

ECONOMICS 2321 – UNIT TWO (CHAPTERS 6-7-8)

CHAPTER 6:

Mankiw introduces two examples of interferences with the market mechanism: (1) price controls and (2) the imposition of an excise tax. He shows that the result is a price signal that is not the normal market-clearing price signal, and reduced output. The implication is that such interference is not a good idea, but other than reduced level of economic activity, at this point we are not told any more.

CHAPTER 7:

Mankiw asks, “Well, what’s so great about the market anyway? Why should we be concerned when its results are distorted as in Chapter 6?” He then introduces the concepts of Consumer Surplus and Producer Surplus as the method of explaining why the unfettered (not-interfered-with) market outcome is the best outcome. The discussion quoting Adam Smith shows that this is a long-standing viewpoint among economists.

CHAPTER 8:

It appears that we are going back to taxes again. In fact, it appears that Chapter 8 is just an extension of Chapter 6 on taxes – all the terminology should be familiar. But now we know how to think about the benefits of the market in terms of Consumers Surplus and Producers Surplus, and we can in a sense “measure” the loss accompanying the interference with the market. This loss is called “deadweight loss” and is the benefit that we no longer receive in terms of gaining Consumer Surplus. Please note that the same kind of demonstration could be done if Chapter 8 dealt with the interference of prices controls rather than taxes.