

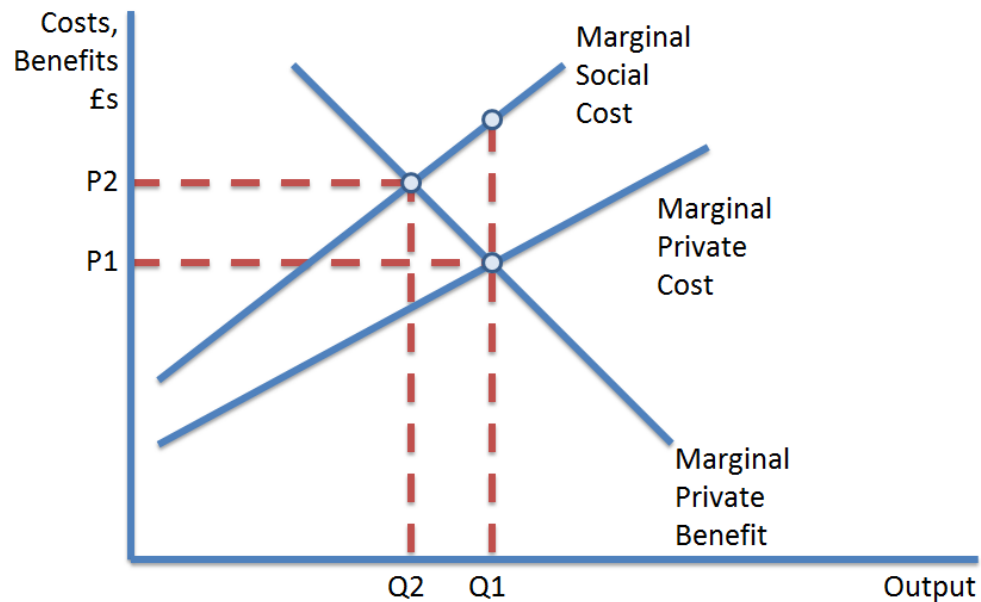
Topic: Negative Externalities

Q1

Negative externalities occur when production and/or consumption impose external costs on third parties outside of the market for which no appropriate compensation is paid.

Negative Externality	Production or consumption
The social impact of drug use in an estate in downtown LA	Consumption
Air pollution from a tyre factory	Production
Health issues as a result of passive smoking	Consumption
An oil spill in the sea during drilling	Production
Noise pollution as a result of neighbours holding all night 'raves'!	Consumption
Damage to the environment and to health from use of pesticides	Production
Noise pollution in the areas around an airport	Production
People throwing household waste into the street	Consumption

Q2

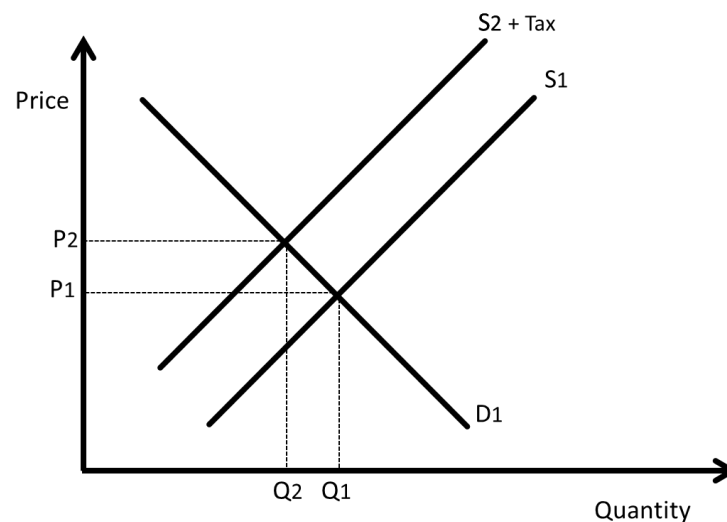


Topic: Negative Externalities

Q3

At the market failure level of output (Q_1), the price ignores the negative externalities in production i.e. pollution and as such this equilibrium is allocatively inefficient. The social cost exceeds the private cost at this point. The government intervenes and brings output down to Q_2 , P_2 , an equilibrium at which the externality has been internalized and the polluter – the firms using coal to produce energy - pays (or passes it onto the consumer in the form of a higher price). At this level, the $MSB=MSC$ which is a socially optimal and allocatively efficient outcome.

Q4



Explain what it is designed to do....	The tax is designed to reduce output and hence pollution by increasing the cost of production and hence the price for the end user. As such people use less energy or move to cleaner energy.
Positive Evaluation	It raises revenue to account for pollution and/or incentivize clean energy
Negative Evaluation	If the product is inelastic – usage doesn't fall as much as governments would hope Governments often fail to set the tax at the correct level and in some countries, avoidance is a problem Impacts those on low incomes – forced not to heat homes
Might work better with...	A tax is useful on its own but if it works in conjunction with a sensibly set green energy subsidy, this can provide a costless solution/improvement, paid for by the polluter