

# Price control

Steve Stoddard outlines two forms of price control that may be used by governments to deal with market failure: minimum prices and maximum prices

## Reasons for price controls

- Governments sometimes take the view that the equilibrium price that would prevail in a free market is either too high or too low.
- High or low prices could lead to market failure.
- For example, if wages for some workers would not give sufficient income to maintain a basic standard of living, governments may wish to set a minimum wage above this level to alleviate poverty.
- Similarly, if prices of certain essential goods and services, such as food, shelter or domestic energy become too expensive for some people to afford, governments may wish to set a maximum price. This again could help to alleviate poverty as well as reducing monopoly power.

## Advantages of minimum prices

- Minimum prices give producers a guaranteed minimum price and income, which helps to generate a reasonable standard of living, such as in the case of farmers in less developed economies.
- They encourage production of essential products, such as food.
- Excess supplies can be bought up and stored, to be released in times of future shortage.

## Minimum prices

- Minimum prices are price floors that establish a legal level below which prices are not allowed to fall.
- Examples include the setting of a national minimum wage, guaranteed minimum prices paid to farmers for their agricultural products, and a legal minimum price per unit of alcohol. The latter is used in Scotland, where the current minimum price per alcoholic unit is 65p, meaning, for example, that the minimum price for a 700 ml bottle of whisky is £18.20.

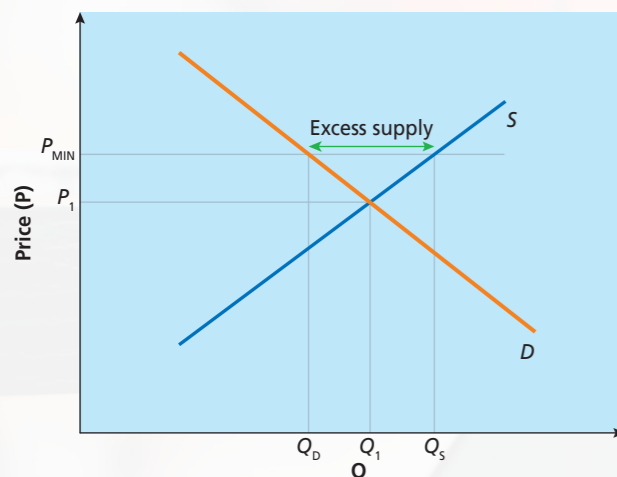


Figure 1 The effect of a minimum price

- The impact of a minimum price is shown in Figure 1. A minimum price ( $P_{MIN}$ ) set above the free market price ( $P_1$ ) for a good or service will create excess supply, equal to  $Q_S - Q_D$ .
- In the case of a guaranteed minimum price, the excess supply is often bought up by a government or other organisation. In Figure 2, which illustrates a guaranteed minimum price paid to wheat farmers, this would cost the buying organisation  $€3,000 \times (30,000 - 10,000 \text{ tonnes}) = €60 \text{ million}$ .

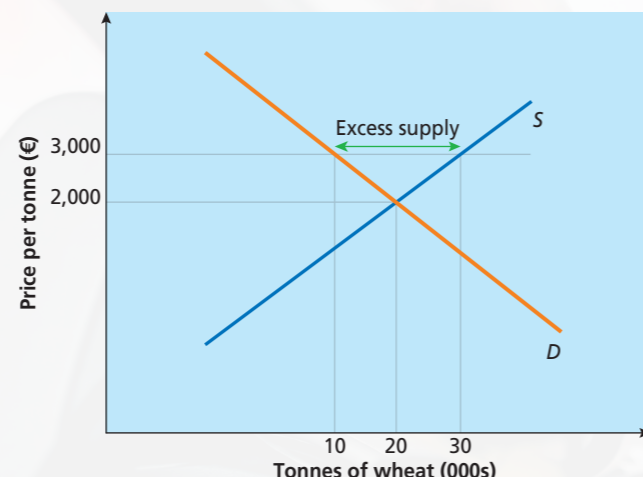


Figure 2 A guaranteed minimum price for wheat

## Disadvantages of minimum prices

- Consumers must pay a higher price, reducing their disposable income.
- They can encourage over-production, especially in the case of agriculture, which is an inefficient use of resources. This excess supply may need to be put into storage, which generates further costs.
- If governments or other authorities must purchase excess supplies, this leads to opportunity costs, i.e. these funds could have been used elsewhere.
- They may reduce international competitiveness if the prices of products are raised above those of foreign competitors.
- In the case of interventions to reduce the affordability of demerit goods, such as tobacco or alcohol, they may encourage people to seek cheaper, potentially more harmful alternatives, leading to government failure.

## Maximum prices

- A maximum price is an upper limit, or price ceiling, above which prices are not permitted to rise.
- The justification for their use is usually that the free-market equilibrium price would be too high for many consumers, leading to problems of reduced affordability.
- Examples include rent controls in densely populated cities, wage caps on highly paid occupations and limits on the ability of utility companies to raise prices above the rate of inflation, sometimes referred to as energy price caps. Between April and June 2025, the energy price cap was £1,849 per year for a typical household's use of gas and electricity.
- The impact of a maximum price is shown in Figure 3. A maximum price ( $P_{MAX}$ ) set below the free market price ( $P_1$ ) for a product will create excess demand, equal to  $Q_D - Q_S$ .

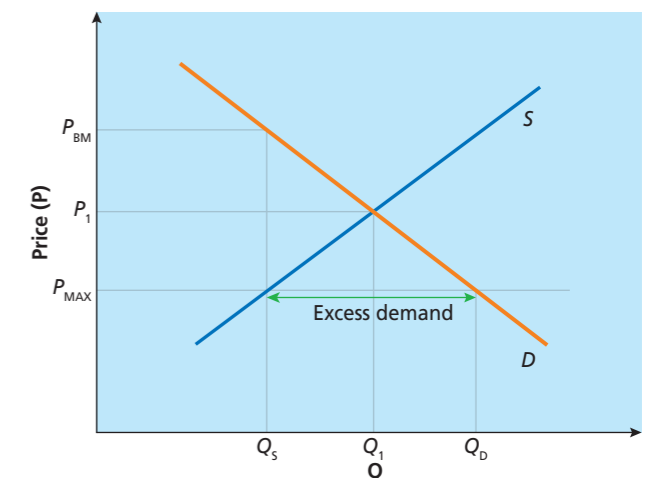


Figure 3 The effect of a maximum price

## Advantages of maximum prices

- Without a maximum price, some people would not be able to afford certain goods or services, for example some prescription medications. Thus, maximum prices promote equity or fairness.
- Maximum prices can reduce the ability of firms with monopoly power to exploit consumers through charging higher prices.

## Disadvantages of maximum prices

- The creation of excess demand implies queues, shortages and waiting lists which, in the case of markets such as healthcare in the UK, can have serious implications.
- Some people who want a good or service will simply not be able to obtain it, leading to frustration and dissatisfaction.
- Maximum prices may lead to the establishment of black markets, sometimes known as shadow markets, for goods and services, such as secondary markets for tickets to music and sporting events. The black-market price, shown at  $P_{BM}$  in Figure 3, is found by looking up to the demand curve at  $Q_S$ .

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