

CONCEPT: EXTERNALITIES – SOCIAL BENEFITS AND SOCIAL COSTS

- Sometimes a market transaction can impose a cost or benefit on “innocent bystanders.”

□ A **negative externality** () imposes an _____ on “innocent bystanders.”

- The _____ cost is borne by the producer of the good.
- The _____ cost is the full cost, including the private cost and the external cost.
- The **marginal social cost curve** includes all private and external costs in a transaction.



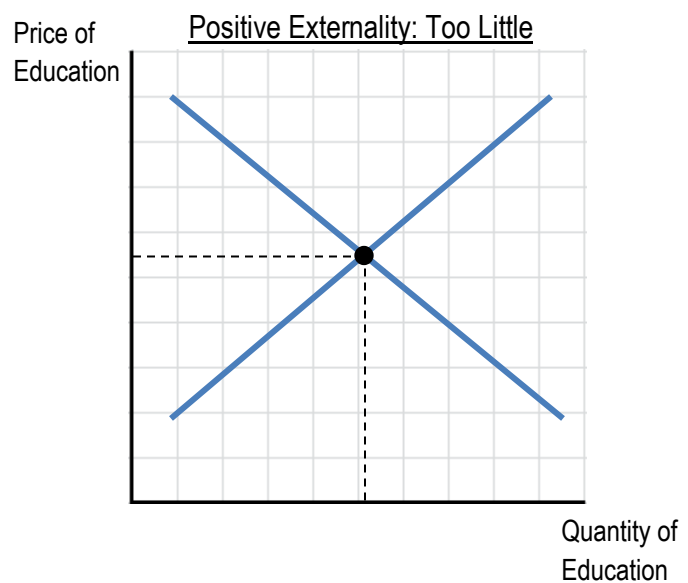
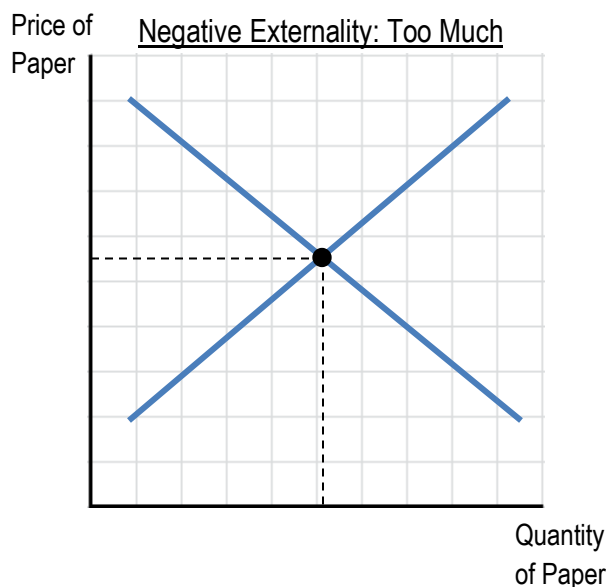
Paper Production		Dog	
<u>Private Cost</u>	<u>External Cost</u>	<u>Private Cost</u>	<u>External Cost</u>

□ A **positive externality** () creates an _____ for “innocent bystanders.”

- The _____ benefit is received by the consumer of the good.
- The _____ benefit is the full benefit, including the private benefit and the external benefit.
- The **marginal social benefit curve** includes all private and external benefits in a transaction.



Vaccinations		Education	
<u>Private Benefit</u>	<u>External Benefit</u>	<u>Private Benefit</u>	<u>External Benefit</u>



- Externalities cause **market failures** because the supply and demand curves do not fully reflect cost and benefit.
 - Overproduction () / Underproduction ()
 - Deadweight Loss
- Externalities exist when _____ are difficult to enforce or not clearly defined.

PRACTICE: Which of the following is an example of a positive externality?

- a) Jim hires Dwight to trim the hedges at his house. Jim pays Dwight \$100 for the service.
- b) While trimming the hedges, Dwight's tools emit smoke that Jim's neighbor, Pam, has to breathe.
- c) Jim's freshly cut hedges make the neighborhood more beautiful.
- d) Jim's community manager will pay him if he promises to keep his hedges trimmed on a regular basis.

PRACTICE: If the production of a good causes a negative externality, then the social-cost curve will lie _____ the supply curve, and the socially optimal quantity is _____ than the equilibrium quantity.

- a) Above; Greater
- b) Above; Less
- c) Below; Greater
- d) Below; Less

PRACTICE: Which of the following is true about externalities?

- a) Positive externalities are efficient, but negative externalities are not efficient
- b) Negative externalities are efficient, but positive externalities are not efficient
- c) Both positive and negative externalities are efficient
- d) Both positive and negative externalities are not efficient