Externalities and Public Goods

Negative Externalities (see Oct 3)

- **Unpriced costs** (pollution). Shifted to people not in the transaction.
- Neither seller nor buyer pays full cost. (subsidy)
- Inefficient: Market doesn't price.
- 'Too much' is produced. Social costs exceed private costs.
- Govt's role:
  - Subsidize alternatives.
  - Tax? Ban, regulate

Problems with legal and policy responses to Negative Externalities

- Regulate / control / ban /zoning

OR…

- Pigouvian taxes
- Defining an externality:
  - objective not subjective.
  - Not a negative effect (e.g., job loss)
- Finally: Coase's approach

Some illustrations

- Is it an NE if my neighbor plants an 'ugly' shrub?
  - If the shrub blocks light from my tomato plants?
- Should we **ban** cell phones in cars?
- What about litter **taxes**, or differential (peak) electricity rates
  - Are these fair?

Illustrations (cont'd)

- Smoking and externalities (health care costs, second-hand smoke, etc.)
- Should smokers be denied medical treatment?
- What about taxing/banning junk food.
- Congestion externalities and traffic tariffs.
  - Role of improved technologies.

Aren't externalities bi-lateral?

- Winter's smoking example. Stop externalities by:
  - Stop polluter (smoker).
  - Relocate victim.
- Why might this be better?
  - Compare lost value to each side.

Are cigarette taxes the best way?

- Do they offset neg externalities? Reduce gap between private and social costs?
- Are smokers a net cost or net benefit to society (from social welfare standpoint).
- Poor smokers.
- What does this sat about Econ Approach?

Problems with bans, regulations, Pigouvian taxes

- Regulations: compliance is more important than efficiency. See Wheelan (p. 119)
- Taxing externalities:
  - More efficient – resource used by those who value it most.
  - Tax system would/could be more rationally targeted at specific behavior
- Problems with taxing:
  - Do we know 'how much'?
  - Value measured by willingness to pay.

Coase's Approach

- All externalities are bi-lateral and reciprocal.
  - Farmer and rancher each cause harm to the other.
  - Externalities are merely conflicts over how resources should be used.
  - Each side is rational, no one is the villain
- Best solution: bargaining to MHVU.
  - Should polluters always be the one to adjust their behavior? More flexible.

Positive externalities (see Oct 3)

- **Unpriced benefits**
- Typical of 'public goods'
  - Jointness of supply and non-excludability– anyone (including non-payers) can enjoy.
  - Non-rivalry – my use doesn't diminish yours.
- Problem of free-riders. Only suckers pay.
- Collective action failures: Too little produced.
- Need for government solutions.

Public Goods

- Roads & infrastructure.
  - Can't efficiently assign, protect property rights.
  - Problem of tolls and technology.
  - Internet – access is private, but cyberspace is a public good…for now.
- Parks and attractive neighborhoods.
  - Tree-planting programs.

- Good government, law enforcement, etc..
  - Power of US stock market comes from regulation.

Problems of redistribution

- Wheelan: Economics can't help to decide redistributive questions. (p. 124)
  - Should we have a flat or progressive income tax?
    - Some issues are about efficiency, others about fairness/justice/distribution
  - Size of the pie vs. share of the pie.
  - Rawls' theory of justice.

What about Consumerism (SUV's, etc..)?

- Do you agree that SUV's should be taxed?
- Why don't we?

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- In the case of public goods there are at least two big problems. The first is the underproduction of a clean environment. Because environmental damage is typically not included in the price of the product which causes it (e.g., cars, toxic chemicals, pesticides), we overconsume environmentally damaging commodities. Indeed, because all production has an impact on the environment, we overconsume virtually all commodities. This means that we consume too much in toto, in comparison to non-environmentally damaging human activities.

- The second problem arises from the fact that business interests-the interests of the producers of private goods-have privileged access to the government and disproportionately influence policy. Because they are typically opposed to public provision, the "market" for public goods is structurally biased against provision. In comparison to what a truly democratic state might provide, we find that a business-dominated government skews outcomes in the direction of private production. We don't get enough, or good enough, education, arts, recreation, mass transport, and other conventional public goods. We get too many cars, too many clothes, too many collectibles.

- For those public goods that are complementary with private spending (roads and cars versus bicycle lanes and bicycles) this bias constrains the choices available to individuals. Without the bicycle lanes or mass transport, private cars are unavoidable. Because so much of our consumption is linked to larger collective decisions, the individual consumer is always operating under particular constraints.