DISCUSSION QUESTION

Name:
Instructor:
Course:

What is a price floor? Why does the government often set price floors in agriculture? Is this a good thing or a bad thing?

PEER GROUP PROBLEM SOLVING

Name:
Instructor:
Course:

In 2000 and 2001, California faced an electricity crisis. The state of California regulated retail electricity prices. (They put a price ceiling on consumer electricity prices.) However, wholesale prices (low at the time of initial regulation) were allowed to fluctuate. Over time, wholesale prices rose, yet the price ceiling prevented retail prices from increasing. How did this policy affect supply and demand?

IN-CLASS EXPERIMENT / ACTIVE EXERCISE

Divide students into groups (depending on class size). Assign the price ceiling topic to half of the groups and the price floor topic to the other half. Ask each group to be prepared to define or “teach” the topic to the other groups. In addition to a brief “lesson,” they should provide an example of their topic other than one found in the textbook.

SOLUTIONS AND INSTRUCTOR NOTES

Discussion Question

What is a price floor? Why does the government often set price floors in agriculture? Is this a good thing or a bad thing?

A price floor is a government imposed limit on the minimum amount that can be charged for a product or service. Farming is inherently unstable, and output is often at the mercy of weather, pests, politics, etc. Governments can desire to encourage domestic agriculture for a variety of reasons such as national security and rural economic development/stability. In order to incentivize farmers to remain in agriculture, governments will often impose price floors for agricultural commodities (and finance them through subsidies). However, as the price to the consumer rises, the government spends more money to cover the difference between the equilibrium price and the price set by the price floor. Strictly speaking, price floors are allocative inefficient. Their desirability is often based on politics just as much as economics.

Peer Group Problem Solving

In 2000 and 2001, California faced an electricity crisis. The state of California regulated retail electricity prices. (They put a price ceiling on consumer electricity prices.) However, wholesale prices (low at the time of initial regulation) were allowed to fluctuate. Over time, wholesale prices rose, yet the price ceiling prevented retail prices from increasing. How did this policy affect supply and demand?

Since retail prices were kept (artificially) low, the amount of electricity demand outpaced the supply of electricity, leading to a shortage. The price ceiling restricted retail electricity companies from increasing their prices. As wholesale prices increased, electric companies were forced to operate at a loss. Eventually, some electricity companies went out of business, further reducing supply. As a result of the shortage, rolling blackouts occurred, hurting businesses, individuals, and economic output.

In-Class Experiment / Active Exercise

Divide students into groups (depending on class size). Assign the price ceiling topic to half of the groups and the price floor topic to the other half. Ask each group to be prepared to define or “teach” the topic to the other groups. In addition to a brief “lesson,” they should provide an example of their topic other than one found in the textbook.

Examples will vary.

For more in-class experiment and active learning ideas, visit www.econedactive.com.