PART 1

Ten Principles of Economics

PRINCIPLES OF
Microeconomics

Shizhe Peng
School of Economics and Management
Changsha University of Science and Technology

Chapter 5: Four Propositions That Most Economists Agree On

Chapter 5: Four Propositions That Most Economists Agree On

- **In this chapter, you will encounter the four propositions that most economists agree on.**

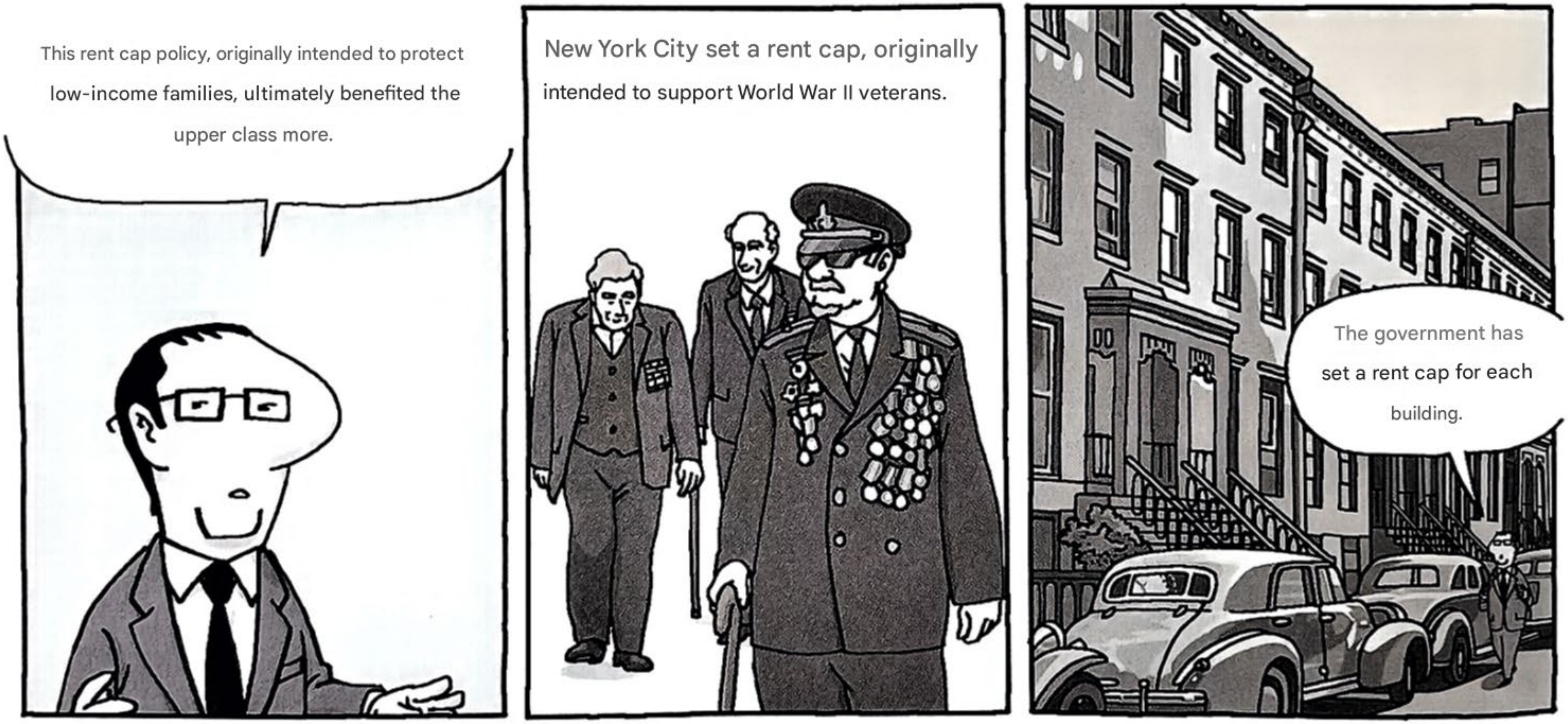
- **In opinion polls of professional economists, these four propositions have garnered agreement from the vast majority of respondents.**

Chapter 5: Four Propositions That Most Economists Agree On

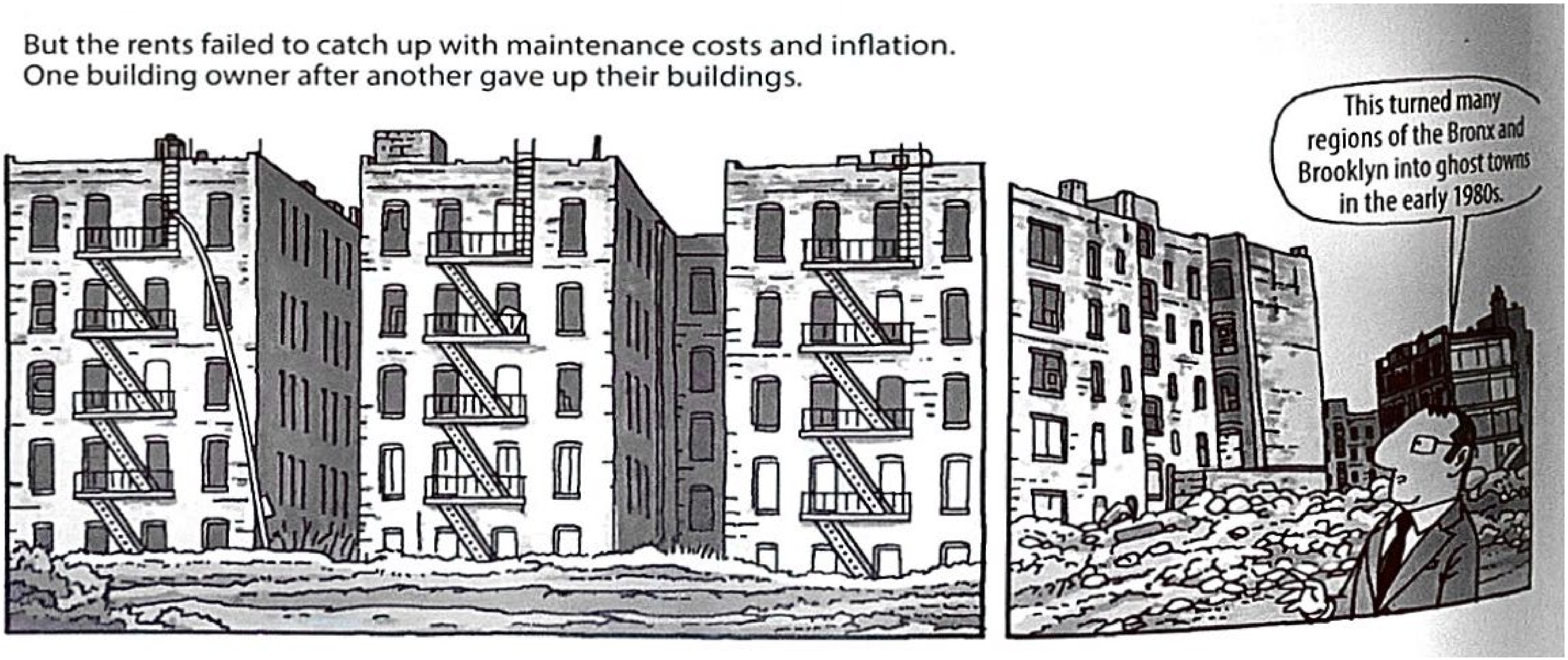
- **Proposition 1: Imposing rent ceilings reduces the quantity and quality of housing available in the rental market.**
- Proposition 2: Setting minimum wages increases unemployment among young and low-skilled workers.
- Proposition 3: Cash payments increase the welfare of recipients to a greater degree than do transfers-in-kind of equal cash value.
- Proposition 4: Pollution taxes and tradable pollution permits are more efficient than mandatory pollution caps in controlling pollution.

Rent Ceilings and the Mia Farrow Act

Rent Ceilings and the Mia Farrow Act



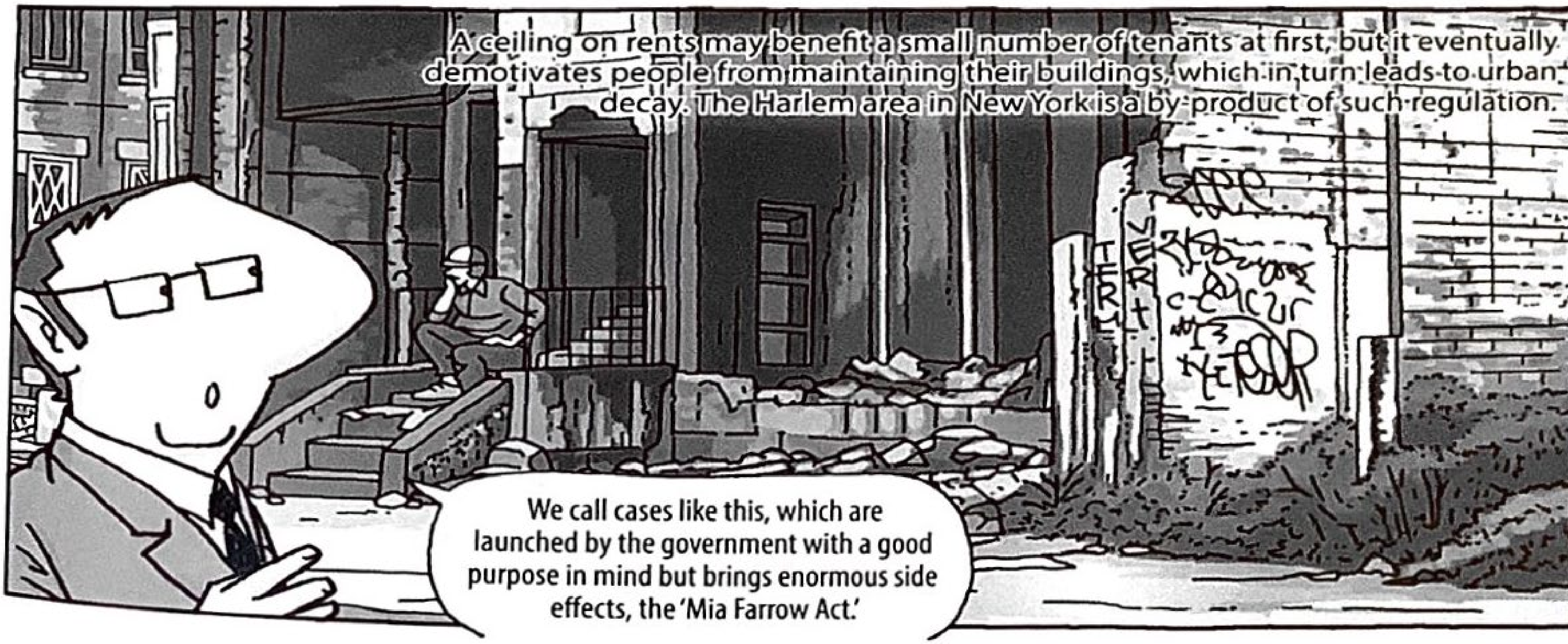
Rent Ceilings and the Mia Farrow Act



Rent Ceilings and the Mia Farrow Act

Rent Ceilings and the Mia Farrow Act

Rent Ceilings and the Mia Farrow Act



SUMMARY

- When policymakers believe that the market prices of goods and services are unfair to consumers or producers, they implement price controls.
  - As a form of price regulation, price ceilings set a maximum price for goods. A typical example is imposing limits on the rent landlords can charge tenants.

- Many municipal governments in the United States use price ceilings to regulate rents, aiming to alleviate the housing burden on low-income families.

SUMMARY

- However, economists criticize such controls as highly inefficient in improving the living conditions of low-income households. Some economists even refer to them as "the best way to destroy a city, short of bombing." Yet, the side effects of these controls only become apparent in the long term, making it difficult for people to recognize them.
- The short-term supply and demand in the housing rental market are relatively unresponsive to market conditions.
  - The number of available rental units remains fixed in the short term and does not easily change, even when market conditions shift.
  - Potential tenants may also be less sensitive to rent changes in the short term because moving is a major life disruption.
  - As a result, under rent control, severe housing shortages may not emerge immediately, and rents may indeed decrease.

SUMMARY

- However, the long-term effects differ significantly from the short-term effects. In the long run, supply and demand become much more responsive to changes in market conditions.
  - From the supply side, as rents decline, property owners are less inclined to construct new rental units or maintain existing ones.
  - From the demand side, lower rents may encourage individuals who previously shared apartments with roommates to live alone, while also attracting more people to move into the city.
  - In other words, when rents are artificially lowered due to regulation, the supply of rental housing decreases while demand increases, ultimately leading to severe housing shortages.

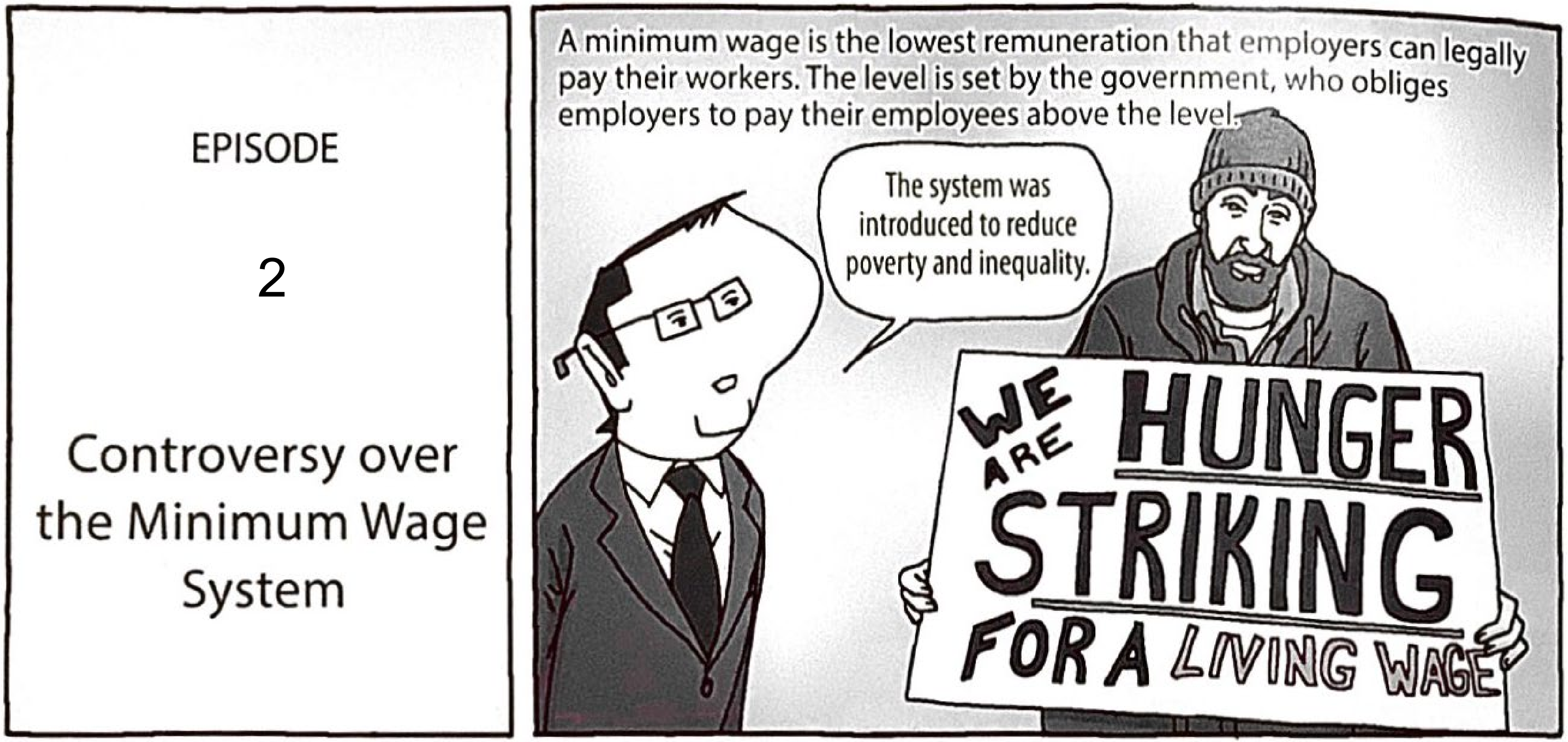
SUMMARY

- In reality, landlords also screen tenants in various ways. They may rent on a first-come, first-served basis or prefer tenants without children.
- To understand the impact of rent control, we can apply the fourth principle of economics: People respond to incentives.
  - Landlords maintain their properties and keep them safe and clean precisely because, in a market economy, higher-quality housing can command higher rents.
  - However, when rents are controlled and housing shortages occur, tenants line up waiting for rentals. This means landlords no longer need to worry about meeting consumer demands. If tenants are queuing up to rent properties in their current condition, why would landlords invest money in maintenance? Ultimately, tenants end up living in low-quality housing at lower rents.

Chapter 5: Four Propositions That Most Economists Agree On

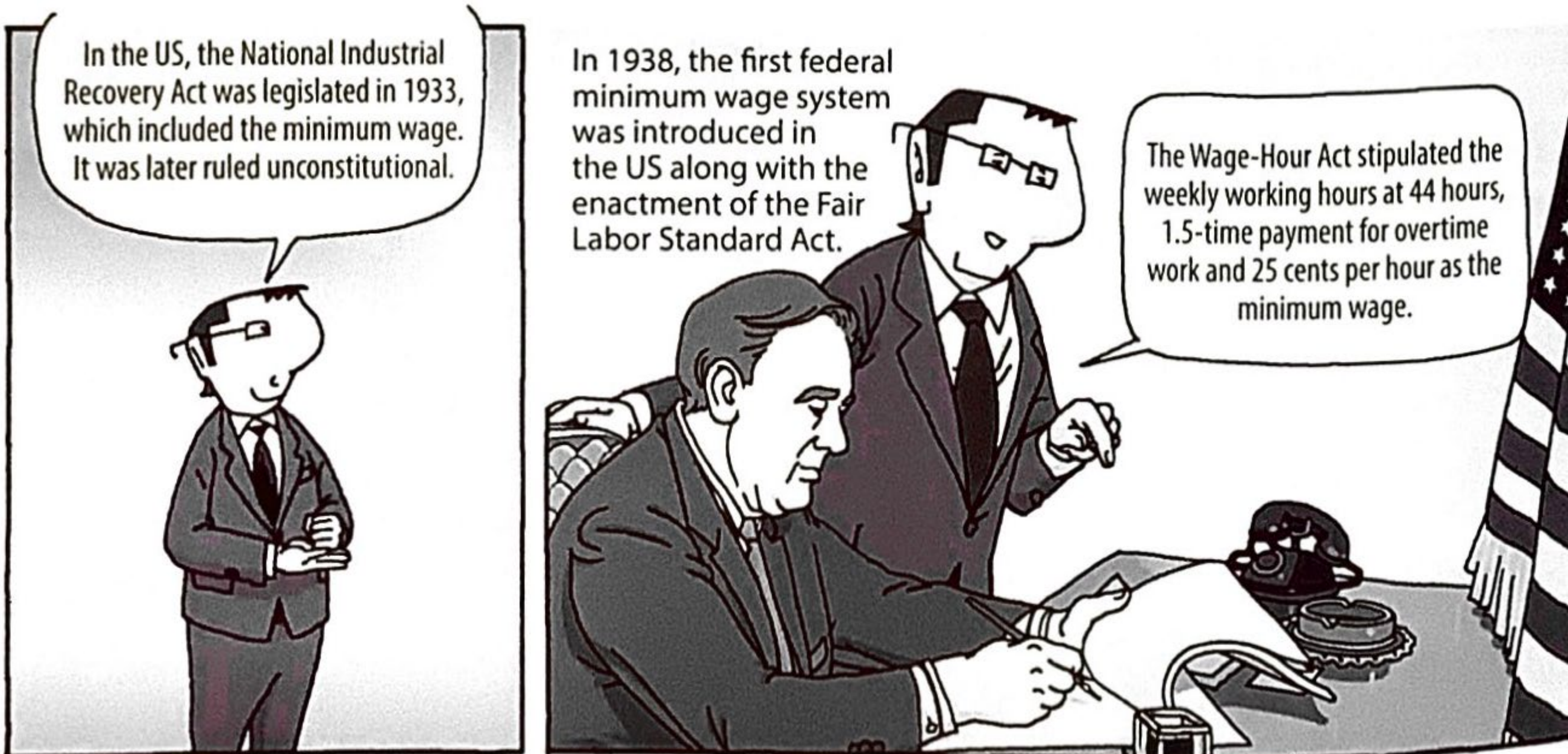
- Proposition 1: Imposing rent ceilings reduces the quantity and quality of housing available in the rental market.
- **Proposition 2: Setting minimum wages increases unemployment among young and low-skilled workers.**
- Proposition 3: Cash payments increase the welfare of recipients to a greater degree than do transfers-in-kind of equal cash value.
- Proposition 4: Pollution taxes and tradable pollution permits are more efficient than mandatory pollution caps in controlling pollution.

Debate over the Minimum Wage

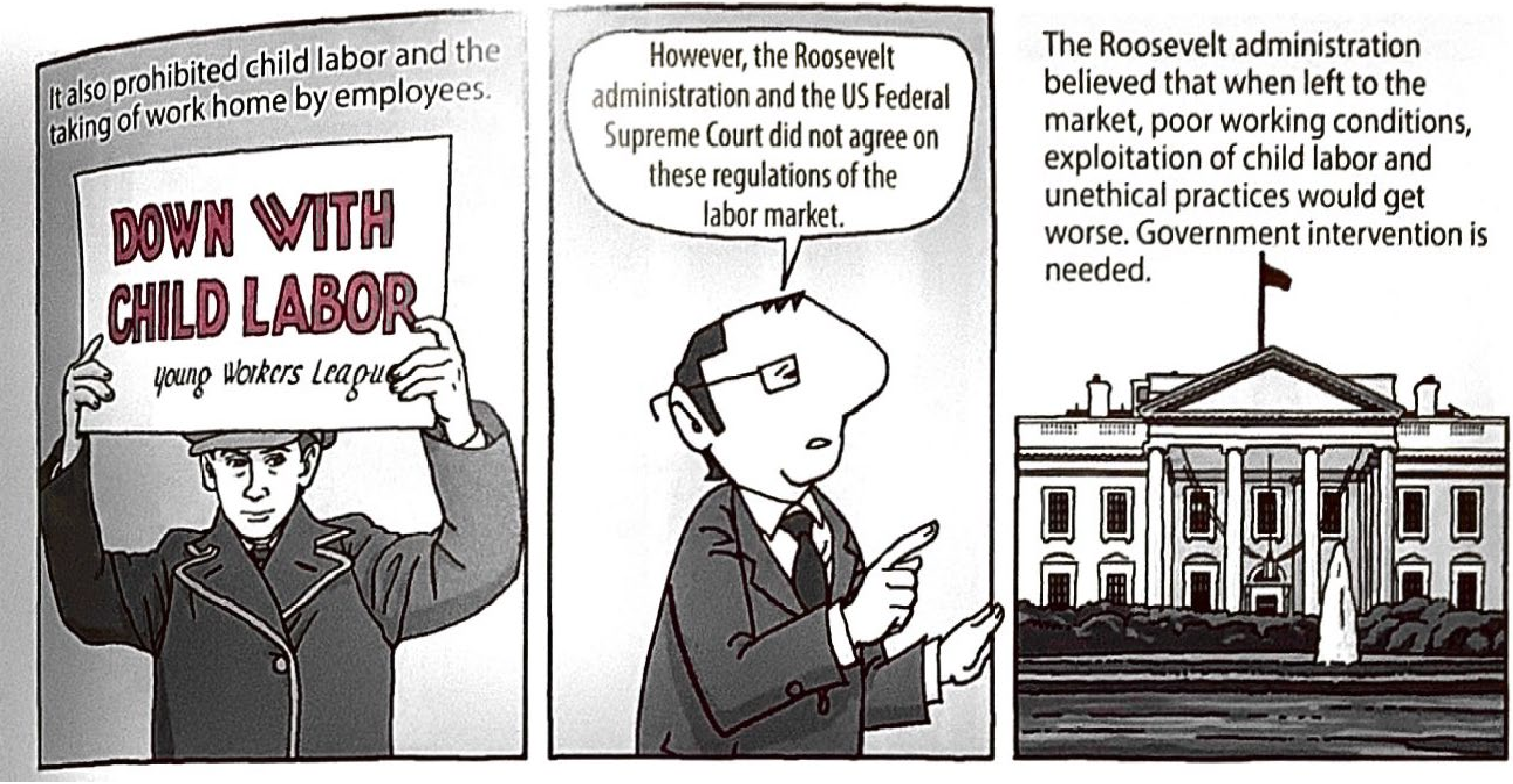


Debate over the Minimum Wage

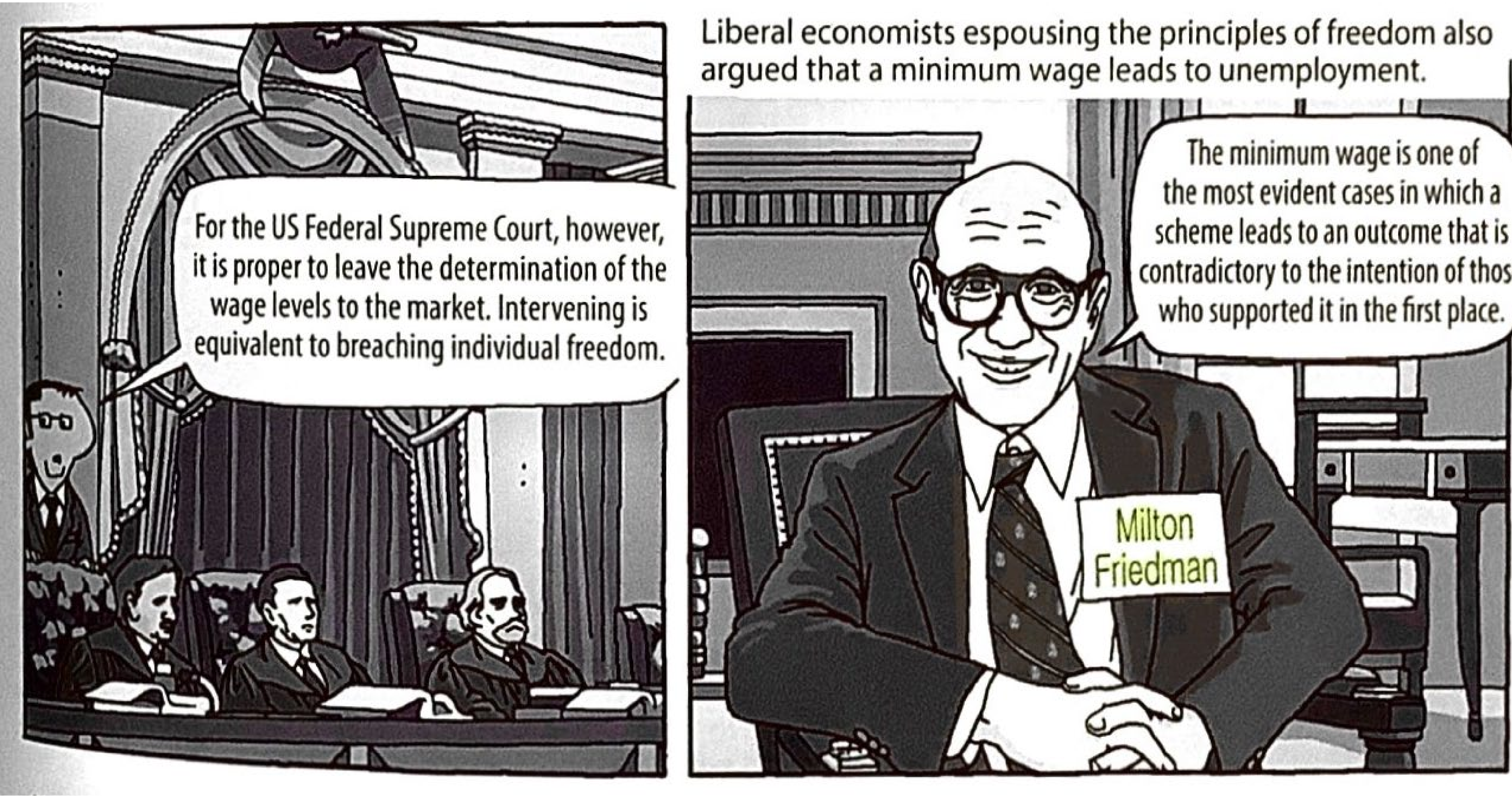
Debate over the Minimum Wage



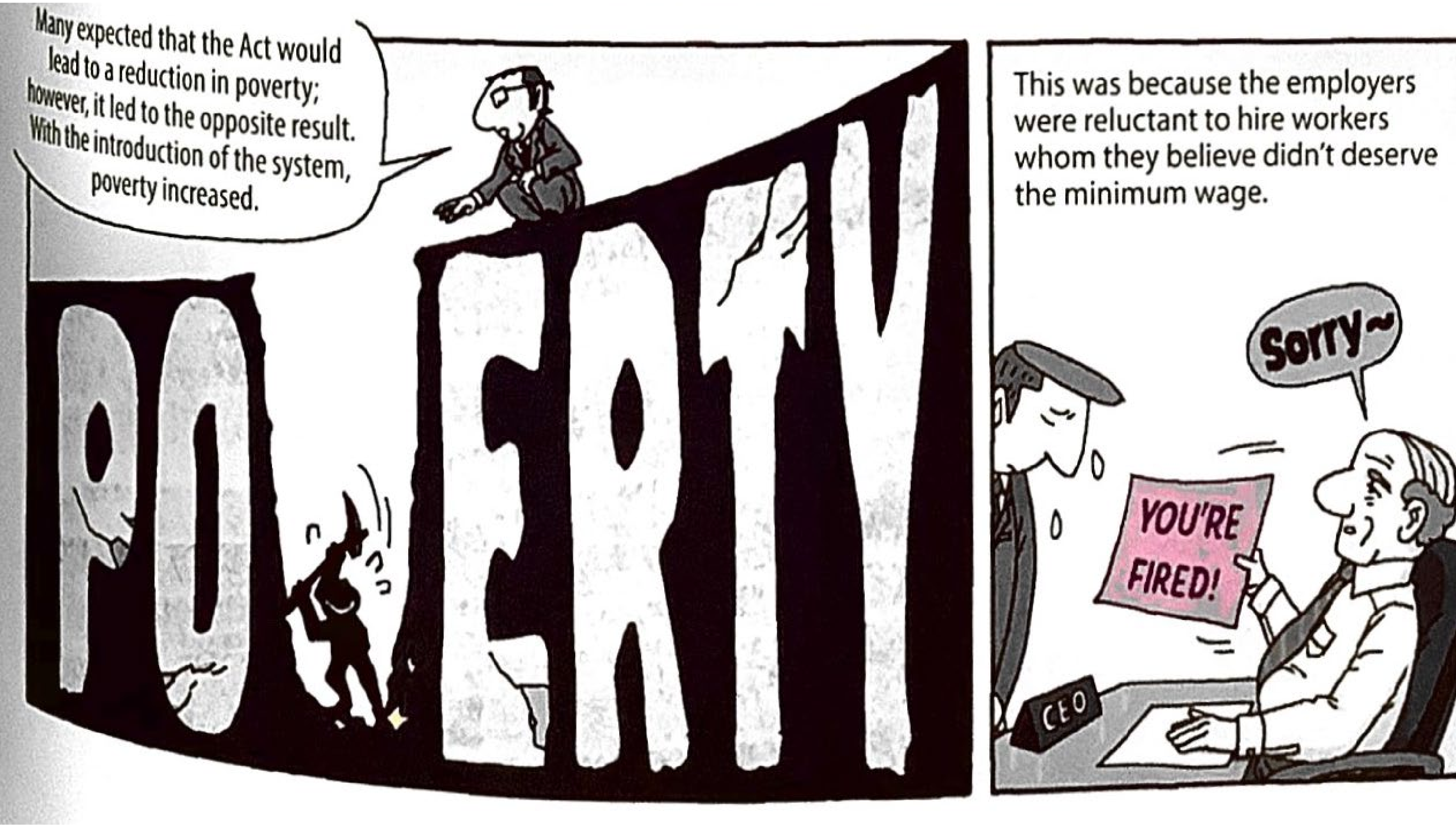
Debate over the Minimum Wage



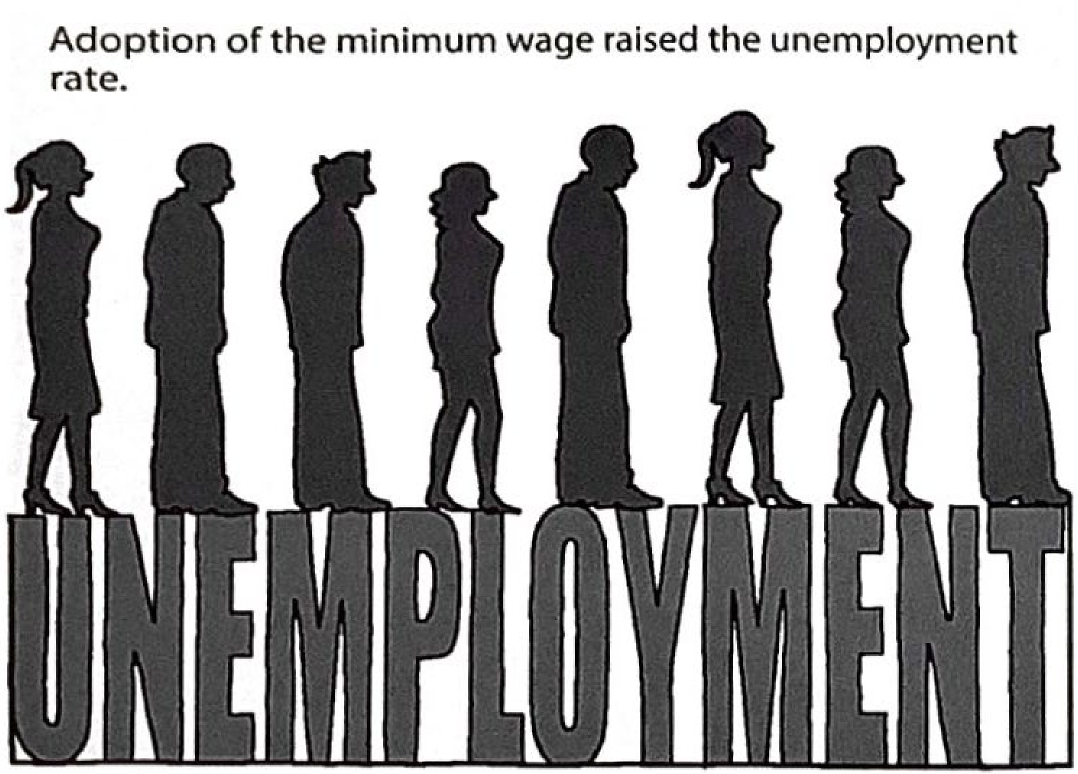
Debate over the Minimum Wage

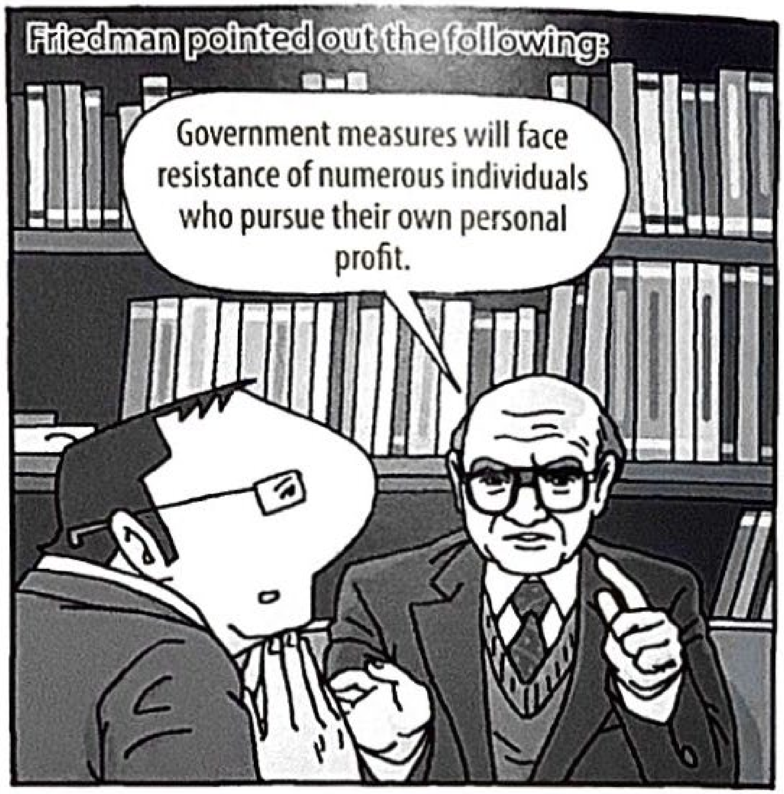


Debate over the Minimum Wage



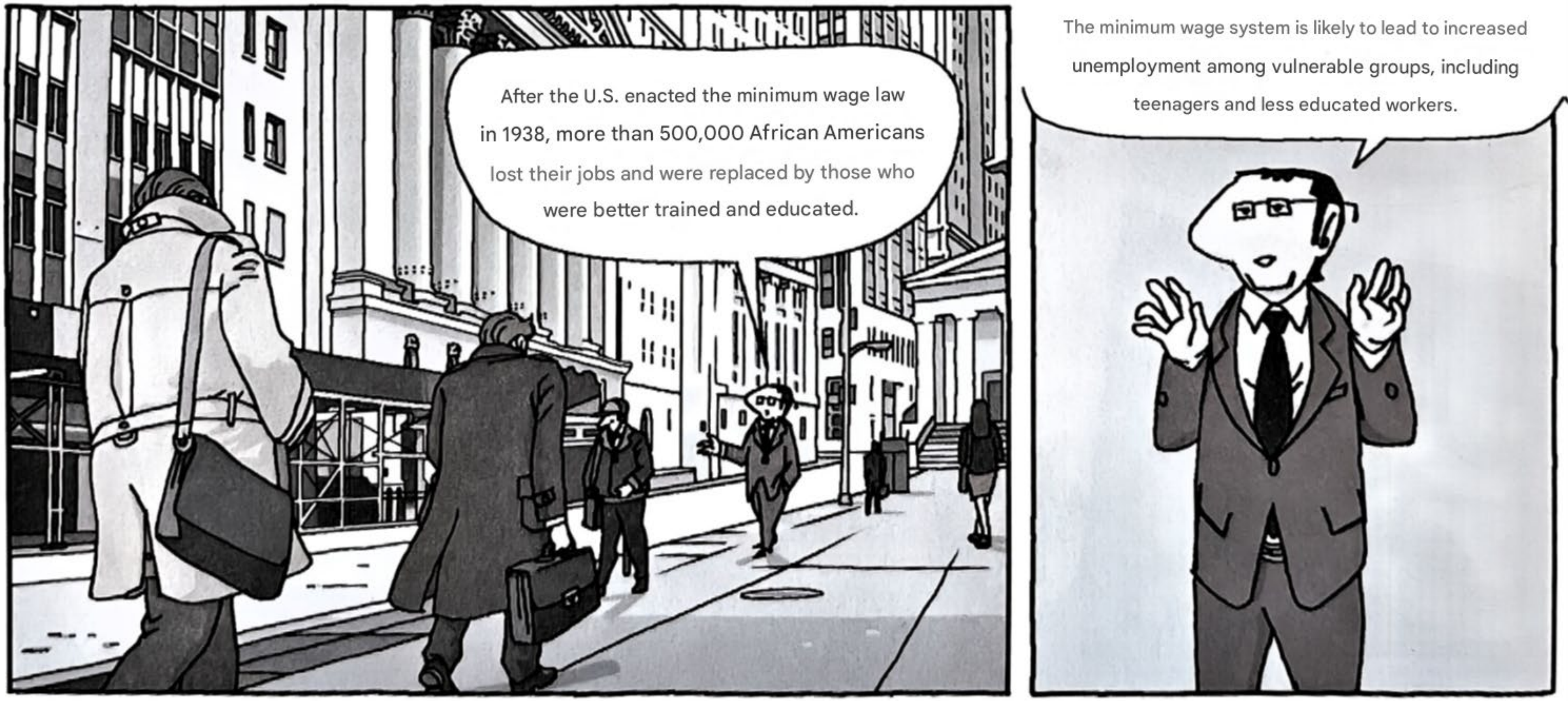
Debate over the Minimum Wage





Debate over the Minimum Wage

Debate over the Minimum Wage



SUMMARY

- A price floor sets the minimum price for a good. The minimum wage, which mandates the lowest hourly rate companies must pay employees, is a classic example of a price floor.
  - New Zealand was the first country to implement a minimum wage system, maintaining it for over 100 years since 1894
  - The United States first enacted the Fair Labor Standards Act in 1938 to safeguard workers' basic living standards.
  - China introduced its minimum wage system in March 2004.

SUMMARY

- To understand the impact of the minimum wage system, it is essential to recognize that the labor market comprises many distinct types of labor. There is no single, unified labor market.
  - Workers with specialized skills or extensive experience remain largely unaffected by the minimum wage, as their wages far exceed the market average.
  - The minimum wage has the most pronounced effect on the teen labor market. Teens, being less experienced and skilled, are often willing to work for lower pay, and their average wages tend to be below the market average.
  - Thus, the impact of the minimum wage is most evident in the teen labor market.

SUMMARY

- The minimum wage system typically applies to unskilled workers.
  - By raising wage levels above the market equilibrium, the minimum wage increases labor costs for businesses, leading to a decline in the demand for labor.
  - As a result, the minimum wage system contributes to higher unemployment rates among unskilled workers. Those who get jobs benefit from higher wages, while those who would have been willing to work for very low wages are unable to get jobs. The magnitude of the impact depends on the flexibility of labor demand.

SUMMARY

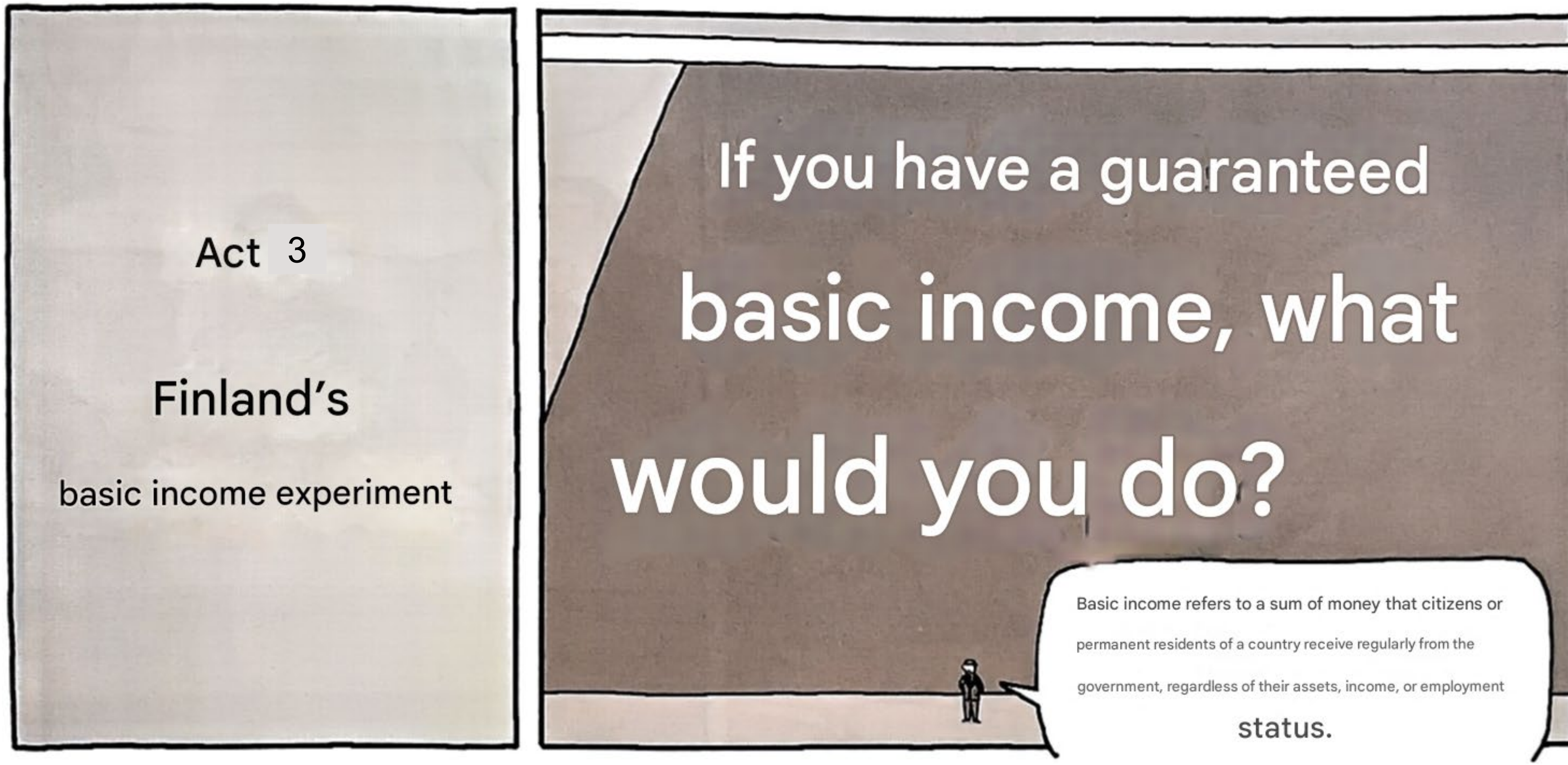
- Supporters of the minimum wage system argue that the government can assist low-income workers at no cost.
- They also claim that the demand for unskilled labor is relatively inelastic, meaning that even with a higher minimum wage, employment levels would not be significantly affected.
- Critics of the minimum wage, however, insist that it harms the poor more than it helps them.
  - They argue that the market demand for unskilled labor is highly elastic, and a higher minimum wage would lead to a substantial decline in employment.
  - They also contend that the minimum wage affects not only the demand for labor but also its supply. As the minimum wage rises, more teenagers may drop out of school to seek jobs, displacing existing teenage workers and further increasing unemployment within this segment of the labor force.

Chapter 5: Four Propositions That Most Economists Agree On

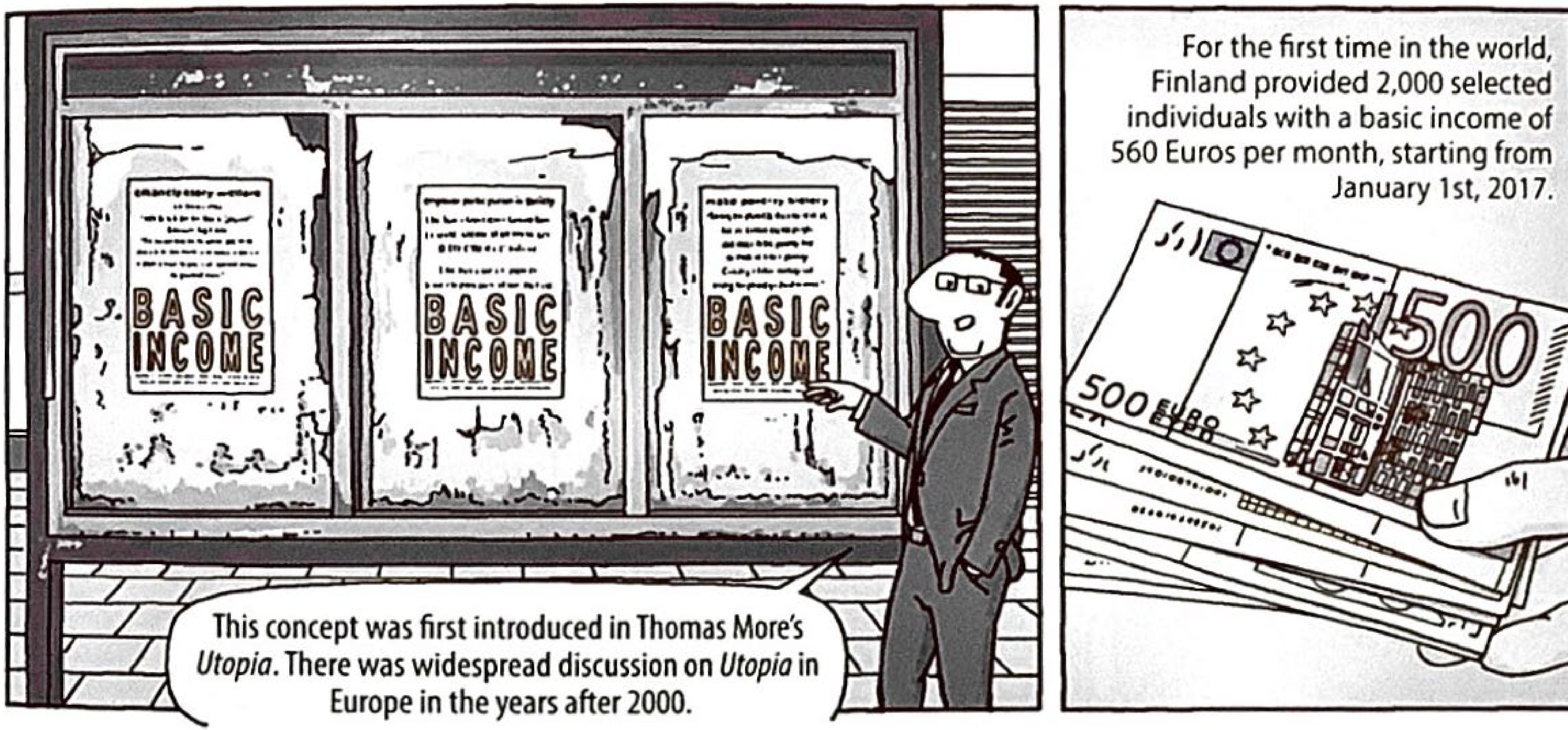
- Proposition 1: Imposing rent ceilings reduces the quantity and quality of housing available in the rental market.
- Proposition 2: Setting minimum wages increases unemployment among young and low-skilled workers.
- **Proposition 3: Cash payments increase the welfare of recipients to a greater degree than do transfers-in-kind of equal cash value.**
- Proposition 4: Pollution taxes and tradable pollution permits are more efficient than mandatory pollution caps in controlling pollution.

A transfer-in-kind is a payment made in the form of specific goods or services, rather than in money.

Finland's Basic Income Experiment



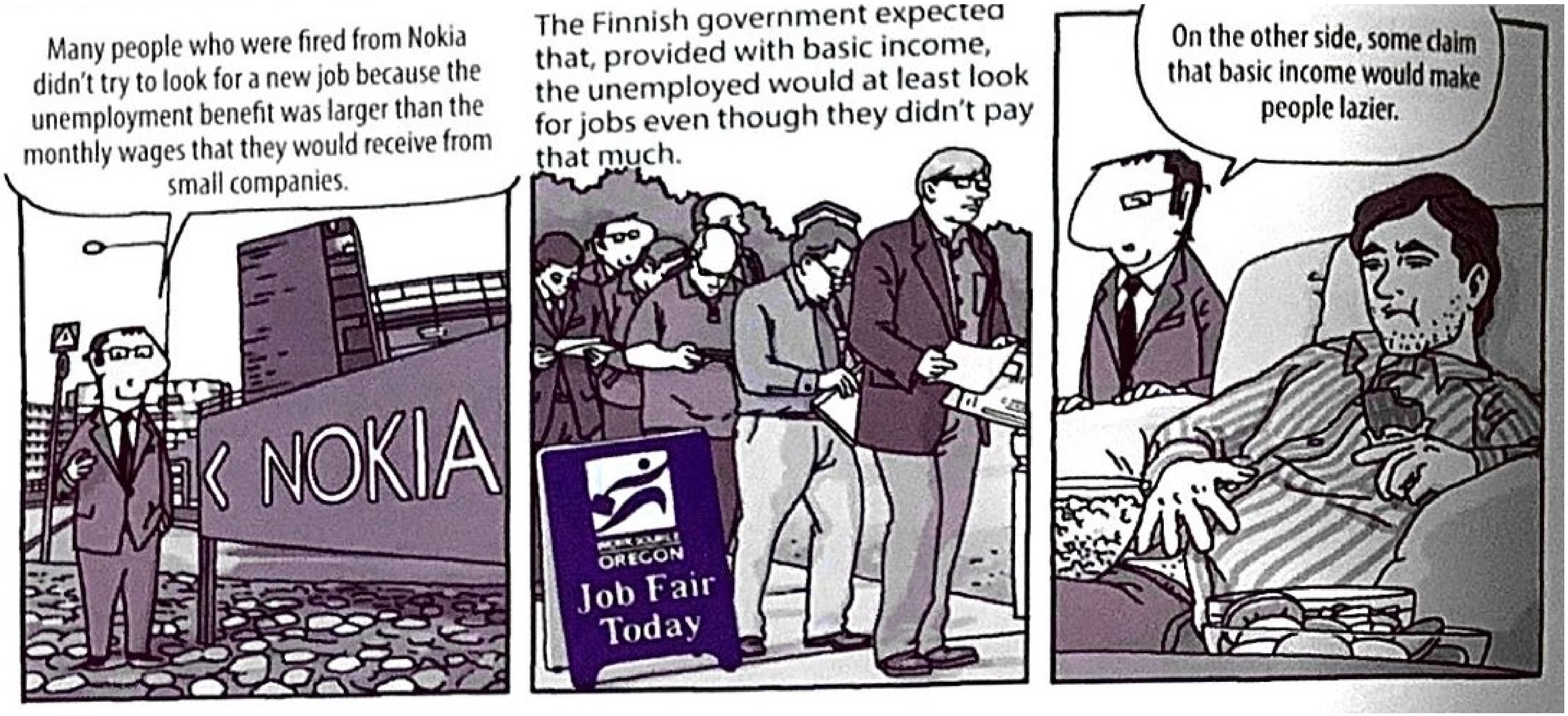
Finland's Basic Income Experiment

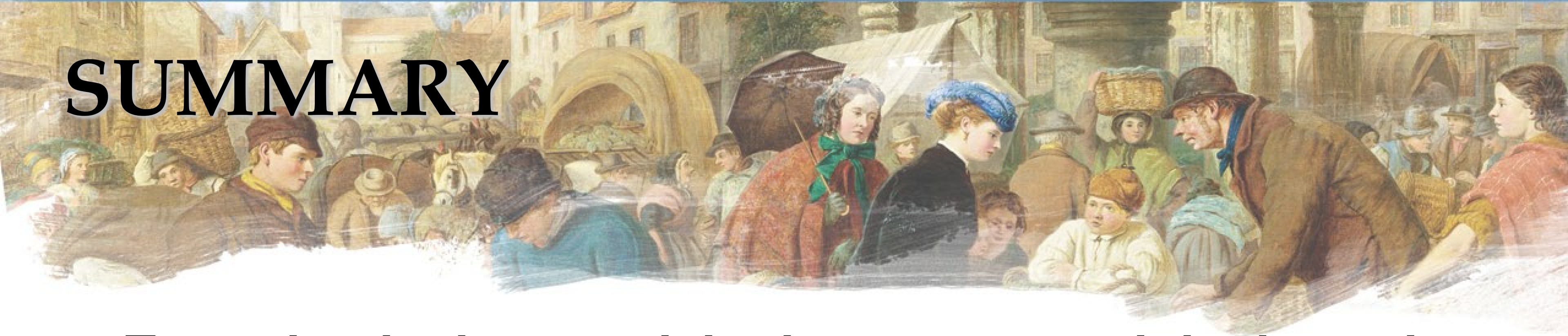


Finland's Basic Income Experiment

Finland's Basic Income Experiment

Finland's Basic Income Experiment

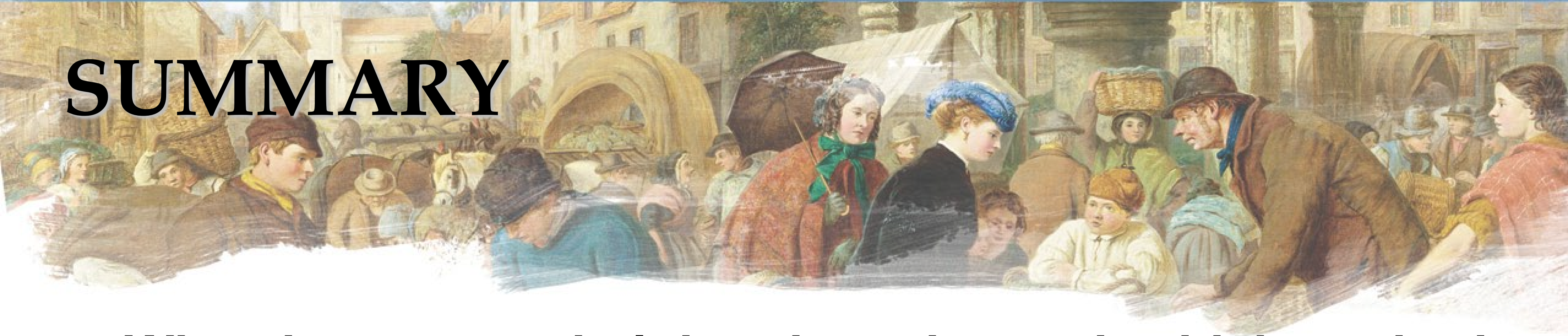




SUMMARY

- To assist the impoverished, one approach is through in-kind transfers.
- In-kind transfers refer to improving the living standards of the poor by providing food stamps, housing subsidies, medical assistance, and other goods or services.
  - Government-issued food stamps are vouchers that can be exchanged for food at grocery stores. The stores then submit these vouchers to the government for cash reimbursement.
  - Additionally, the government can safeguard the health of the impoverished through programs like Medicaid.

SUMMARY



- **When it comes to helping those in need, which method is more effective: cash transfers or in-kind transfers?**
  - **Proponents of in-kind transfers argue that they ensure essential goods and services are provided to those who need them. For instance, among people living in slums, many struggle with addiction to alcohol or drugs. If cash were given, it might be used to purchase alcohol or drugs, making in-kind transfers a preferable alternative.**
  - **Those who support cash transfers insist that in-kind transfers can be humiliating to those who receive them. The government may not fully understand what the poor truly need, but the poor themselves know best how to improve their living standards. Instead of providing specific goods or services, offering cash allows them to purchase what they need most.**

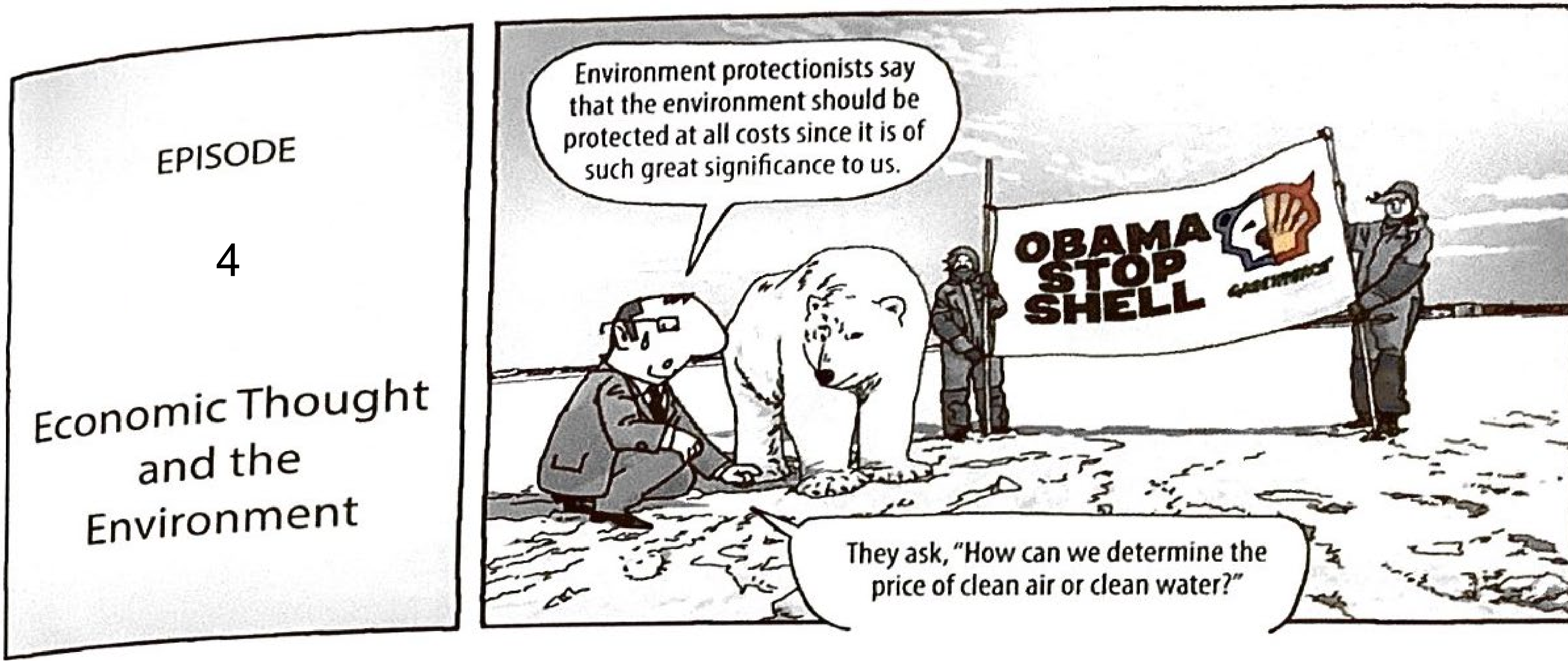
SUMMARY

- **In-kind transfers are not counted as income in official economic reports, which distorts economic statistics.**
  - **The poverty rate, commonly used to measure income distribution, refers to the proportion of the population living below a certain income threshold.**
  - **In the United States, the poverty line is set at three times the cost of a basic diet. It is adjusted annually for inflation and also depends on the number of household members.**
  - **A study by the U.S. Census Bureau found that if in-kind transfers were taken into account, the number of families living below the poverty line would decrease by approximately 10%.**

Chapter 5: Four Propositions That Most Economists Agree On

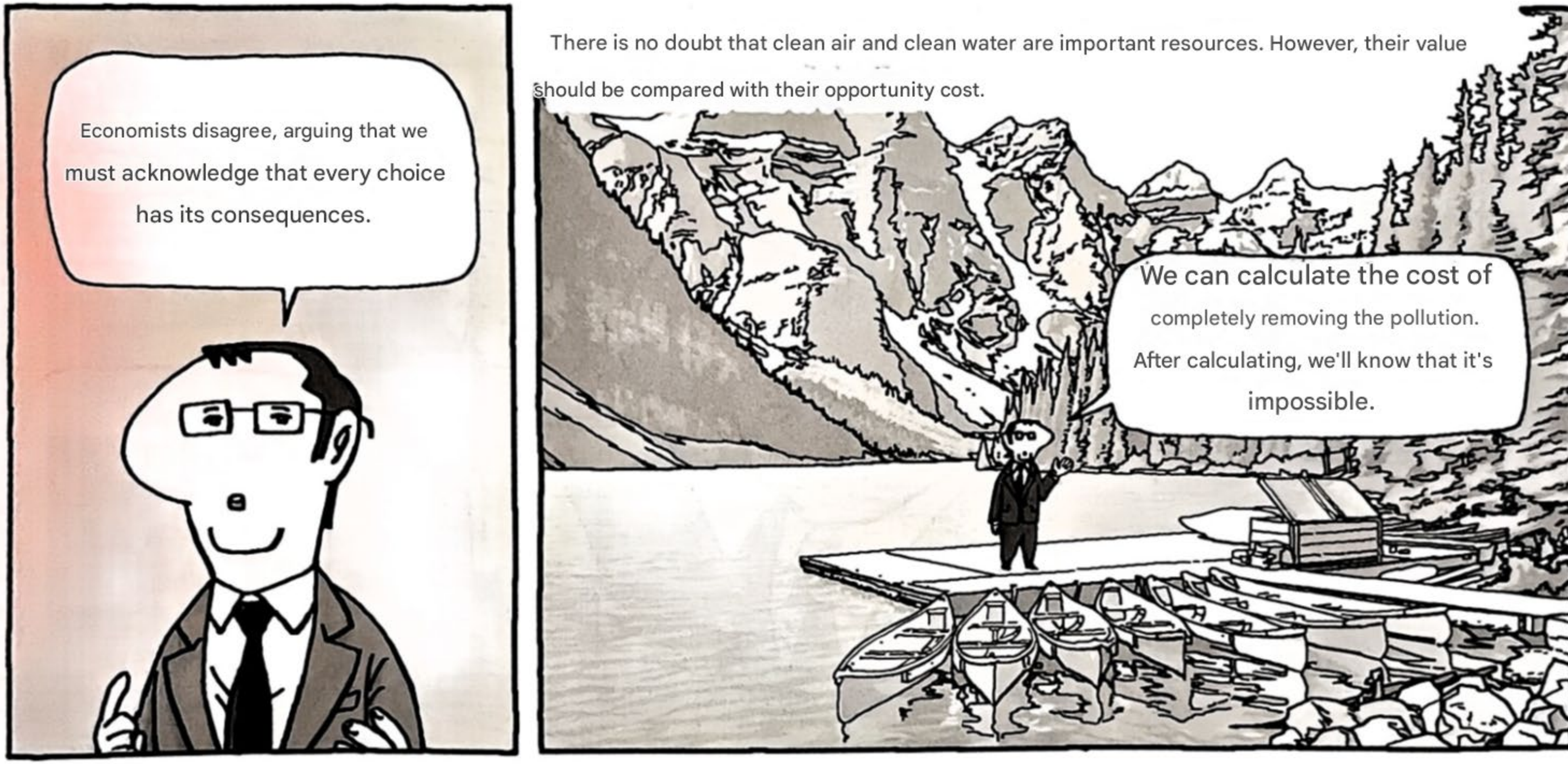
- Proposition 1: Imposing rent ceilings reduces the quantity and quality of housing available in the rental market.
- Proposition 2: Setting minimum wages increases unemployment among young and low-skilled workers.
- Proposition 3: Cash payments increase the welfare of recipients to a greater degree than do transfers-in-kind of equal cash value.
- **Proposition 4: Pollution taxes and tradable pollution permits are more efficient than mandatory pollution caps in controlling pollution.**

Economic Thought and Environmental Protection

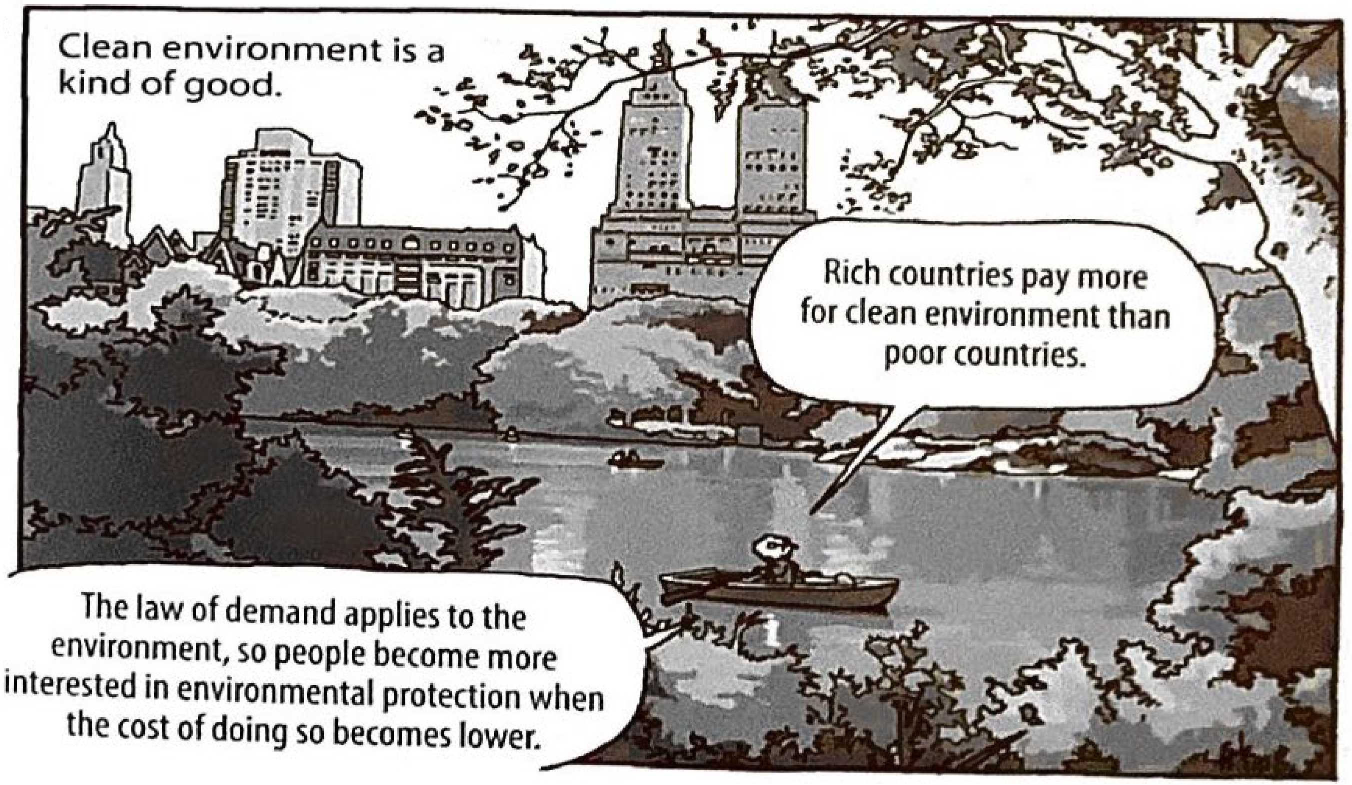


The phrase "Obama stops Shell" refers to a series of actions by the Obama administration that ultimately prevented Shell from drilling for oil in the Arctic.

Economic Thought and Environmental Protection



Economic Thought and Environmental Protection

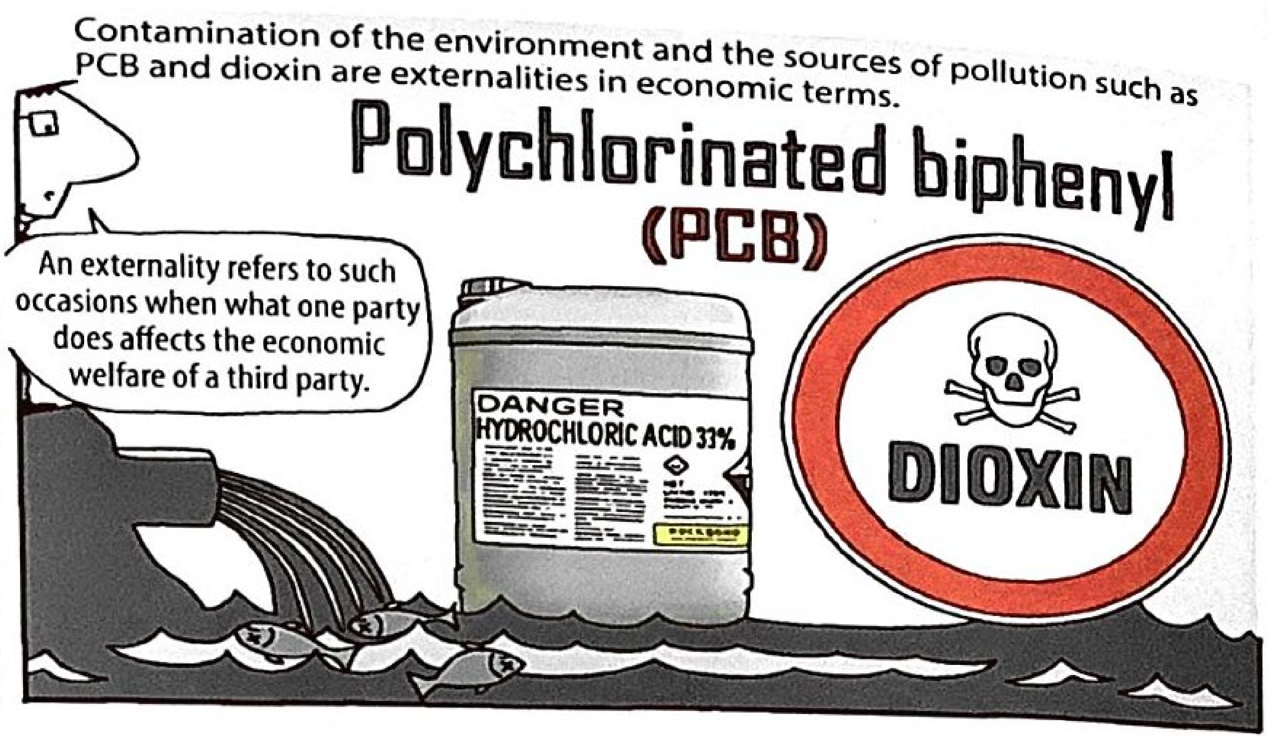


Economic Solutions to Pollution

EPISODE

5

Economic Solutions to Pollution



Economic Solutions to Pollution

Externality consists of two types.

Positive Externality

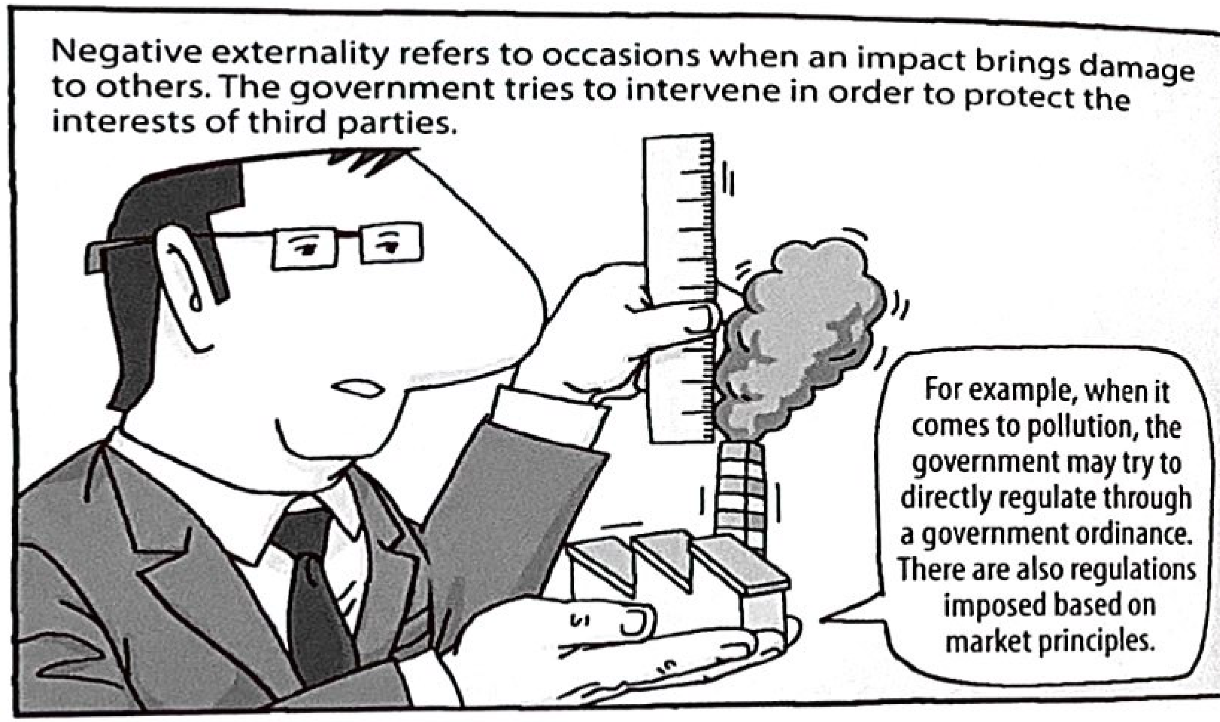
Historic architecture

New technological developments, etc.

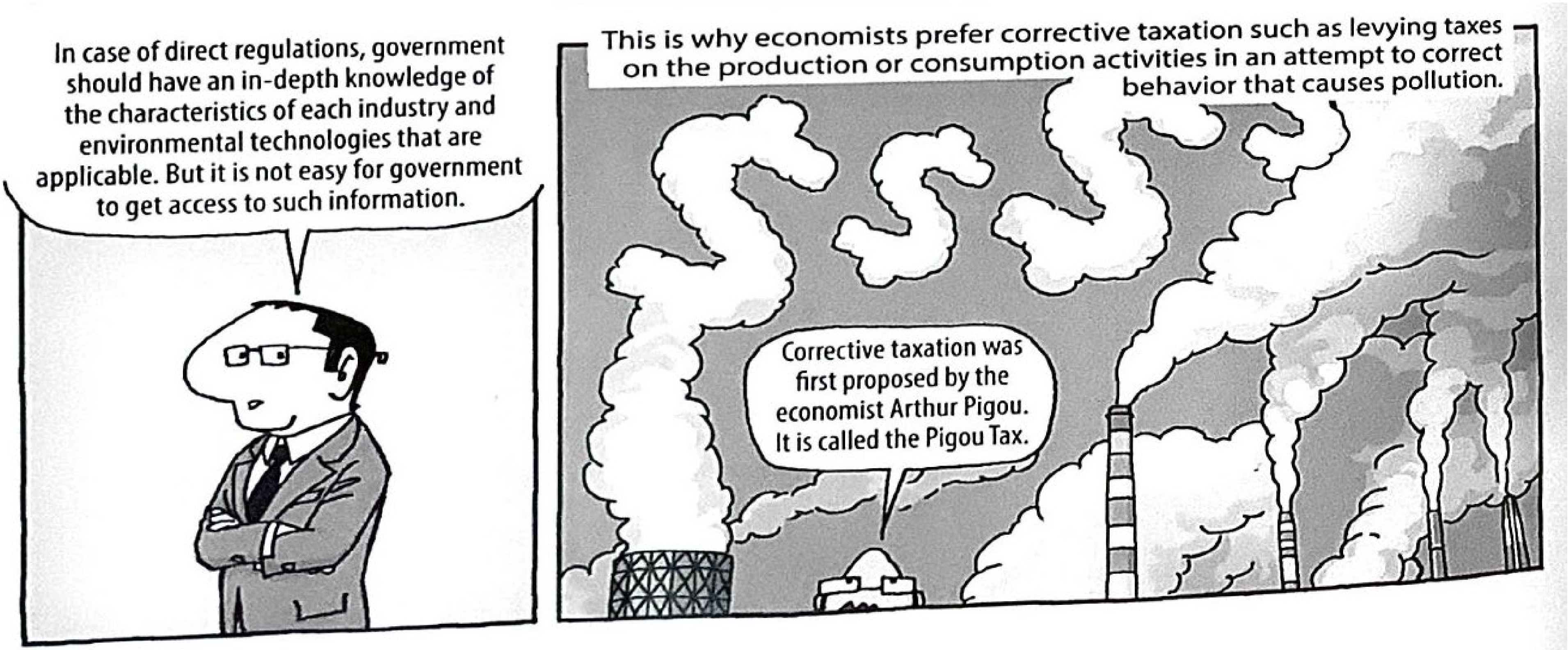
Negative Externality

Exhaust from cars

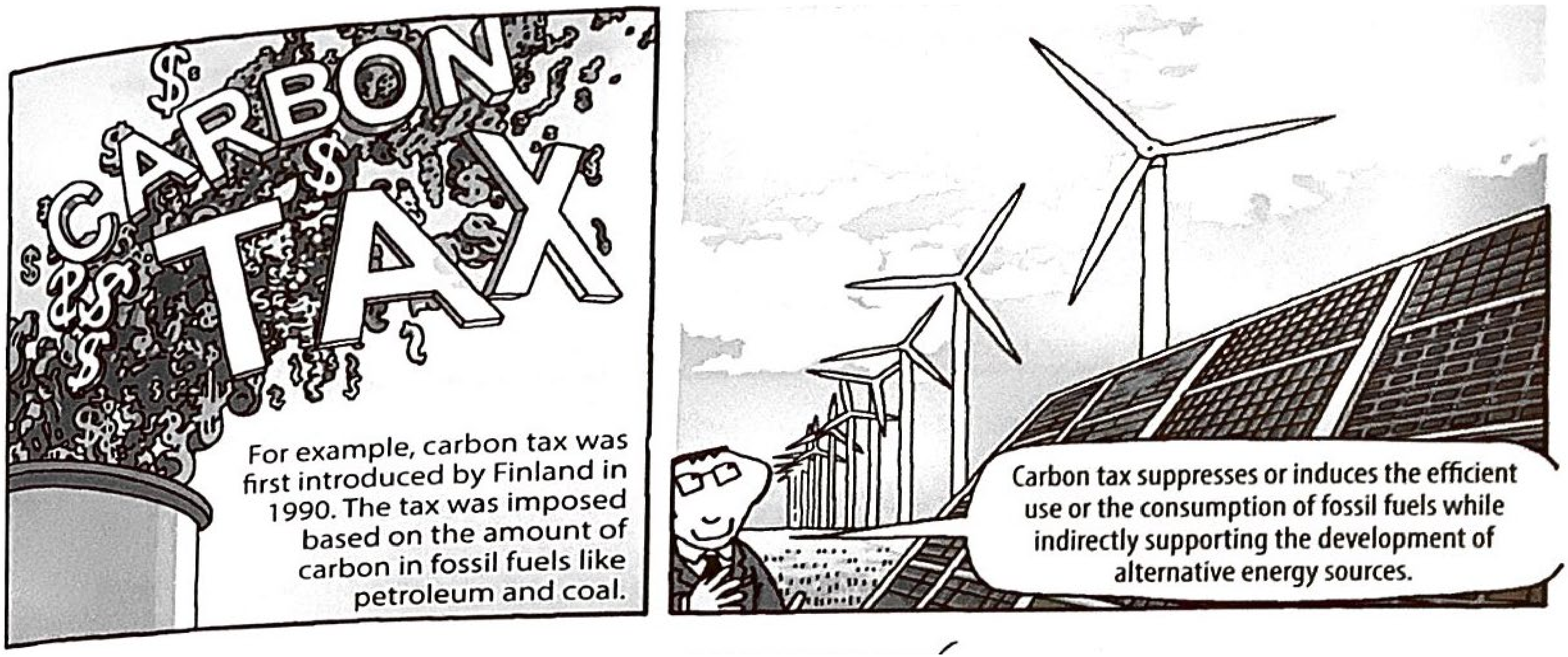
Cigarette smoke, etc.



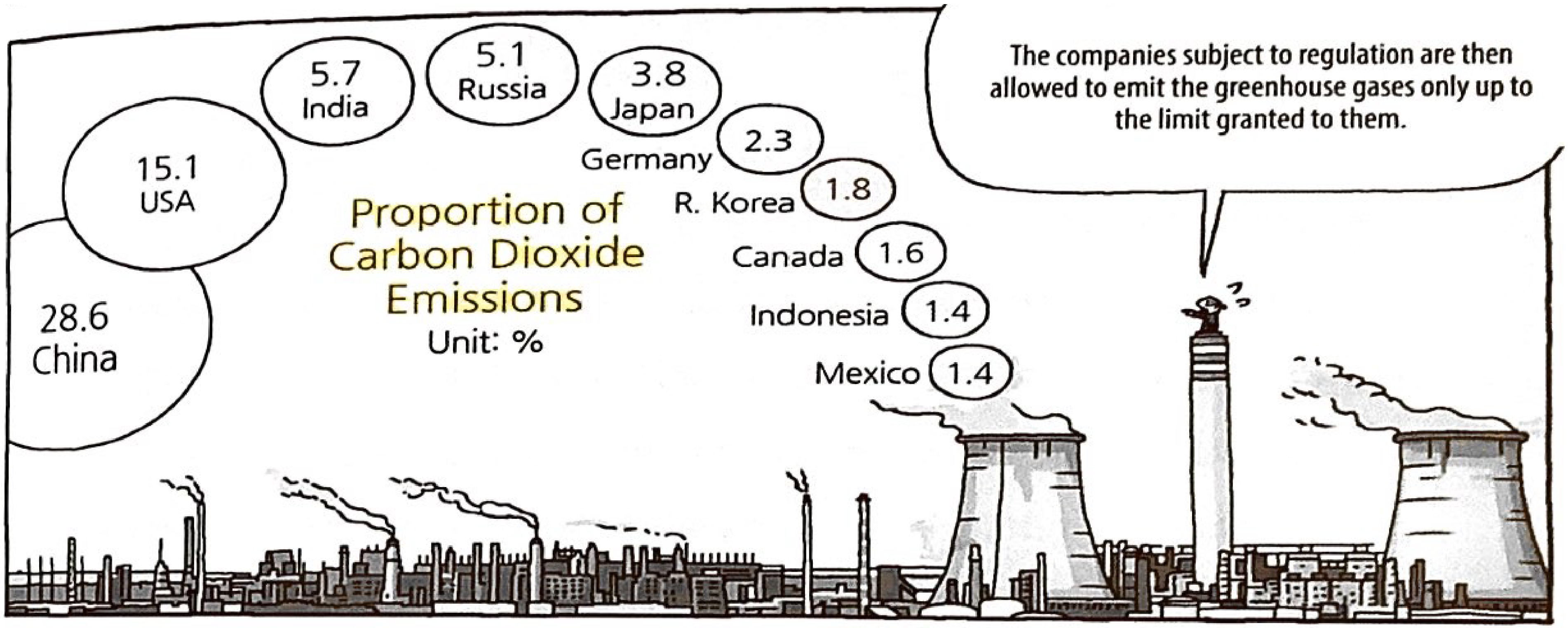
Economic Solutions to Pollution



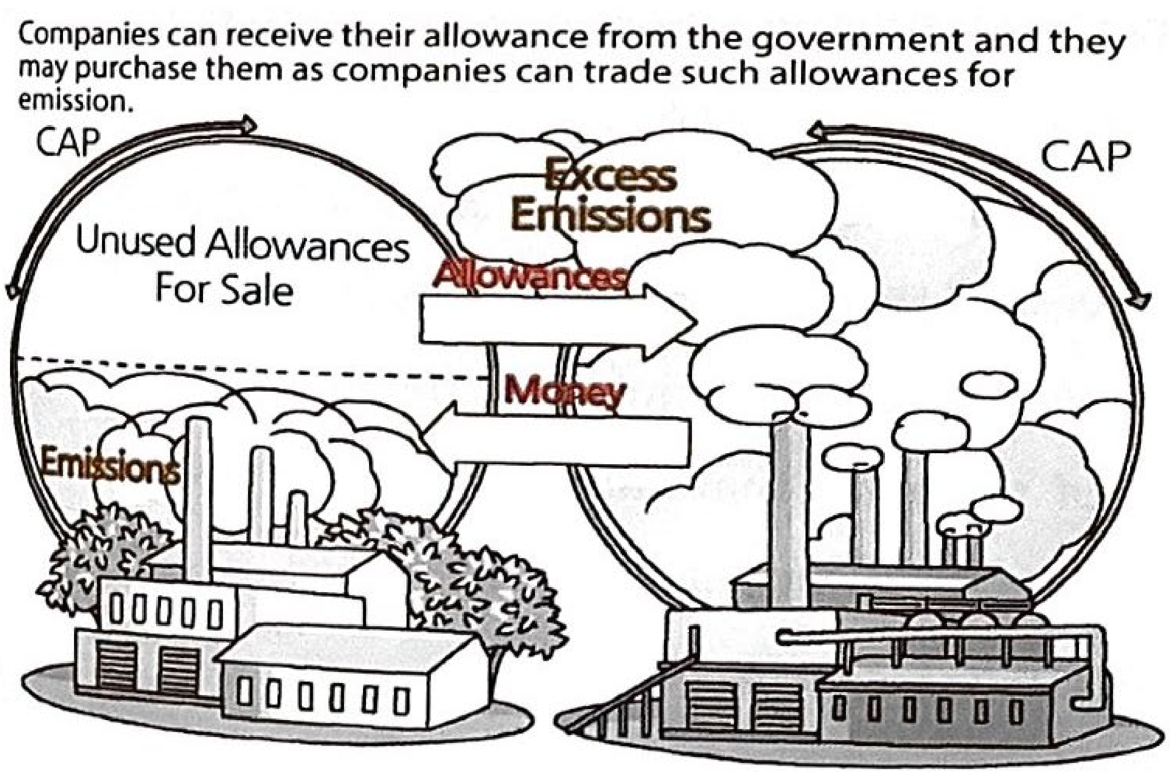
Economic Solutions to Pollution

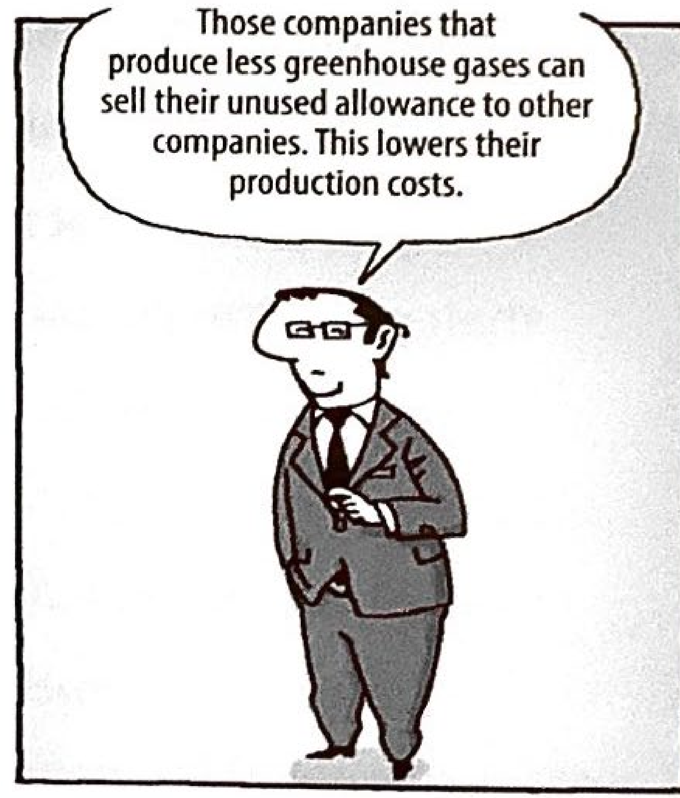


Economic Solutions to Pollution

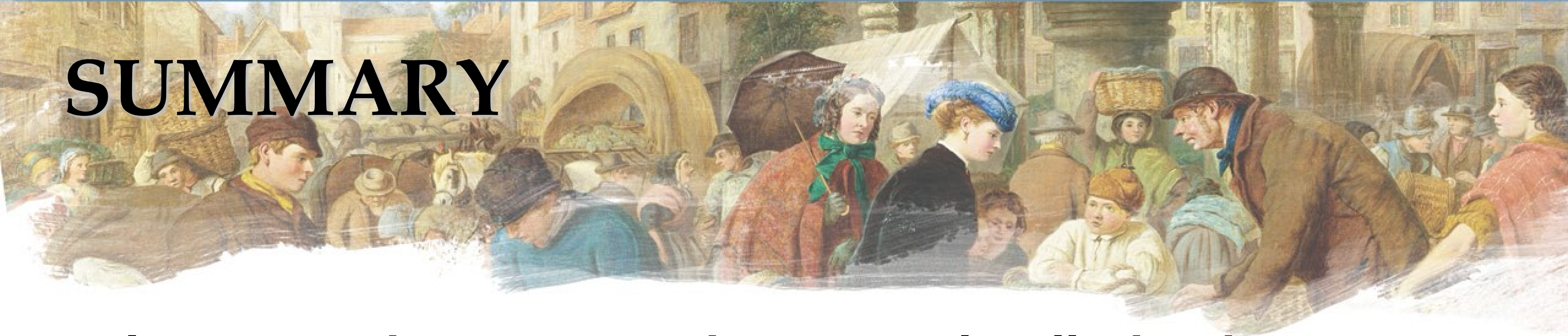


Economic Solutions to Pollution



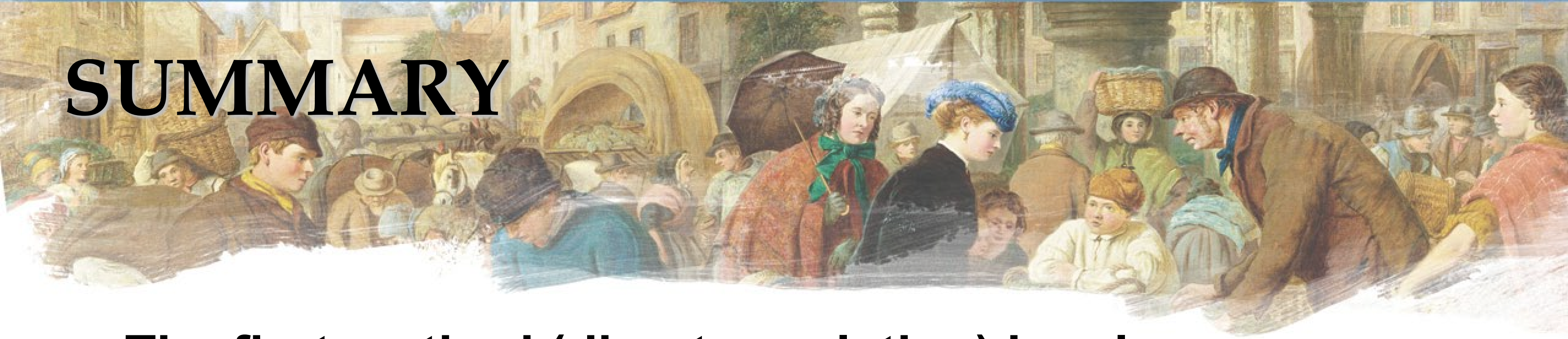


SUMMARY



- **In economic terms, environmental pollution issues such as PCBs and dioxins are referred to as externalities.**
  - **Externalities occur when the actions of one party affect the welfare of a third party without compensation for that impact.**
  - **In such cases, the government can regulate through direct command-based approaches or market-based principles.**

SUMMARY



- **The first method (direct regulation) involves controlling the behavior of the involved parties directly. For example, emission caps are a typical case.**
- **Market-based regulation, on the other hand, provides incentives for decision-makers to address the issue themselves. Emissions trading systems and emission fees are good examples.**
- **Under direct regulation, the government determines the permissible level of pollution. Under market-based regulation, the government provides incentives, while businesses actively seek ways to reduce pollution.**

SUMMARY

- **Emission cap systems often impose uniform reduction requirements on all factories, mandating equal percentage cuts. This is not the most cost-effective way to reduce pollution.**
  - **If a paper mill can reduce emissions at a lower cost than a steel plant, it should be allowed to reduce as much as possible.**
  - **Meanwhile, the steel plant might prefer paying taxes (or fines) rather than reducing emissions.**
  - **However, under direct regulation, once both companies meet their emission caps, they have no further incentive to continue reducing emissions.**

SUMMARY

- To address this issue, the government can tax externalities, forcing decision-makers to account for costs they would otherwise ignore. This is known as "internalizing" externalities.
- Taxes levied to correct the negative effects of externalities are called corrective taxes. The concept of corrective taxes was first proposed by the economist Arthur Pigou.
  - Emission fees are a form of Pigouvian tax, effectively setting a price for the right to pollute.
  - Pollution permits will be allocated to those with the highest willingness to pay, helping society achieve the same environmental goals at the lowest social cost.
  - Under such a system, companies are motivated to adopt environmentally friendly technologies to minimize their tax burden.

SUMMARY

- **Emissions trading systems are based on voluntary transactions between parties, benefiting all participants.**
  - **With a predetermined total emission cap, no additional social burden is created.**
  - **Once the government allows emissions trading, a spontaneous market for emission rights emerges, where efficient allocation occurs according to the laws of supply and demand.**
  - **Companies with higher pollution reduction costs are willing to pay more for emission rights. While emission fees are taxes paid by companies to the government, emissions trading allows firms to purchase pollution permits.**
  - **Both approaches require companies to pay for their pollution and share a common feature: the internalization of externalities.**