

Economics 1: Spring 2012
Correcting and Overriding Markets;
Consumers

J. Bradford DeLong, Lanwei Wang, and a
cast of thousands...

February 27, 2012

The Midterm...

- Looks by and large good...
 - We are going to pick up the pace...
 - More doing of sample problems in lectures...
 - Slightly longer problem sets...

Economics 1: Spring 2012

Correcting and Overriding Markets

J. Bradford DeLong, Lanwei Wang, and a
cast of thousands...

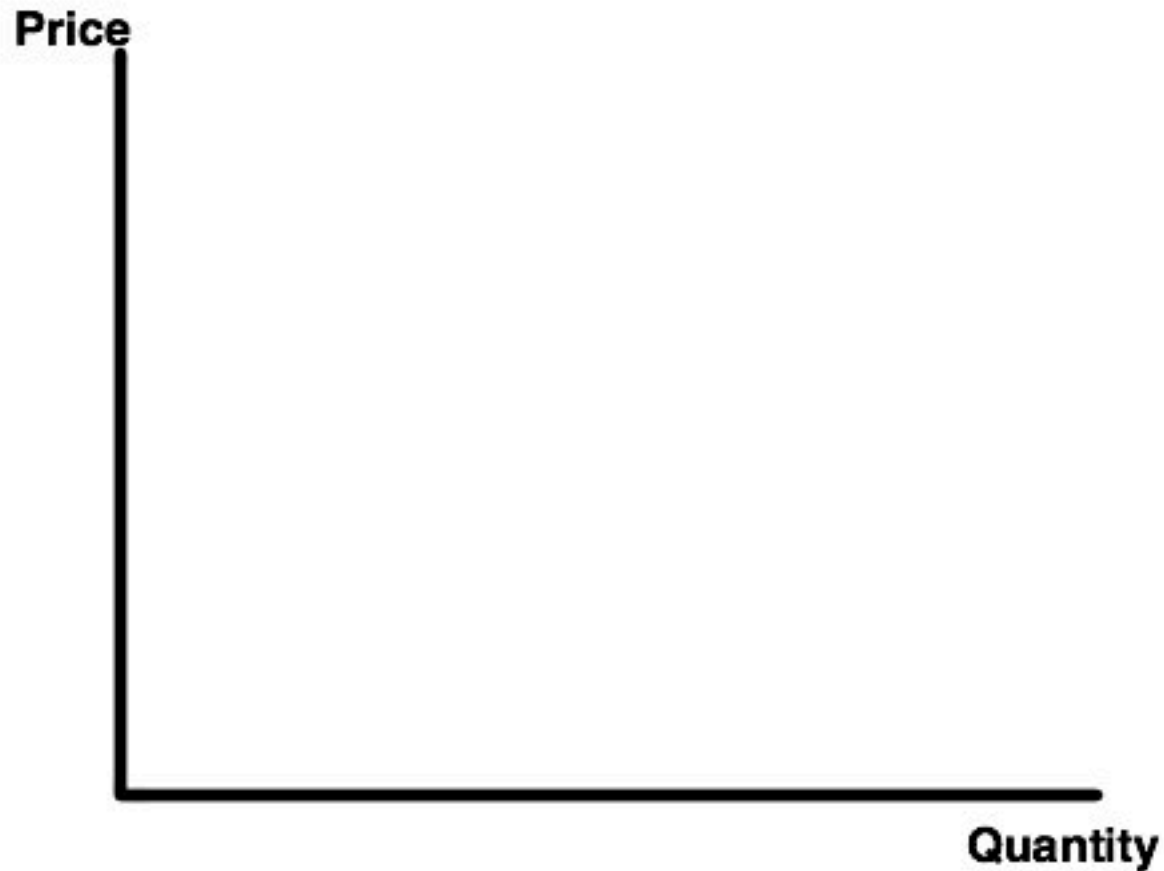
February 27, 2012

Governments Correct/Override Markets

- Taxes (to repair externalities)
- Subsidies (to compensate for spillovers)
- Quotas
 - No more than X can be imported or sold
 - Voluntary Export Restraints of the Reagan Administration
- Price ceilings: rent control
- Price floors: price maintenance

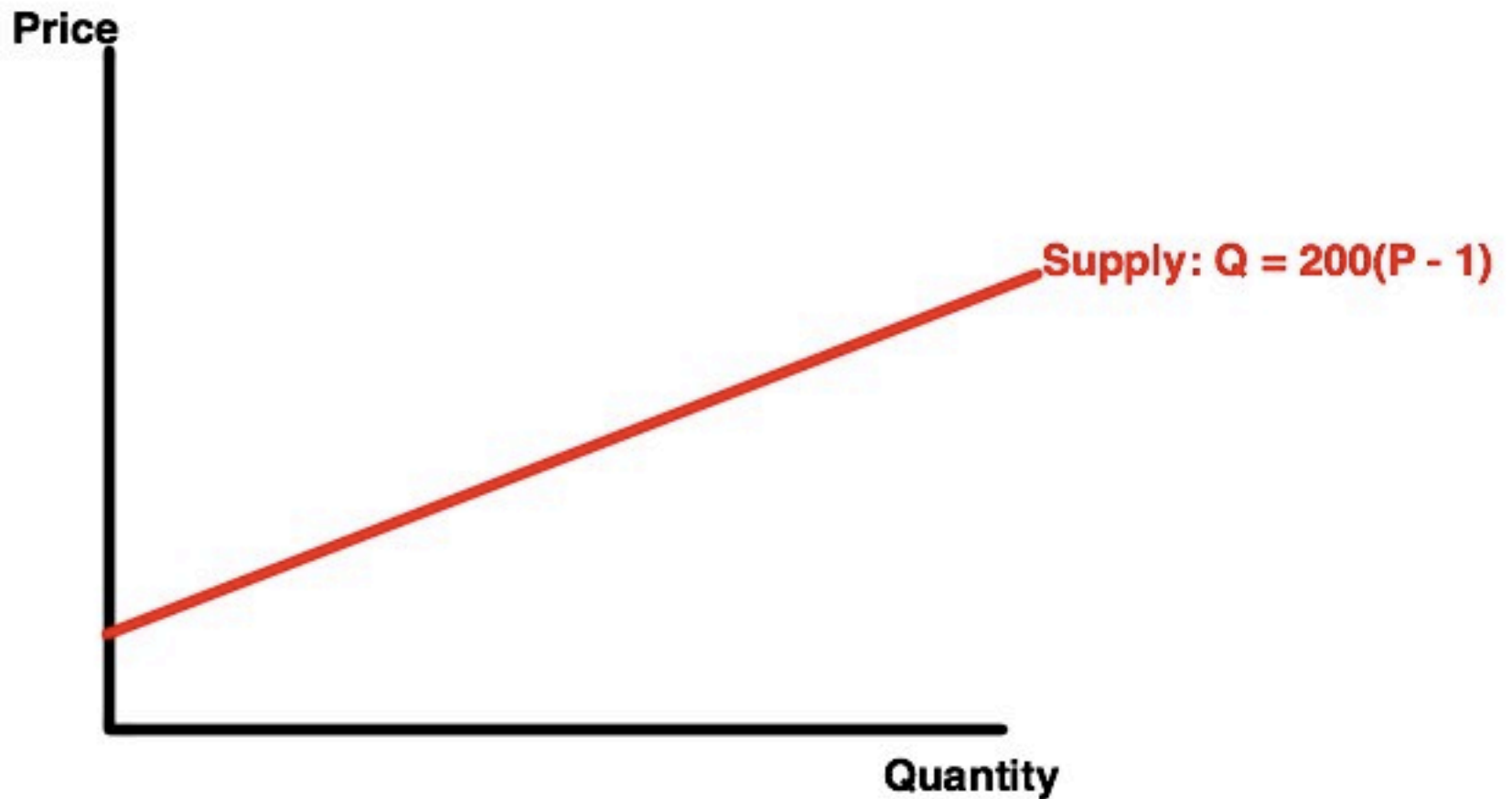
Supply and Demand

The Market for Lattes in Sunnydale



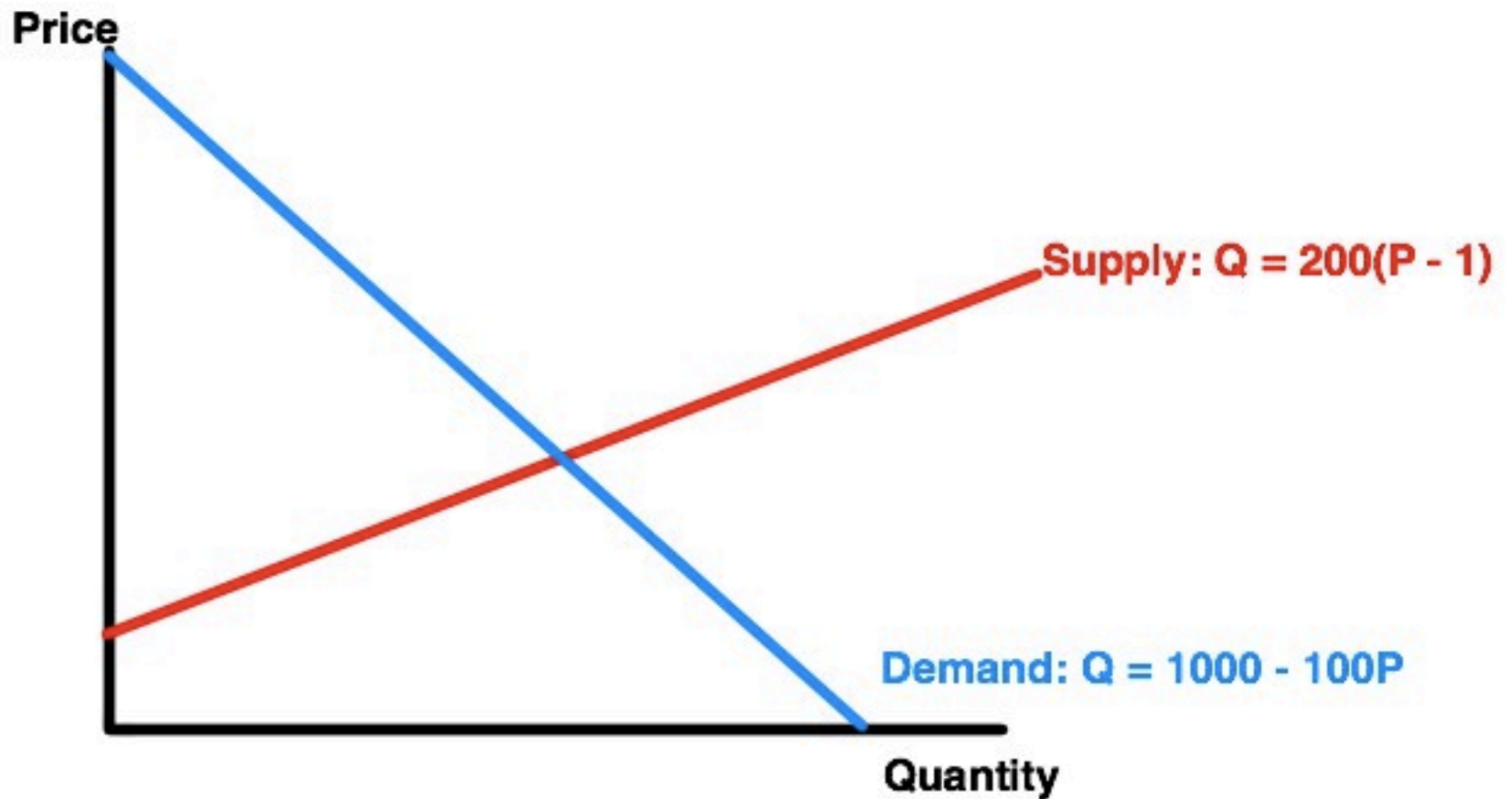
Supply and Demand

The Market for Lattes in Sunnydale



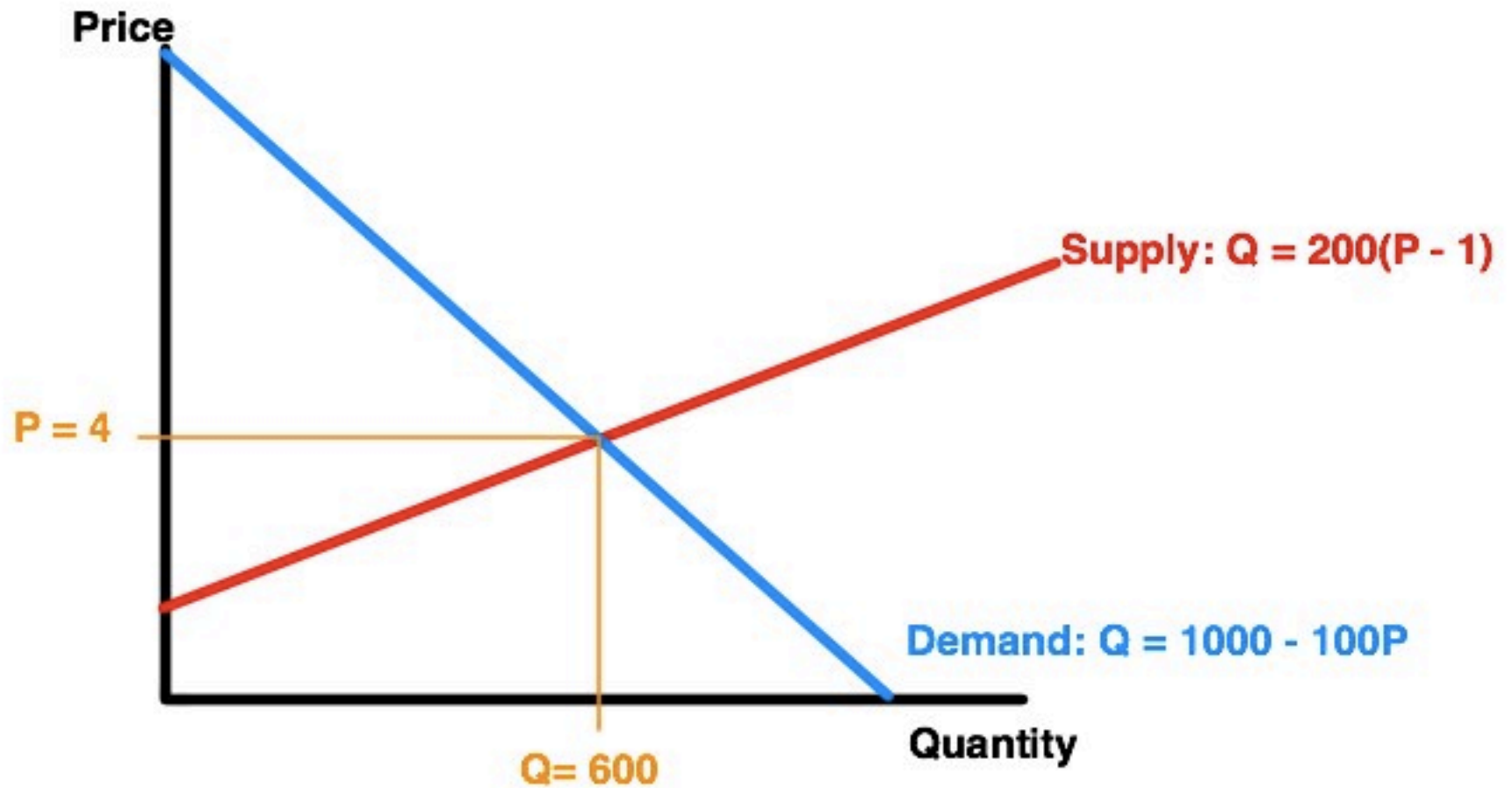
Supply and Demand

The Market for Lattes in Sunnydale



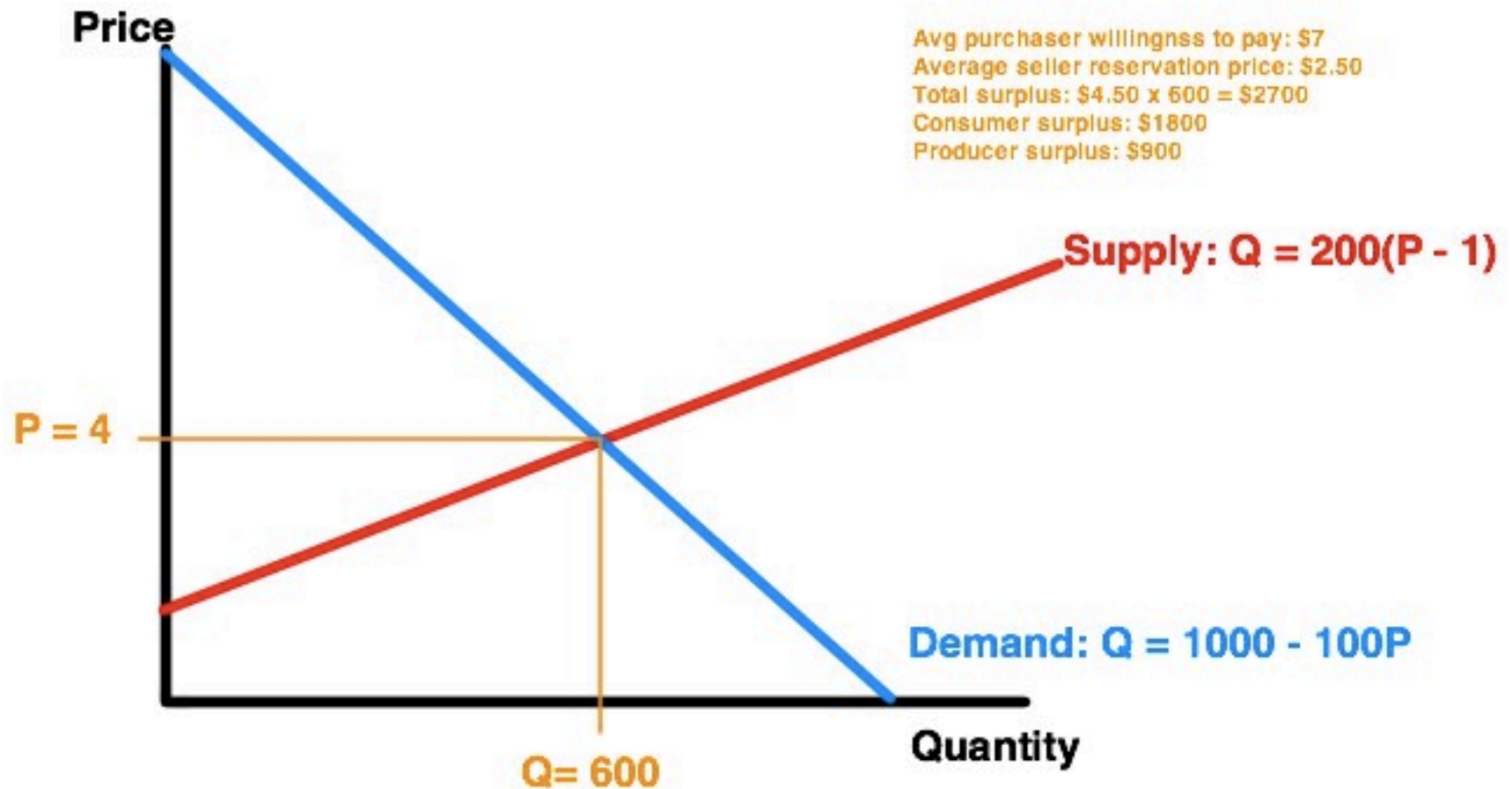
Supply and Demand

The Market for Lattes in Sunnydale



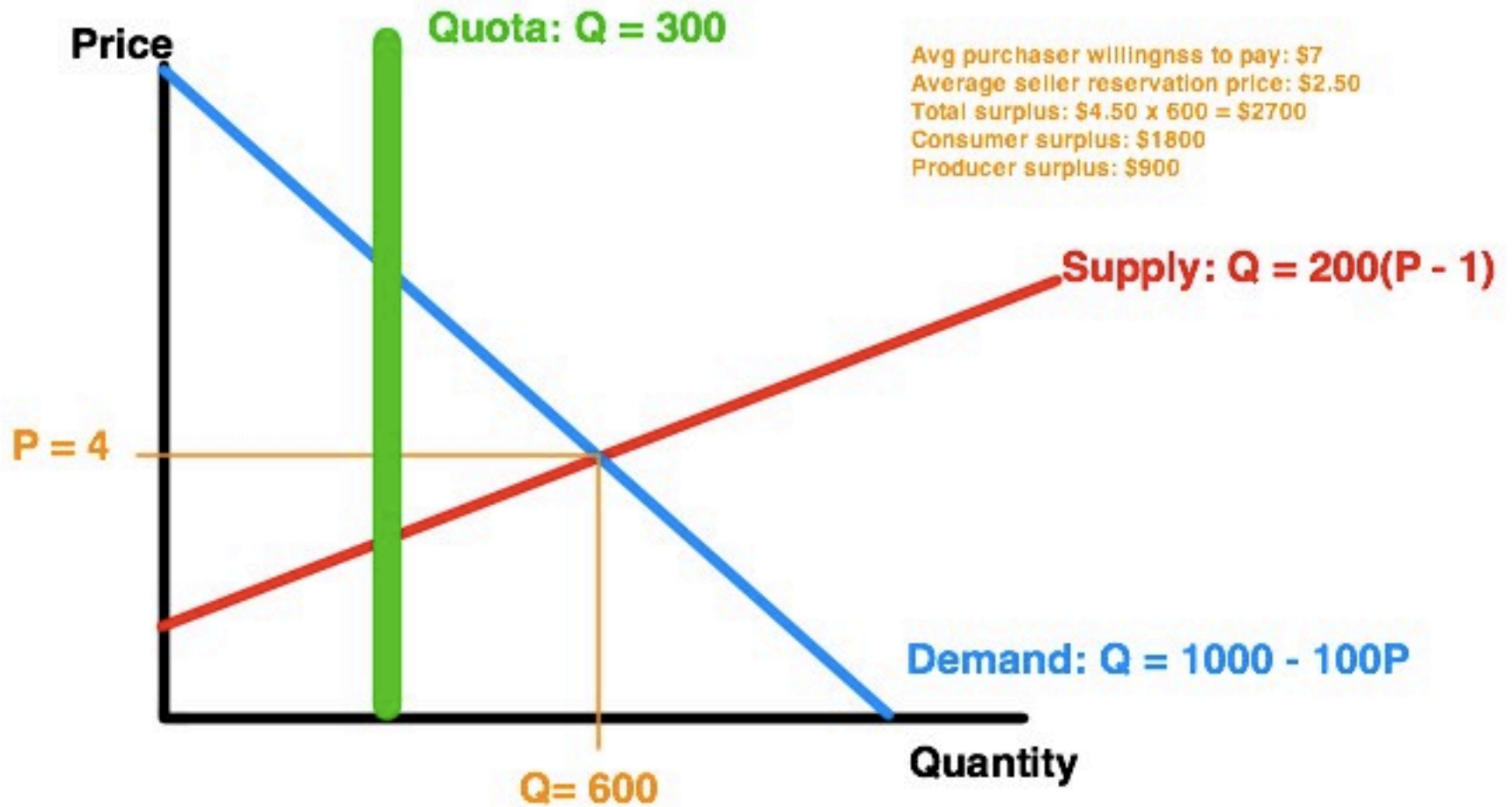
Supply and Demand

The Market for Lattes in Sunnydale



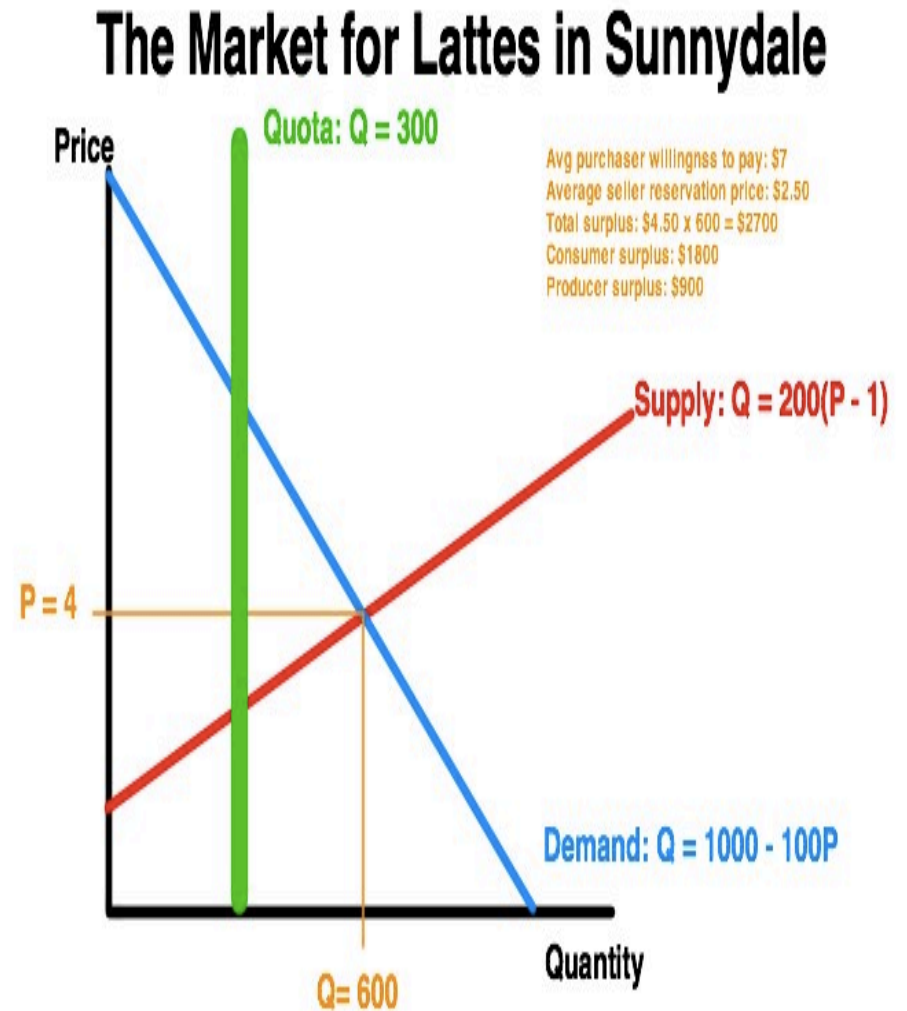
A Quota (Litter, etc.): No More than 300 Lattes/Day

The Market for Lattes in Sunnydale



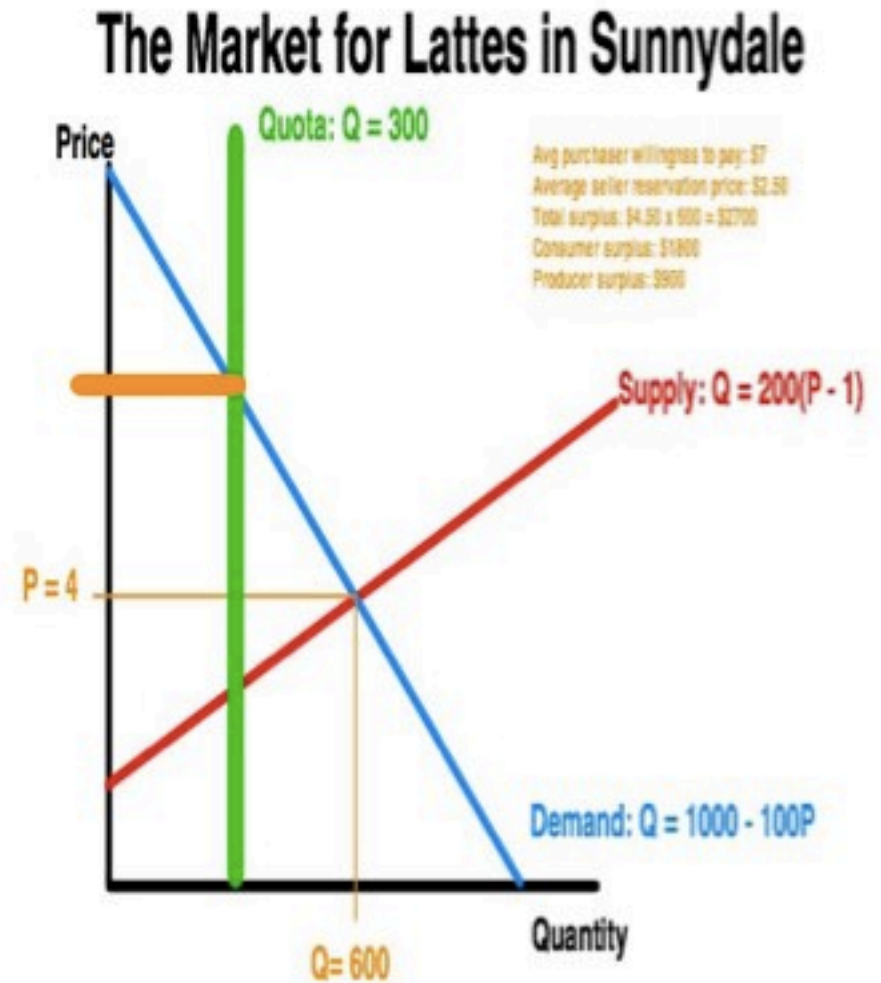
Ladies, and Gentlemen, to Your i>Clickers...

- If PDC puts on a quota of 300 lattes per day, what is the price at which those lattes are going to be sold?
 - A. \$4
 - B. \$7
 - C. \$2.50
 - D. \$8
 - E. Not enough information



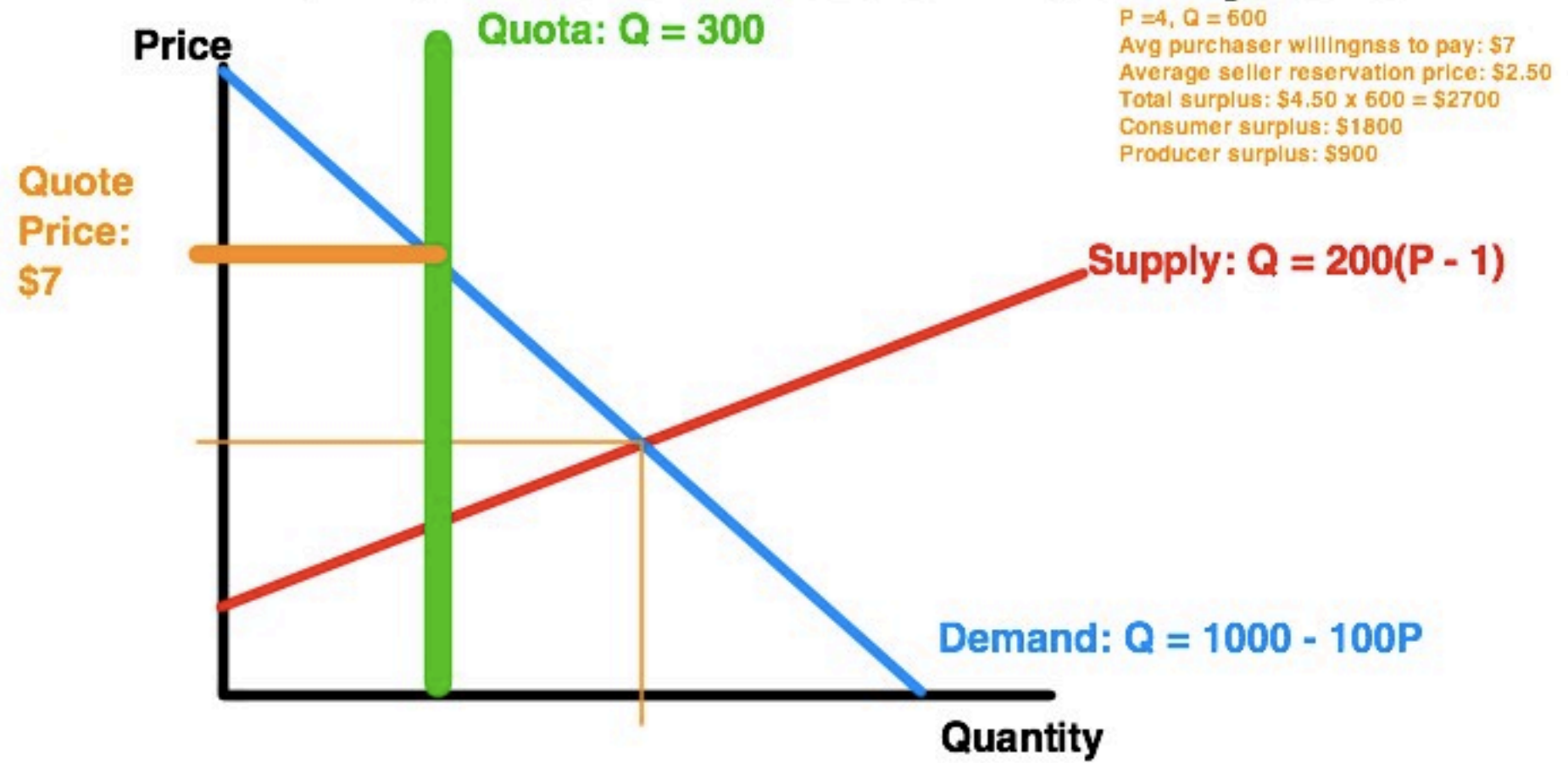
Ladies, and Gentlemen, to Your i>Clickers...

- If PDC puts on a quota of 300 lattes per day, what is the price at which those lattes are going to be sold?
 - A. \$4
 - B. \$7
 - C. \$2.50
 - D. \$8
 - E. Not enough information



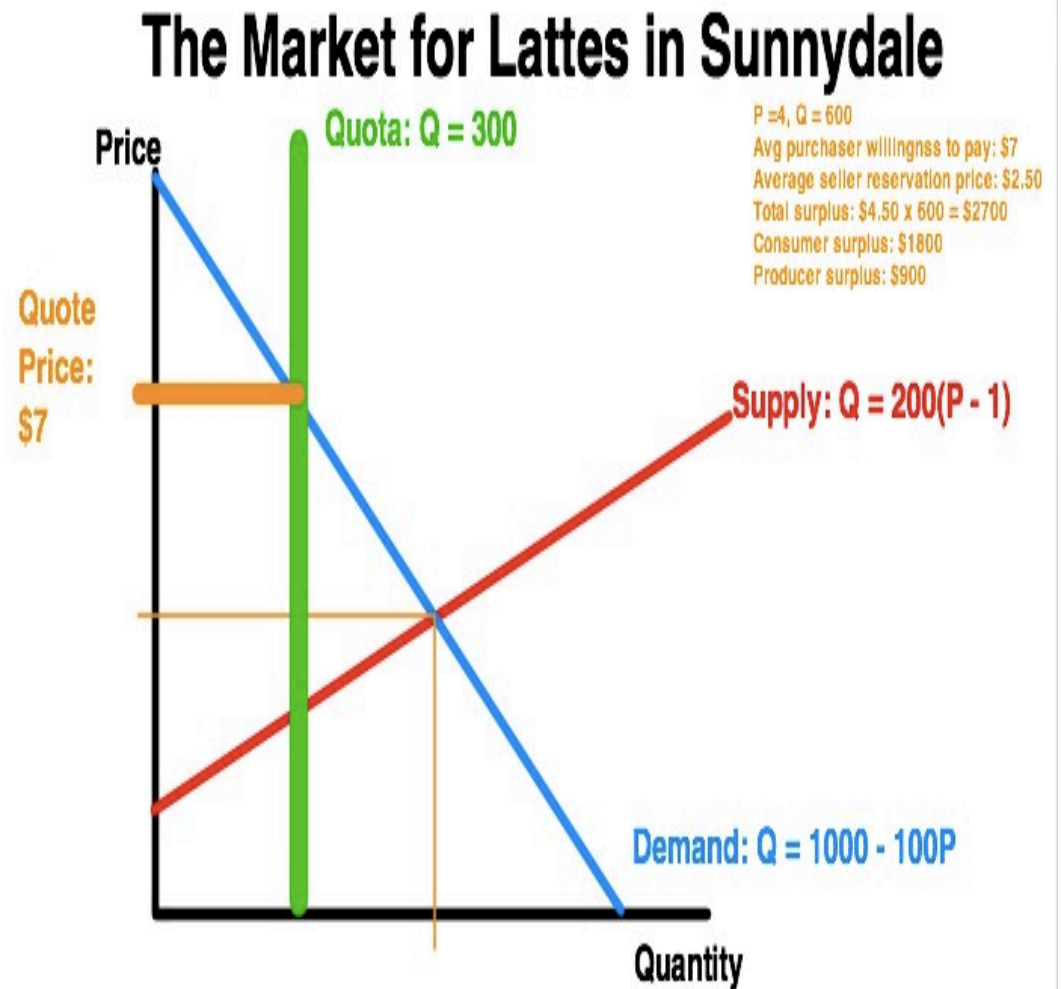
What Is Consumer Surplus Going to Be?

The Market for Lattes in Sunnydale



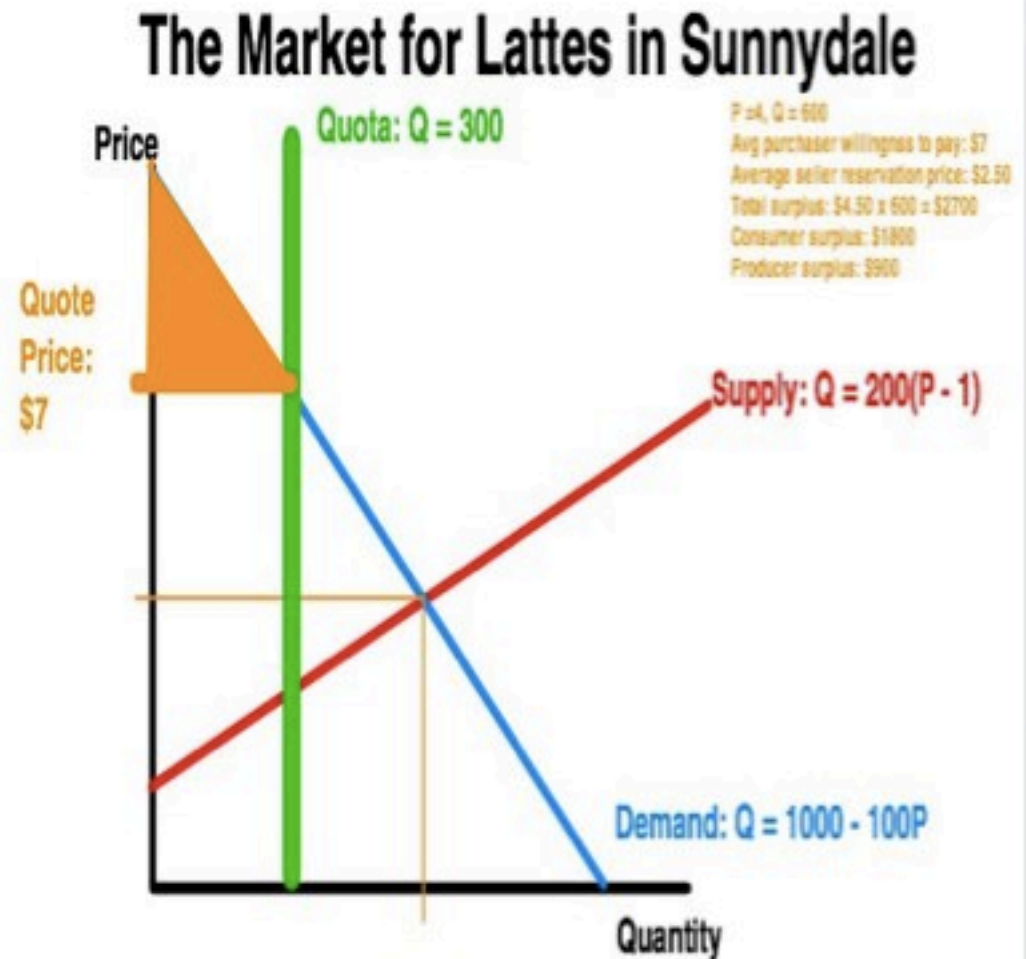
Ladies, and Gentlemen, to Your i>Clickers...

- If PDC puts on a quota of 300 lattes per day, what is consumer surplus going to be?
 - A. \$1800
 - B. \$900
 - C. \$450
 - D. \$2400
 - E. Not enough information



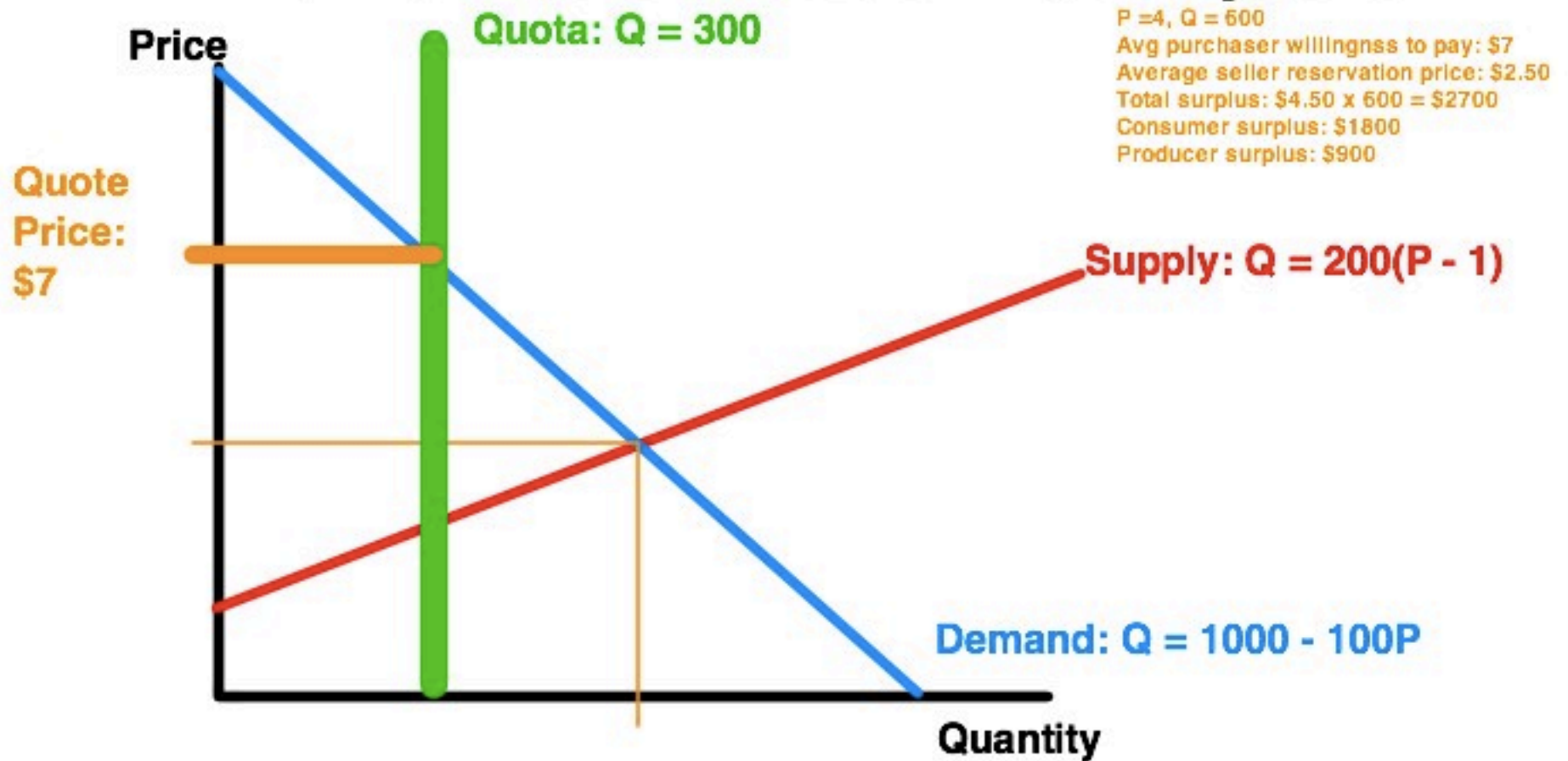
Ladies, and Gentlemen, to Your i>Clickers...

- If PDC puts on a quota of 300 lattes per day, what is consumer surplus going to be?
 - A. \$1800
 - B. \$900
 - C. \$450
 - D. \$2400
 - E. Not enough information



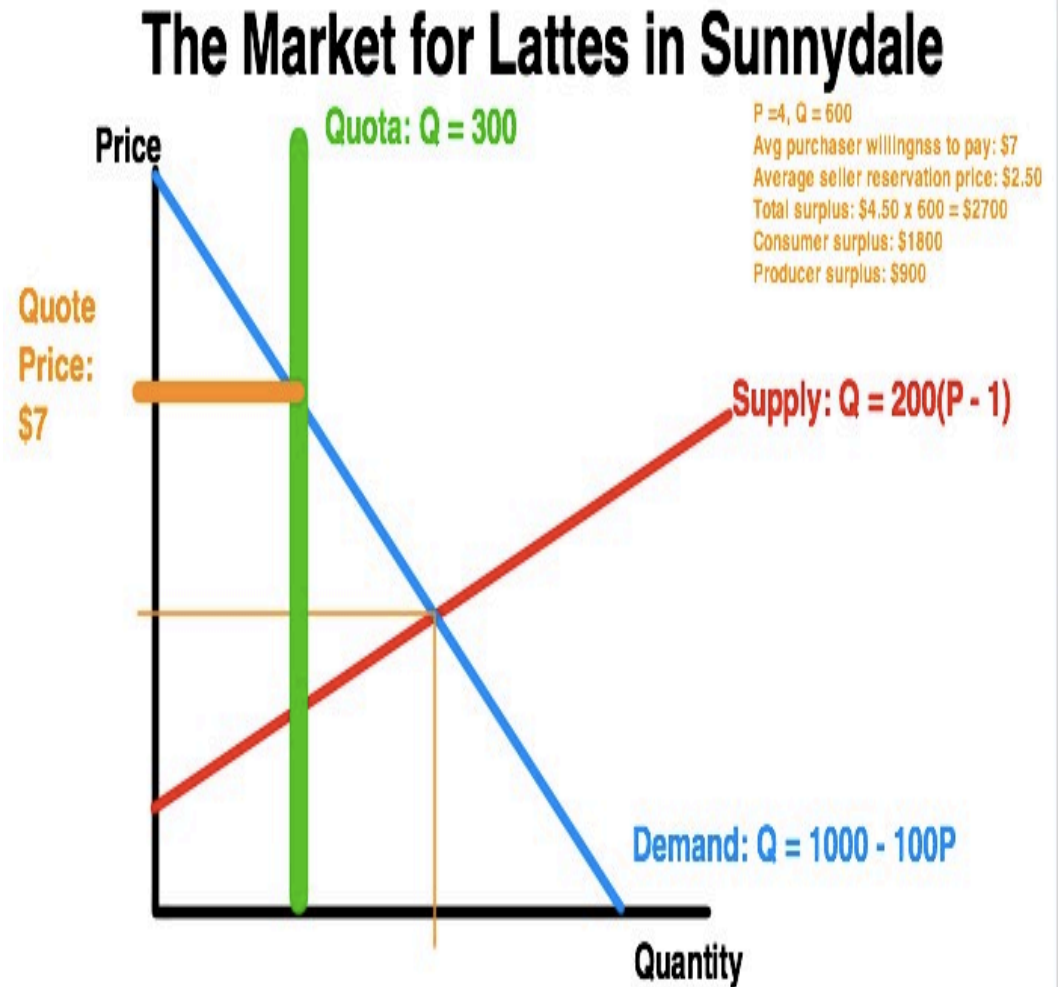
What Is Producer Surplus Going to Be?

The Market for Lattes in Sunnydale



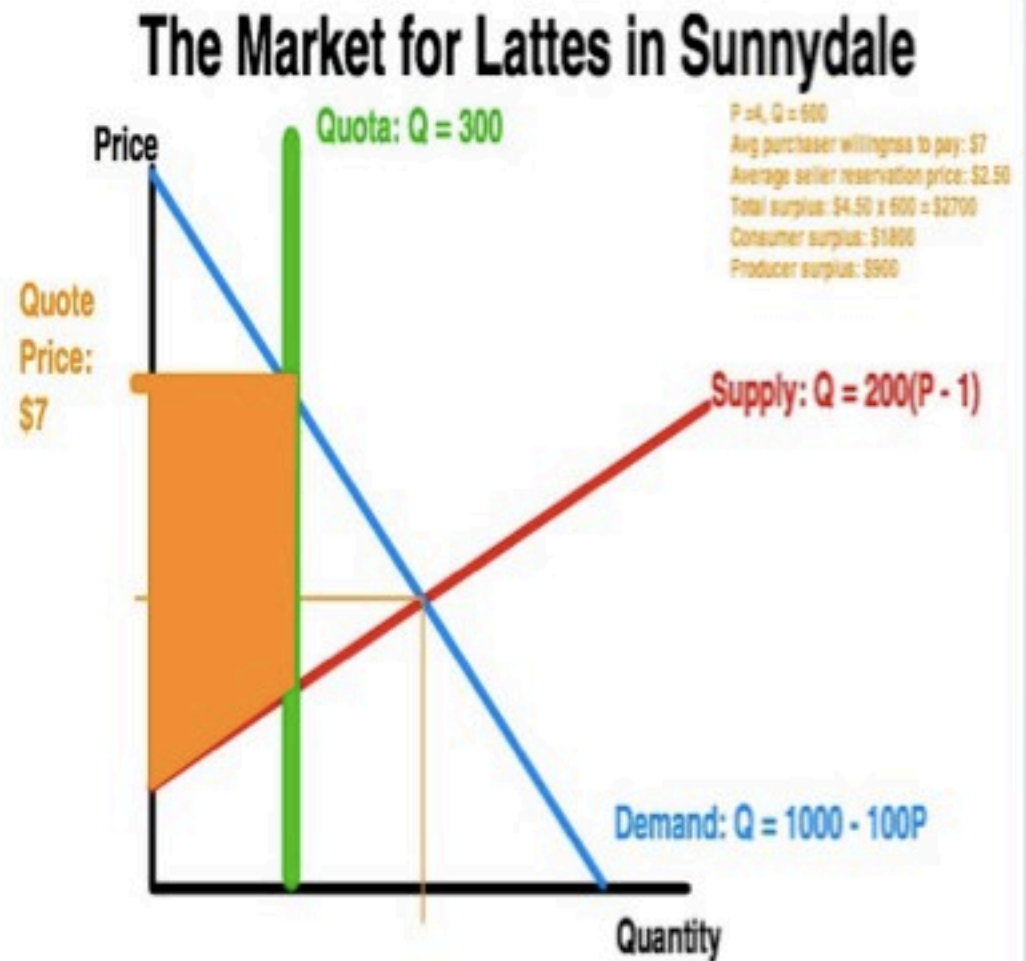
Ladies, and Gentlemen, to Your i>Clickers...

- If PDC puts on a quota of 300 lattes per day, what is producer surplus going to be?
 - A. \$225
 - B. \$900
 - C. \$1575
 - D. \$1800
 - E. Not enough information



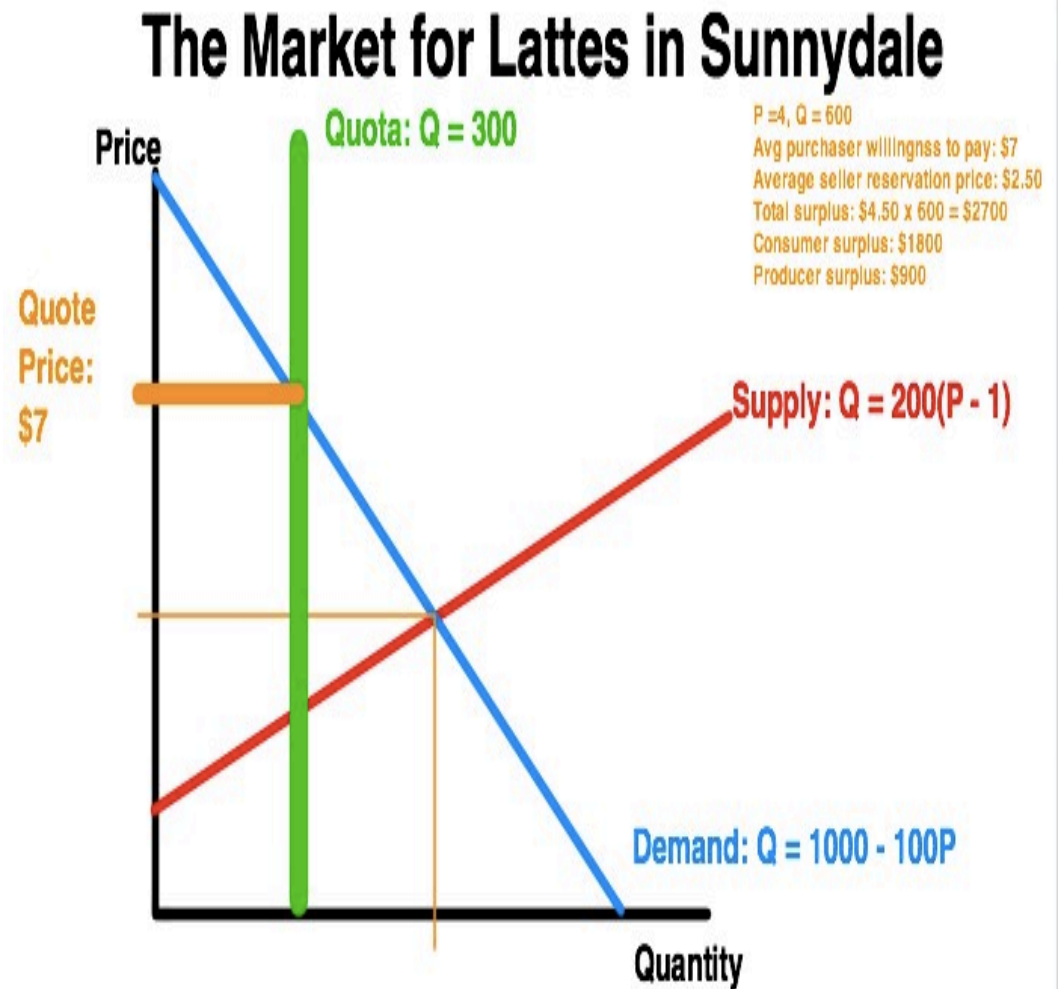
Ladies, and Gentlemen, to Your i>Clickers...

- If PDC puts on a quota of 300 lattes per day, what is producer surplus going to be?
 - A. \$225
 - B. \$900
 - C. \$1575
 - D. \$1800
 - E. Not enough information



Ladies, and Gentlemen, to Your i>Clickers...

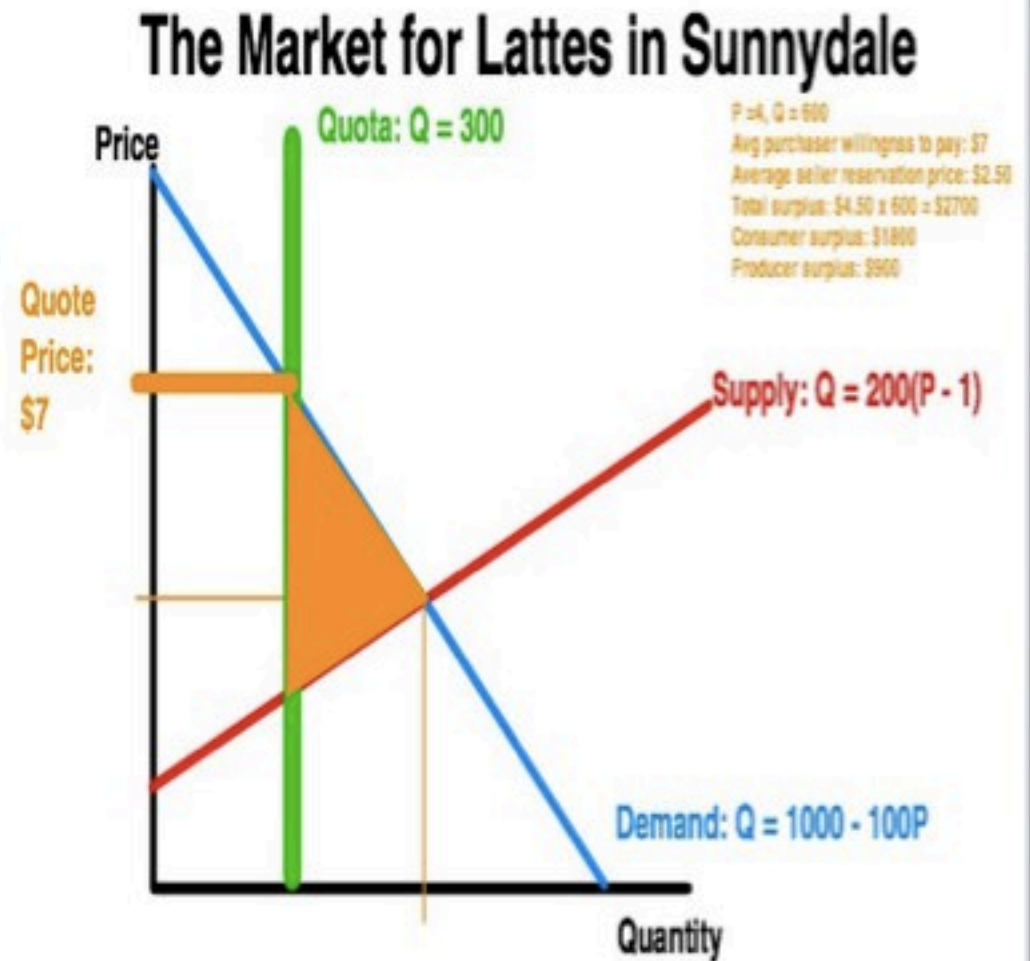
- If PDC puts on a quota of 300 lattes per day, what is the deadweight loss?
 - A. \$675
 - B. \$1350
 - C. \$225
 - D. \$1800
 - E. Not enough information



Ladies, and Gentlemen, to Your i>Clickers...

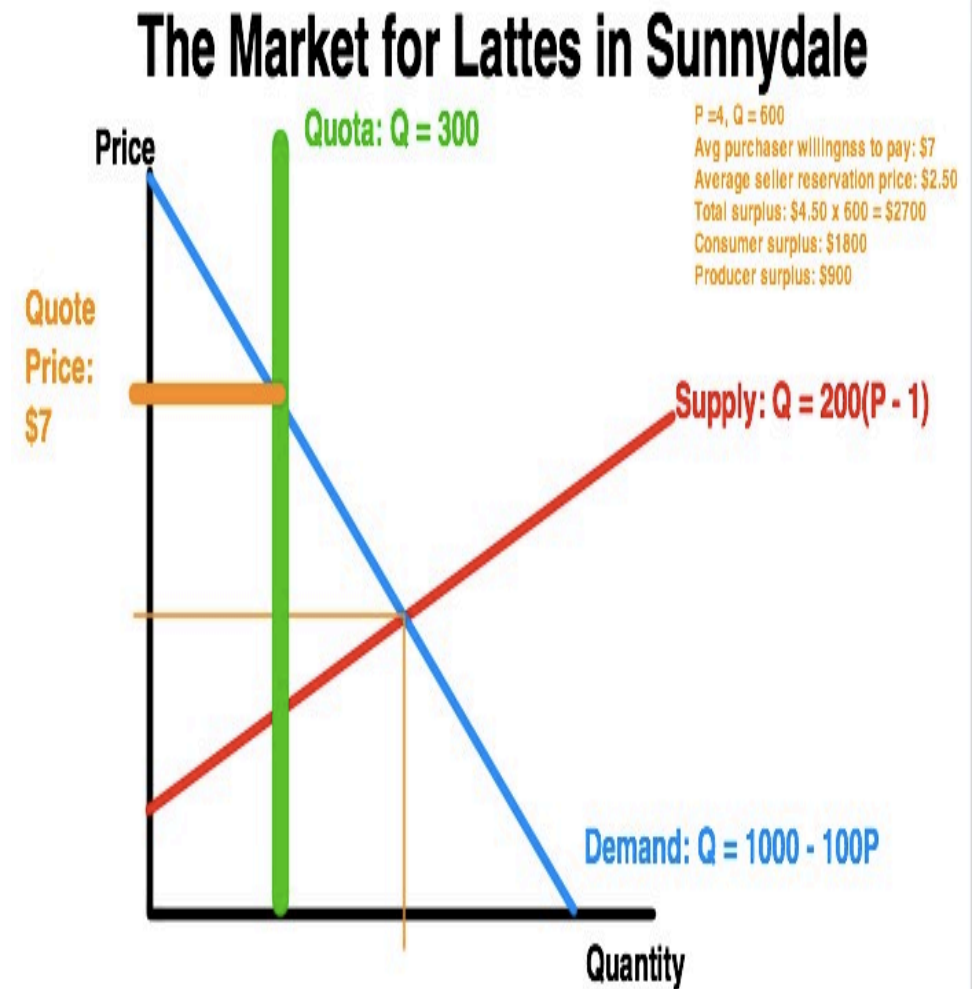
- If PDC puts on a quota of 300 lattes per day, what is the deadweight loss?

- A. \$675
- B. \$1350
- C. \$225
- D. \$1800
- E. Not enough information



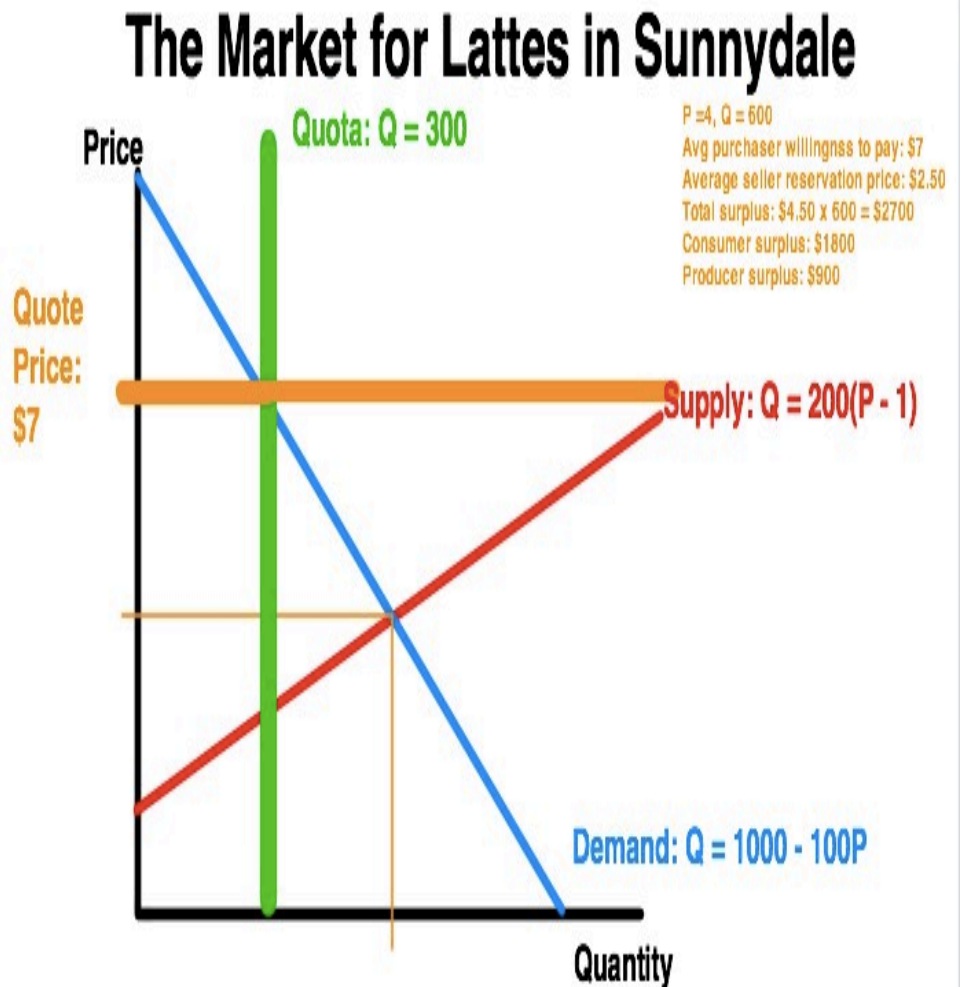
Ladies, and Gentlemen, to Your i>Clickers...

- PDC puts on a quota of 300 lattes per day. Is there a better way to accomplish its policy goals?
 - A. Yes
 - B. No
 - C. Not sure



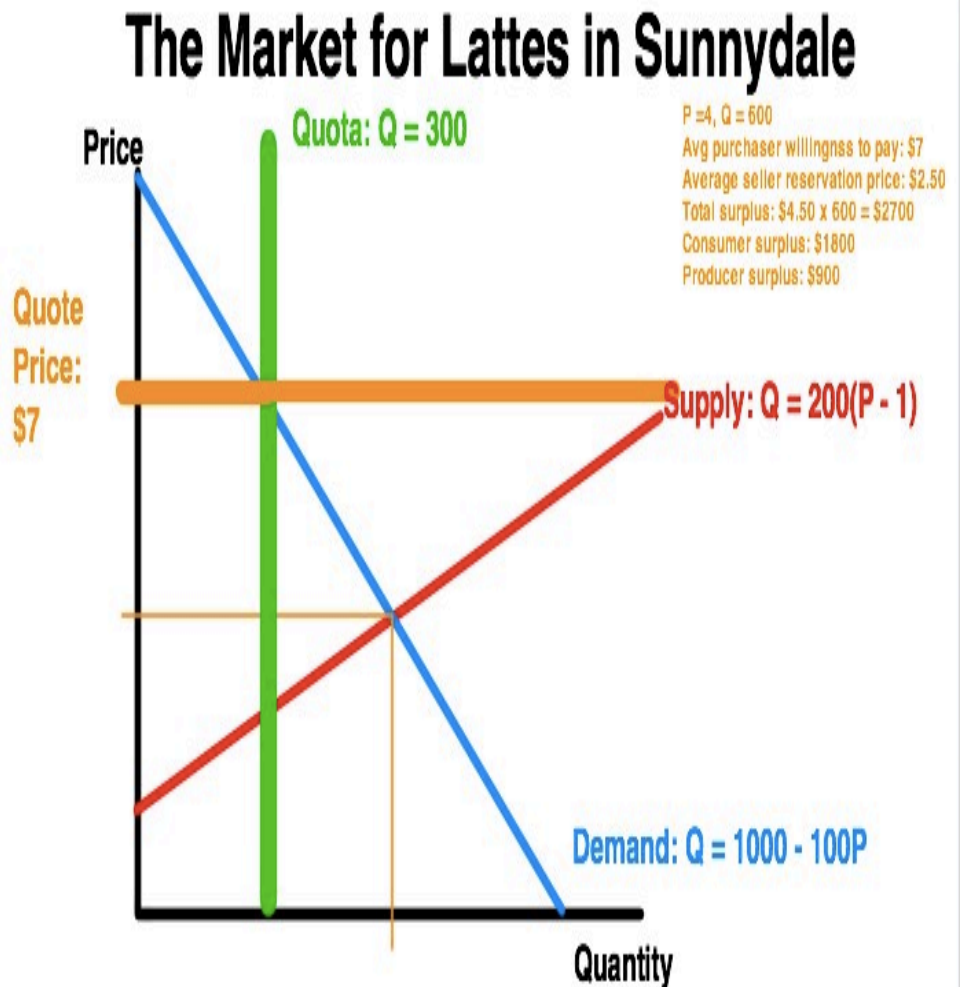
Yes, There Is a Better Policy: A \$4.50/ Latte Tax on Lattes

- Why is this policy better?
- Because:
 - Are we sure that the low-cost producers will wind up being the ones making the lattes?
 - Anybody with a reservation price of less than \$7 would want to produce
 - How does PDC sort out who gets the latte-producing licenses?
 - Friends of PDC?
Campaign contributors?
Lobbyists?



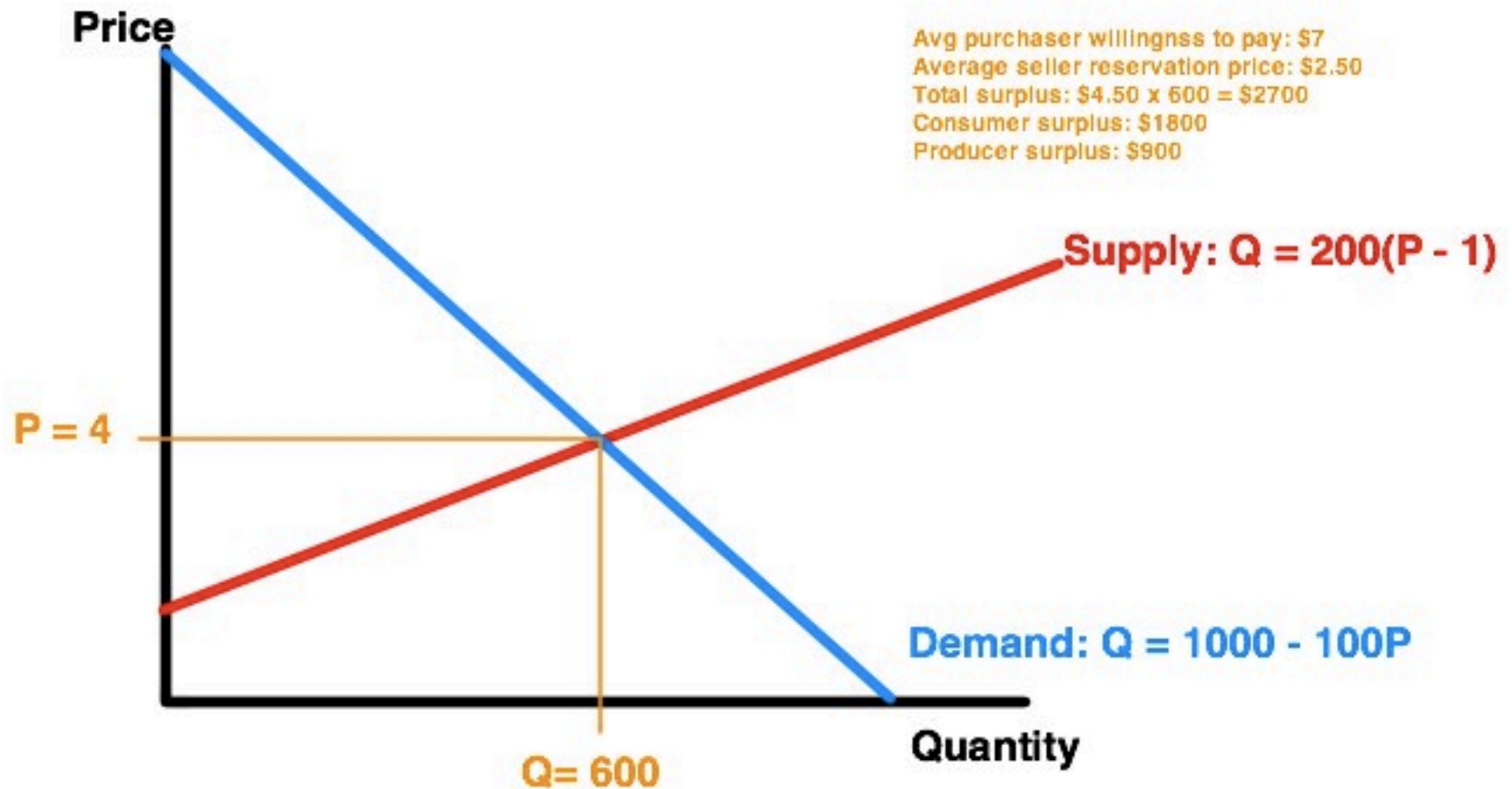
Yes, There Is a Better Policy: A \$4.50/ Latte Tax on Lattes

- Why is this policy better?
- Because:
 - If licenses are handed out to low-cost producers, a quota looks like a tax—but with the tax revenue all handed back to producers
 - If licenses are handed out according to some other logic, well then...
 - Average reservation cost = \$4
 - Consumer surplus = \$450
 - Producer surplus = \$900
 - Deadweight loss = \$1350
- And do you want the potential revenue from the tax going to the producers?
 - Cap-and-trade



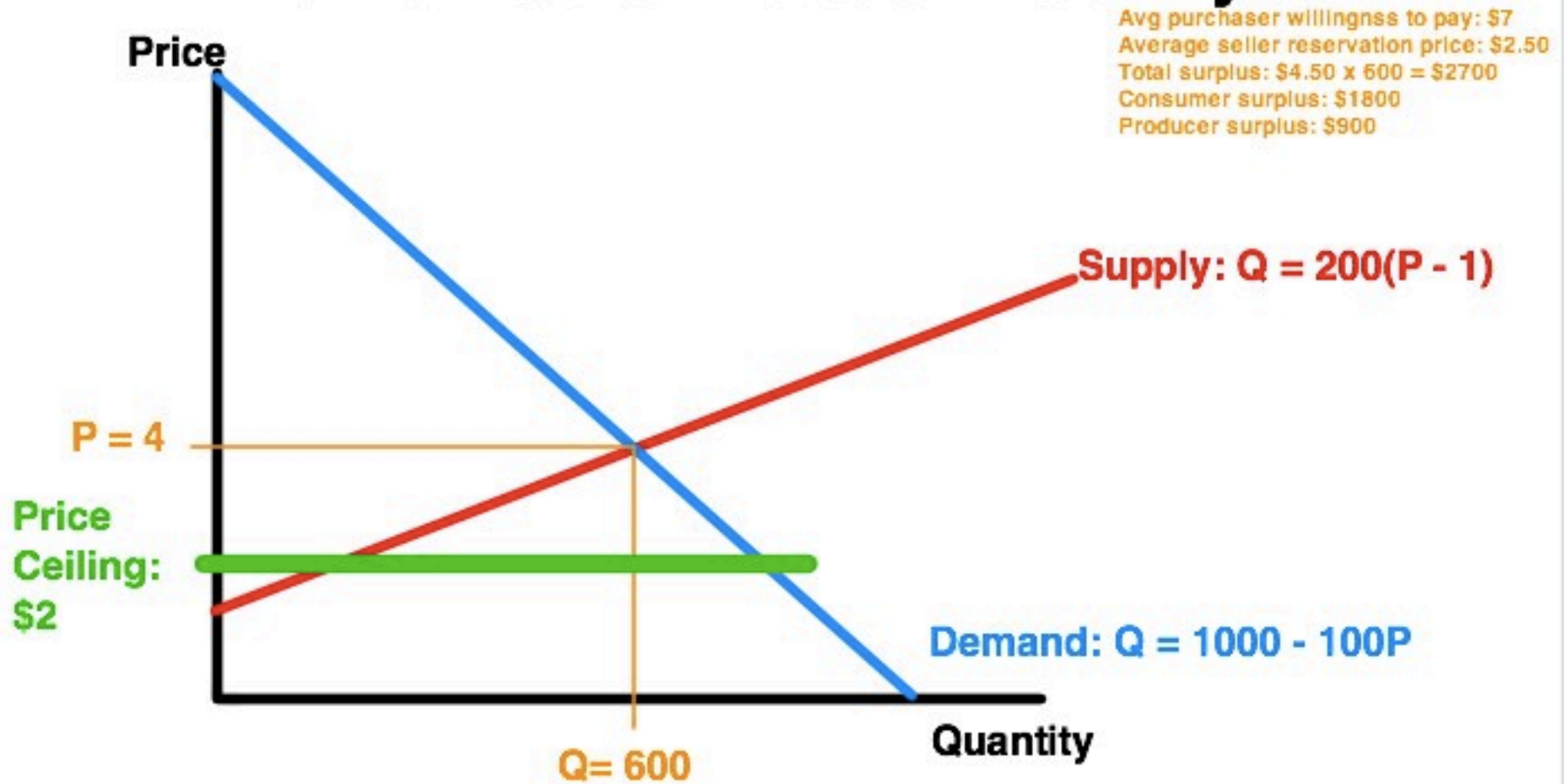
Supply and Demand

The Market for Lattes in Sunnydale



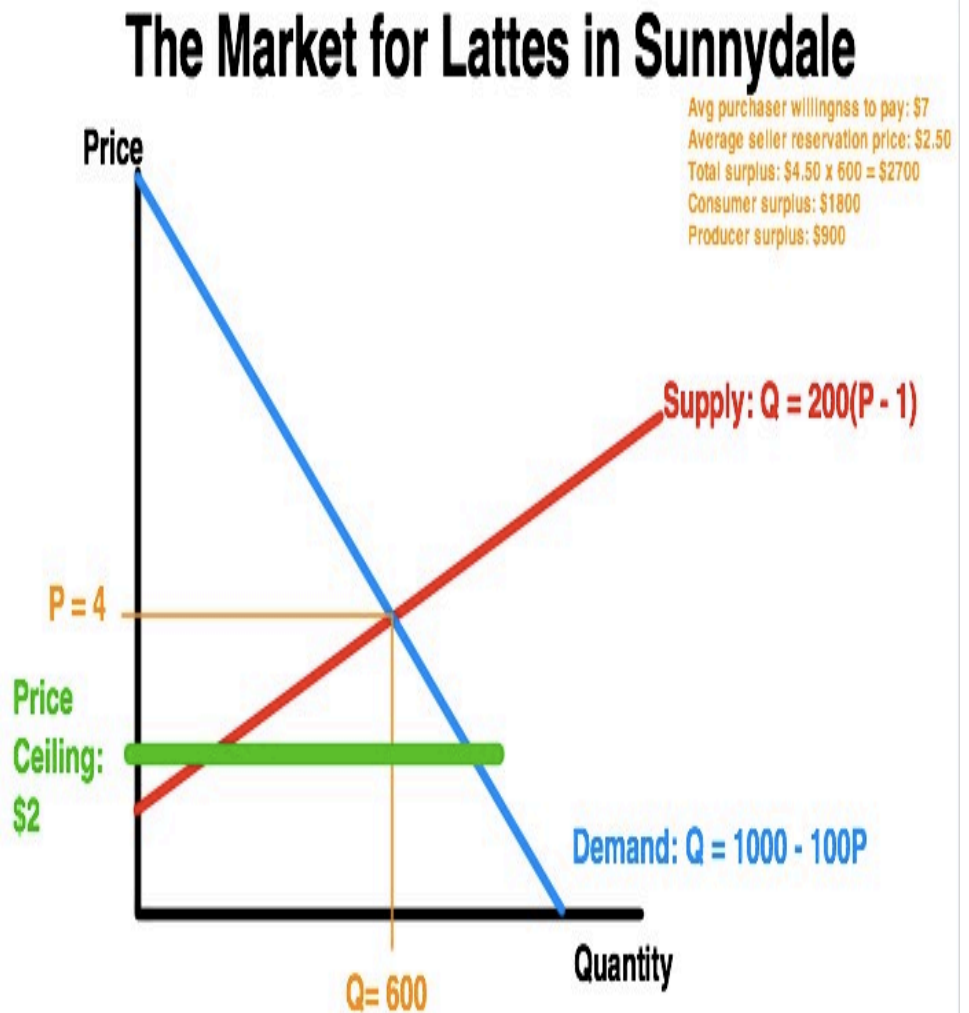
A Price Ceiling: PDC Says: It Is Unfair to Charge More than \$2/latte

The Market for Lattes in Sunnydale



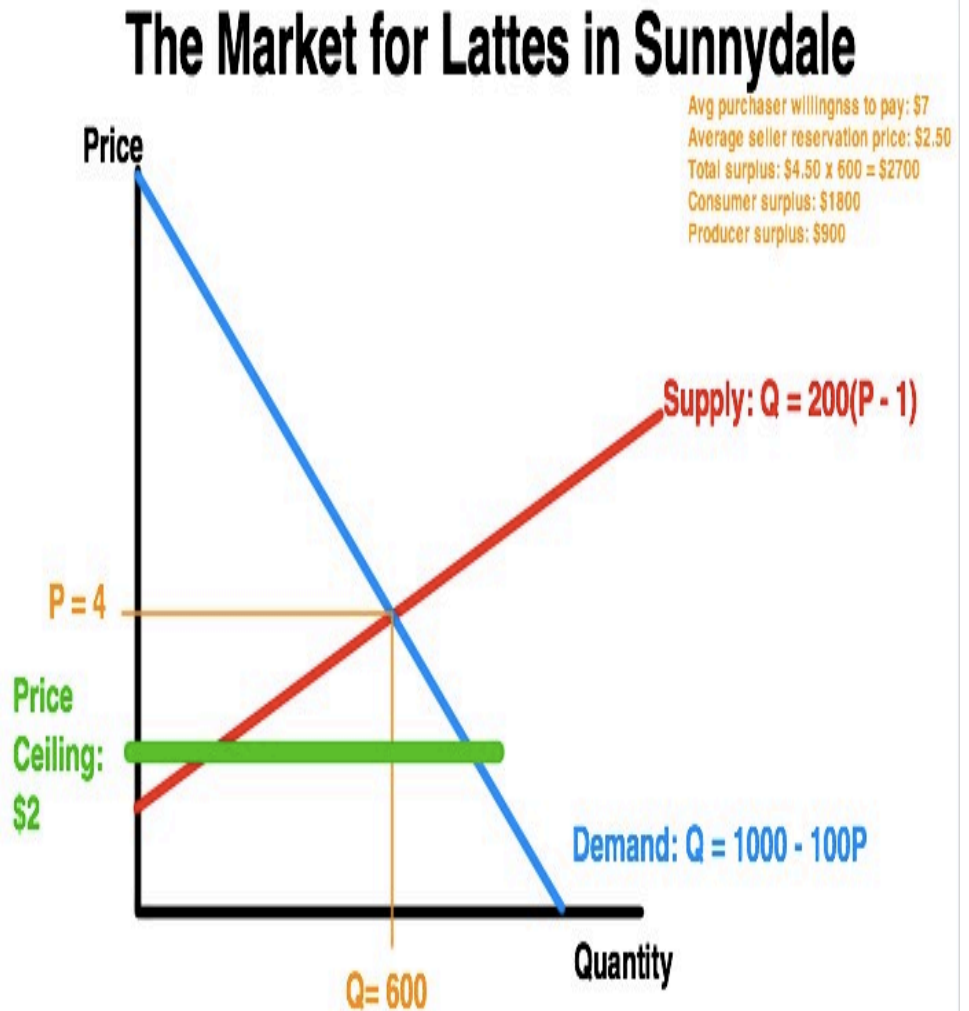
Ladies, and Gentlemen, to Your i>Clickers...

- If PDC puts on a price ceiling of \$2/latte per day, what is the equilibrium price and quantity?
 - A. (\$2, 200)
 - B. (\$4, 600)
 - C. (\$8, 200)
 - D. (\$2, 800)
 - E. Not enough information



Ladies, and Gentlemen, to Your i>Clickers...

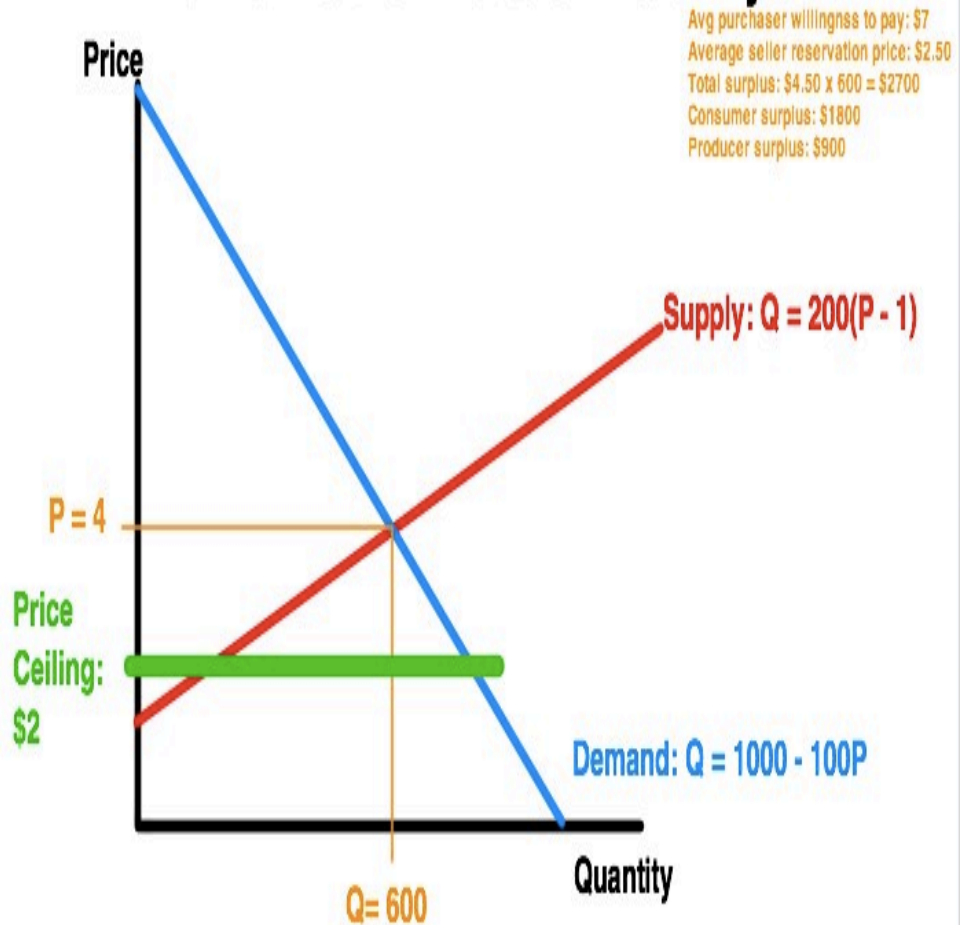
- If PDC puts on a price ceiling of \$2/latte per day, what is the producer surplus?
 - A. \$900
 - B. \$450
 - C. \$225
 - D. \$100
 - E. Not enough information



Ladies, and Gentlemen, to Your i>Clickers...

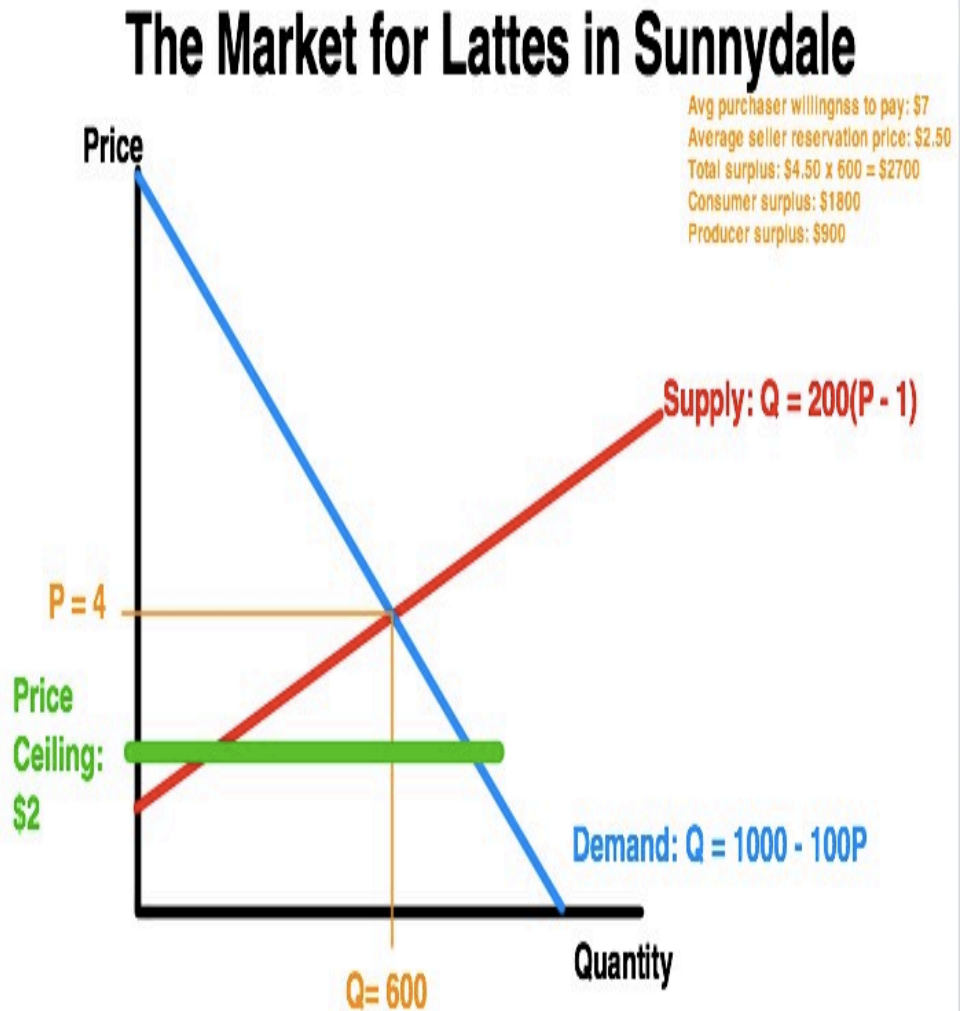
- If PDC puts on a price ceiling of \$2/latte per day, what is the producer surplus?
 - A. \$900
 - B. \$450
 - C. \$225
 - **D. \$100**
 - E. Not enough information

The Market for Lattes in Sunnydale



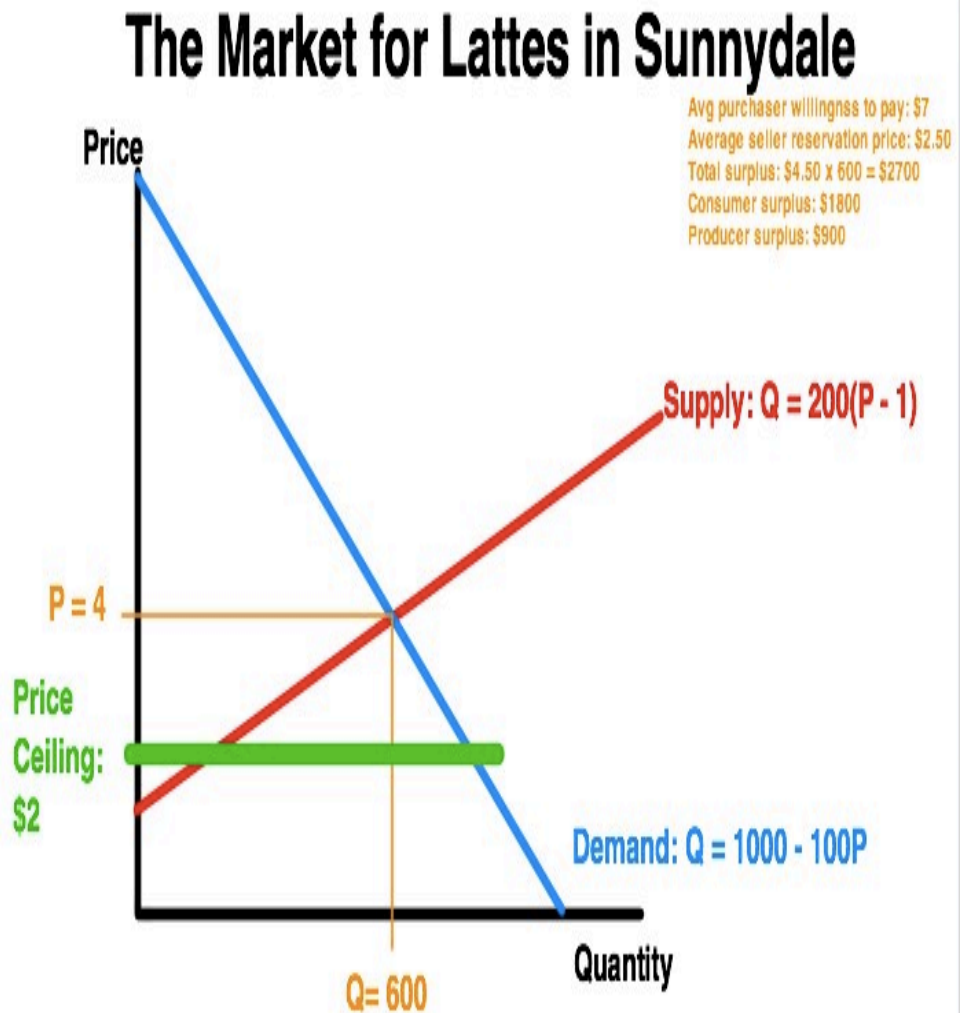
Ladies, and Gentlemen, to Your i>Clickers...

- If PDC puts on a price ceiling of \$2/latte per day, what is the consumer surplus?
 - A. \$900
 - **B. \$1400**
 - C. \$445
 - D. \$100
 - E. Not enough information



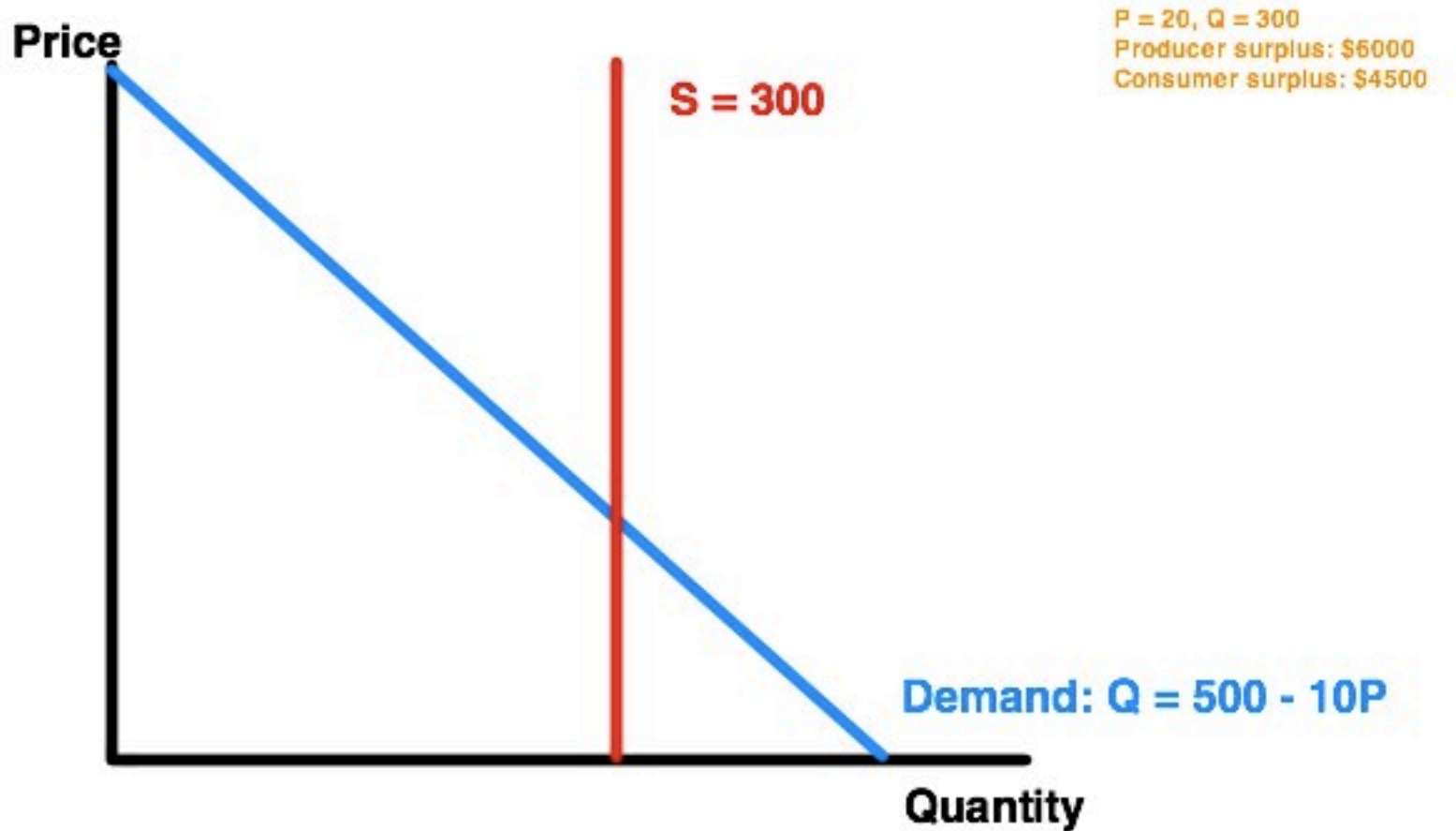
Effects of a \$2 Price Ceiling

- Consumer surplus has gone from \$1800 to \$1400
- Producer surplus has gone from \$900 to \$100
- \$1200 of deadweight loss...
- And this analysis may not be right:
 - Remember: everyone who would find a latte worth more than \$2 is a potential demander
 - Random demand: average willingness to pay is \$6
 - That would mean not \$1400 but rather \$800 of consumer surplus
 - That would mean not \$1200 but \$1800 of deadweight loss.



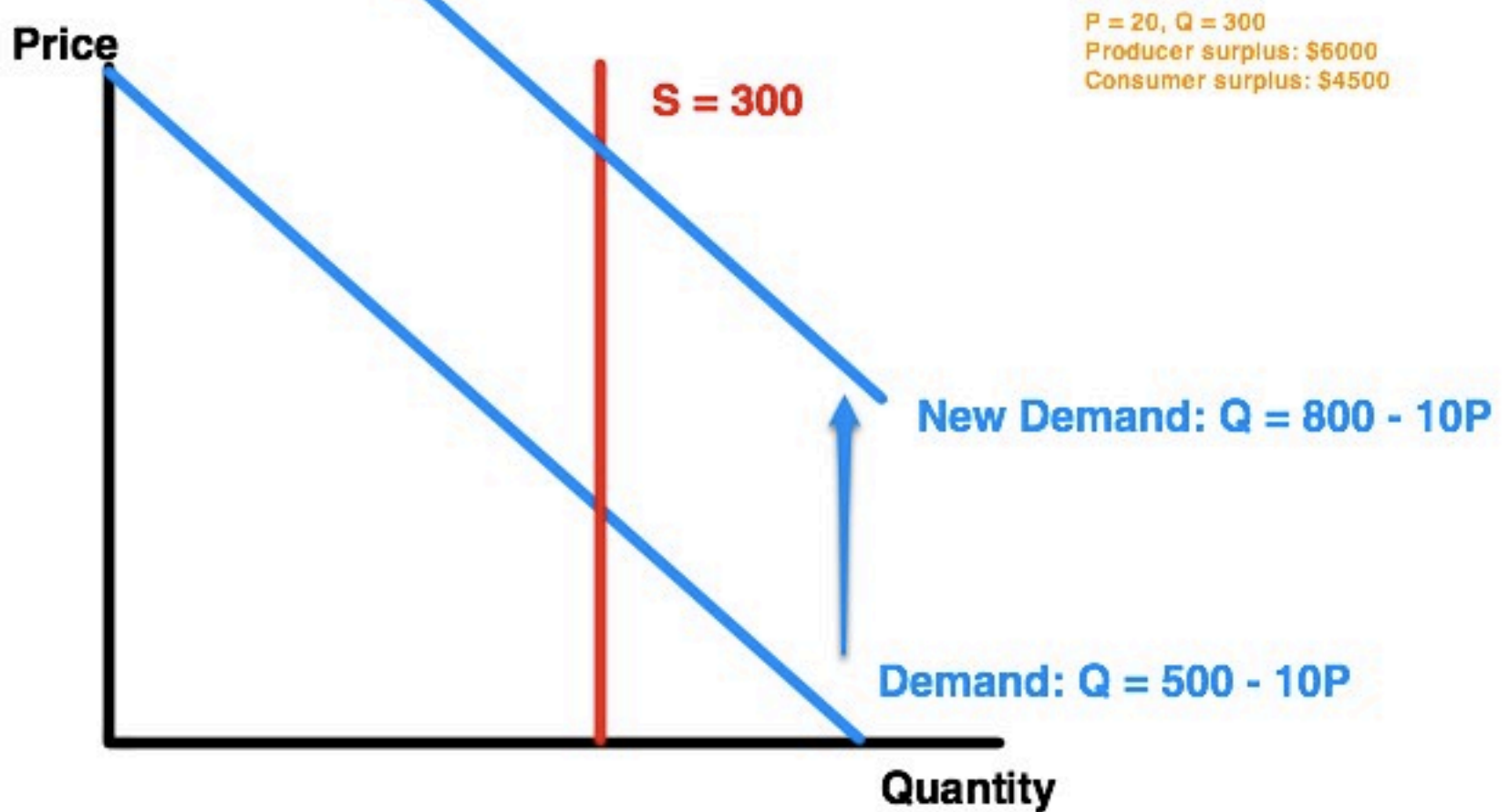
Why Would Anybody Ever Impose a Price Ceiling?

The Market for Yoga in Sunnydale



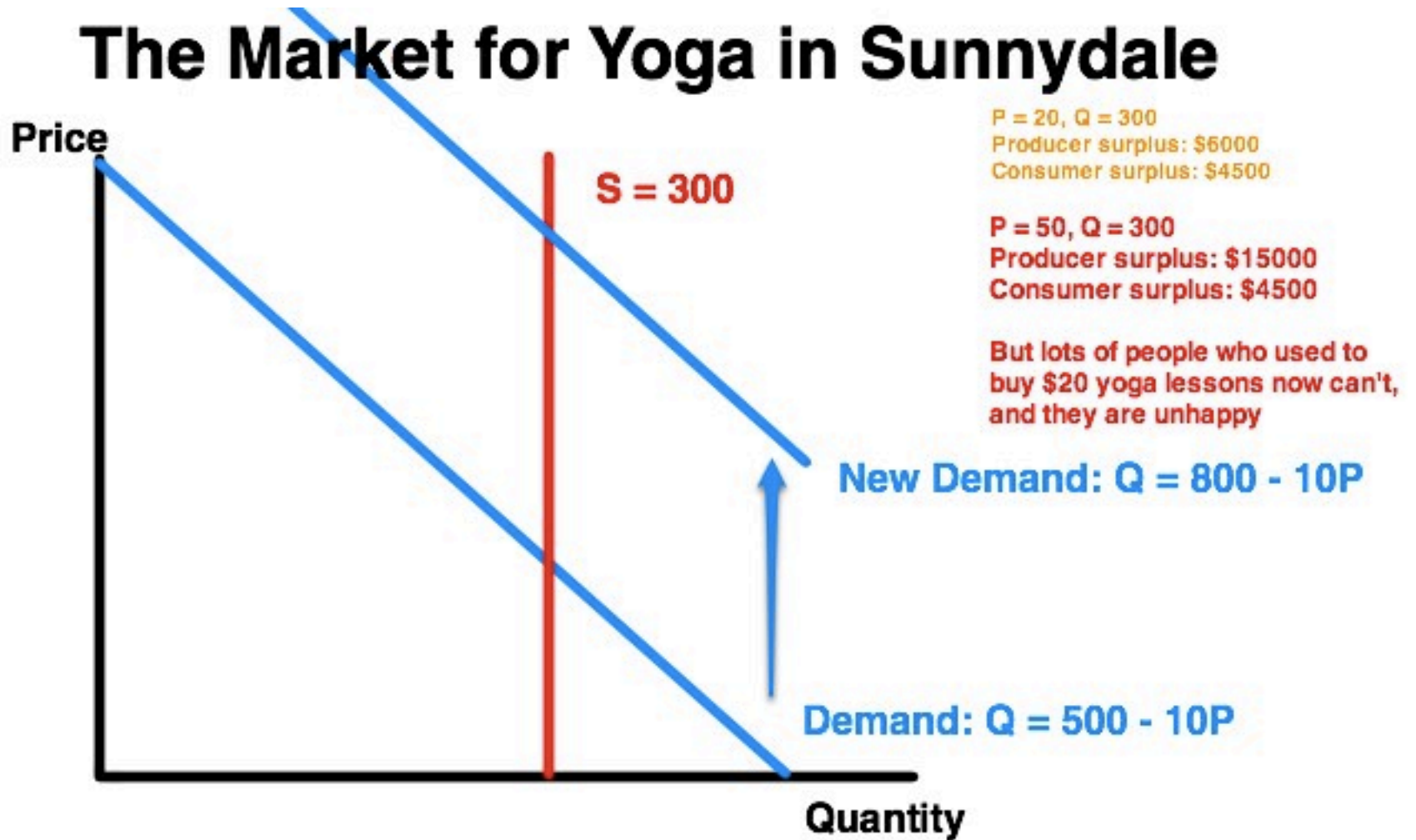
A Yoga Boom...

The Market for Yoga in Sunnydale



A Yoga Boom...

The Market for Yoga in Sunnydale



Economics 1: Spring 2012

Consumers

J. Bradford DeLong, Lanwei Wang, and a
cast of thousands...

February 27, 2012

How Do/Should Consumers Behave?