feel that the forces of supply and demand result in prices that are either unfairly high to buyers or unfairly low to sellers. In such cases, government may intervene by legally limiting how high or low the price may go.

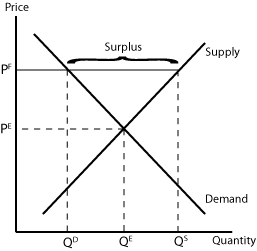
**A Price-Controlled Market: Price Ceilings**

A price ceiling is the maximum legal price a seller can charge for a good or service. The rationale for ceiling prices is that they enable consumers to obtain some “essential” good or service that they could not afford at the equilibrium price. (Examples are provided in the Case Studies benchmark lesson.)



**A Price-Controlled Market: Price Floors**

A price floor is a minimum price established by the government that is above equilibrium price. Price floors generally have been invoked when society has felt that the free-functioning market is not providing a sufficient price for the legislation and price supports. Agricultural products are a good example.



**Case Studies in Price Controls**

**Rent Control in New York City: A Price Ceiling**

Since 1943, New York City (NYC) has had a system of rent controls that impose ceilings on rents. The purpose was to establish a rent (the price of an apartment for a month) below the equilibrium level so the poor could better afford a place to live.

In the short run, rent control is likely to transfer income from landlords to tenants. However, rent control can have some very undesirable effects. Shortages result because the quantity of apartments demanded exceeds the quantity supplied. Estimates suggest that NYC now has about a $3 billion shortage of new rental housing, despite a population loss in past decades and the nation’s largest government-assisted, middle-income and low-rent public housing programs. It can take a year or more to obtain an apartment in NYC today.

Because the quantity demanded exceeds the quantity supplied for NYC apartments, some device other than price must ration the available apartments. This allows landlords to discriminate in choosing tenants, accept side payments or bribes from those looking for housing, and curtail maintenance. Renters are willing to pay bribes, accept poorer service,

and handle maintenance themselves because of the housing shortage. In addition, landlords often try to subdivide apartments, since the rent ceiling on the subdivisions may exceed that of the original apartment.

Studies show that rent controls do keep the cost of housing down for renters

who are able to keep or obtain rent-controlled apartments. For housing units built before 1943, the average increase in rents was about 2% per year, and the average increase in landlords’ costs was about 6% a year. Not surprisingly, relatively little new housing has been built since rent controls were enacted, and existing housing is often poorly maintained.

**Rent Control in California Mobile-Home Parks: A Price Ceiling**

Rent-control laws covering mobile-home parks are common in California. A mobile-home park is a tract of land on which pads are rented to residents who live in mobile homes that they own. Once placed on a pad, very few mobile homes are ever moved. The rent-control laws prevent the owners of mobile-home parks from raising rents in accord with increases in their costs. In a case involving the city of Santa Barbara, the U.S. Court of Appeals expressed its concern that these laws have “eviscerated” the property rights of the park owners and given “a windfall to current park tenants at the expense of current mobile-park owners.”

Studies have shown that these laws increase the price of mobile homes in communities with price ceilings. In fact, the price of a mobile home tends to be about 32% higher in communities with rent-controlled mobile home parks than in communities without them. (The demand curve for mobile homes is pushed outward, as demand for the homes increases with the reduction in price of a complementary good, the rental of the land, which thereby raises the price of a home.) Once rent-control laws are enacted, mobile-home owners in areas with price ceilings see the value of their mobile homes rise, while the rent paid to park owners falls.

**Office of Price Administration and WWII: Price Ceilings**

During World War II, the market price of many civilian goods was driven upward as war production created shortages. Tires, gasoline, and many consumer products were exceedingly scarce, and some products disappeared altogether during the war (e.g., new car production ceased after April 1942). The result was that some sellers who possessed products in short supply could and did charge a “high” price—one that the market would bear. Often the selling price was many times over the actual cost. Charges of price gouging were rampant, and many goods went only to those who could and would pay the high prices.

In response, President Franklin D. Roosevelt established a system of price controls to maintain some “equitable” price structure under war-generated shortages. He also established the U.S. Office of Price Administration (OPA) to regulate the price controls. In April 1942, the OPA issued a general maximum- price regulation, making prices charged in March 1942 the ceiling price for most commodities. As real prices continued to rise, the OPA implemented drives to secure compliance. The drives included giving each consumer a small share of a commodity in an effort to reduce the scramble for supply that would produce black markets.

Goods were rationed using unit and point systems. Under the unit system, a ration ticket permitted the consumer to purchase a specified quantity of a rationed good at the fixed monetary price. The coupon was used for most products other than processed foods, meats, and fats, which were rationed under another system. Sometimes shares of the goods were equal, but other times shares were rationed through a complex formula designed to tailor the shares to a consumer’s needs (e.g., gasoline).

The point system was used to ration processed foods (the “blue” point system) and meats and fats (the “red” point system). Under point rationing, the consumer received a certain number of points, which could be used to purchase a specified range of rationed commodities that sold at varying point prices. The consumer had to pay controlled money prices for other food products. This gave consumers some choice while also receiving a fair share of the controlled commodity.

Problems with the price controls and rationing abounded. The ration tickets were like currency and were frequently referred to as ration currency. Consequently, ration coupons were counterfeited and sometimes currency was overissued, which led to point inflation or bare shelves. Markets were inefficient. Because prices could not adjust between commodities and regional price variations could not occur, markets could not reallocate supplies and locational shortages developed. Shortages of fluid milk existed in southern and western cities. The northeast was plagued by gasoline shortages, and the west and rural areas witnessed shortages of clothing.

Evasion of the rationing controls became widespread. To suppress evasion, the OPA increased control over the marketplace through injunctions, license suspensions, treble damage suits, and criminal proceedings. The treble damage suit was the most used sanction. However, evasion techniques evolved for commodities, including:

• Food: Evasion existed in the form of overcharging of food prices and tie-in sales. Wholesalers complained that meat packers forced them to take a variety of unwanted products along with the more desirable cuts. Quality deterioration or “adulteration” became a serious problem— adding fat to hamburger, reducing the butterfat content of milk, adding cornstarch to spices, stretching coffee with fillers. Upgrading (selling lower quality merchandise as if it were a higher quality) and short- weighting were common.

• Clothing: Evasion generally took two forms: quality deterioration and forced upgrading. This was a difficult area to control because clothing is a highly diversified commodity and seasonal changes made it hard to specify prices. In addition, clothing relied heavily on the cotton industry, which had powerful friends in Congress.

• Shelter: Despite widespread support for rent controls, evasion was widespread. Owner-occupied housing was not controlled, so rental owners could evict their tenants, sell the property at market price, and have the buyer pay in monthly installments with an extremely slow accumulation of equity. Other forms of evasion included bribes and cash on the side. In 1946, rents in Portland, Oregon, ranged from $38 to $60 a month, plus black market bribes ranging from $5 to $500 to get the apartment and monthly side payments of $10 to $15.

• Fuel: Stations frequently would sell gasoline without receiving ration coupons, and counterfeiting of gasoline coupons was common. Quality deterioration, upgrading, short-weighting, tie-in sales, and cash on the side were also common. By January 1945, an estimated one in 16 stations had been sanctioned by the OPA.

At the end of the war, price controls and rationing were gradually abolished. The OPA was finally disbanded in 1947.

**Nixon and Wage/Price Controls: Price Ceilings**

Rampant inflation in the late 1960s created a need to curb rising prices without economic contraction. Bill Burns, Federal Reserve Chair, believed that wage and price controls could augment monetary policy to achieve this goal. Early in 1970, Congress passed the Economic Stabilization Act, which gave President Richard Nixon the authority to impose price controls. On August 15, 1971, the first phase of wage and price controls began. Wages, prices, and rents were frozen for 90 days, and contradictory fiscal policy measures were implemented. In Phase II, a mandatory system of wage and price controls was developed to allow for controlled adjustments through 1972. Phase III moved toward voluntary controls and a greater reliance on market adjustments, but prices rose rapidly. In June 1973, the administration imposed a 60-day freeze on many wages and prices. Shortages resulted, especially in food products. Phase IV began the decontrol of prices in August 1973; and on April 30, 1974, all wage and price controls were terminated.

Nixon’s wage and price controls created supply uncertainties and resource misallocation. They reduced production, which caused even higher prices. For the most part, instead of restraining wages and prices, they reduced the profit margins of businesses. This meant that once controls were removed, catch-up price inflation occurred.