CONCEPT: PRIVATE SOLUTIONS TO EXTERNALITIES

● According to the *Coase theorem*, parties can <u>privately</u> reach an efficient solution to externalities if:

    ☐ Property rights are clearly defined <u>AND</u>

    ☐ Transaction costs are low

        - Time   - Money   - Coordination   - Other Resources

EXAMPLE: The barking dog

Owner's benefit of owning a dog:	Owner's benefit of owning a dog:	Owner's benefit of owning a dog:
Neighbor's cost because of loud dog:	Neighbor's cost because of loud dog:	Neighbor's cost because of loud dog:
Property Rights Regarding Noise:	Property Rights Regarding Noise:	Property Rights Regarding Noise:
Possible Coase Theorem Solution:`	Possible Coase Theorem Solution:	Possible Coase Theorem Solution:

<u>Note</u>: It doesn't matter which party has the property rights, an efficient outcome is still reached.

PRACTICE: A key element of the Coase theorem is:

    a) The ability to negotiate at a minimal cost

    b) That externalities occur in the production and consumption of all products

    c) That there are no efficient solutions to the problems caused by externalities

    d) None of the above

PRACTICE: Which of the following is not a way of dealing with externalities?

    a) Internalization

    b) Raising taxes

    c) Increasing competition

    d) Creating an additional market

PRACTICE: If the assumptions of the Coase theorem are satisfied, then

a) The externality problem is resolved.

b) The assignment of property rights does not matter for efficiency.

c) There are no coordination and motivation problems.

d) There is no role for the government.

PRACTICE: It is possible to remedy a positive externality by:

a) Introducing a tax

b) Introducing a subsidy

c) Doing nothing because it is good to have positive externalities

d) None of the above

PRACTICE: The socially optimal level of pollution:

a) Is zero.

b) Is constant.

c) Is above zero.

d) None of the above