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Consumers, Producers, and the Efficiency of Markets

Consumers, Producers and the Efficiency of Markets

- Revisiting the Market Equilibrium
  - Do the equilibrium price and quantity maximize the total welfare of buyers and sellers?
  - Market equilibrium reflects the way markets allocate scarce resources.
  - Whether the market allocation is desirable can be addressed by welfare economics.

Consumers, Producers and the Efficiency of Markets

- Welfare Economics
  - *Welfare economics* is the study of how the allocation of resources affects economic well-being.
  - Buyers and sellers receive benefits from taking part in the market.
  - In the following slides, by ‘equilibrium’ we mean the one in a perfectly competitive market.
  - The equilibrium in a market maximizes the total welfare of buyers and sellers.

Consumers, Producers and the Efficiency of Markets

- Welfare Economics
  - Equilibrium in the market results in maximum benefits, and therefore maximum total welfare for both the consumers and the producers of the product.

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- Welfare Economics
  - Consumer surplus measures economic welfare from the buyer's side.
  - Producer surplus measures economic welfare from the seller's side.

CONSUMER SURPLUS

- *Willingness to pay* is the maximum amount that a buyer will pay for a good.
- It measures how much the buyer values the good or service.

CONSUMER SURPLUS

- *Consumer surplus* is the buyer’s willingness to pay for a good minus the amount the buyer actually pays for it.

Table 1: Four Possible Buyers' Willingness to Pay

Buyer	Willingness to Pay
John	$100
Paul	80
George	70
Ringo	50

Using the Demand Curve to Measure Consumer Surplus

- The market demand curve depicts the various quantities that buyers would be willing and able to purchase at different prices.

The Demand Schedule and the Demand Curve

Price	Buyers	Quantity Demanded
More than $100	None	0
$80 to $100	John	1
$70 to $80	John, Paul	2
$50 to $70	John, Paul, George	3
$50 or less	John, Paul, George, Ringo	4

Figure 1 The Demand Schedule and the Demand Curve

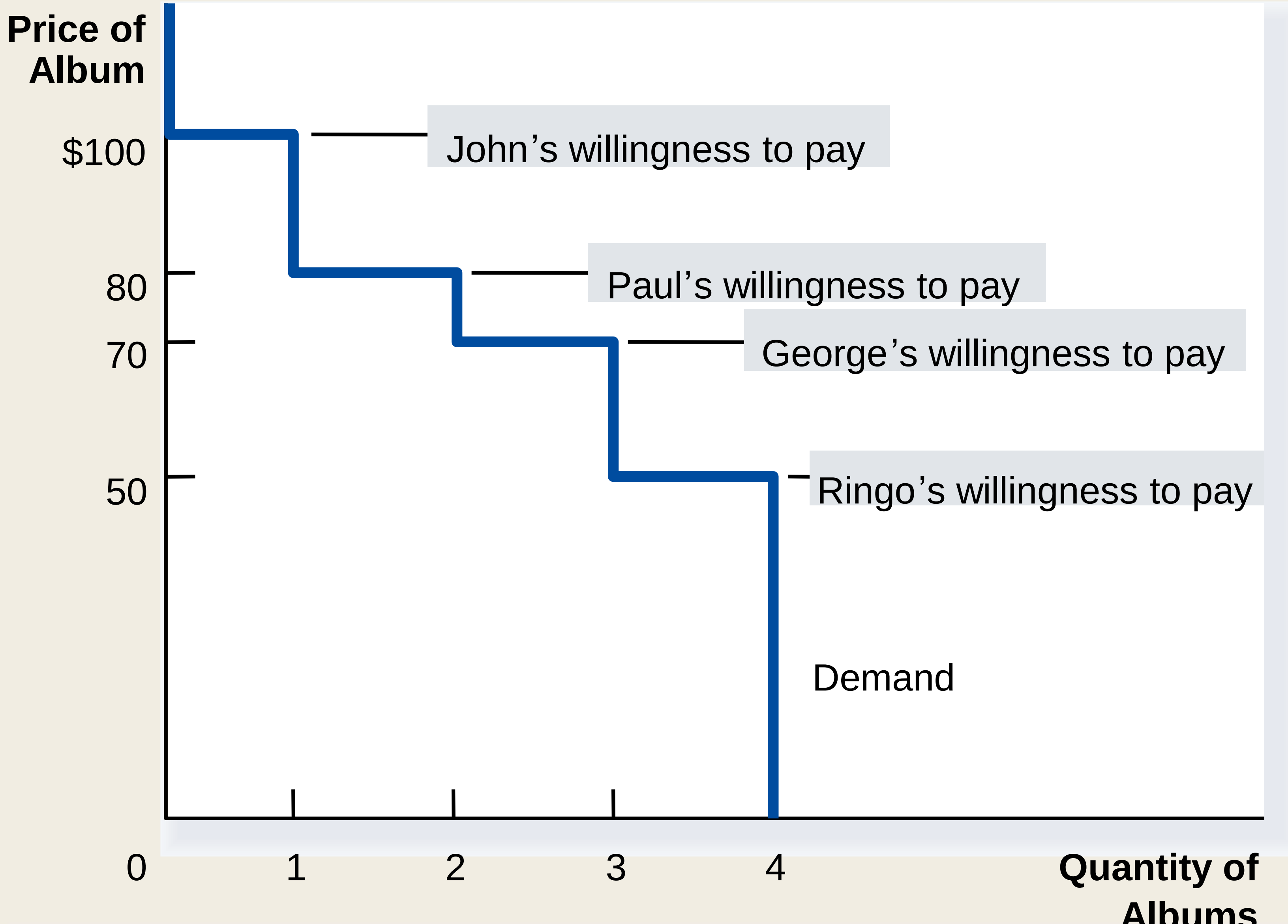
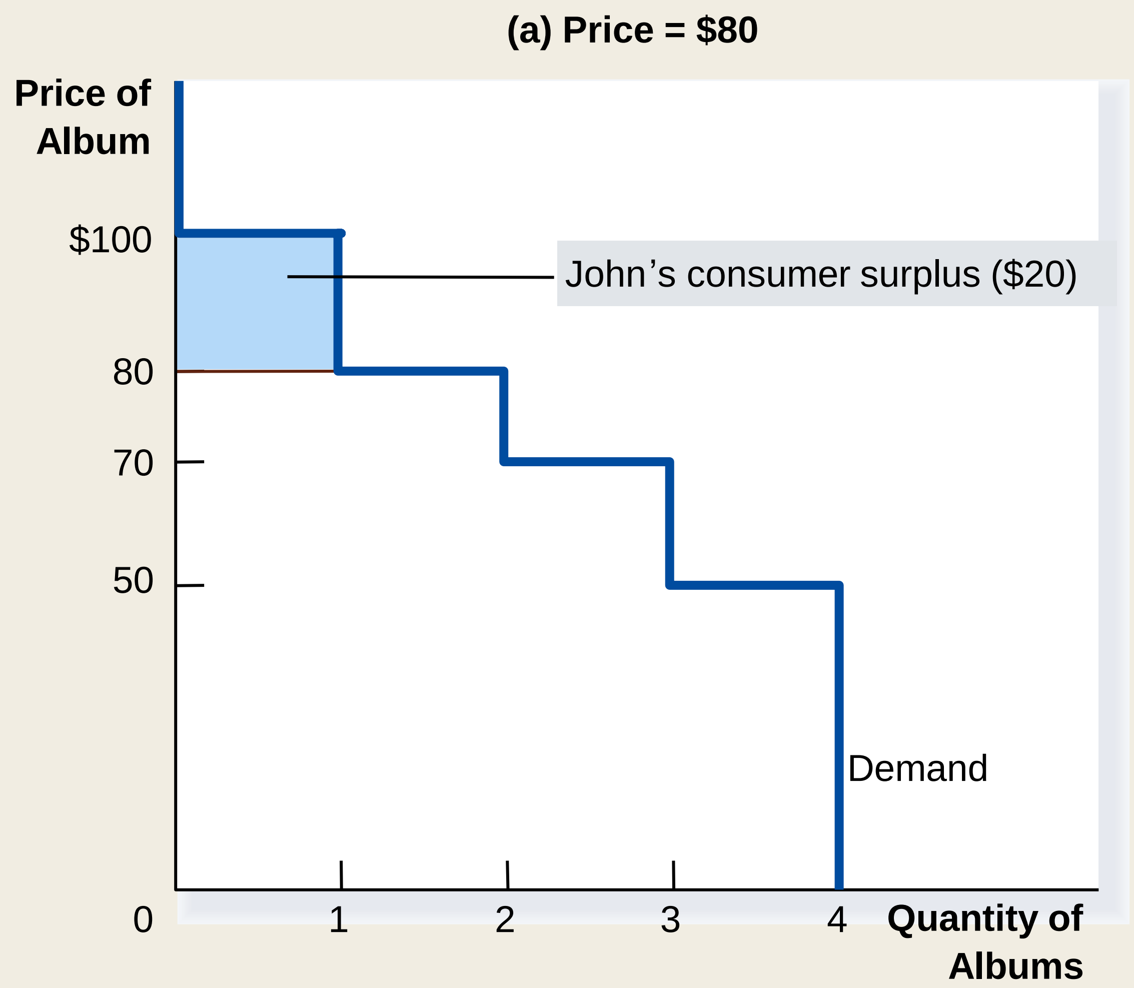


Figure 2 Measuring Consumer Surplus with the Demand Curve



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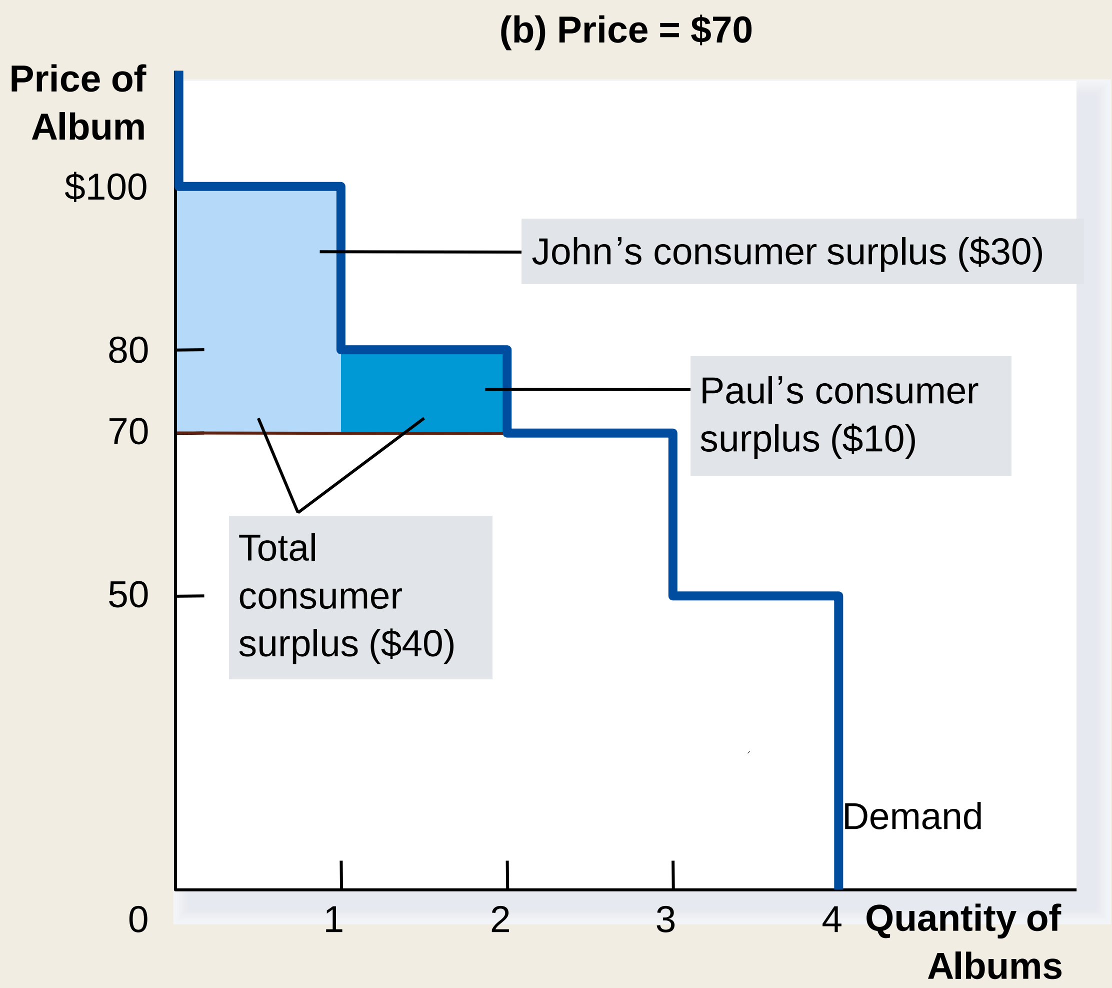

Using the Demand Curve to Measure Consumer Surplus

- The area below the demand curve and above the price measures the consumer surplus in the market.

Figure 3 How the Price Affects Consumer Surplus