CONSUMER SURPLUS

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- Consumers buy goods because it makes them better off (or provide utility). Consumer Surplus measures how much better off they are.
- Consumer Surplus
  - from each unit: The amount a buyer is willing to pay for a good minus the amount the buyer actually pays for it.

CONSUMER SURPLUS AND DEMAND

- Consumer surplus for a given quantity is therefore the difference between your maximum willingness to pay (reservation price) and what you actually paid (actual price).
- CS = the sum of the difference between MB and MC (price) for all units consumed

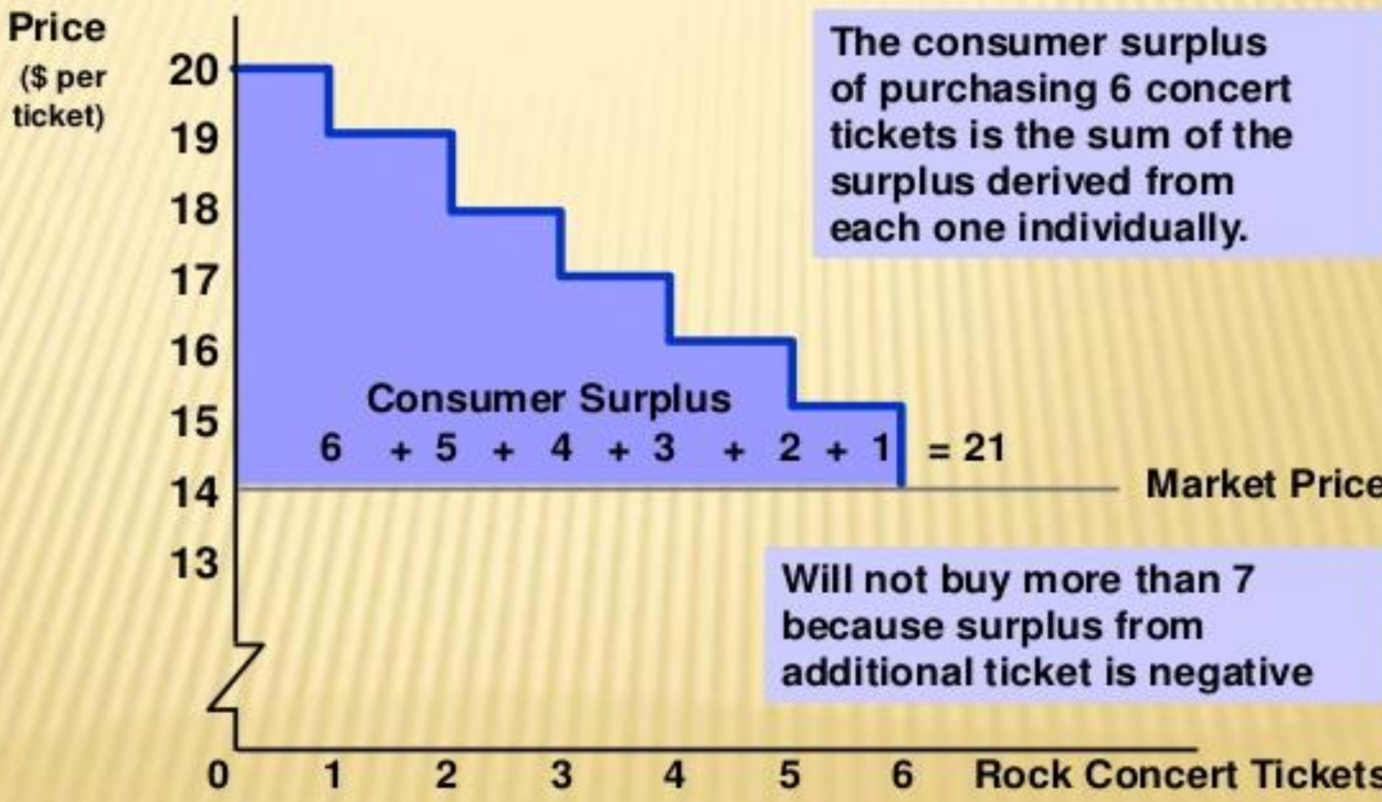
CONSUMER SURPLUS EXAMPLE

- What happens when you purchase something for a price that is less than your maximum willingness to pay?
- E.g. you are willing to pay $20,000 for a new car and you buy it for 18,000
- You receive a “surplus” of benefit over cost = $2,000

CONSUMER SURPLUS - EXAMPLE

- Assume a student wants to buy concert tickets.
- Demand curve tells us the student's willingness to pay for each concert ticket
  - 1st ticket worth $20 but price is $14 so student generates $6 worth of surplus.
  - We can measure this for each ticket.
  - Total surplus is sum of surplus from each ticket purchased.

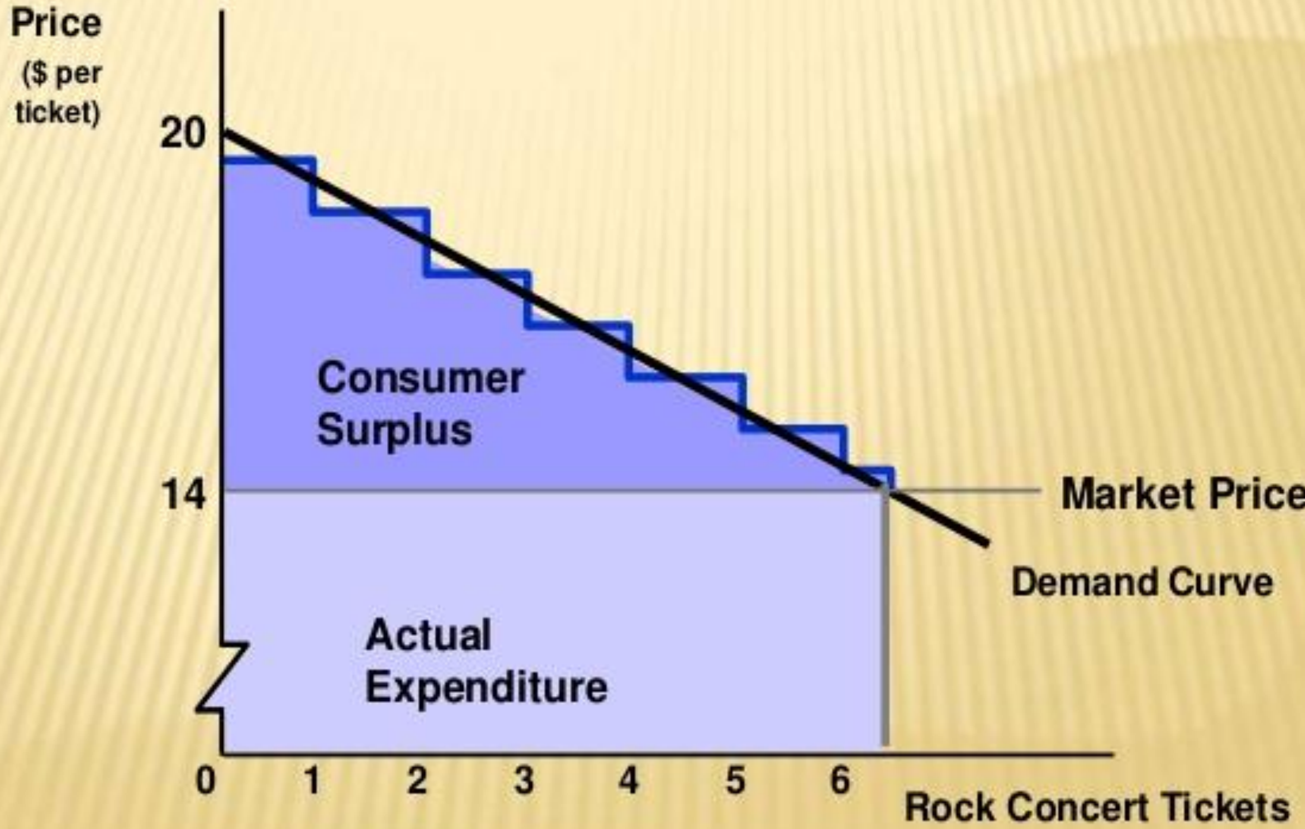
CONSUMER SURPLUS - EXAMPLE



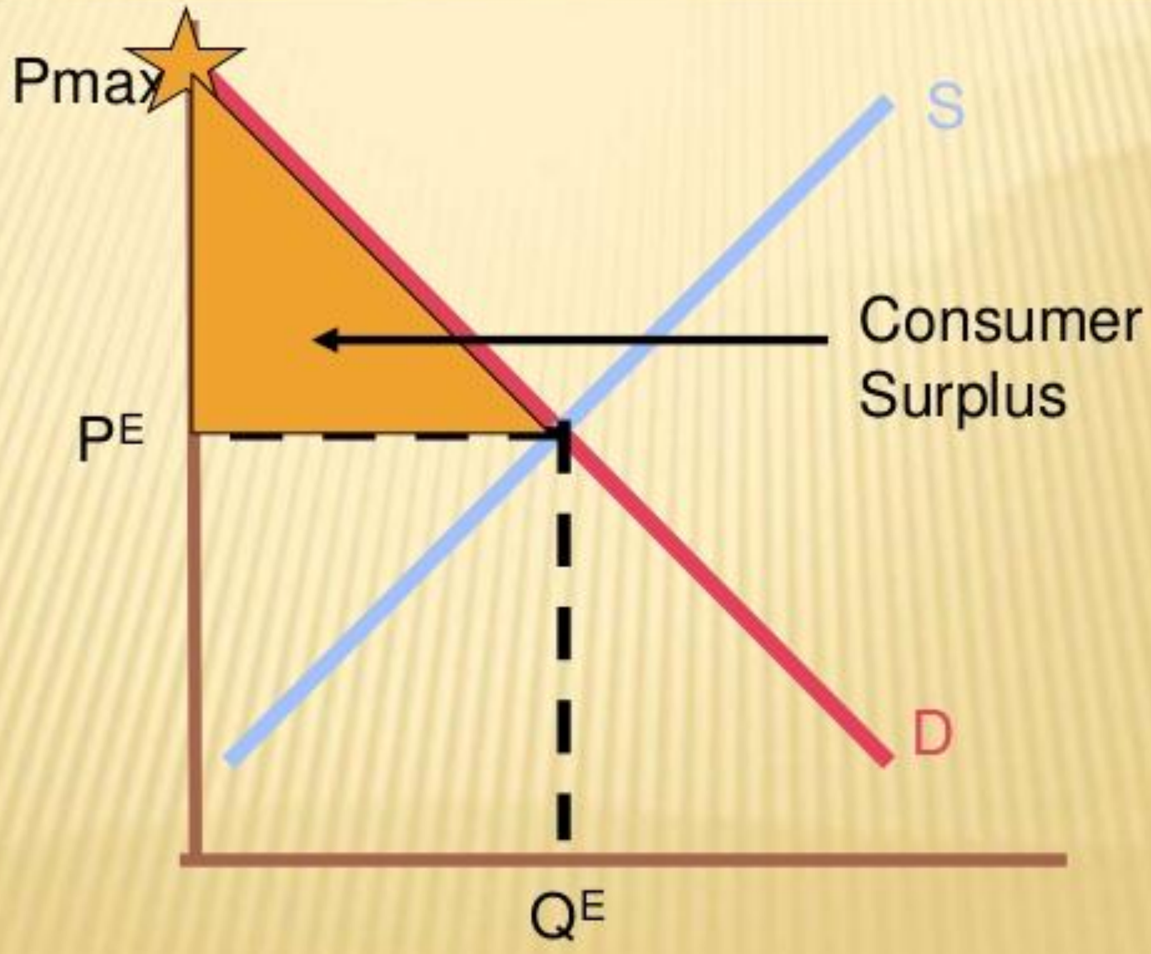
CONSUMER SURPLUS

- The stepladder demand curve can be converted into a straight-line demand curve by making the units of the good smaller.
- Consumer surplus measures the total net benefit to consumers = total benefits from consumption minus the total expenses.
- Thus, consumer surplus is area under the demand curve and above the price.
- Note that the area under the demand curve up to the level of consumption measures the total benefits.

CONSUMER SURPLUS



CONSUMER SURPLUS: GRAPHICAL



CONSUMER SURPLUS AND MARKET PRICE

- A *lower market price* will usually increase consumer surplus.
- A *higher market price* will usually reduce consumer surplus.

- Consumer surplus will be smaller when the demand curve is more elastic and larger when the demand curve is inelastic.

CRITICISM

- Concept is hypothetical, imaginary and illusory.
- It ignores the interdependence between the goods.
- It is based on the questionable assumptions of cardinal measurability of utility and constancy of marginal utility of money