

Quadrant II – Notes

Programme: B. Sc. (Hons.) Agri.

Subject: Agricultural Economics

Course Code: ECON-121

Course Title: Fundamentals of Agricultural Economics

Module Name: Consumer's Surplus - Meaning, Assumptions, Explanation, Difficulties in measuring Consumer's Surplus, Importance. Ordinal Approach-Consumer's equilibrium, indifference curve analysis

Module No: 8

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Notes :

CONSUMER'S SURPLUS

Importance:

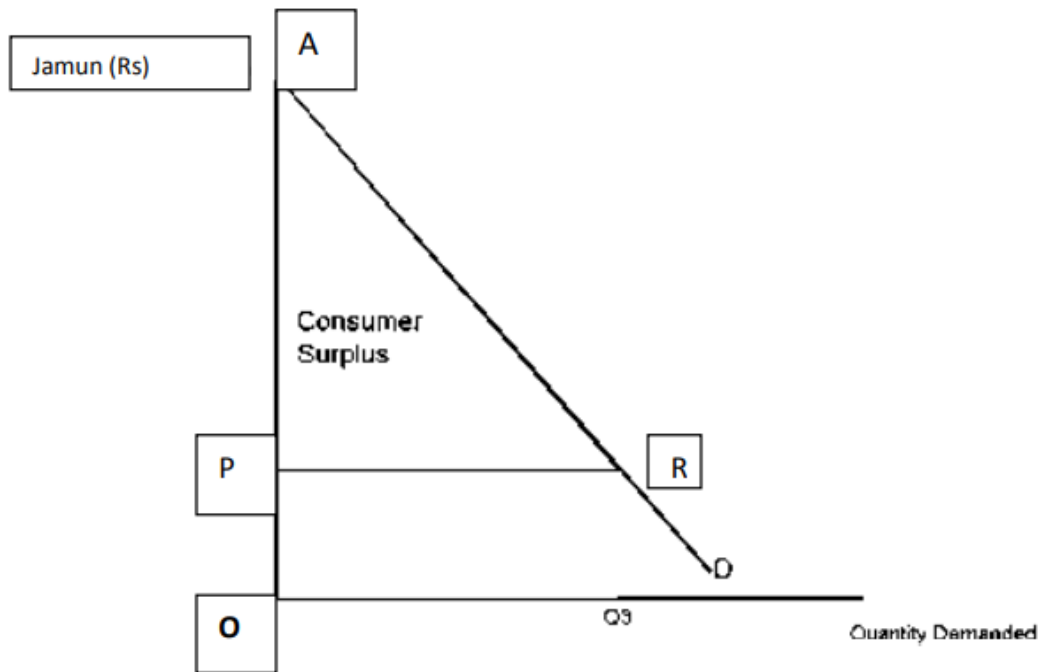
The concept of consumers surplus is based on the theory of demand. It was introduced by Marshall in 1895 in his publication „principles of economics. “

According to Marshall consumer's surplus is “the excess of the price which he would be willing to pay rather than go without the thing, over that which he actually does pay, is the economic measure of this surplus satisfaction”. In brief, consumers surplus is the difference between what the consumer is willing to pay and what he actually pays.

Assumptions:

1. Marginal utility of money for the consumer is assumed to be the same throughout the process of exchange.
2. Commodity does not have substitutes

3. In the market at the given point of time, there are no differences of income, tastes, preferences and fashions among the consumers and
4. Each commodity is considered independent of others.



Consumer's surplus is represented diagrammatically Price per units is OQ. At this price, the consumer will demand OQ quantity of commodity, he will get total satisfaction equal to the area OQRA, and thus gets a surplus satisfaction equal to PRA (OQRA – OQRP). Thus, surplus satisfaction has been defined as consumer's surplus.

Difficulties in measuring Consumer's Surplus:

1. The cardinal measurement of utility is difficult because it is close to impossible for a consumer to say that the first unit of commodity gave him 10 units of satisfaction and the second unit of commodity gave him 5 units of satisfaction.
2. Marginal utility for the same commodity is different to different consumers. Marginal utility for a particular commodity varies from person to person depending upon their income, tastes and preferences.

3. Existences of substitutes: In the real world a number of substitutes for a commodity exist, thus making the work of measuring consumer's surplus a complicated task.

4. Marginal utility of money is not constant: Marshall based his concept of consumer's surplus on the simplifying assumption that the marginal utility of money is constant. As the consumer buys more and more units of a commodity x, the amount of money with him diminished, in this case, the marginal utility of money is bound to increase rather than remain constant.

5. Lack of awareness of different price: It is not possible for a consumer to be aware of the entire demand schedule.

Importance of Consumers Surplus

1. Conjunctural Importance: When the people enjoy larger consumer's surplus, it does not indicate that they are better off. Thus it serves as an index of economic betterment.

2. Useful to the Monopolist: The monopolist can freely raise the price of the goods if they bring in higher consumer's surplus, without any fear of foregoing the sales.

3. Helps in Public Finance and Taxation: More taxes can be imposed by the government to get more revenue, on those goods for which consumer's surplus is high.

4. Helps to measure benefits from International Trade: International trade implies transaction of commodities across the frontiers. Generally, those commodities which happen to be cheaper in the foreign markets are imported thereby resulting in higher consumer's surplus of satisfaction for the commodity.