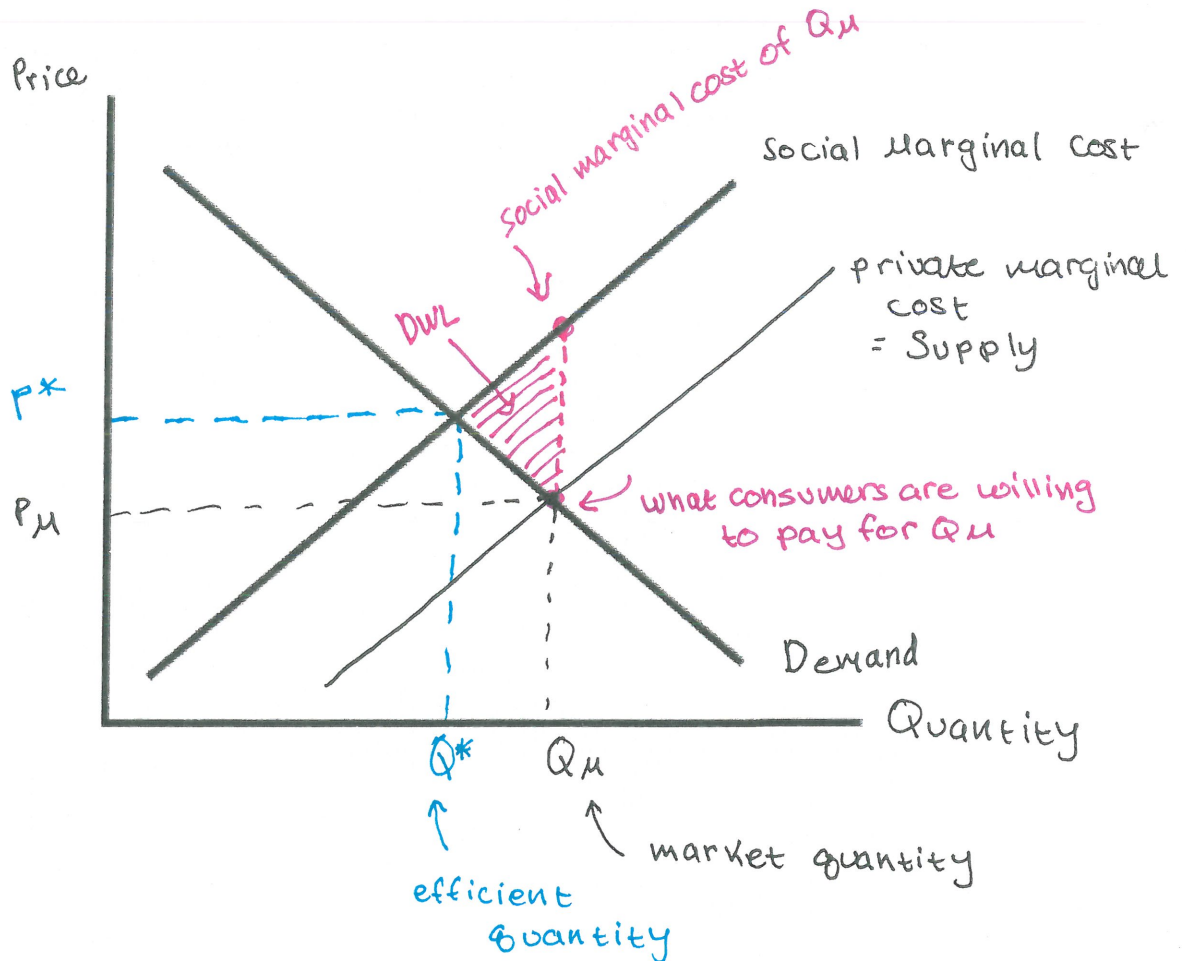


NAME: KEY

10/21/15 (Week 9)

The 3 curves shown on the below curve are: (1) private marginal cost, (2) private marginal benefit, and (3) social marginal cost.



Does the graph show a production externality or a consumption externality? production

Assume the externality is negative. Label each of the curves, the market quantity and price, the efficient quantity and price, and the dead weight loss.

NAME: _____

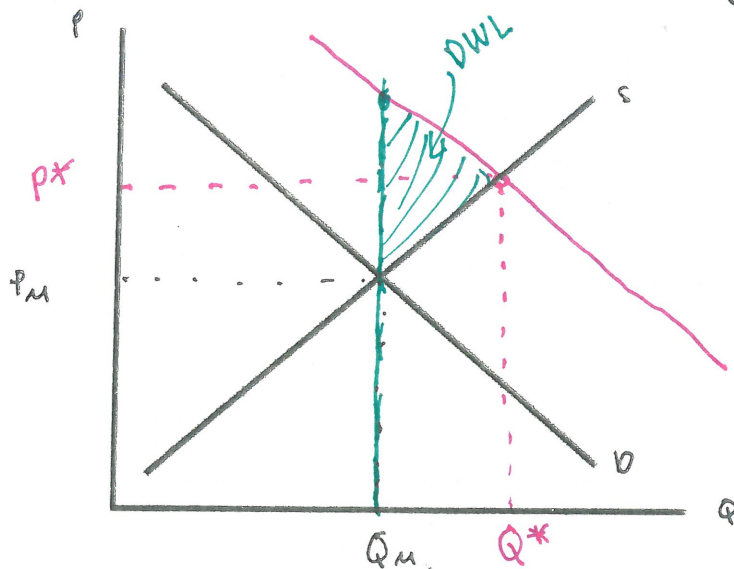
10/21/15 (Week 9)

What is a positive consumption externality. Give a real life example of this type of externality.

When a benefit is created by consuming a good for someone other than the consumer who doesn't have to pay for the benefit. An example is college education, which creates benefits for people other than the students receiving the education.

Show what the following market graph would look like with a positive consumption externality. Label the resulting dead weight loss. How will the market quantity and price differ from the efficient quantity and price - the one's that take the externality into account (are they higher, lower, or the same)?

Explain why the market quantity and price are different than the efficient quantity and price, or explain why they will not be different.



With a positive consumption externality, the market quantity is less than the efficient quantity & the market price is less than the efficient price.

They are different because the social marginal benefit (SMB) is greater than the private marginal benefit (PMB) of consuming the good. ($SMB > PMB$).

What type of government policy could be used to deal with this type of externality, and what would be an advantage and disadvantage of that policy?

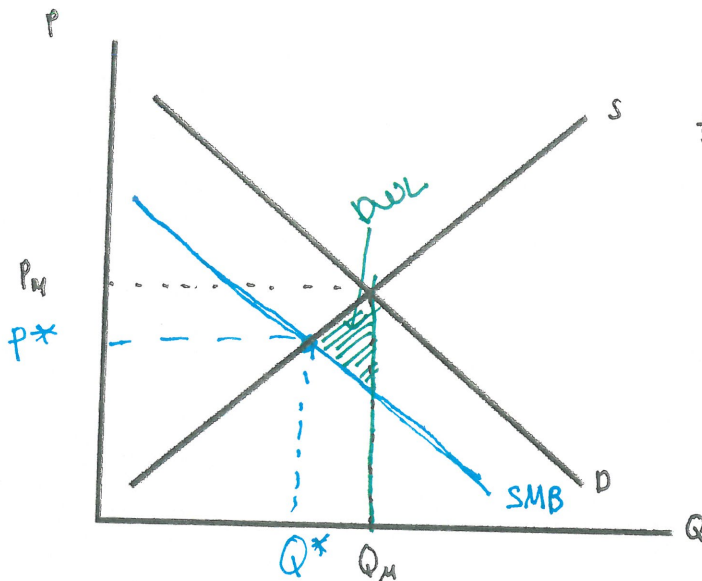
The government can correct the externality by giving consumers a subsidy equal to the value of the externality. This would get rid of the dead weight loss & so would increase efficiency. A disadvantage is that it would cost the government money.

NAME: _____

10/21/15 (Week 9)

What is a negative consumption externality. Give a real life example of this type of externality.
 When consuming a good inadvertently generates some costs that the consumer does not have to pay for. An example is a neighbor playing loud music, making it harder for others to enjoy and do things in their homes.

Show what the following market graph would look like with a negative consumption externality. Label the resulting dead weight loss. How will the market quantity and price differ from the efficient quantity and price - the one's that take the externality into account (are they higher, lower, or the same)? Explain why the market quantity and price are different than the efficient quantity and price, or explain why they will not be different.



with a negative consumption externality the market produces too much ($Q_M > Q^*$)
 \therefore the market price is greater than the efficient price ($P_M > P^*$).

They are different because the social marginal benefit is less than the private marginal benefit. ($SMB < PMB$).

What type of government policy could be used to deal with this type of externality, and what would be an advantage and disadvantage of that policy?

The gov't could impose a tax on consumers equal to the amount of the cost of the externality. This would increase efficiency $\&$ raise government revenue. On the other hand taxes can sometimes lead to inequalities.

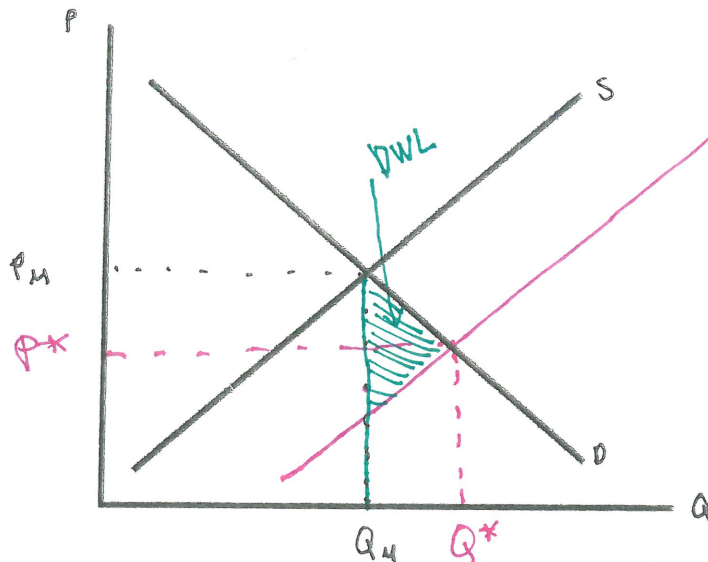
NAME: _____

10/21/15 (Week 9)

What is a positive production externality. Give a real life example of this type of externality.

When the production process inadvertently creates some benefit to people outside the firm & those people don't have to pay for that benefit. An example is a soap factory that makes the surrounding area smell good.

Show what the following market graph would look like with a positive production externality. Label the resulting dead weight loss. How will the market quantity and price differ from the efficient quantity and price - the one's that take the externality into account (are they higher, lower, or the same)? Explain why the market quantity and price are different than the efficient quantity and price, or explain why they will not be different.



with a positive production externality the market produces too little ($Q^* > Q_M$) and the market price is greater than the efficient price ($P_M > P^*$).

They are different because the social marginal cost is less than the private marginal cost. ($SMC < PMC$).

What type of government policy could be used to deal with this type of externality, and what would be an advantage and disadvantage of that policy?

The gov't could subsidize firms to produce more. Again, a subsidy could increase efficiency, but has to be paid for by the gov't.

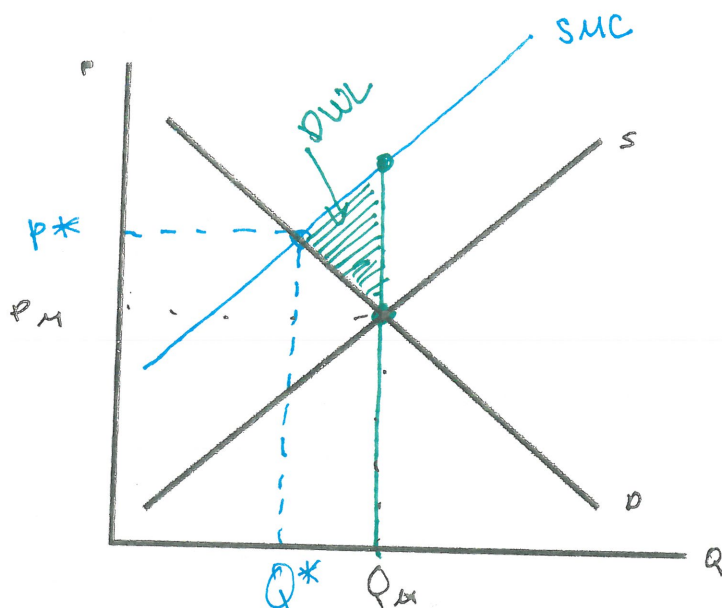
NAME: _____

10/21/15 (Week 9)

What is a negative production externality. Give a real life example of this type of externality.

When the production process inadvertently generates some cost that the firm does not have to pay for. An example is production that creates pollution.

Show what the following market graph would look like with a negative production externality. Label the resulting dead weight loss. How will the market quantity and price differ from the efficient quantity and price - the one's that take the externality into account (are they higher, lower, or the same)? Explain why the market quantity and price are different than the efficient quantity and price, or explain why they will not be different.



with a negative production externality the market produces too much ($Q^* < Q_M$) and the market price is less than the efficient price ($P_M < P^*$).

They are different because the social marginal cost is ~~more~~ greater than the private marginal cost, ($SMC > PMC$).

What type of government policy could be used to deal with this type of externality, and what would be an advantage and disadvantage of that policy?

The gov't could restrict production, telling firms they're not allowed to make more than a certain amount. This would decrease the quantity but is unlikely the lowest cost way to do so.

