

OUTLINE — September 18, 2019

- Price Mechanism
 - The Normative Question
 - Non-price rationing mechanisms
- Price Ceilings & Price Floors
- Consumer & Producer Surplus
- Taxes, Burdens, and Deadweight Loss

*Midterm #1: Wed Oct 2, 7-8:30 pm, two weeks from today
Read the old midterms yet?*

Video (link in syllabus) expands on last item above

Bottled Water after Katrina



Price Mechanism Ceilings & Floors Consumer & Producer Surplus Taxes

Fairness of distribution (equity)

- Normative economic analysis
- “Price-gouging”

Price Mechanism Ceilings & Floors Consumer & Producer Surplus Taxes

Bottled H₂O: Utility or Ability to Pay?

- Utility
 - A measure of satisfaction we derive from consuming a good
- If I'm willing to pay \$20 and you're willing to pay \$1, do I necessarily derive more utility?

Price Mechanism Ceilings & Floors Consumer & Producer Surplus Taxes

Who gets bottles of water?

- Price rationing
- Non-price rationing

Price Mechanism Ceilings & Floors Consumer & Producer Surplus Taxes

Need non-price rationing: Price Ceiling



Price Mechanism **Ceilings & Floors** Consumer & Producer Surplus Taxes

Need non-price rationing: Price Floor



Price Mechanism **Ceilings & Floors** Consumer & Producer Surplus Taxes

Consumer Surplus

- Compares
 -
 -
- *Difference* between the two is called “*consumer surplus*” (CS)

NOTE!!! This is **different** definition of “*surplus*” than “*market surplus* = $q_s - q_d$ ”

Price Mechanism Ceilings & Floors **Consumer & Producer Surplus** Taxes

Consumer Surplus



Price Mechanism Ceilings & Floors **Consumer & Producer Surplus** Taxes

Producer Surplus

- Compares
 - **Minimum** price sellers are willing to accept
 - Price sellers actually receive
- *Difference* between the two is called “*producer surplus*” (PS)

Price Mechanism Ceilings & Floors **Consumer & Producer Surplus** Taxes

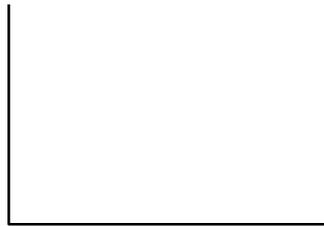
Producer Surplus



Price Mechanism Ceilings & Floors **Consumer & Producer Surplus** Taxes

Markets Maximize Total Surplus

- When price is determined by the market, total surplus is maximized



Price Mechanism Ceilings & Floors **Consumer & Producer Surplus** Taxes

Effect of a Tax Increase

- Sales or excise tax
 - If tax is remitted to government by **seller**
 - If tax is remitted to government by **buyer**
- *Same result either way*

Price Mechanism Ceilings & Floors Consumer & Producer Surplus **Taxes**

Effect of a Tax Increase

- Sales or excise tax



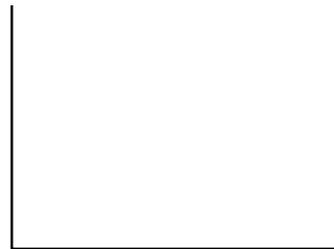
Price Mechanism Ceilings & Floors Consumer & Producer Surplus **Taxes**

Burden of a Tax

- Tax on an item increases its price
 - But not by the full amount of the tax
- Who “bears the (greater) burden” of the tax?
 - Definition: Burden = % of tax paid

Price Mechanism Ceilings & Floors Consumer & Producer Surplus **Taxes**

Slopes and “who bears burden”



Price Mechanism Ceilings & Floors Consumer & Producer Surplus **Taxes**

