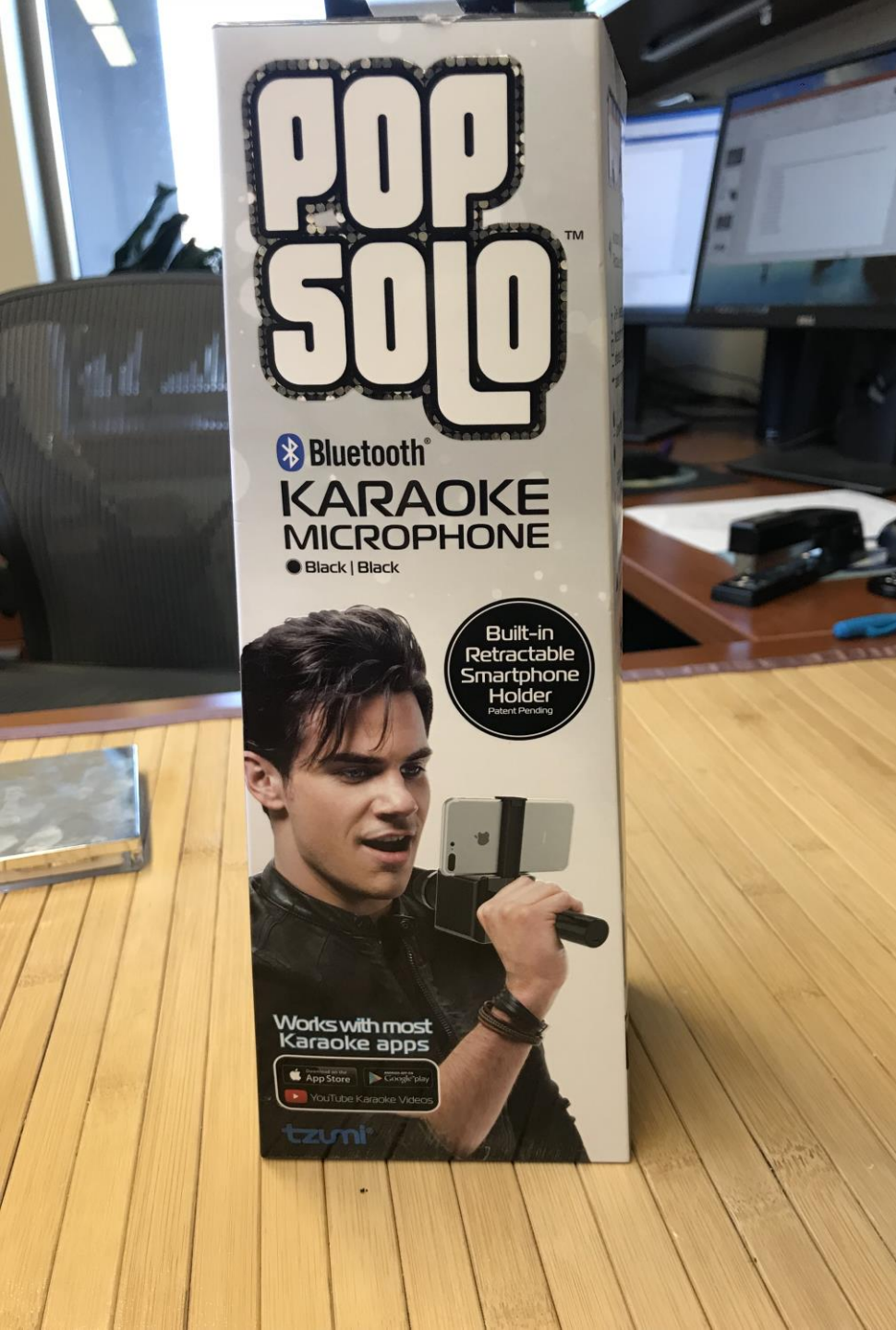




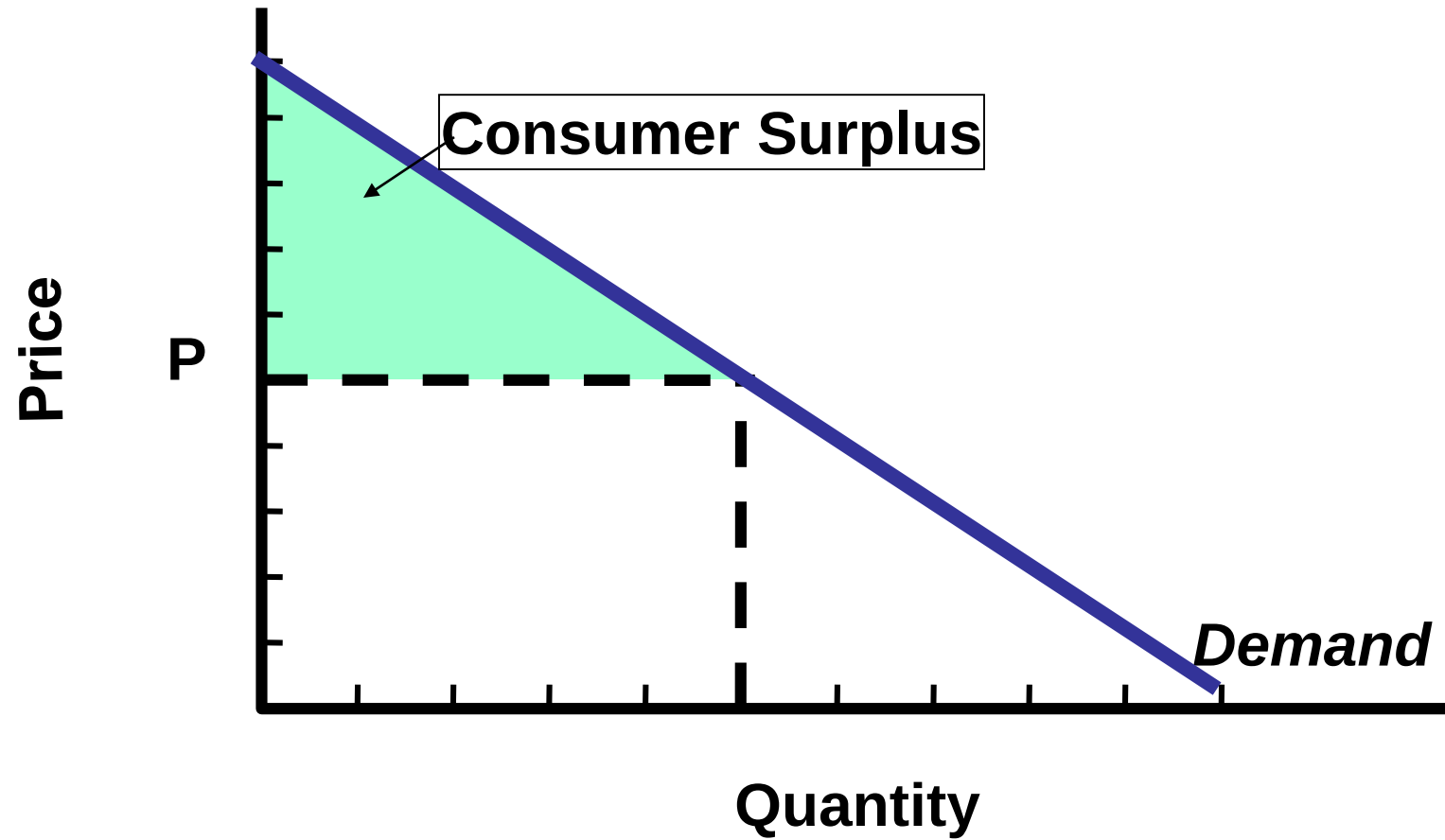
Ch. 7 Welfare Economics
The study of how the allocation of resources affects
economic well-being, p. 117



Consumer Surplus

The amount a buyer is willing to pay for a good (threshold value) minus the amount the buyer actually pays for it.

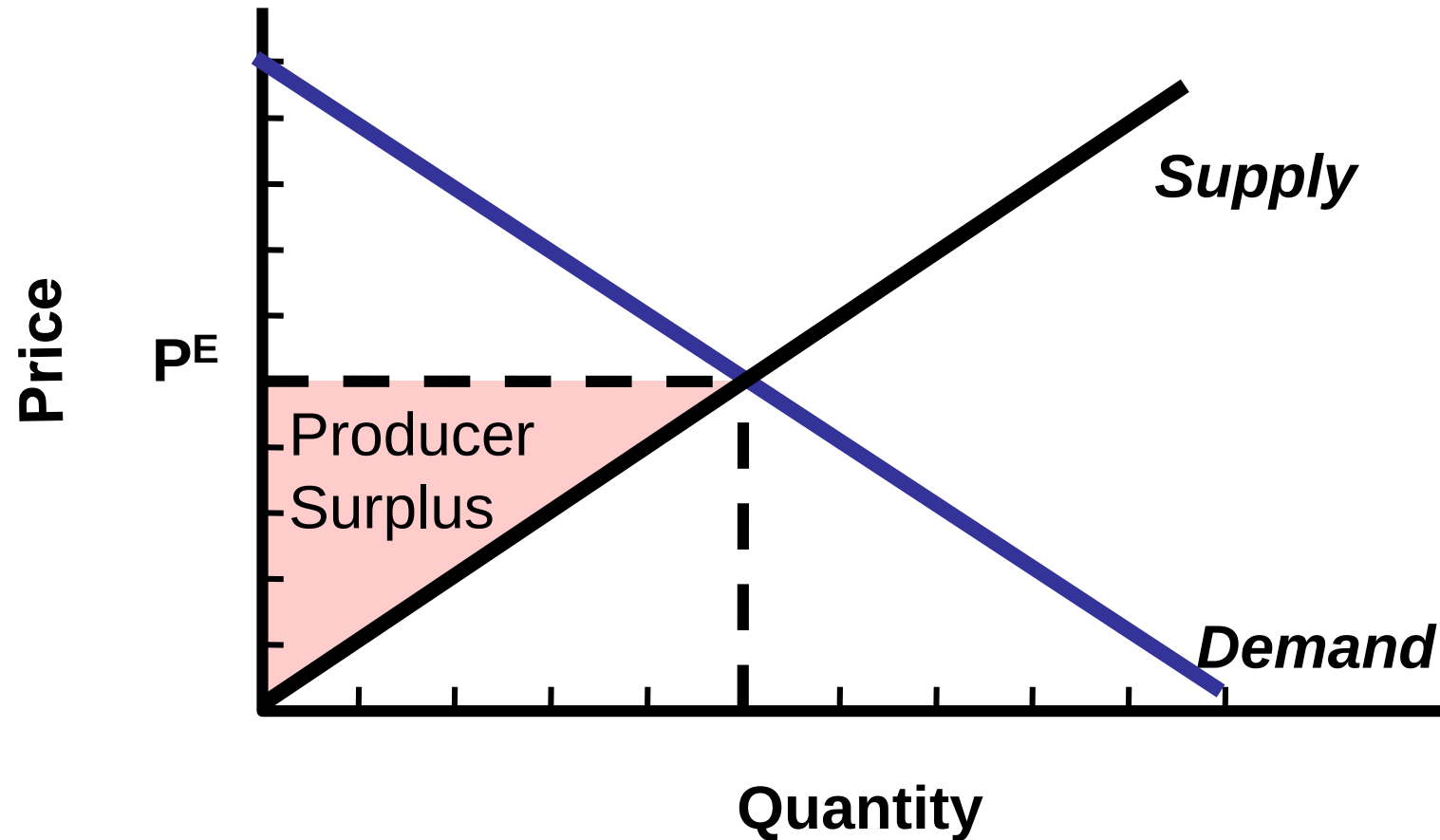
p. 117



II. Producer Surplus p.119

The difference between the price suppliers actually receive (market price) and the minimum price they would be willing to accept (threshold value).

Producer Surplus, p.119



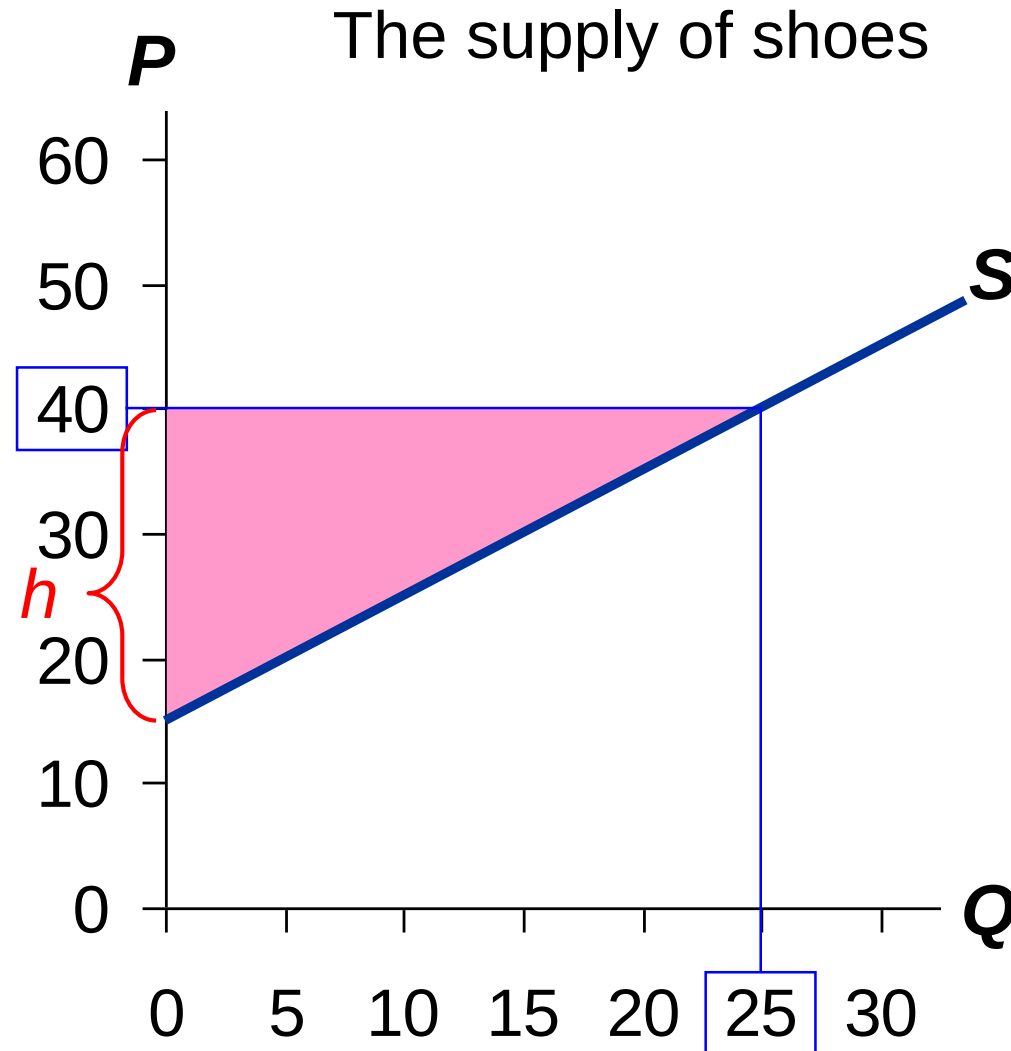
PS with Lots of Sellers & a Smooth S Curve, p. 120

PS is the area b/w
P and the **S** curve,
from 0 to **Q**.

The height of this
triangle is
 $\$40 - 15 = \25 .

So,

$$\begin{aligned} \text{PS} &= \frac{1}{2} \times b \times h \\ &= \frac{1}{2} \times 25 \times \$25 \\ &= \underline{\underline{\$312.50}} \end{aligned}$$



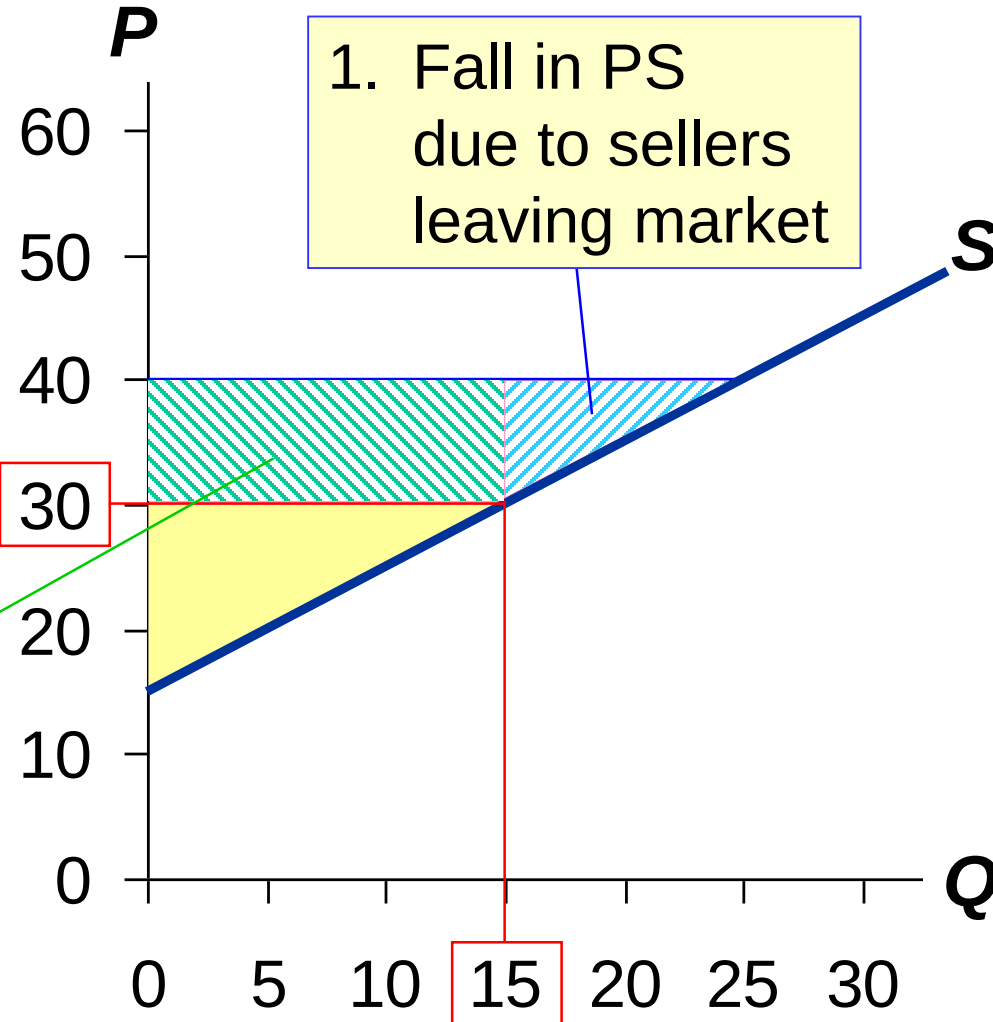
How a Lower Price Reduces PS

If P falls to \$30,

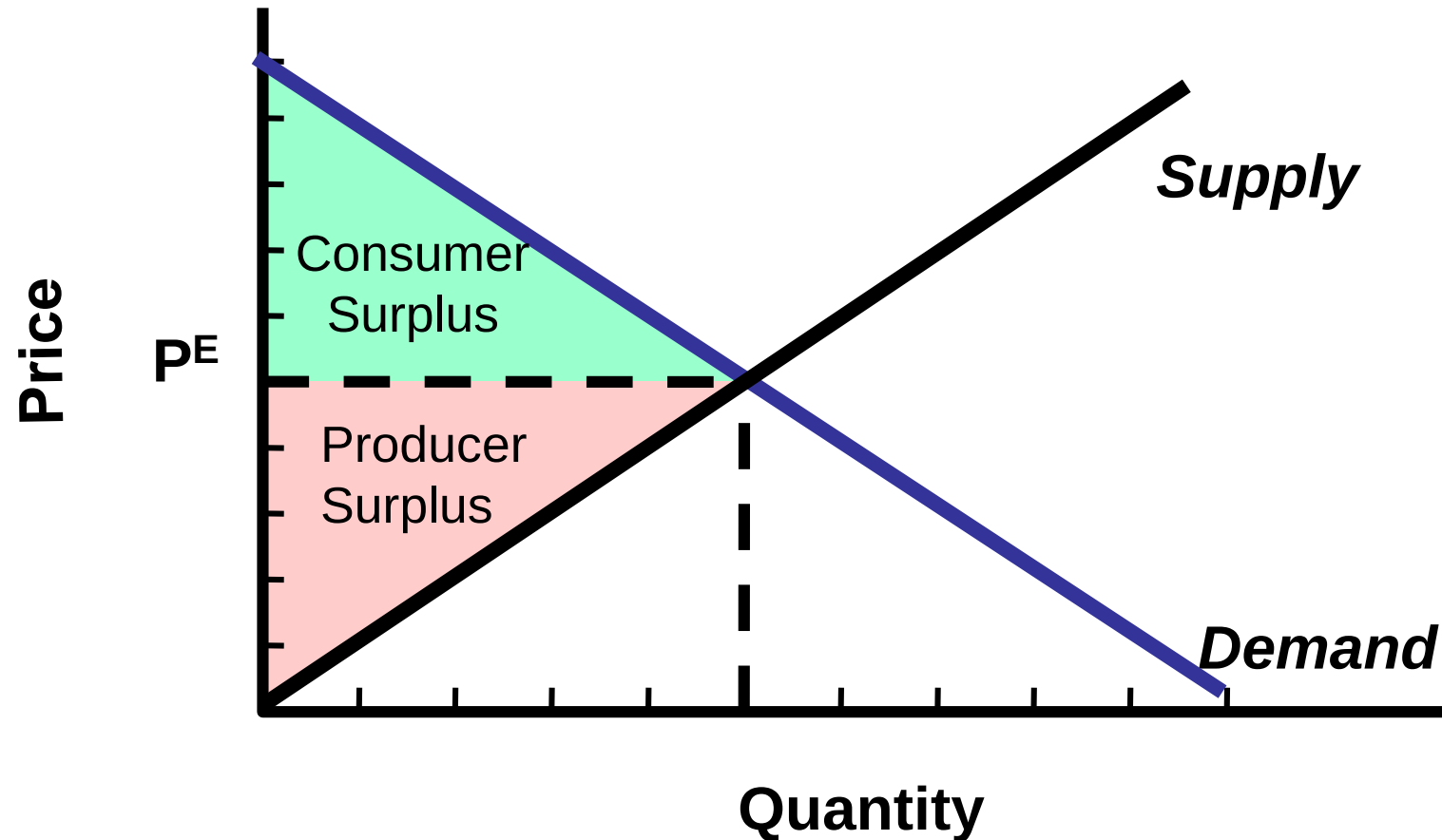
$$\begin{aligned} PS &= \frac{1}{2} \times 15 \times \$15 \\ &= \underline{\underline{\$112.50}} \end{aligned}$$

Two reasons for the fall in PS.

2. Fall in PS due to remaining sellers getting lower P



p. 121 III. Market Efficiency- a resource allocation in which all potential gains from trade have been realized. (Maximizes total surplus.)



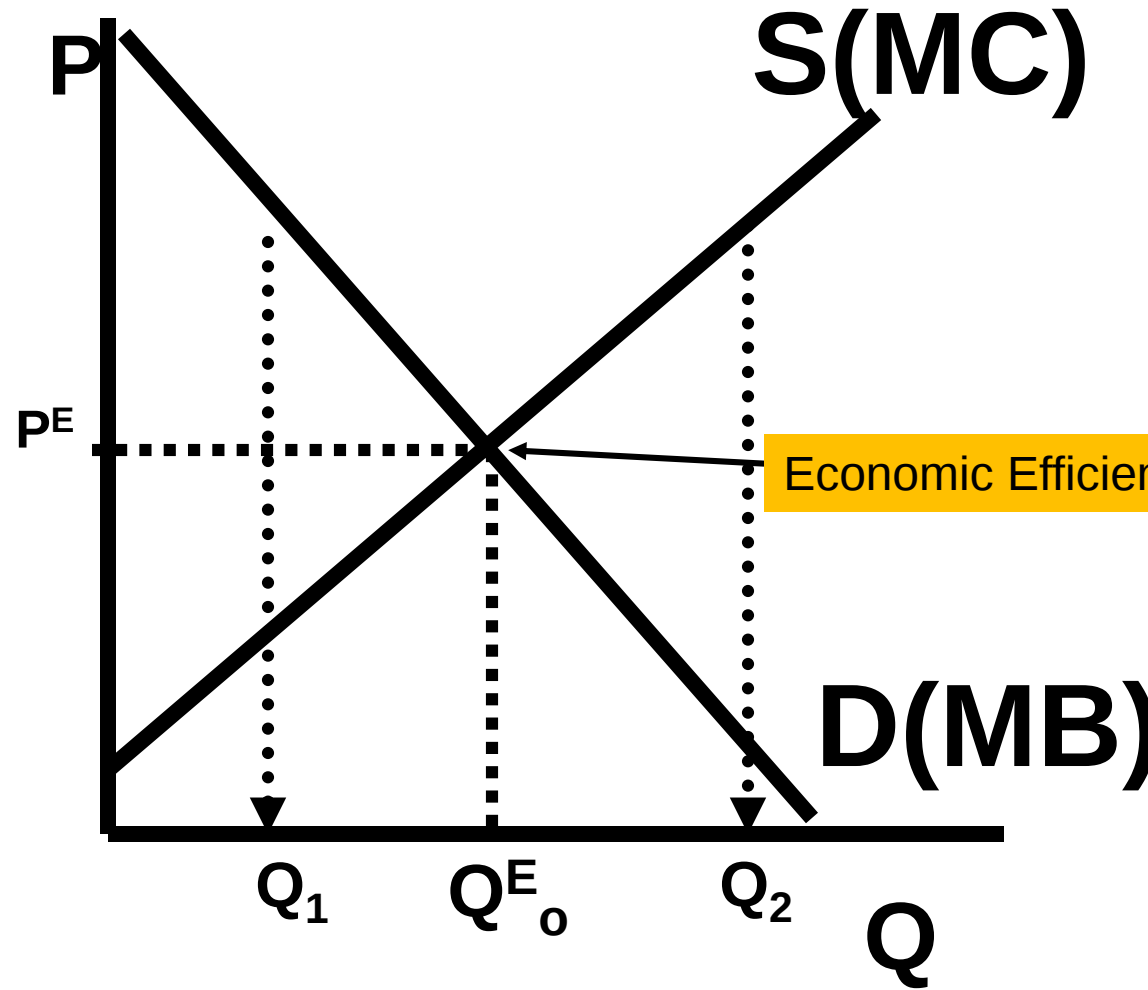
Market Efficiency and Market Failure

Assumptions for efficient markets:

- 1) Well Defined Private Property Rights
- 2) Competitive markets
- 3) No Externalities
- 4) Readily available and accurate information for consumers and producers

- When one of these assumptions does not hold, market might not be efficient – market failure.
- Sometimes government policy can help when markets fail.

**III. Market Efficiency Graphically-same graph as previous slide
(from a broad social viewpoint, not individual viewpoint), p. 121**



- Economic Efficiency-A situation that occurs
- At Q_o $MB=MC$ efficient
- 1) all activities generating more benefits than cost are undertaken and
- $Q_1(MB>MC)$ inefficient
- 2) no activities are undertaken for which the cost exceeds the benefit
- $Q_2 (MB<MC)$ inefficient

Efficiency and equality not same thing.

Welfare Economics and Taxation

p. 127



Chapter 8
Application:
The Costs
of Taxation,
p. 127

I. The Costs of Taxation and the Deadweight Loss of Taxation

II. The Determinants of Deadweight Loss

III. Deadweight Loss and Tax Revenue as Taxes Vary (The Laffer Curve)



I. The Costs of Taxation and the Deadweight Loss of Taxation, p. 127

1) Tax revenue to government

2) Administrative Costs

3) Loss of Consumer and Producer Surplus (deadweight loss)

Deadweight loss from a tax, p. 128

A+B+C Consumer surplus before tax

A consumer surplus after tax

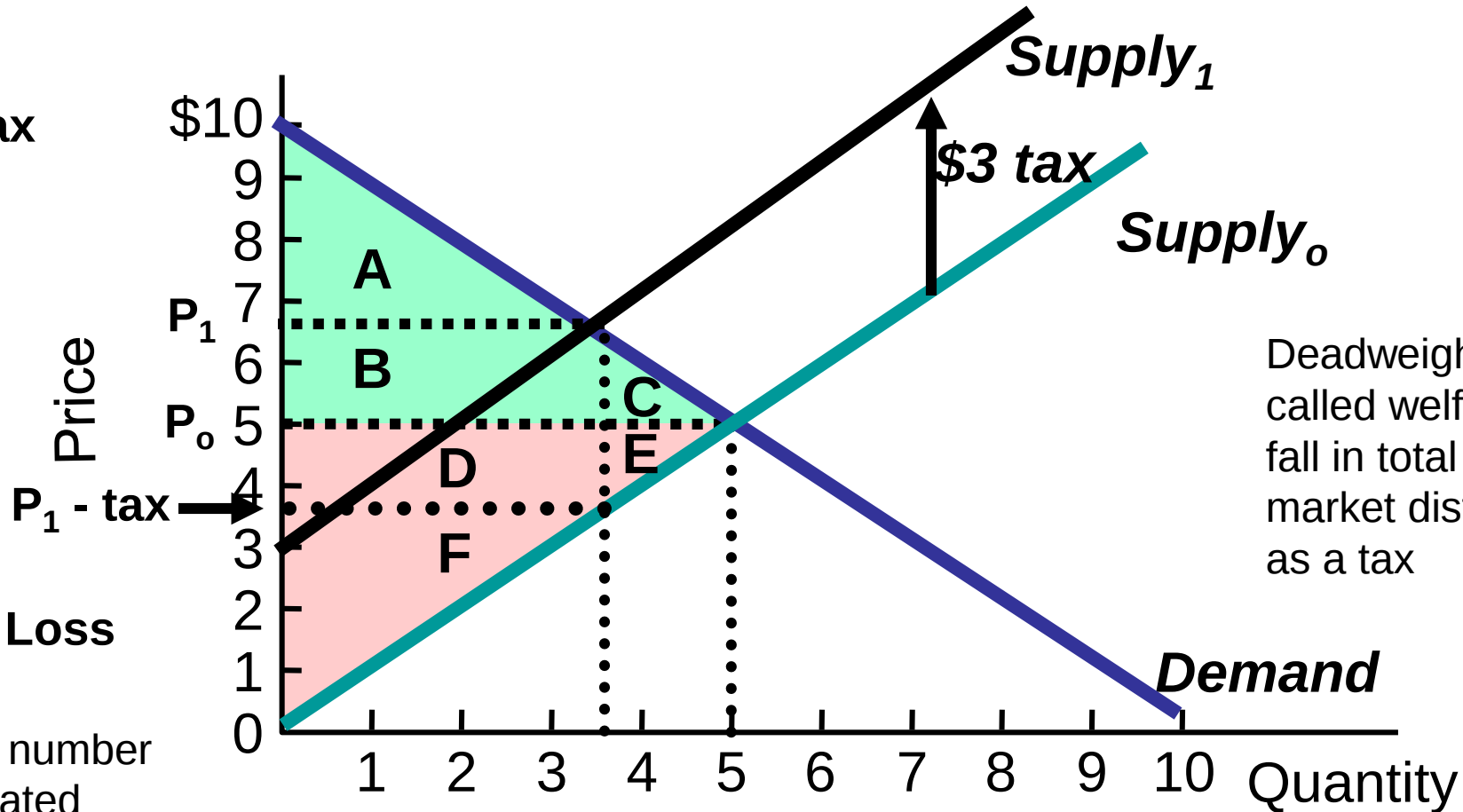
D+E+F Producer Surplus before tax

F Producer surplus after tax

B+D Tax revenue to government

C+E Deadweight Loss

The tax reduces the number of trades and the related gains from trade. (C+E)



Deadweight loss also called welfare loss – the fall in total surplus from a market distortion, such as a tax

II. The Determinants of Deadweight Loss, p. 129

- The impact of a tax on welfare in a market depends upon elasticity.



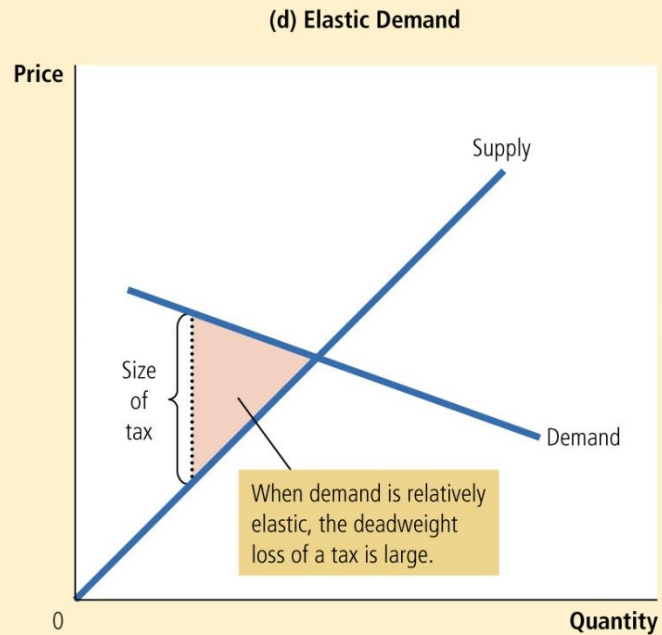
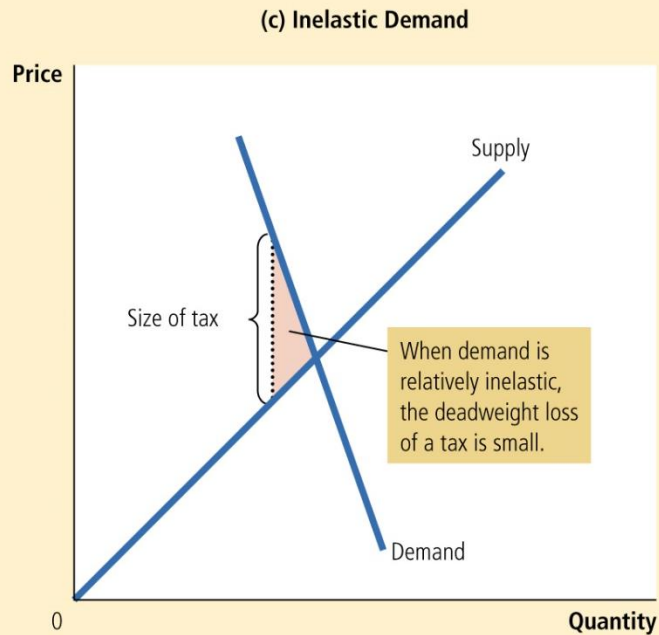
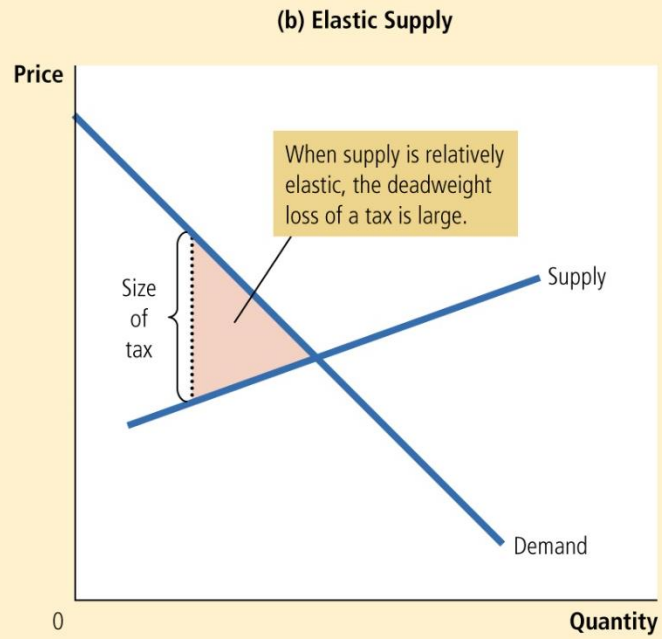
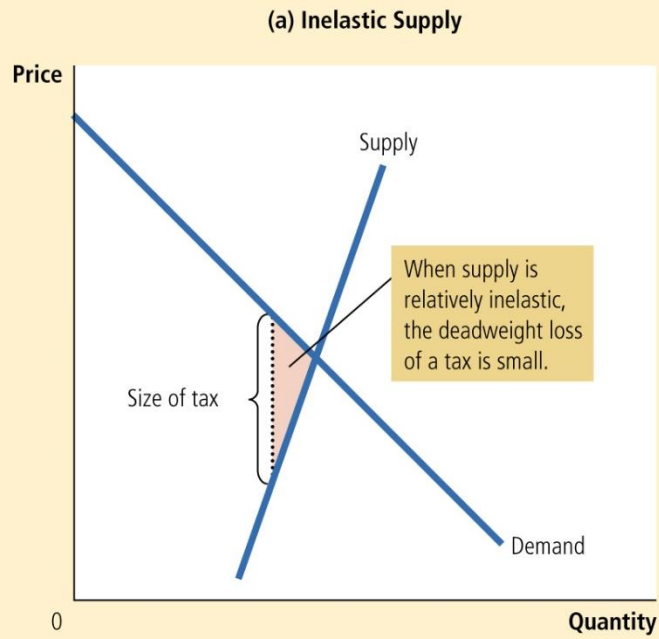
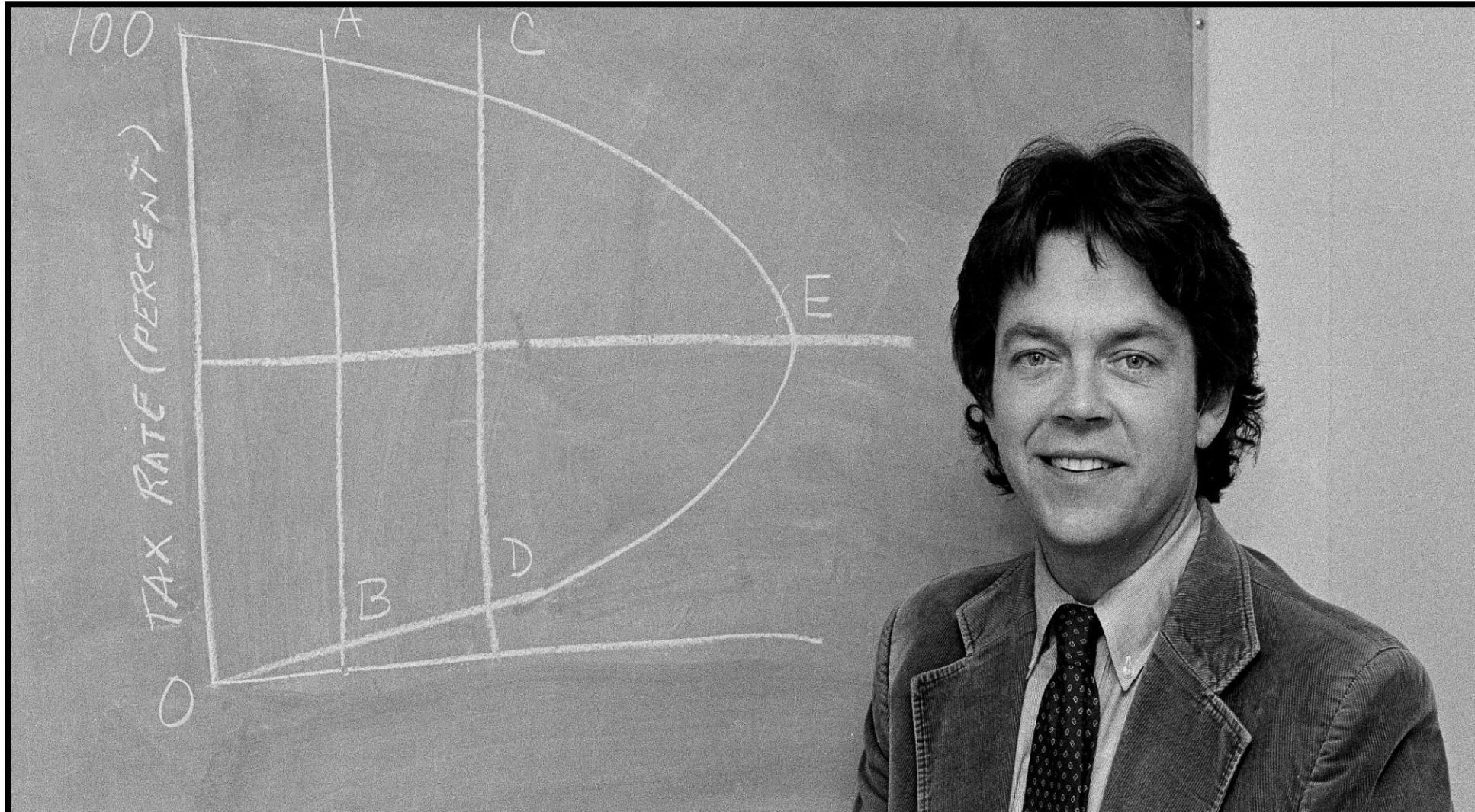


Figure 5
from text, p.129

The more responsive buyers and sellers are to changes in the price, the more the equilibrium quantity shrinks. Hence, the greater the elasticities of supply and demand, the greater the deadweight loss of a tax.

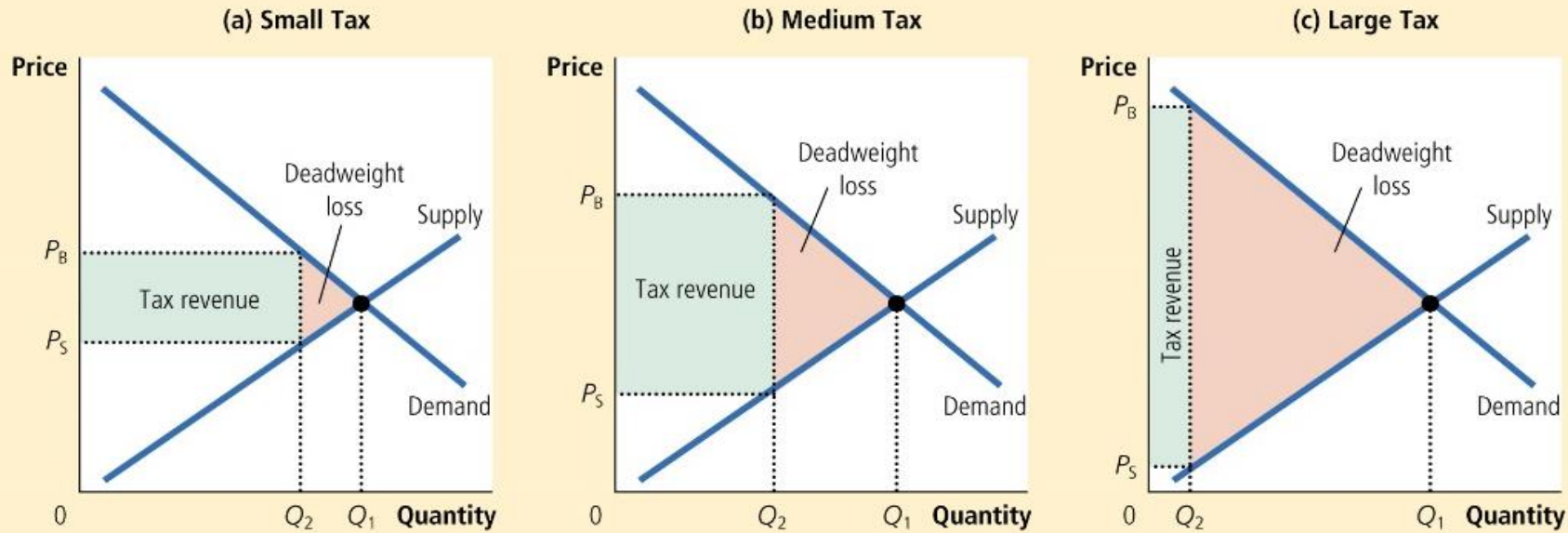
Arthur Laffer

1974 Laffer Curve

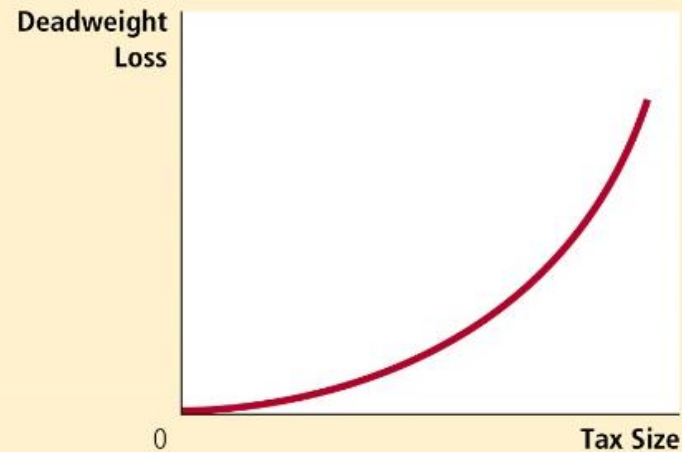


III. Deadweight Loss and Tax Revenue as Taxes Vary.

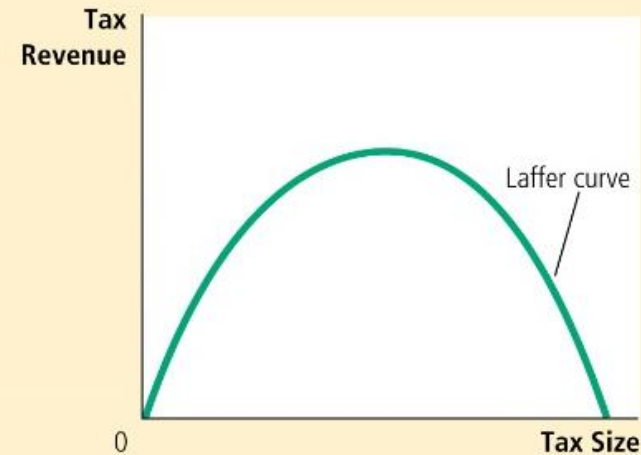
Figure 6 from text, p. 130



(d) From panel (a) to panel (c),
deadweight loss continually increases.



(e) From panel (a) to panel (c), tax
revenue first increases, then decreases.



The Laffer Curve:
illustrates
relationship
between the
tax rate and
tax revenues.



Art Laffer
at UK
September
2017