

Answer on Question #38254 – Economics - Microeconomics

In economics, a deadweight loss (also known as excess burden or allocative inefficiency) is a loss of economic efficiency that can occur when equilibrium for a good or service is not Pareto optimal.

Causes of deadweight loss can include monopoly pricing (in the case of artificial scarcity), externalities, taxes or subsidies, and binding price ceilings or floors (including minimum wages). The term deadweight loss may also be referred to as the "excess burden" of monopoly or taxation.

Conversely, deadweight loss can also come from consumers buying a product even if it costs more than it benefits them. To describe this, let's use the same nail market, but instead it will be perfectly competitive, with the government giving a 3 cent subsidy to every nail produced. This 3 cent subsidy will push the market price of each nail down to 7 cents. Some consumers then buy nails even though the benefit to them is less than the real cost of 10 cents. This unneeded expense then creates the deadweight loss: resources are not being used efficiently.

The deadweight loss is the area of the triangle formed by the grey tax income box (to the right of it), the original supply curve, and the demand curve. This is sometimes called Harberger's triangle.

If the price of a glass of wine is \$3.00 and the price of a glass of beer is \$3.00, a consumer might prefer to drink wine. If the government decides to levy a wine tax of \$3.00 per glass, the consumer might prefer to drink beer. The excess burden of taxation is the loss of utility to the consumer for drinking beer instead of wine, since everything else remains unchanged.