Question #61220, Economics, Other

Explain what will happen to consumer and producer surplus and deadweight loss if the government imposes a tax on sellers for each radio they produce in order to raise government income? Include in your answer an explanation of the three concepts – consumer surplus, producer surplus and deadweight loss. (With graph) (300words).

Answer:

If the government puts a tax on each radio that sellers produce, the outcome will be negative for both sellers and buyers. The consumer surplus will shrink and the producer surplus will also shrink. As the two surpluses shrink, deadweight loss increases.

Consumer surplus and producer surplus are essentially mirror images. Consumer surplus is the difference between what consumers actually pay for a good or service and what they would be willing to pay. Producer surplus is the difference between the amount the producer actually receives when they sell a good or service and the minimum amount they would be willing to accept. You can see these on a supply-demand graph if you draw a horizontal line from the equilibrium price over to the y-axis. The area between the line and the demand curve is the consumer surplus and the area between the line and the supply curve is the producer surplus (Figure 1).

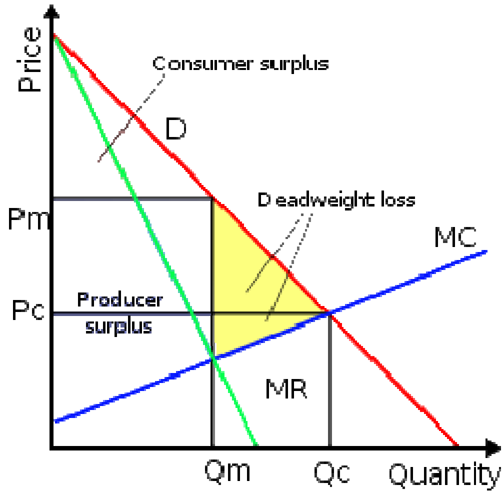

Figure 1 – Consumer and producer surplus

If a tax is imposed, both surpluses shrink. The consumer pays a higher price and does not get as much product as if there were no tax. The producer produces less and gets less money than if there were no tax. In these ways, their respective surpluses both shrink. When this happens, instead of consumer surplus or producer surplus, you get deadweight loss, which is the cost to society (the consumers and producers) of the economic inefficiency created by the tax.