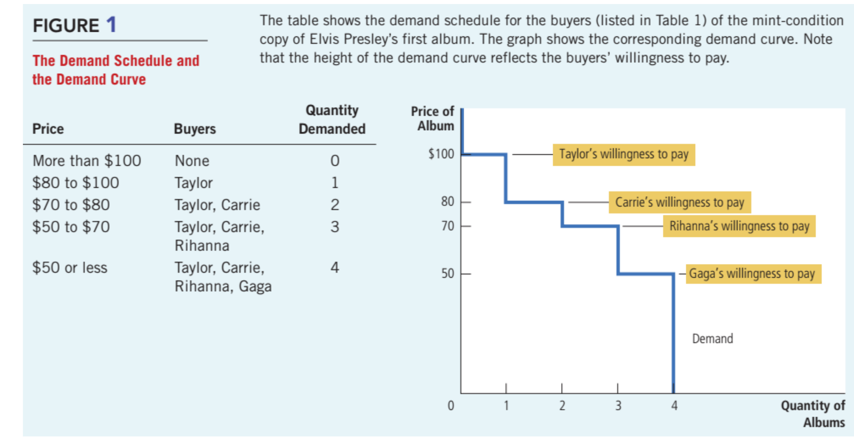
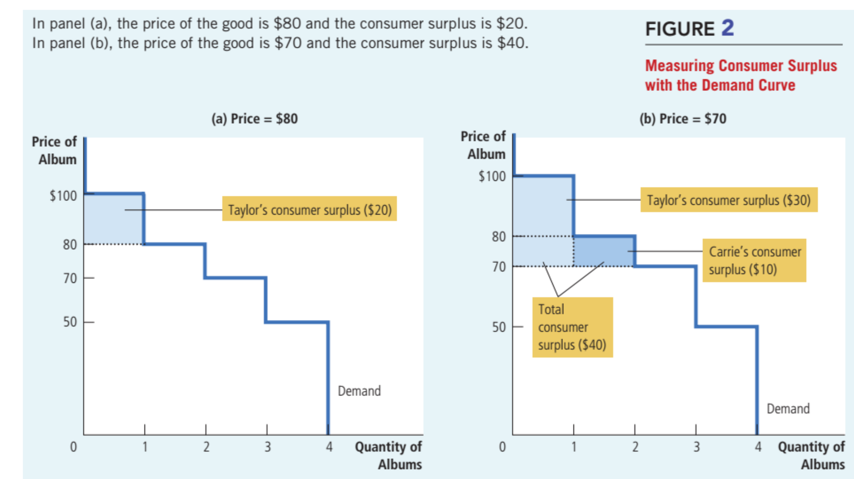
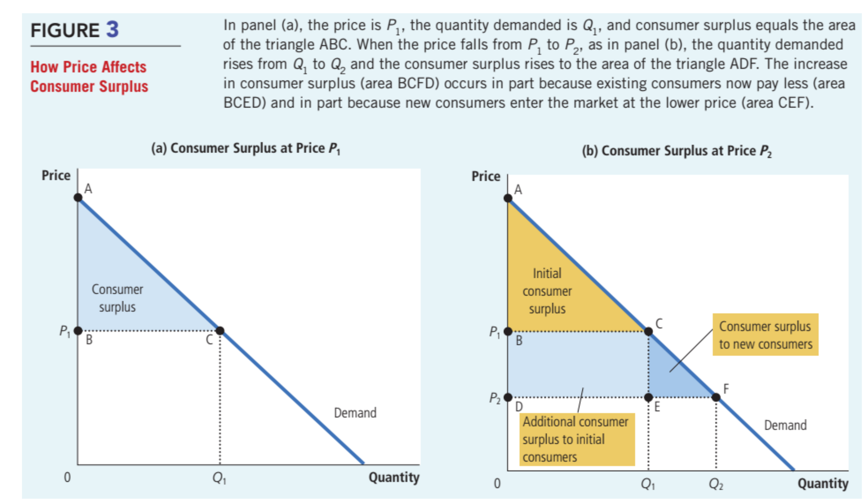
Chap 7 Consumers, Producers, and the Efficiency of Markets

- welfare economics: the study of how the allocation of resources affect economic well-being
- Consumer Surplus
  - Willingness to Pay
    - willingness to pay: the maximun amount that a buyer will pay for a good
    - consumer surplus: the amount a buyer is willing to pay for a good minus the amount the buyer actually pays for it
  - Using the Demand Curve to Measure Consumer Surplus
    - marginal buyer: the buyer who would leave the market first if the price were any higher

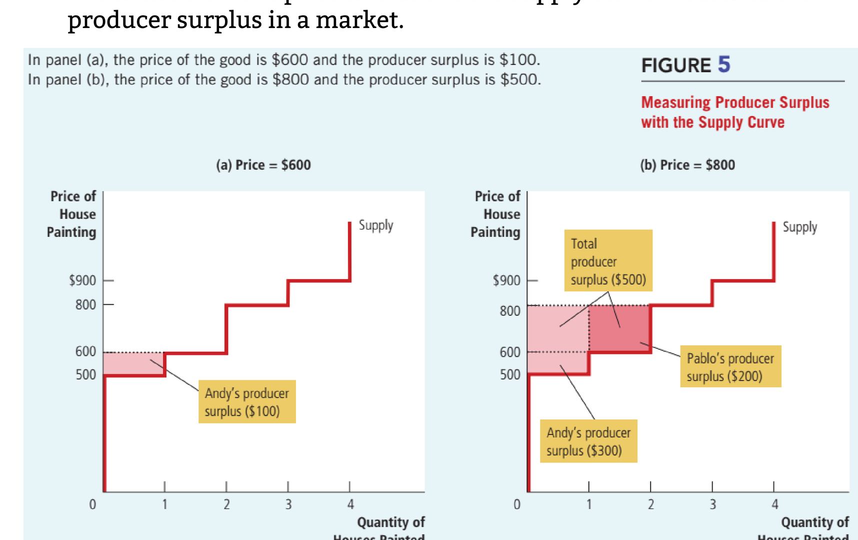




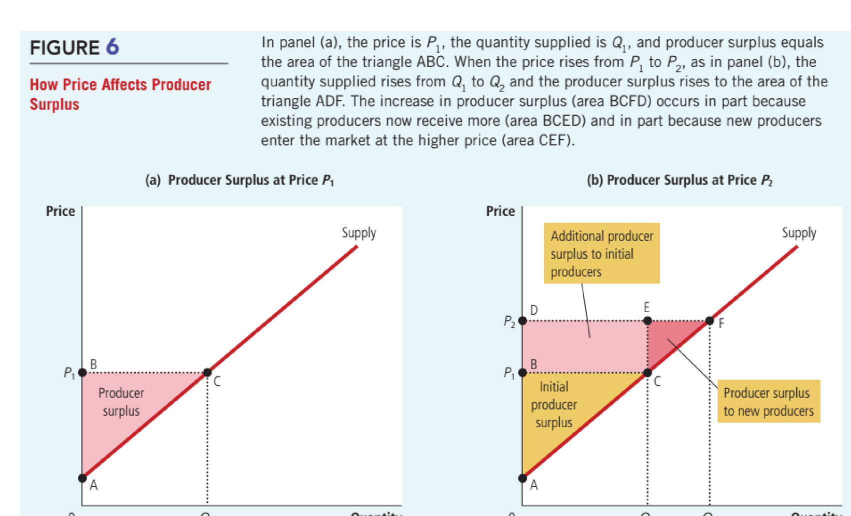
    - The area below the demand curve and above the price measures the consumer surplus in a market
  - How a Lower Prive Raise Consumer Surplus?
    - This increase in consumer surplus is composed of two parts.



    - Those buyers who were already buying Q1 of the good at the higher price P1 are better off because now they pay less. The increase in consumer surplus of existing buyers is the reduction in the amount they pay; it equals the area of the rectangle BCED.
    - Some new buyers enter the market because they are willing to buy the good at the lower price. As a result, the quantity demanded in the market increases from Q1 to Q2. The consumer surplus these newcomers receive is the area of the triangle CEF.
  - What Does Consumer Surplus Measure?
    - Consumer surplus is a good measure of economic well-being if policymakers want to satisfy the preferences of buyers
    - In some circumstances, policymakers might choose to disregard consumer surplus because they do not respect the preference that drive buyer behavior. For example, drug addicts are willing to pay a high price for heroin.
- Producer Surplus
  - Cost and the Willingness to Sell
    - cost: the value of everything a seller must give up to produce a good
    - producer surplus: the amount a seller is paid for a good minus the seller's cost of providing it
  - Using the Supply Curve to Measure Producer Surplus
    - marginal seller: the seller who would leave the market first if the price were any lower
    - The area below the price and above the supply curve measures the producer surplus in a market.



  - How a Higher Price Raises Producer Surplus



- Market Efficiency
  - Is the allocation of resources determined by free market desirable?
  - The Benevolent Social Planner
    - total surplus: the sum of consumer and producer surplus
      - Total surplus = Value to buyers - Cost to sellers
    - efficiency: the property of a resource allocation of maximizing the total surplus received by all members of society
    - equality: the property of distributing economic prosperity uniformly among the members of society
    - In addition to efficiency, the social planner might also care about equality -- that is, whether the various buyers and sellers in the market have a similar level of economic well-being. In essence, the gains from trade in a market are like a pie to be shared among the market participants. The question of efficiency concerns whether the pie is as big as possible. The question of equality concerns how the pie is sliced and how the portions are distributed among members of society.
  - Evaluating the Market Equilibrium
    1. Free markets allocated the supply of goods to the buyers who value them most highly, as measured by their willingness to pay.
    2. Free markets allocated the demand for goods to the sellers who produce them at the lowest cost.
    3. Free markets produce the quantity of goods that maximizes the sum of consumer and producer surplus.
    - Suppose our social planner tried to choose an efficient allocation of resources on her own, instead of relying on market forces. To do so, she would need to know the value of a particular good to every potential consumer in the market and the cost for every potential producer. And she would need this information not only for this market but for every one of the many thousands of markets in the economy. The task is pratically impossible, which explains why certrally planned economies never work very well.