Price Ceilings & Price Floors

What effect do price ceilings and floors have on markets?

Market Equilibrium

When a market is in equilibrium, the quantity demanded equals the quantity supplied at the price that clears the market. This is the equilibrium price.

Nonbinding Price Ceiling

A price ceiling is nonbinding when it doesn’t have an effect on the market price. A nonbinding price ceiling occurs when the price level is greater than or equal to the market equilibrium price.

Binding/Effective Price Ceiling

A government-mandated maximum price that can be charged for a good or service $Pc = \text{Price ceiling}$

$Pc > Qd$ = Surplus

$Pc < Qd$ = Shortage

Nonbinding Price Floor

A price floor is nonbinding when it doesn’t have an effect on the market price. A nonbinding price floor occurs when the price level is less than or equal to the market equilibrium price.

Binding/Effective Price Floor

A government-mandated minimum price that must be paid for a good or service $Pf = \text{Price floor}$

$Qd > Qs$ = Surplus

$Qd < Qs$ = Shortage

REAL WORLD EXAMPLES

Price Ceilings

- Rent Control
- Gasoline

Price Floors

- Agricultural Products
- Minimum Wage

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