

# APPENDIX A

# PRICE THEORY AND APPLICATIONS

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Decisions, Markets, and Information

SEVENTH EDITION

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Market share by group size, medical practice

Group size	1965	1969	1975	1980
1-2	84.69%	78.25%	68.67%	67.45%
3-7	8.37%	11.53%	13.31%	13.14%
8-25	4.30%	5.09%	8.53%	7.78%
26-99	1.33%	3.00%	5.08%	4.66%
100+	1.31%	2.12%	4.42%	6.97%
Total	100%	100%	100%	100%

Sources: Frech and Ginsberg, p. 30; Marder and Zuckerman, p. 167.

The data in the table can be interpreted quite differently, depending on whether a *static* or *dynamic* viewpoint is adopted. From the static point of view, even in 1980 most of the market consisted of single-physician or two-physician groups. This suggests that small size must indeed be the most efficient in medical practice. On the other hand, these sizes declined relative to all others. So it appears that, *on the margin*, larger firms have been more profitable. New entrants have found it profitable to form larger groups, whereas exiting firms have come disproportionately from the one-to-two-physician category.

A possible explanation is that in any period there is an efficient *mixture* of firm sizes. Even though one-physician and two-physician firms may on the whole be most efficient, in recent years there may have been relatively too many firms of these sizes. So market shares have shifted in favor of the larger groups.

<sup>a</sup> H. E. Frech III and P. Ginsberg, "Optimal Scale in Medical Practice: A Survivor Analysis," *Journal of Business*, v. 47 (January 1974), p. 30.

<sup>b</sup> William D. Marder and Stephan Zuckerman, "Competition and Medical Groups: A Survivor Analysis," *Journal of Health Economics*, v. 4 (June 1985), p. 167.

### 7.3 THE BENEFITS OF EXCHANGE: CONSUMER SURPLUS AND PRODUCER SURPLUS

One of the most important principles of economics is *The Fundamental Theorem of Exchange*:

**PROPOSITION:** Trade is mutually beneficial.

Voluntary exchange benefits all parties involved. An alternative, mistaken view might be called "the exploitation theory" – the idea that what one side gains in exchange is a loss to the other side. The proof of the Fundamental Theorem of Exchange, and disproof of the exploitation theory, is elementary. In voluntary exchange between rational persons, both sides must expect to gain. True, owing to mistakes or trickery, one or both participants might lose out. However, if beliefs are not systematically mistaken, the proposition remains true.

But *how much* does each side gain from trade? As explained in Chapter 3, economists do not generally believe it possible to compare one person's utility with another person's. So it would be helpful to have a way of measuring the benefits of trade in objective units, independent of subjective utilities. Consumer Surplus and Producer Surplus are such measures. In Figure 7.7 the market supply-demand equilibrium is at price  $P^*$

