

Microeconomics, Module 18, "Externalities – Transaction Costs" (chapter 13)

*Micro module 18: Readings for ninth edition*

(The attached PDF file has better formatting.)

{The Landsburg textbook is excellent. We say to read certain sections and to skip others. This does not mean that certain sections are better; it means that the homework assignments and exam problems are based on the sections that you must read for this course. Some skipped sections are fascinating but are not tested.}

Read section 13.3, transaction costs. Understand (i) how transaction costs affect the Coase analysis and (ii) the types of transaction costs.

Read section 13.4, "Law and Economics." Casualty insurance depends on the legal rights of policyholders vs claimants. Many of the principles in this section are repeated on actuarial exams.

Read the summary at the end of the chapter.

Review questions R2, R3, and R4 on page 446. Question R4 is the historical event that led to much of the theory. Early trains caused sparks that could ignite crops on farmland adjacent to the tracks. The best solution was for farmers not to plant crops close to the tracks, and perhaps the railroad company should compensate the farmers for the (minor) loss of crops. Letting farmers plant right up to the tracks and then charging the railroad for fire losses to the farms is a poor solution.

Problem 1 on page 446 is the classic example of a positive externality. Most externalities are negative; most good things are not free, but pollution is widespread.

Review problem 12 on pages 448-449. Know whether the tariff increases or decrease social welfare.

Review problems 16 and 17 on pages 449-450. Focus on the difference between social gain and private gain.

Review problems 18 and 19 on pages 450-452. Focus on the effect of transaction costs on optimal social relations.

Review problem 25 on page 454-455. Insurers have conflicting incentives. They want to reduce traffic accidents to minimize their loss payments, but without traffic accidents, drivers would have no incentive to buy insurance. Auto insurance is required by law, but for other lines of business, insurers have clearer conflicts.