Price

UNIT VI – Fundamentals of Economics
In a market-based economy, the price system has four traits:

- **Neutral** – does not favor producer or consumer because both make choices determining equilibrium.
- **Market Driven** – gov’t policy does not determine price (usually).
- **Flexible** – prices can change quickly and easily as demand changes.
- **Efficient** – prices will continue to adjust until the maximum number of goods and services are sold.
Factors that affect price...

- What factors affect pricing?

- These factors can come from the producer, the consumer, and in a mixed economy the government.
1. Prices and Producers

- The price system provides info and motivation to producers.

- Producers prefer rising prices to falling prices.

- When prices are rising it is a signal to make more, when prices are falling it is a signal to leave the market.
**Surplus v. Shortage**

**Surplus**
- Amount supplied is higher than amount demanded
- Signals that price is too high
- Won’t last long because sellers will lower prices or production (ex: clearance items)

**Shortage**
- When amount demanded is higher than amount supplied
- Signals price is too low
- Won’t last long because sellers will raise prices or production (ex: gaming systems)
2. Prices and Consumers

- Prices act as signals and incentives for consumers

- Surpluses that lead to lower prices tell consumers it is a good time to buy, consumers are usually afraid the bargain won’t last—sense of urgency is created.

- Producers use advertising and displays as signals for the consumer

- High prices discourage consumers, prompting them not to buy or to switch to a substitute
Black Market

- When consumers sell items illegally

- Can have lower or higher prices depending on the good or service
  - Lower prices for items that are not scarce – stolen goods, labor
  - Higher prices for items that are scarce – drugs, organs

- This will effect businesses and the economy

- Found less in areas with more economic freedom
3. Prices and Government

- The gov’t can play a role in influencing price
  - Price ceilings
  - Price floors
  - Minimum Wage
  - Interest Rates
Price Ceilings and Floors

- **Price Ceiling** – a maximum price that sellers charge for a good or service
  - Example – rent control

- **Price Floor** – a minimum price that buyers pay for a good or service
  - Example – agricultural floors for corn, milk, etc.
Minimum Wage

- Best example of a price floor

- Gov’t says that producers must pay a minimum price for labor per hour

- Created in 1938 with the passing of the **Fair Labor Standards Act** (this also set a 40 hour work week)

- Current federal minimum wage = $7.25/hour

- Changes as the value of money changes
### Value of Money

#### Inflation
- Increase in prices
- Value of money goes down
- Will lead to a higher minimum wage
- Hurts economy because it reduces purchasing power

#### Deflation
- Decrease in prices
- Value of money goes up
- Usually comes with a recession or depression
- Not good – often last attempt to make money and businesses can’t hire many people
Interest Rates

- The gov’t sets the minimum interest rate for loans.

- Higher the interest rate, the less people that are willing to spend, the more likely a surplus will occur.

- Lower the rate the better because more people will buy at a lower price.