Analyse the concept of consumer surplus economics essay

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The definition for consumer surplus is the difference between the amount of money money willing to pay by the consumer for a service provided or a good and the actual price paid for the good. Consumer surplus is a measurement to measure the wellfare of fellow consumers who had purchase our products at a certain level of price. The market demand curve tells us how much amount of money is willing to be paid by the consumers at a certain level of price.

The concept of consumer surplus can be explained by the graph above. Assume that there is only one quantity of a good in the market, if the price of good is at P1, the consumer are able to buy one unit of the good. Under this condition, it is assumed that this particular consumer has a relatively strong desire to buy the good at a high price or the consumer has a high income. If the price is lowered from P1 to P2, the consumer might be induced to buy another unit of the good. This condition can also be said that the price reduction has encouraged more consumers to buy the good. Similarly, when the price of good is reduced from P2 to P3, more consumers would buy the good or the first consumer is tempted to buy three units of the good.

The second category would be the producer surplus. Producer surplus is the difference between the price of sellers willing to accept for one unit of good and the price that producers actually receive. The market supply curve would show the amount of units of good that a business would supply at a certain price that might prevail. In other words, the market supply curve tells us the willingness of a producer to accept any amount of quantity of goods demanded in the market.

D

S

P

P3

P2

P1

Q

1

2

3

Lets assume that currently there is only one quantity of good is demanded in the market. In the graph shown above, a certain business is willing to agree to the price P1 when only one unit of good is produced. However, if two units of good is produced, then the minimum price would rose to price P2. If a higher price, P3 of goods supplied is charged, this would induce the business to increase the quantity supplied to 3.

Part B

A production possiblity frontier (PPF) shows the maximum output combination of two goods that can be produced given that we only have

limited resources and technology within a certain period of time. The PPF graph is able to explain several economic concepts, mainly efficiency, opportunity cost and marginal rate of transformation(MRT).

Ceteris paribus, it means that any factor which is related to demand of a certain good must be maintained and fixed. In reality, in order to increase a goods quantity, another good's production has to be sacrificed.

a

Quantity of margarine

b

c

Quantity of butter

Based on the graph above, in order to produce more margarine, the production of butter has to be sacrificed and decreased. Assume that the factors of production of the goods is fixed, to increase the production of margarine would mean that the required resources to produce butter has to be redirected to produce margarine. If the production of the good is efficient, the economy can choose different combinations of outputs of the two products. Hence, every point on the curve are maximum points, it has the maximum output for both products. Which means at these points, the production of goods are efficient. Any point which lies inside of the frontier are inefficient productions. Any point which lies outside the frontier would be unachievable in a short run.

Quantity of margarine

A

-5

B

-10

C

+10

+10

Quantity of butter

If the productive resources remain fixed, increasing the production of good 1 would be impossible, unless production of good 2 decreases. The resources to produce good 1 is transferred to produce good 2. The sacrifice of production of good is known as opportunity cost. Opportunity cost is measured in the number of unit of second good that has been neglected for the first good. The opportunity cost is determined through the shape of the curve and varies depending on the ending and starting point. Based on the graph above, producing 10 more butter would cost the opportunity of margarine by 5 (point A to B). At point C, production of margarine is reduced by 5 to produce 10 more butter (point B to C). But at point B, the economy is close to having the maximum output. The ratio of opportunity cost is determined by the MRT.

A

Quantity of margarine

Quantity of butter

B

Any of the point that lies on the curve of the PPF is called the MRT. It shows how the output of good 1 can be transformed to output of good 2. It is the opportunity cost of X in term of Y at the margin, which is also called as the " opportunity cost" of a commodity. It can also measure the unit of good Y that has been forgone for unit of good X. The shape of PPF is usually drawn as a downward curve to denotes an increasing opportunity cost. Thus as MRT increases, one moves from the top left of the curve to the bottom right. The marginal opportunity cost of margarine in terms of butter is simply the reciprocal of the marginal opportunity cost of butter in terms of margarine. For example, slope at point A is 2, in order to produce extra 1 unit of butter, production of 2 margarine must be sacrificed.