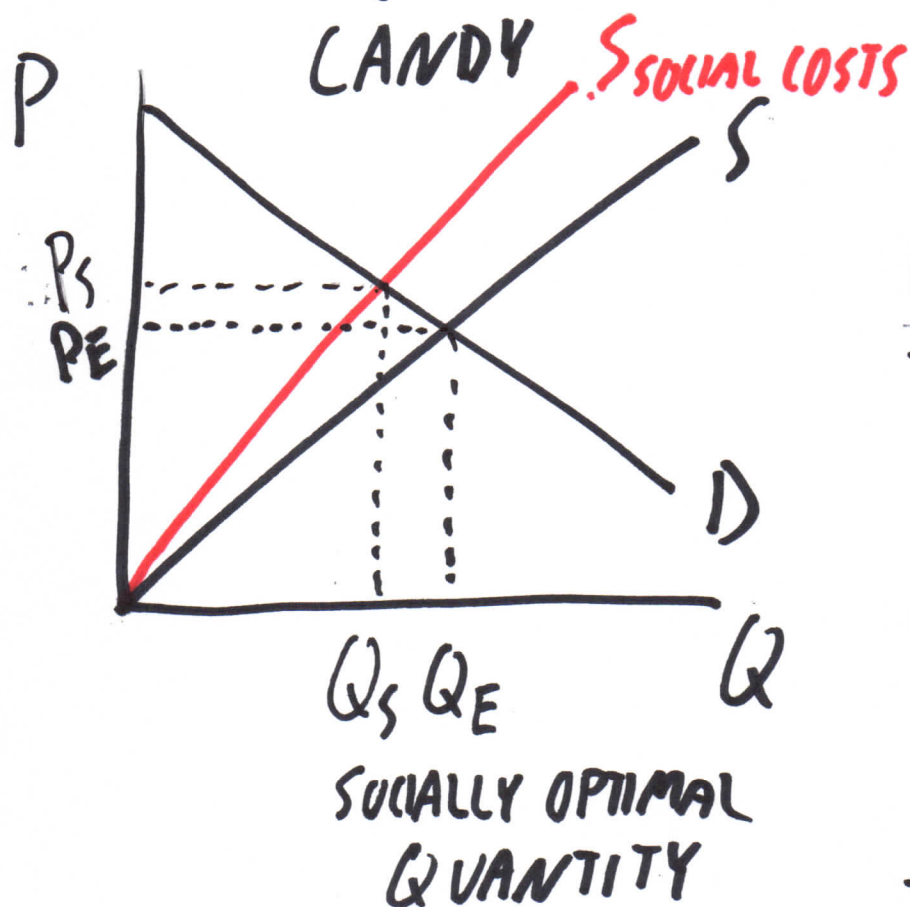


(H. 10) EXTERNALITIES

- UNCOMPENSATED IMPACT OF ONE INDIVIDUAL (OR FIRM'S) ACTIONS ON A BYSTANDER

NEGATIVE EXTERNALITY

- POLLUTION

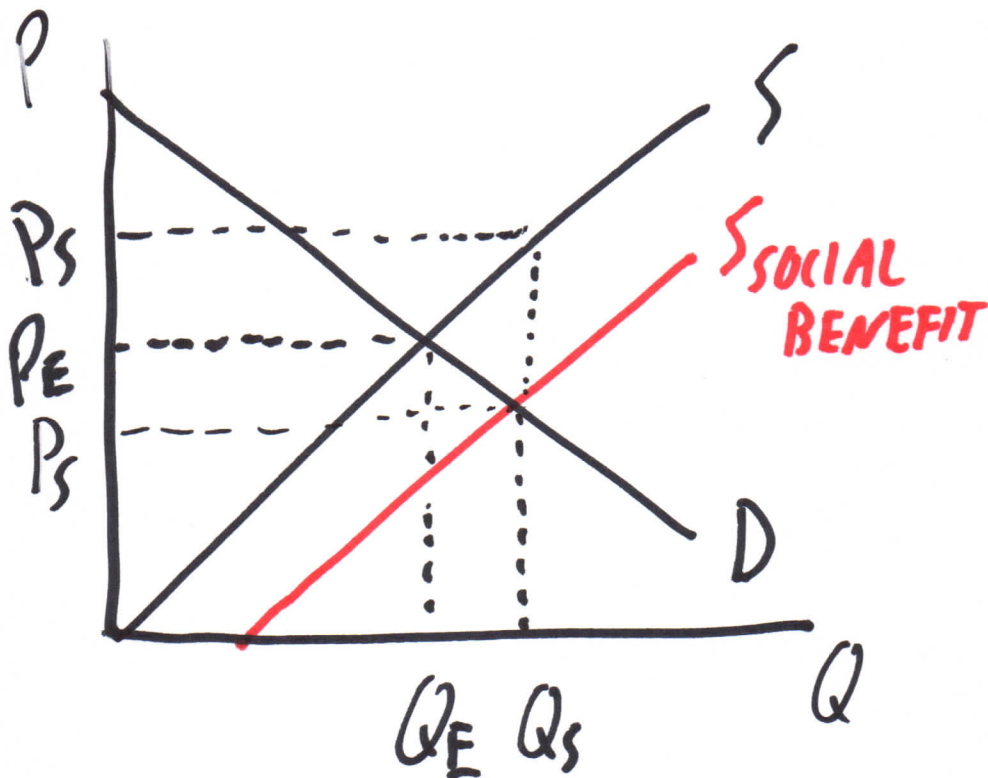


PIGOU TAX

- TAX NEGATIVE EXTERNALITIES UNTIL SOCIALLY OPTIMAL Q IS ACHIEVED
- INTERNALIZE THE EXTERNALITY

POSITIVE EXTERNALITY

- EDUCATION
- WEEDS + PESTS / vs PRETTY LAWN
- STARBUCKS SMELL



SUBSIDIZE POSITIVE EXTERNALITIES

RONALD COASE

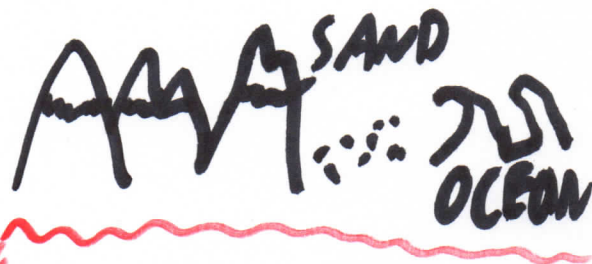
COASE THEOREM - PRIVATE INDIVIDUALS

CAN INTERNALIZE EXTERNALITIES
WITH BRIBES

, IF THERE ARE NO BARGAINING COSTS

, IF THERE ARE CLEAR PROPERTY
RIGHTS

FENCE EXAMPLE



FENCE COSTS \$1000

FENCE

HOUSE A

WOOF

HOUSE A VALUES FENCE
AT \$1200

HOUSE B

HOUSE B VALUES UNOBSTRUCTED
VIEW AT ~~\$1200~~ \$500

WORLD VALUE OF FENCE? \$1200

-1000

IDEALLY NO FENCE
IS BUILT

-500

-300

HOUSE A REQUIRES A BRIBE > 200

HOUSE B BRIBES NO MORE THAN \$500

- NO ~~BRIBE~~ FENCE IS BUILT

(H. 10) EXTERNALITIES

METHODS OF INTERNALIZING EXTERNALITIES

- ① TAX NEGATIVE EXTERNALITIES
SUBSIDIZE POSITIVE EXTERNALITIES

- PROBLEM: DIFFICULT TO
DETERMINE SOCIAL COST OR
SOCIAL BENEFIT

- ② REGULATION

- PROBLEM: NOT EFFICIENT

- ③ TRADEABLE PERMITS
(LIMIT QUANTITY TO SOCIALLY
OPTIMAL LEVEL)

- PROBLEM: SOCIALLY OPTIMAL
QUANTITY?