

Provide incentives so that private decision-makers will choose to solve the problem on their own.

Corrective tax

A tax designed to induce private social optimum

Pigouvian tax

Corrective tax that equals social benefit

Corrective taxes & subsidies

Align private incentives with society's interests

Make private decision-makers take into account the external costs and benefits of their actions

Move economy toward a more efficient allocation of resources

Corr. Taxes vs. regulations

Efficient outcome: firms with the lowest abatement costs reduce pollution the most

A pollution tax is efficient:

Firms with low abatement costs will reduce pollution to reduce their tax burden

Firms with high abatement costs have greater willingness to pay tax

Corr. Taxes are better for the environment:

The corr. Tax gives incentives as long as the cost of doing so is less than the tax
Cleaner tech.

Tradable pollution permits

Carbon credits

Private solutions

Charities, etc.

Coase theorem

If private entities can form a large enough stake that the externality fixes their problem because to pay off the private entities is more expensive

Public Goods

National parks, clean air & water, national defense

When goods have no prices, the market forces that normally allocate resources are absent

Private market does not supply an efficient amount of such goods for

Important characteristics

Excludable is if a person can be prevented from using it

Rival in consumption is if one person's use of it diminishes others' use

Kinds of goods

Private: excludable, rival in consumption

food

Public: not " " "

National defense

Common resources: rival but not excludable

Fish in the ocean

Natural monopolies: excludable but not rival

Cable TV

Public goods and common resources create externalities cuz something of value has no price attached to it.

Public goods are difficult for private market to supply cuz of free rider

Free rider: a person who receives the benefit of a good but avoids paying for it

If good is not excludable, people have incentive to be free riders, cuz firms can't prevent non-payers from consuming the good

Cost-benefit analysis

Assess value for non-market items

Microeconomics

The theory of the firm

Generate profit--increase share-holder wealth