Price Ceiling and Price Floor:

We discussed the distinction between Market Price and Equilibrium Price. So far we have been assuming that Equilibrium price is the price that exists in the market and that is the Market Price. But that is only true without any sort of Government intervention in the market. However, sometimes the government does interfere with the working of the market and creates distortions. In those times the market price can be different from the equilibrium price. So it is important to remember the distinction between Market price and Equilibrium price.

**Equilibrium Price:** The price at which the market clears. That is the price at which there is no excess demand and no excess supply. At this price the quantity demanded is always exactly met by quantity supplied.

**Market Price:** The price at which goods are exchanged in the market. The market price may or may not equal the Equilibrium Price.

The government can impose different types of price controls. If the government believes that the equilibrium price is too high, it may try to lower the price. In this situation it may impose a **price ceiling.** The purpose of imposing a price ceiling is to protect the consumers from paying a higher price. Since the price ceiling is imposed below the equilibrium price, it creates chronic excess demand in the market. To ensure the lower market price (ceiling price), the government has to adopt some sort of rationing mechanism to distribute the small quantity that is available in the market. We discussed the different problems and inefficiencies associated with this type of price ceilings and specifically discussed rent control and its adverse consequences.

The other type of price control that the government can impose is known as setting a **price floor.** Price floors are used to protect the producers. It does not allow the price to fall below a certain floor level, set by the government. Since the floor price is set above the equilibrium price, there is always an excess supply in the market. To ensure a market price above the equilibrium price, the government has to remove the excess supply from the market. This creates all sorts of problems for the government, which was discussed in class.