

Abstract:\*

Governments often impose price floors to prevent price declines in markets characterized by uncertainty. Hard price floors are used to support the prices of grains and currencies while soft floors (auction reserve prices) are used to support the prices of emissions permits in cap-and-trade programs. Using a unified approach, we investigate a novel characteristic of such floors: even if the floor is inserted below the equilibrium price, the price may jump up—higher with a hard floor than with a soft floor. Since the floor is then strictly below the equilibrium price, it appears “nonbinding.” We provide sufficient conditions for this result not only in the traditional stochastic competitive storage model with an infinite horizon but in a more transparent version with two periods. We then use the two-period version to test our results in the laboratory.

\*joint with Stephen Salant and William Shobe