

# Understanding public policy in competitive markets

rent seeking behavior and market failures

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**Block 2**

Economics for Everyone

Lecture 7

Motivation

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Rent seeking behavior

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Market failures

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Next class

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# Motivation

## Objectives for this block of classes

1. Understand the neoclassical theory of value
  - in a perfectly competitive market
  - only hint at other market structures
2. Apply our understanding
  - commodity markets
  - public policy directed to producers in these markets
3. Market failure as a rationale for public policy
  - “efficient” outcomes in perfectly competitive markets
  - public policy directed to externalities and other market failures

## Price or quantity as a rationing mechanism?

 **Wojtek Kopczuk**  
@wwwojtekk

Lesson in price mechanism, the same block in NYC:  
- left: Duane Reade (owned by Walgreens), a chain that doesn't adjust prices (at least not quickly)  
- right: a small independent hardware store



4:17 PM · Mar 12, 2020 · [Twitter for Android](#)

Figure 1: What an 'undercover' economist noticed

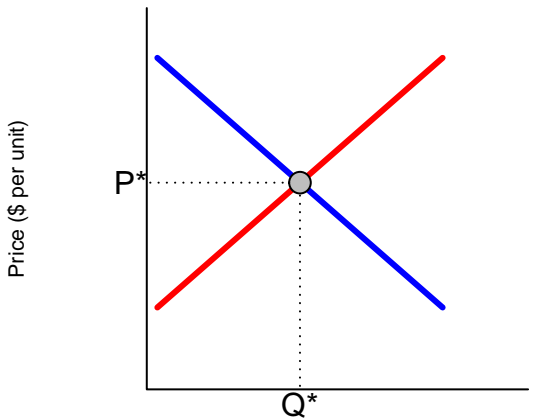
## Price or quantity as a rationing mechanism?

Many good questions appeared in the comments to the last lecture, but I've saved this one for this class.

*“right now consumers are clearing the shelves at grocery stores everywhere. People are panic shopping and “hoarding” goods like toilet paper and food. This has been going on for weeks and grocery stores cannot keep up with the demand. If people continue to be uncertain about the future (like, not knowing if the grocery stores will close next and for how long) could consumers still reach a satiation point?”*

# Market equilibrium maximizes social surplus

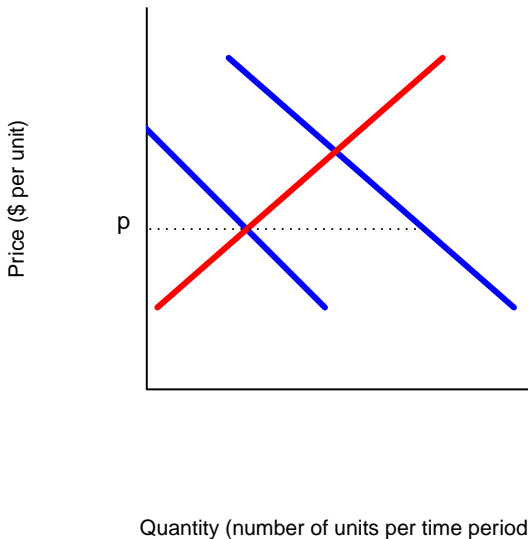
## Perfectly competitive markets and Pareto Efficiency



Quantity (number of units per time period)

# Market equilibrium maximizes social surplus

## Price or quantity as a rationing mechanism?



Motivation

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Rent seeking behavior

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Market failures

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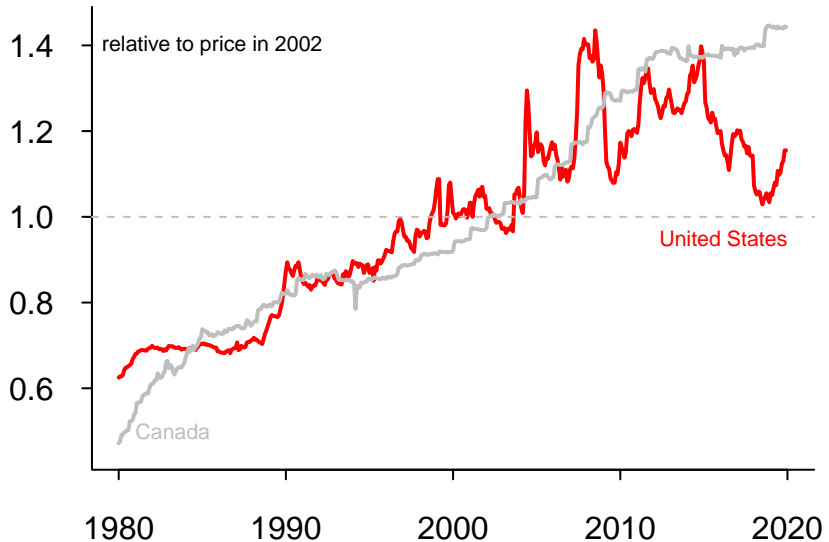
Next class

oo

## Rent seeking behavior



## Milk prices: domestic consumer prices (monthly)



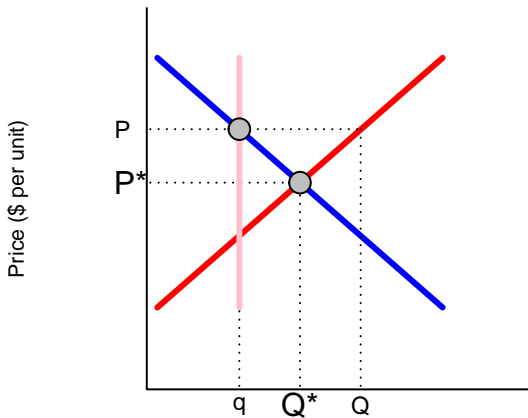
## Rent-seeking behavior and agricultural supports

### Question 5 of the assignment

5. Compare the outcome of a perfectly competitive market to three alternative agricultural support programs: (i) quotas; (ii) a price-support program; (iii) deficiency payments.
- Compare the effects of each of these programs on:
    - price;
    - quantity purchased by consumers;
    - gross incomes of suppliers;
    - financial cost to the government. (Assume that the goods purchased by the government under the price-support program are disposed of at zero cost.)
  - Explain which program, if any, you would recommend to the following constituents:
    - producers of the commodity;
    - consumers of the commodity;
    - a social planner interested the well being of all citizens.

# Depicting quotas with demand and supply curves

an enforceable limit placed on the amount each supplier can sell



Quantity (number of units per time period)

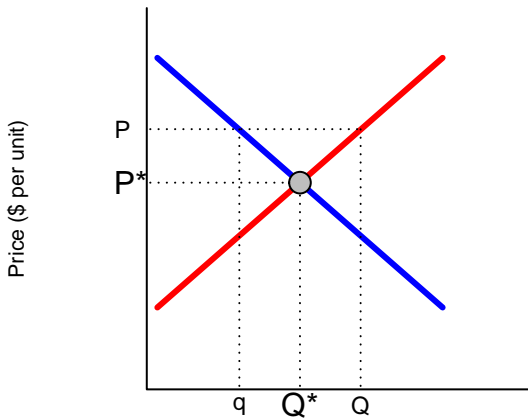
# Rent-seeking behavior and agricultural supports

## Question 5 of the assignment

program	Price	Quantity	Incomes	Cost
Quotas	$P > P^*$	$q < Q^*$	$P \times q$	—
Price supports				
Deficiency				

# Depicting price supports with demand and supply curves

government purchases to support a particular price



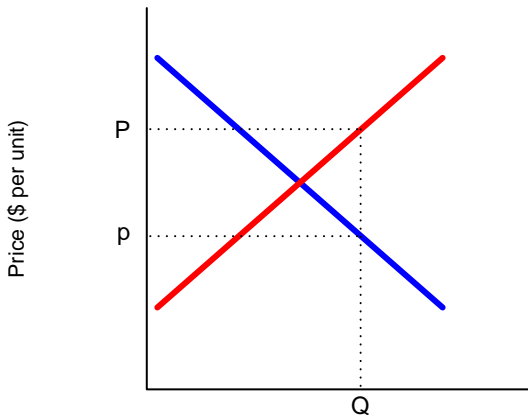
Quantity (number of units per time period)

# Rent-seeking behavior and agricultural supports

## Question 5 of the assignment

program	Price	Quantity	Incomes	Cost
Quotas	$P > P^*$	$q < Q^*$	$P \times q$	—
Price supports	$P > P^*$	$q < Q^*$	$P \times Q$	$P \times (Q - q)$
Deficiency				

## Depicting deficiency payments government subsidies offering suppliers a price guarantee



Quantity (number of units per time period)

# Rent-seeking behavior and agricultural supports

## Question 5 of the assignment

program	Price	Quantity	Incomes	Cost
Quotas	$P > P^*$	$q < Q^*$	$P \times q$	—
Price supports	$P > P^*$	$q < Q^*$	$P \times Q$	$P \times (Q - q)$
Deficiency	$p < P^*$	$Q > Q^*$	$P \times Q$	$(P - p) \times Q$

- which program would you recommend?
  - producers
  - consumers
  - society as a whole



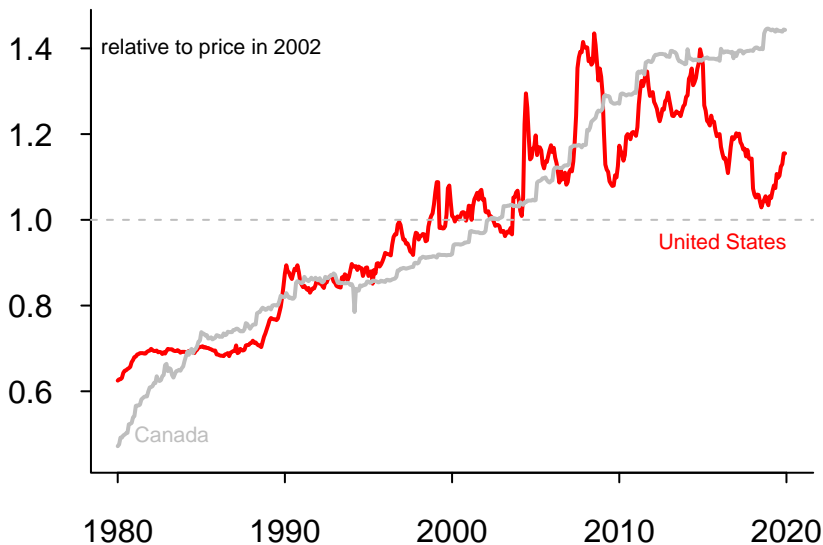
# Rent-seeking behavior and agricultural supports

## Question 5 of the assignment

An answer from one of the submitted assignments:

*“I think I would tell them to let Mr. Smith’s invisible hand to to its work, and to not interfere . . . ”*

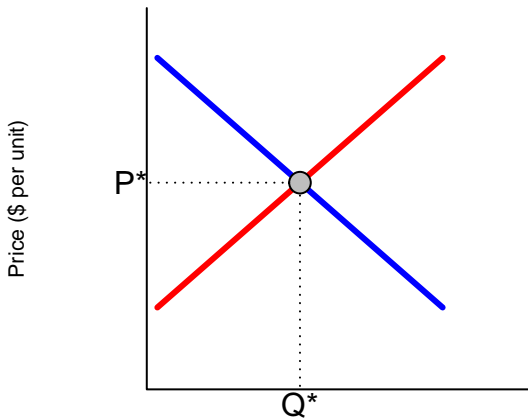
## Milk prices: domestic consumer prices (monthly)



## Market failures

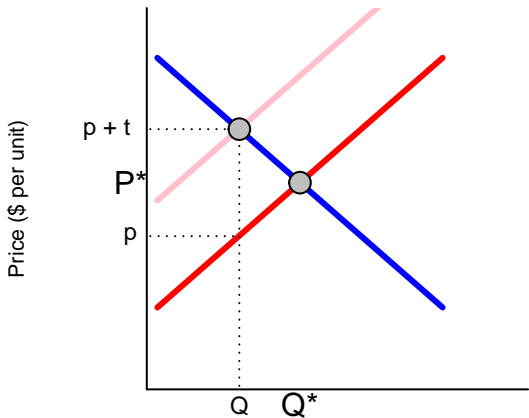
# Market equilibrium maximizes social surplus

## Perfectly competitive markets and Pareto Efficiency



Quantity (number of units per time period)

## Market equilibrium does not maximize social surplus when private and social costs don't align



Quantity (number of units per time period)

# Market equilibrium does not maximize social surplus

when private and social costs don't align

- a very strong agreement among economists on appropriate government intervention
  - market failures due to a negative externality
  - regulate quantities
  - set an appropriate price through a “Pigouvian” tax
- “Economists’ statement on carbon dividends”
  - carbon pricing garners a big consensus
  - Climate Leadership Council published a consensus letter in the *Wall Street Journal*
  - <https://clcouncil.org/economists-statement/>

## Market equilibrium does not maximize social surplus

### other types of goods rationalize government provision

- unit 12 of the text categorizes commodities

	Rival	Non-rival
Excludable	Private goods (food, clothes, houses)	Public goods that are artificially scarce (subscription TV, uncongested tollroads, knowledge subject to intellectual property rights, Unit 21)
Non-excludable	Common-pool resources (fish stocks in a lake, common grazing land, Units 4 and 20)	Non-excludable public goods and bads (view of a lunar eclipse, public broadcasts, rules of arithmetic or calculus, national defence, noise and air pollution, Units 20 and 21)

Figure 2: Types of commodities

Motivation  
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Rent seeking behavior  
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Market failures  
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Next class  
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Next class



## Class on April 22<sup>nd</sup>

1. Class assignment
  - distributed by email, so a confirmation of receipt is needed
  - due by return email to arrive by 6:30pm April 22nd
2. Notice of book review topics also due by April 22nd
  - please choose a book on the list, or seek professor's approval
3. Set up student interviews or Question and Answer period
  - collectively or in small groups
4. Continue our discussion of macroeconomics