ECO101: Introduction to Microeconomics

LECTURER: ADDRITA SHAMS

SECTION: 11

LECTURE 09

TOPIC: EFFICIENCY OF COMPETITIVE EQUILIBRIUM

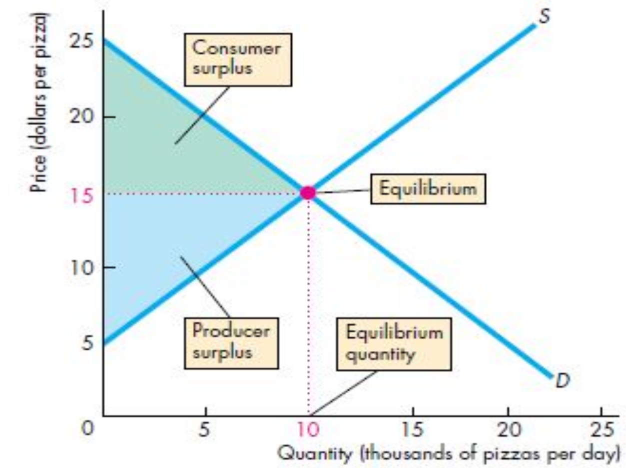
Efficiency of Competitive Equilibrium

- The market demand curve for a good or service tells us the marginal social benefit from it. The market supply curve of a good or service tells us the marginal social cost of producing it.
- Equilibrium in a competitive market occurs when the quantity demanded equals the quantity supplied at the intersection of the demand curve and the supply curve.
- At this intersection point, marginal social benefit on the demand curve equals marginal social cost on the supply curve.
- This equality is the condition for allocative efficiency. So in equilibrium, a competitive market achieves allocative efficiency.

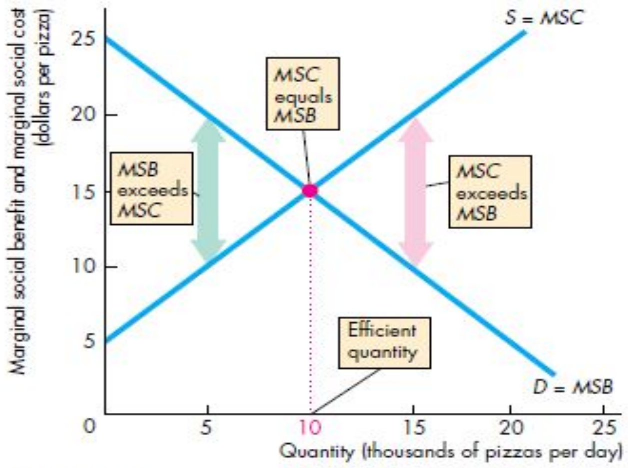
- If production is less than 10,000 pizzas a day, the marginal pizza is valued more highly than it costs to produce. If production exceeds 10,000 pizzas a day, the marginal pizza costs more to produce than the value that consumers place on it.
- Only when 10,000 pizzas a day are produced is the marginal pizza worth exactly what it costs.

- Figure 5.5(a) also shows the consumer surplus and producer surplus. The sum of consumer surplus and producer surplus is called **total surplus**.
- When the efficient quantity is produced, total surplus is maximized. Buyers and sellers acting in their self-interest end up promoting the social interest.

FIGURE 5.5 An Efficient Market for Pizza



(a) Equilibrium and surpluses

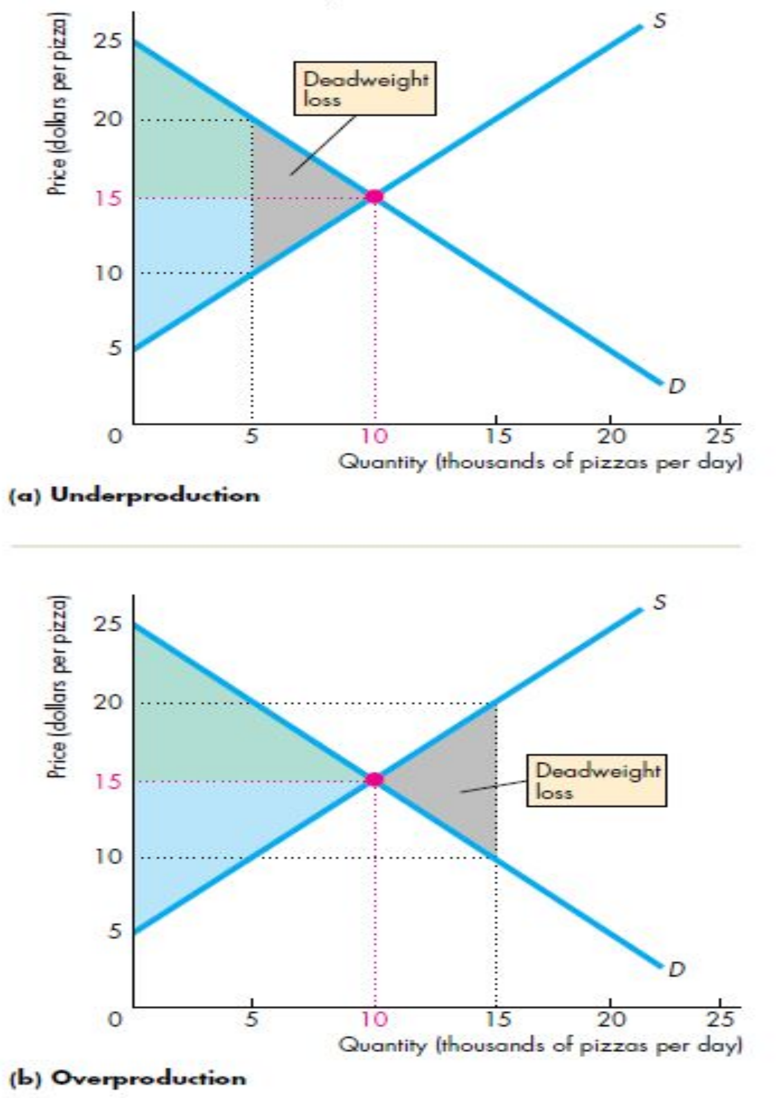


(b) Efficiency

Market Failure

- We call a situation in which a market delivers an inefficient outcome one of **market failure**.
- Market failure can occur because too little of an item is produced (underproduction) or too much is produced (overproduction).
- We measure the scale of inefficiency by **deadweight loss**, which is the decrease in total surplus that results from an inefficient level of production.
- The gray triangle in Fig. 5.6 shows the deadweight loss.
- Inefficient production creates a deadweight loss that is borne by the entire society: It is a social loss.

FIGURE 5.6 Underproduction and Overproduction



Sources of Market Failure (Self-study)

- Obstacles to efficiency that bring market failure and create deadweight losses are
  - Price and quantity regulations
  - Taxes and subsidies
  - Externalities
  - Public goods and common resources
  - Monopoly
  - High transactions costs

Read this in detail from the book and ask me if you have any questions. DO NOT SKIP.