Microeconomics, Module 17, “Externalities – Coase Theorem”

Micro module 17: Readings for tenth 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.}

Pigou’s analysis was not complete, as Coase showed; we focus on the Coase theorem, not on Pigou taxes.

Read section 13.1; focus on the graphics of welfare gains and losses. Pigou taxes are rare in practice, and economists no longer advocate them, but they help you grasp the welfare concepts.

Read section 13.2, “The Coase Theorem.” Focus on the illustration of the doctor and the confectioner. The final exam may give a similar scenario like the doctor and the confectioner, a court decision about who is liable for damages, and ask for the Coase solution (who pays whom to do what). Other final exam problems deal with chemical pollution, noise pollution, light pollution, odor pollution, air pollution. For instance, a pig farm destroys the value of any residential real estate downwind; Coase explains how to solve the disputes.

Know the difference between the strong and weak Coase Theorems. The reserve clause in baseball makes the theory clear. Landsburg discusses baseball, but all professional sports leagues have rules about trading players.

The Coase theorem has many applications to insurance, such as

- Who should pay defense counsel costs, the primary insurer or the reinsurer?
- Who should pay adjustment expenses, the insurer or the retrospectively rated insured?

The homework assignment for this module shows an insurance application of the Coase theorem.

Review end of chapter problems R2, R3. These terms are used in final exam problems, but they are not always familiar to students.

End of chapter problem 3 is the classic example of a positive externality. Most externalities are negative; most good things are not free, but pollution is widespread.

Review end of chapter problems 3, 4, 7, 8, 9, 10, 11, 14, and 19.