

NP 302

At page 22, Dr. Wilson states “rates which reflect marginal cost responsibility are more allocatively efficient and better embody the principles of fairness, equity and causal responsibility....” Why does Dr. Wilson think marginal cost-based rates are more fair than embedded cost-based rates, and does Dr. Wilson believe most of society shares that opinion?

RESPONSE:

A price equal to the marginal cost of a product requires buyers to pay a price equal to the cost incurred or saved by supplying one more or one less unit of the product. In this way sellers are not required to produce additional units that provide less benefit than they cost to produce; buyers are not encouraged to consume additional units that provide less benefit than they cost to produce; sellers will continue to produce additional units as long as the benefits derived from each additional unit exceed production costs; and buyers will not be denied additional consumption, the benefits of which exceed the cost of production. In addition, production resources will be allocated among products so as to maximize society’s aggregate economic welfare (i.e., total benefits minus total costs). These fundamental principles are virtually unexceptional and

universally accepted as the key underpinnings of allocative efficiency and economic welfare maximization.