

Tut 6 – Externalities

- Externalities
 - Positive – implies not enough is consumed/produced
 - Negative – implies too much is consumed/produced
 - Can be \wedge but externalities are never good
- Private marginal Cost/benefit
 - Usually \rightarrow PMC is drawn like SC; PMB drawn like DC
- Social SMC and SMB
 - Is usually a theoretical line
 - \rightarrow DO NOT DRAW OR SHIFT CURVE to SMC/SMB
 - Especially if:
 - Externality does not internalise = nothing is being done with the externality therefore **do not shift the curve**
 - **DO NOT LABEL IT AS A SHIFT IT IS JUST ANOTHER GRAPH**
 - **Is actually two graphs PMC+PMB and then PMC+SMB**
 - \rightarrow ONLY SHIFT CURVE IF TOLD TO TRY FIX THE EXTERNALITY
 - Normally the gov. is the one that tries to fix externalities
- Solutions to Consumption Externalities (implies demand)
 - Positive
 - SMB vertically above PMB
 - E.g. Vaccines
 - Buyer's +ve Externality \rightarrow not enough consumed
 - Solution: Per unit subsidy
 - Incentive to consume
 - Dead weight loss (triangle with the two bottom points of the old and new equilibrium)
 - If buyers/seller causing the externalities \rightarrow penalise buyers/sellers
 - Negative
 - SMB vertically below PMB
 - E.g. Smoking
 - Buyers -ve Externality \rightarrow too much consumed + inflict negatives on others
 - Solution: Per unit Tax
 - Incentive to reduce consumption
 - Dead weight loss (triangle with the two top points of the old and new equilibrium)
- Solutions to Production Externalities (implies supply)
 - Positive
 - SMC vertically below PMC
 - Dead weight loss (triangle with the two top points of the old and new equilibrium)
 - Sellers +ve Externality \rightarrow not enough produced
 - E.g. Robots
 - Give incentive to produce
 - Solution:
 - Per Unit Subsidy
 - To give incentive to produce more
 - Negative
 - SMC vertically above PMC
 - Dead weight loss (triangle with the two bottom points of the old and new equilibrium)
 - Sellers -ve Externality \rightarrow too much produced
 - Give incentive to reduce
 - E.g. Pollution
 - Solution
 - Per Unit tax
- When SMC/SMB not parallel always calculate the tax/subsidy at the OPTIMAL POINT
 - The point of the intercept where SMC+PMB or PMC and SMB

- So it is the vertical distance between the old and new curve at the OPTIMAL POINT
- CORRECTIVE TAXES = PIGOVIAN TAXES
- Pigovian Taxes vs Direct Regulation
 - Direct regulation = you can't do this/do that -> human rights movement & unpopular government
 - Only fined when caught
 - So need to constantly watch and regulate = very costly
 - Pigovian taxes affect everyone