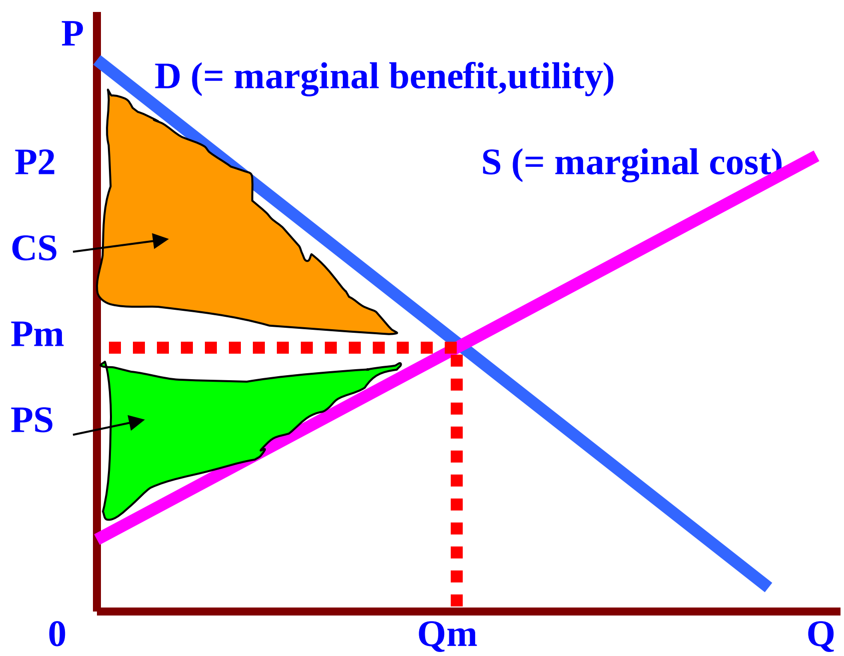
Webnote 204

Big Question: How can we graphically show that the market is the best resource allocation(fop) system?

Syllabus Reference 2.3: Consumer Surplus + Producer Surplus + (Society/Community Surplus)

Consumer / surplus (CS) is the difference in price that the consumer is willing to pay as distinct from the market price. In the diagram opposite then the consumer is willing+ able to pay a higher price e.g. p2 but the consumer only pays the market price so this is a clear gain / surplus for the consumer.

Producer surplus (PS) is where the producer receives a market price above prices that firm is willing to supply. So firm gains a surplus in this case.
Social/Community surplus is the addition of CS + PS.



See also webnote 135 and the concept of 'deadweight loss'

(syllabus 2.3)

Notes:

- Pm = equilibrium price or clearing price agreed between the consumer and the producer
- CS = benefit to consumer, Pm < ability to pay
- PS = benefit to producer, Pm > willingness to supply
- CS +PS = CS, (community surplus) This is important as at Pm community surplus is maximized.
- This is why the market is desirable and can allocate resources effectively as both consumer and producer benefit