

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

*Micro module 18: 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.}

Read section 13.3, transaction costs. Understand (i) how transaction costs affect the Coase analysis and (ii) the types (sources) of transaction costs. Know the effects of incomplete property rights.

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, such as negligence law and strict liability.

Read the summary at the end of the chapter.

Review question R4, the historical event that led to much of the theory. Economists seek optimal solutions that maximize social welfare. People think "whoever is liable should pay," but that is a tautology. The question is: "Who should be liable?" 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.

Review end of chapter problems R5, R6, R7.

Review problem 13. Focus on the transactions cost of a dealership vs motorists.

Review problem 14a. Lack of transactions costs simplifies the problem.

Review problem 47 and 48. Insurers have conflicting incentives. They want to reduce accidents to minimize their loss payments, but without accidents, people have no incentive to buy insurance. Auto insurance is required by law, but for other lines of business, insurers have clearer conflicts.