Questions 11 and 12

Business

Business Business 11. How does a price ceiling undermine the rationing function of market-determined prices? How could rationing coupons insure that consumers with the highest values get the limited amount of a good supplied when government price ceilings create shortages? Fully explain your answer based upon demand, supply and market equilibrium.

Market equilibrium is a " state of equality or a state of balance between market demand and supply" (Riley, 2006). Riley goes on further to say that " equilibrium price is the price at which the quantity demanded by consumers and the quantity that firms are willing to supply of a good or service are the same" (2006). A price ceiling is not the equilibrium price. It is dictated by government and is below the equilibrium price. For any price that is below the market-determined price or what is also known as the equilibrium price, the quanity demanded is greater than the quantity supplied. It will then create a shortage. In a free market where government does not intervene, any shortage will result in an increase in price until it reaches market equilibrium. At the equilibrium price, the problem of shortage is eliminated because quantity demanded is equal to quantity supplied. If a price ceiling is imposed by government, the market forces are prevented from moving towards market equilibrium.

Rationing coupons insure that consumers with the highest values get limited amount of a good supplied when price ceilings are imposed because the cost of the product is changed to the price in money plus the price in coupons (Schenk, n. d.). The cost of the coupon is equivalent to the ceiling price, which is below equilibrium price. This means that demand for the good or service will increase because of the lower price. However with rationing coupons, the buyers need to pay a higher price because they still need to pay an additional amount on top of the coupon price. This effectively weeds out consumers who cannot afford the additional premium over the coupon price; thus, decreasing quantity demanded and the shortage problem. The consumers who can afford the highest value or premium on top of coupon price will ultimately get the limited amount supplied because the suppliers will prefer to sell to them the good or service.

12. Are organizations more risk adverse or individuals more risk adverse? Is one more risk tolerant? Use economic theory to explain your position.

An economic model, the expected utility theory helps both organizations and individuals in making decisions under risk (Thomas-Maurice, 2011). “ The expected utility theory is a theory of decision-making under risk that accounts for a manager’s attitude toward risk” (Thomas-Maurice, 2011). Both organizations and individuals are bounded by limited resources which must be used optimally. Decisions on how to use these resources involve risks. Organizations however are less risk adverse than individuals because they have more resources; thus, they are willing to take on more risk. It is easier for an organization to diversify to minimize risk. Individuals on the other hand, are more risk averse because they have limited resources. Diversification will be difficult for individuals considering that their resources may not be as much as those of the organization. Organizations are more risk tolerant than individuals because of the reasons cited above.

References

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