Mankiw Macro Chapter VII: Consumers, Producers, and the Efficiency of Markets

Introduction (pg 135)

Welfare Economics: the study of how the allocation of resources affects economic well-being….

Consumer Surplus

Willingness to Pay: How much a person would pay for something

Imagine an auction for a new iPhone 6e

4 buyers, (Allen, Bill, Charles and Dan)

Willing to pay 25,000 20,000 15,000 and 10,000……

How much will the phone sell for?

What if two phones are available?

Consumer surplus: the amount a buyer is willing to pay for a good, minus the amount he actually pays for it

Consumer surplus for the market is the area between the demand curve and the price

Note: the LESS elastic the demand curve, the GREATER consumer surplus usually is

What does consumer surplus measure?

It measures how much benefit above the price consumers get

The greater the surplus, the greater the benefits to consumers, assuming…

That they actually know what they want

And that we don't mind it, and no externalities

Graphical illustration of Consumer surplus…

(how a drop in price RAISES consumer surplus)

Producer Surplus

Producer Surplus: the amount a seller is paid for a good less the seller's cost of providing it

Cost: The value of everything a seller must give up to produce a good.

Graphical illustration of producer surplus

Inelastic supply (Oil), Elastic Supply (street food).

Question: If the LR elasticity of supply is elastic, does that mean producers get very little?

Accounting Profits and Economic Profits….

Market Efficiency

The *Competent* Benevolent Social Planner

(the Singapore model)

Efficiency: the property of a resource allocation that maximizes the total surplus to society

To be efficient, goods must be consumed by those who value them most, and produced by those who can do so most cheaply.

Free markets supply goods to the buyers who value them the most, as measure by their willingness to pay

Free markets produce goods for the buyers by allocating the resources necessary to produce them, to those who can do so most cheaply

And thus, free markets produce the quantity of goods that maximizes the sum of consumer and producer surplus

AND THEY DO SO WITHOUT ANYBODY NEEDING TO KNOW WHAT THE EQUILIBRIUM PRICE OR QUANTITY “SHOULD BE”

The social planner DOES NOT HAVE THE INFORMATION (or often, the desire), to do this…

But, externalities and public goods – Market Failure does exist.

The case for redistribution: declining marginal returns of money.

(this argues for INCOME redistribution, not public provision)