

As you know, the equilibrium we will see in this market, absent any distortions, will be  $P^*$  and  $Q^*$ . Before you begin, you should shade in CS, PS, and total GFT for this case.

Now, suppose due to government intervention, we find out the market price turns out to be  $P_3$ , and the quantity turns out to be  $Q_1$ .

1. Which area(s) represents
  - a. consumer surplus. Have consumers gained or lost? (compared to  $P^*$  and  $Q^*$ )
  - b. producer surplus. Have producers gained or lost? (compared to  $P^*$  and  $Q^*$ )
  - c. DWL. Has society gained or lost? (compared to  $P^*$  and  $Q^*$ )
2. Compared to the undistorted equilibrium ( $P^*$  and  $Q^*$ ), which area(s)
  - a. Represents the surplus transferred directly from consumers to producers?
  - b. the surplus that is lost by consumers who can no longer purchase the good?
  - c. the surplus that is lost by producers due to the restriction of trade?

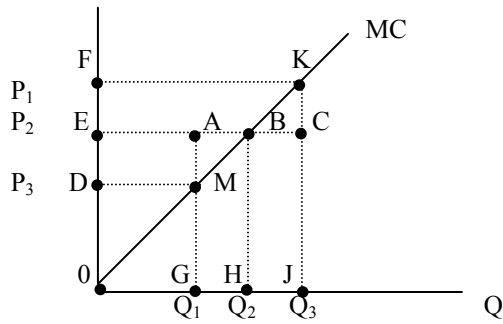
As you know, the equilibrium we will see in this market, absent any distortions, will be  $P^*$  and  $Q^*$ .

Suppose due to government intervention, we find out the market price turns out to be  $P_1$ , and the quantity turns out to be  $Q_1$ .

3. Which area(s) represent
  - a. consumer surplus. Have consumers gained or lost (compared to  $P^*$  and  $Q^*$ )?
  - b. producer surplus. Have consumers gained or lost? (compared to  $P^*$  and  $Q^*$ )
  - c. DWL. Have consumers gained or lost? (compared to  $P^*$  and  $Q^*$ )
4. Compared to the undistorted equilibrium, which area
  - a. represents the surplus transferred directly from producers to consumers who can still get to consume the good?
  - b. the surplus that is lost by consumers who can no longer purchase the good?
  - c. the surplus that is lost by producers due to the restriction of trade?
5. At  $Q_1$ , how does MV compare to MC? Explain how people could be made better off.
6. Suppose for some reason, we were at  $Q_3$ . How does MV compare to MC? What should we do?

cs\_practice

Suppose the firm shown below can sell as many units of the good as it wants at a price of  $P_2$ .



Match the area with the description (Hint: area under a marginal curve is a total).

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|--|----------|
| 1. The TC of producing $Q_1$ units.                                    | A. HBCJ  |
| 2. The TR of producing $Q_1$ units.                                    | B. OMG   |
| 3. The TC of producing $Q_3$ units.                                    | C. OECJ  |
| 4. The TR of producing $Q_3$ units.                                    | D. OKJ   |
| 5. The TC of producing only those units between $Q_2$ and $Q_3$ units. | E. GABH  |
| 6. The TR of producing only those units between $Q_2$ and $Q_3$ units. | F. GMBH  |
| 7. The TC of producing only those units between $Q_1$ and $Q_2$ units. | G. OEAG  |
| 8. The TR of producing only those units between $Q_1$ and $Q_2$ units. | H. HBKJ. |

By the way, using our decision rule, does comparing #7 and #8, and then comparing #5 and #6 help you to understand the decision rule for supply?