

AMERICAN CAPITALISM



AMERICAN CAPITALISM

CHAPTER CONTENTS



*É THE IMPORTANCE OF THE
RIGHT LAWS AND POLICIES TO
THE CAPITALIST SYSTEM IN A CIVIL
SOCIETY*

*É WHEN THE GOVERNMENT DOES GET
INVOLVED :*

ó “ PUBLIC GOODS ”

ó REGULATION

*ó WELFARE PROGRAMS = “ SAFETY
NETS ”*

AMERICAN CAPITALISM

CHAPTER CONTENTS

É GOVERNMENT INVOLVEMENT :

ó EFFORTS TO PROMOTE GROWTH AND STABILITY

É HOW TO MANAGE AND AVOID NEGATIVE “EXTERNALITIES”



AMERICAN CAPITALISM
LAWS AND POLICIES
HOW OUR FREEDOMS ARE PROTECTED



AMERICAN CAPITALISM

*THE GOVERNMENT PROTECTS OUR
ECONOMIC FREEDOMS THROUGH THE
RULE OF LAW > 3 FACTS ABOUT THIS :*

*É PROTECTING PERSONAL LIBERTIES IS
CRITICAL TO PROMOTING INCENTIVE ,
COMPETITION AND PROFIT*

*É PROTECTING PROPERTY RIGHTS > IS
CRITICAL TO PROMOTING EXCHANGES
OF RESOURCES AND CREATING
CAPITAL*

*É ENSURING ENFORCEMENT SYSTEMS TO
PROTECT THE LIBERTIES AND RIGHTS*

AMERICAN CAPITALISM

WHAT IS THE DIFFERENCE BETWEEN LAWS AND POLICIES ?

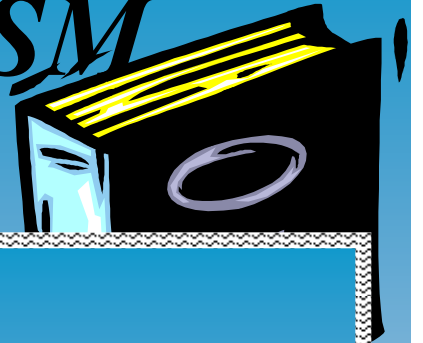
*LAWS - A RULE , OR NORM ,
ESTABLISHED BY AN AUTHORITY
OR SOCIETY PROTECT THE
“ PUBLIC INTEREST ”*



*WHAT IS THE ECONOMIC “ PUBLIC
INTEREST ” ?*

*THE COLLECTIVE NEEDS OF THE
POPULATION THAT CAN NOT BE*

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DIFFERENCE BETWEEN LAWS

Eminent domain > Noun . The right of a government to take private property for public use , usually with compensation for the owner .

Synonym

Seizure

Related

Confiscated

Antonym

The city declared the property to be under eminent domain so that the new road could be built .

PROPERTY EXCHANGE SYSTEMS

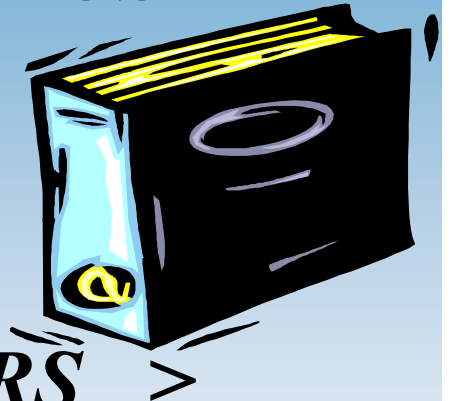
AMERICAN CAPITALISM

EXAMPLES OF LAWS :

*É LAWS TO PROMOTE COMPETITION >
SHERMAN / CLAYTON ANTI – TRUST
ACTS*

*É LAWS TO ENSURE PUBLIC
HEALTH AND SAFETY > OSHA*

*É LAWS TO PROTECT CONSUMERS >
“ CAVEAT EMPTOR ” LABELING*



*THESE ARE ALSO EXAMPLES OF
“ TRADE OFFS ” > REGULATION FOR SOME
PROTECTION IN THE PUBLIC’S INTEREST*

AMERICAN CAPITALISM

***POLICY** - A COURSE OF ACTION,
GUIDING PRINCIPLES, OR PROCEDURES
CONSIDERATIONS REGARDING POLICIES :
É EVERY POLICY HAS 2 ASPECTS TO IT :*

*ó **ENDS** - WHAT DECISION MAKERS
ARE ATTEMPTING TO ACHIEVE > EX ;
IMPROVING NATIONAL SECURITY*

*ó **MEANS** - WAYS BY WHICH THE
DESIRED ENDS ARE TO BE ACHIEVED
> EX ; CREATING THE DEPT.
OF HOMELAND SECURITY*



AMERICAN CAPITALISM

CONSIDERATIONS REGARDING POLICIES :

Adverse > Adjective . Opposed , contrary to one's interests or welfare .

Synonym

Opposed

Antagonistic

Related

Contrary

Counter

Hostile

Antonym

Favorable

Positive

Supportive

The decision had an adverse effect to what was intended which hurt growth .



AMERICAN CAPITALISM

TWO ADDITIONAL POLICY EXAMPLES :

Discretionary > Adjective . Left to judgment .

Synonym

Optional

Elective

Related

Choice

Antonym

Required

Mandatory

She used discretion in making the decision .

*POLICY MAKING IS VERY IMPORTANT TO THE
EXECUTIVE BRANCH OF GOVERNMENT AS IT
DETERMINES HOW DISCRETIONARY
TAX MONEY GETS SPENT*

AMERICAN CAPITALISM

WHAT IS THE ROLE OF ECONOMIC THEORIES IN THE DEVELOPMENT OF LAWS AND POLICIES ? > 2 POINTS :

É THEY ARE USED IN AN ATTEMPT TO EXPLAIN (IMPOSE ORDER ON) EVENTS AND OBSERVATIONS, USUALLY IN RELATION TO STATEMENTS / QUESTIONS

É A THEORY PROVEN TO BE CORRECT HAS THE GREAT VALUE THAT IT HELPS US TO PREDICT IN ADVANCE THE CONSEQUENCES OF VARIOUS ACTIONS

AMERICAN CAPITALISM

*AS A CITIZEN , TO HOLD YOUR PEERS
AND GOVERNMENT ACCOUNTABLE FOR
THE RIGHT LAWS AND POLICIES YOU
MUST UNDERSTAND TWO IMPORTANT
POINTS ABOUT THE TYPES OF THEORIES
/ STATEMENTS THAT WILL BE USED AND
WHAT YOU MUST DO WITH THEM :*

*É FIRST, YOU MUST BE ABLE TO
DISTINGUISH BETWEEN THE TYPES OF
THEORIES / STATEMENTS USED :*

ó POSITIVE - STATEMENTS THAT ARE ...



AMERICAN CAPITALISM

*TWO IMPORTANT POINTS ABOUT THE
TYPES OF THEORIES / STATEMENTS :*

*AN EXAMPLE , WHICH IS THE POSITIVE
AND WHICH IS THE NORMATIVE ?*

“ IT IS IMPOSSIBLE TO BREAK UP ATOMS ”

*“ SCIENTISTS OUGHT NOT TO BREAK
UP ATOMS ”*

AMERICAN CAPITALISM

*TWO IMPORTANT POINTS ABOUT THE
TYPES OF THEORIES / STATEMENTS :*

*É SECOND , YOU MUST BE ABLE TO TURN
NORMATIVE STATEMENTS INTO SOME -
THING USEFUL FOR STUDY > FOR
EXAMPLE :*

*“ ITS TRUE IN THEORY, BUT NOT IN
PRACTICE ”*

*“ ALL RIGHT THEN , TELL ME ABOUT
WHAT DOES HAPPEN IN PRACTICE ”*

AMERICAN CAPITALISM

*TWO IMPORTANT POINTS ABOUT THE
TYPES OF THEORIES / STATEMENTS :*

*TURNING NORMATIVE STATEMENTS INTO
SOMETHING USEFUL FOR STUDY > A
REAL EXAMPLE :*

*“IT IS MY JUDGMENT THAT WE OUGHT
TO HAVE RENT CONTROL BECAUSE
CONTROLS ARE GOOD ”*

*THE POSITIVE APPROACH SIMPLY ASKS , “
OK , WHY ” ?*

AMERICAN CAPITALISM

WHEN IT MAKES SENSE TO DEVIATE

Deviate > Verb . To turn away from a specified course , or mode of behavior .

Synonym

Change

Related

Alter

Inconsistent

Antonym

Stay

Consistent

He deviated from his original plan .

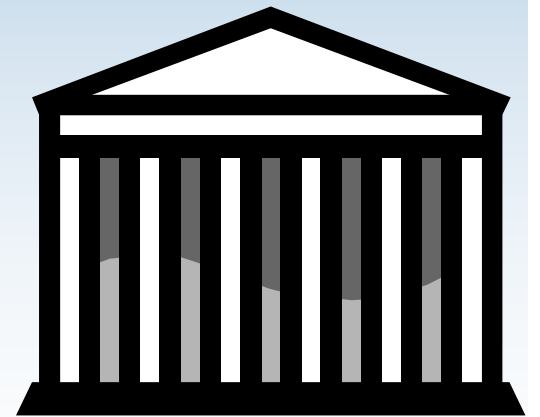


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WHEN DOES IT MAKES SENSE FOR OUR GOVERNMENT TO BE INVOLVED BEYOND ENFORCING THE RULE OF LAW ?

THERE IS ONLY 1 RATIONAL REASON THAT ADAM SMITH WOULD FIND ACCEPTABLE :

THE CAPITALIST SYSTEM IS NOT COMPLETELY SELF – SUFFICIENT, AS THERE ARE SOME NEEDS THAT CAN NOT BE MET



AMERICAN CAPITALISM

*.... EVEN BY THE FREE MARKET > THE
GOVERNMENT CAN HELP US BE MORE
EFFICIENT AND SATISFY
THE NEEDS*

*WHAT NEEDS COULD
THESE BE ??*



AMERICAN CAPITALISM

*EXAMPLES OF NEEDS THAT CAN NOT
BE MET BY THE FREE MARKET :*

É TRANSPORTATION SYSTEMS

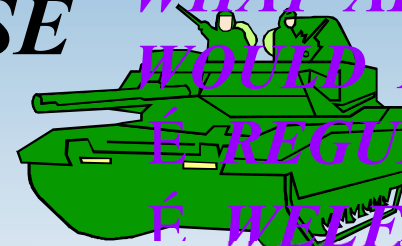
É NATIONAL DEFENSE

É EDUCATION

É PUBLIC SAFETY

É IMPORTANT

SCIENTIFIC WORK



*WHAT ADAM SMITH
WOULD NOT SUPPORT :*

É REGULATION

É WELFARE

PROGRAMS

MARKETS

STUDIES

*ADAM SMITH SAID “ LITTLE GOVERNMENT
INTERVENTION ” > THESE ARE GOOD EXAMPLES
OF WHEN IT MAKES SENSE*

AMERICAN CAPITALISM

*WHAT GOVERNMENT INVOLVEMENT
SHOULD DEPEND ON :*

*É OUR NEEDS , VALUES , PRIORITIES , AND
ECONOMIC GOALS ARE AS A SOCIETY*

É THE TESTS OF EQUITY & EFFICIENCY :

*ó WILL IT BE **EQUITABLE (EQUITY)** –
TREAT EVERYONE FAIRLY/
REASONABLY ?*

*ó WILL IT BE EFFICIENT AND COST
EFFECTIVE > PRODUCE AN OUTCOME
THAT WILL CORRECT A PROBLEM,
OR PROVIDE A BENEFIT, AT*

AMERICAN CAPITALISM

*WHAT GOVERNMENT INVOLVEMENT
SHOULD DEPEND ON :*

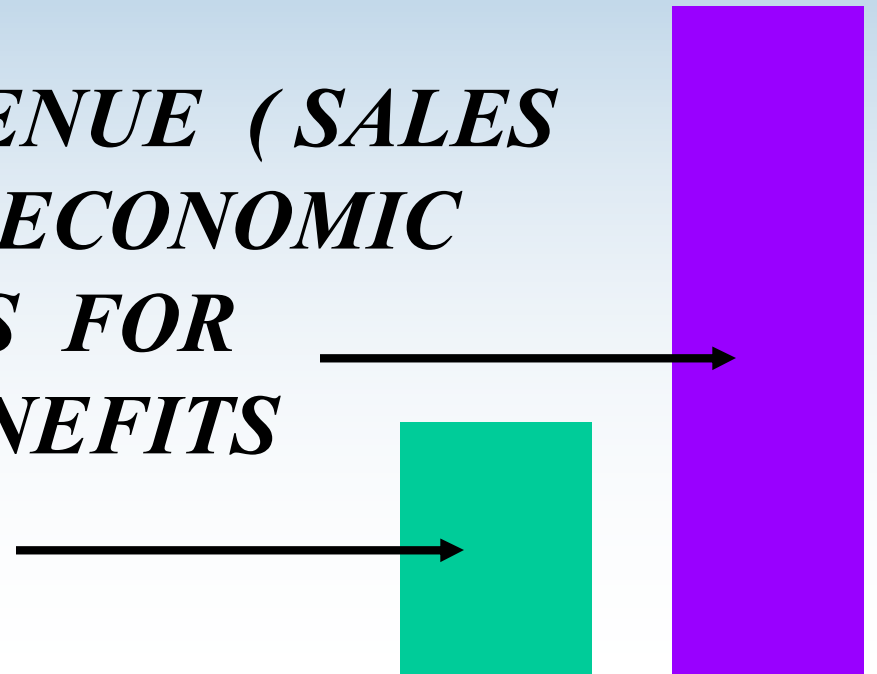
É THE TESTS OF EQUITY & EFFICIENCY :

*ó ... LOWER COST THAN NOT GETTING
INVOLVED , AND NOT UPSET EQUITY*

BRIDGE EXAMPLE :

*INCREASED TAX REVENUE (SALES
AND INCOME) FROM ECONOMIC
EXPANSION = ALLOWS FOR
POSSIBLE SOCIAL BENEFITS*

COST TO TAXPAYERS



AMERICAN CAPITALISM

*THE GOVERNMENT INVOLVEMENT
TAKES MANY FORMS > HERE ARE SIX :
É PUBLIC GOODS - GOODS AND SERVICES
PROVIDED BY THE GOVERNMENT AND
AVAILABLE TO EVERYONE*

ó 4 CHARACTERISTICS :

*É THEY ARE PAID FOR THROUGH
TAXES*



AMERICAN CAPITALISM

*THE GOVERNMENT INVOLVEMENT
TAKES MANY FORMS > HERE ARE SIX :*

É PUBLIC GOODS > CONT . :

ó 4 CHARACTERISTICS > CONT. :

*É THEY ARE SHARED GOODS AND
SERVICES > DAMS AS AN EXAMPLE*

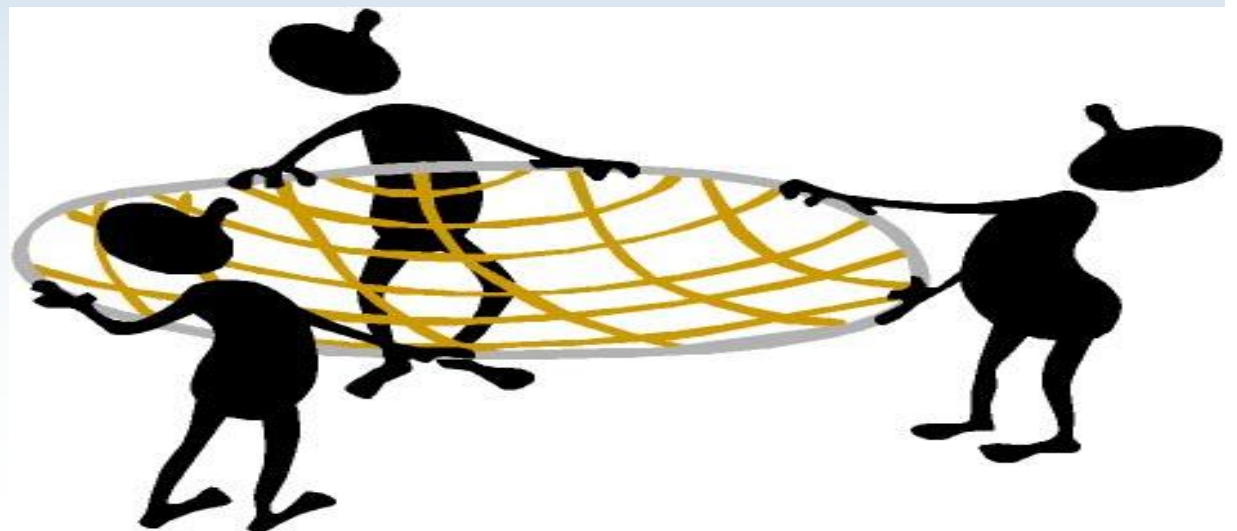
*É ANY NUMBER OF CONSUMERS CAN
USE THEM USUALLY WITHOUT
REDUCING THE BENEFITS TO ANY
SINGLE CONSUMER*

É INCREASING THE NUMBER OF

AMERICAN CAPITALISM

*THE GOVERNMENT INVOLVEMENT
TAKES MANY FORMS > HERE ARE SIX :*

*É WELFARE PROGRAMS (ALSO KNOWN
AS “ SAFETY NETS ”) - GOVERNMENT
ASSISTANCE HAVING THE OBJECTIVE
OF REDUCING THE NUMBER OF
PEOPLE LIVING BELOW THE POVERTY
THRESHOLD*





AMERICAN CAPITALISM

WELFARE PROGRAMS > 5 EXAMPLES :

É SOCIAL SECURITY

É UNEMPLOYMENT INSURANCE

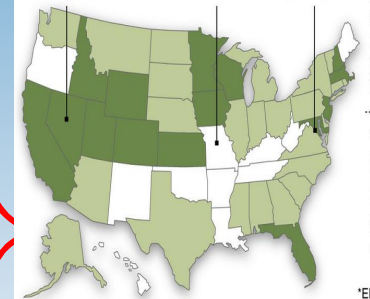
É WORKER'S COMPENSATION
AND DISABILITY

Who's getting food stamps

The percent of eligible poor Americans getting food stamps varies considerably from state to state. The rates for 2004:

■ 32%-45% ■ 46%-60% □ More than 60%

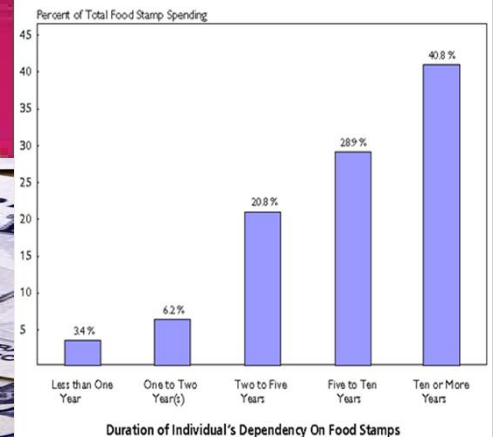
Worst Nev. 32% Best Mo. 72% Best D.C. 72%



Source: National Priorities Project
Graphic: Judy Treible, Tim Goheen

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Food Stamp Expenditures and Long Term Dependence (Nonelderly Adults and Children), 1979-1998



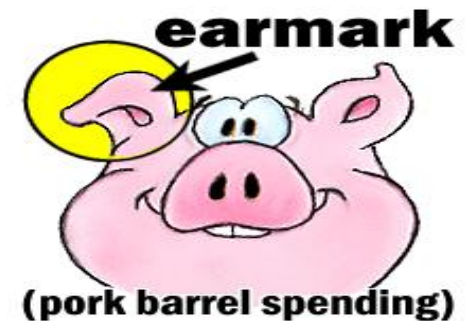
Source: National Longitudinal Survey of Youth



AMERICAN CAPITALISM

*THE GOVERNMENT INVOLVEMENT
TAKES MANY FORMS > HERE ARE SIX :*

*É **EARMARKS** - LEGISLATION THAT
PROVIDES MONEY FOR A FAVORED
PROJECT OR INDUSTRY >
KNOWN AS “ PORK BARREL ”
LEGISLATION > **3 PROBLEMS** :*



É CREATES INEFFICIENCY

É WASTES RESOURCES

*É INHIBITS COMPETITION
AND GROWTH*

AMERICAN CAPITALISM

*THE GOVERNMENT INVOLVEMENT
TAKES MANY FORMS > HERE ARE SIX :*

É PRICE CEILINGS

É PRICE FLOORS



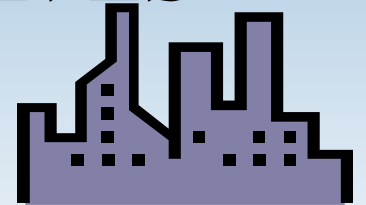
*DETAILS IN
CHAPTER # 7*



AMERICAN CAPITALISM

*DUE TO GOVERNMENT INVOLVEMENT
OUR VERSION OF THE FREE MARKET
SYSTEM IS MADE UP OF 2 MAJOR PARTS :*

*É THE **PRIVATE SECTOR** - THE PORTION
OF THE ECONOMY THAT INVOLVES
TRANSACTIONS OF
INDIVIDUALS AND BUSINESSES*



*É THE **PUBLIC SECTOR** - THE PORTION
OF THE ECONOMY THAT INVOLVES
THE TRANSACTIONS
OF THE GOVERNMENT*



AMERICAN CAPITALISM

MANAGING THE GENERAL SIDE EFFECTS OF CAPITALISM AND GOVERNMENT INTERVENTION



AMERICAN CAPITALISM

*OUR ECONOMIC SYSTEM NATURALLY
PRODUCES SOME **EXTERNALITIES***

*A SIDE EFFECT FROM THE PRODUCTION
OF A GOOD OR SERVICE , OR ECONOMIC
INTERVENTION , THAT GENERATES BEN-
EFITS (POSITIVE) OR COSTS (NEGATIVE
UNINTENDED CONSEQUENCES / MARKET
FAILURE) TO SOMEONE OTHER THAN
THE PRODUCER OR
DIRECT CONSUMER*



AMERICAN CAPITALISM

HOWEVER , ANY GOVERNMENT INVOLVEMENT IN THE ECONOMY WILL ALWAYS RESULT IN CREATING EXTERNALITIES :

THE CHALLENGE IS TO MAKE SURE THAT THE INVOLVEMENT SATISFIES THE TESTS OF EQUITY, AS WELL AS EFFICIENCY, AND IF POSSIBLE , CREATES POSITIVE EXTERNALITIES



LETS LOOK AT SOME EXAMPLES

AMERICAN CAPITALISM

NEGATIVE EXTERNALITY EXAMPLES

***INDUSTRIAL
PRODUCTION OF
GOODS POLLUTES A
WATERWAY***

***HAS A NEGATIVE
EFFECT ON THE
FISHING AND
RECREATION
INDUSTRIES***



AMERICAN CAPITALISM

NEGATIVE EXTERNALITY EXAMPLES :

***REMEMBER THE
VIDEO STORY
ABOUT THE
TEXTILE
INDUSTRY ?***

***THE NATURALLY
PRODUCED
EXTERNALITY WAS
BROWN LUNG
DISEASE***



AMERICAN CAPITALISM

***HOW CAN YOU SOLVE PROBLEMS
CAUSED BY NEGATIVE EXTERNALITIES ??
THERE ARE TWO OPTIONS TO CHOOSE
FROM :***

***É HAVE THE GOVERNMENT HANDLE IT
GENERALLY THROUGH REGULATION***

***É LET THE PRIVATE MARKET HANDLE IT
THROUGH NEGOTIATION***



AMERICAN CAPITALISM

*GOVERNMENTS HANDLE EXTERNALITIES
THROUGH REGULATION > LAWS
DESIGNED TO FORCE ELIMINATION OF
THE SIDE EFFECTS > 4 EXAMPLES :*

É OCCUPATIONAL SAFETY & HEALTH ACT

É ENVIROMENTAL PROTECTION ACTS

É PRODUCT SAFETY ACTS

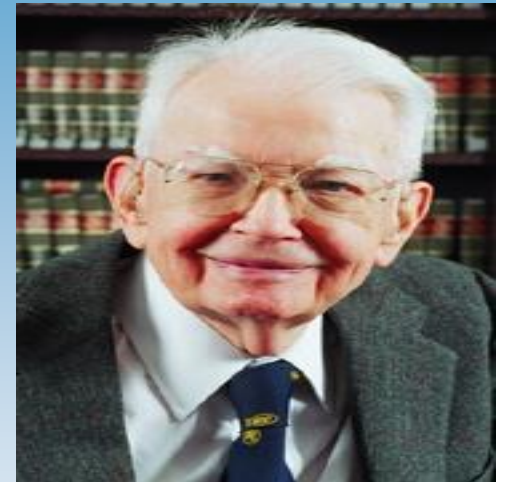
É DISCLOSURE AND REPORTING ACTS



AMERICAN CAPITALISM

*THE PRIVATE MARKET TRIES TO SOLVE
PROBLEMS CAUSED BY EXTERNALITIES
THROUGH NEGOTIATION :*

*COASE THEOREM - PRIVATE
PARTIES WILL GENERALLY
STRIVE TO REACH A BARGAIN
IN WHICH EVERYONE IS
BETTER OFF AND THE OUTCOME IS
EFFICIENT IN OTHER WORDS , TRY
TO FIND WHAT IS CALLED A “WIN / WIN
” SOLUTION*



RON COASE

AMERICAN CAPITALISM

THE PRIVATE MARKET SOLVES

Legitimate > Adjective . In accordance with law or established standards .

Synonym

Lawful

Related

Valid

Accepted

Antonym

Illegitimate

His claim to ownership of the property was legitimate .

*OPTIONS WORKED WITH THE
TEXTILE INDUSTRY EXAMPLE*


Negotiating Agreement
Without Giving In

Roger Fisher and William Ury
and for the Second Edition Bruce Patton
of the Harvard Negotiation Project

***AMERICAN CAPITALISM
RESOLVING THE TEXTILE INDUSTRY
EXTERNALITY :***

***É COMPANIES AND THE LABOR
UNION STARTED WITH
NEGOTIATIONS***

***É UNION FELT THEY HAD A
“BATNA” = TO SUE UNDER
THE OSHA TO COMPLETELY
ELIMINATE THE DISEASE***

***É THE UNION’S GOAL WAS
ACCOMPLISHED , BUT THE
INDUSTRY DISAPPEARED***



THE JOURNAL OF
THE
ROYAL ANTHROPOLOGICAL INSTITUTE

Negative Explanations and the Coped Theorem

DAVID J. GORDON
AND
JENNIFER J. GORDON

AMERICAN CAPITALISM

Commerce > Noun . The buying and selling of goods on a large scale .

Synonym

Trade

Traffic

Related

Business

Contact

Antonym

Inaction

Rational government economic policies will encourage commerce .

*TO PROMOTE
COMMERCE AND
GROWTH*



AMERICAN CAPITALISM

***THE TRAGEDY IS THE NEGATIVE
EXTERNALITY THAT RESULTS FROM
OVER USE :***

***COST OF TRAFFIC
CONGESTION
IRONICALLY LIMITS
COMMERCE , GROWTH ,
AND HAS DESTROYED
COMMUNITIES***



AMERICAN CAPITALISM

HOW DO YOU SOLVE THIS ? WHAT ARE THE OPTIONS ?

É BUILD MORE ROADS ?

ó COST IS HIGH WHICH MEANS THAT TAXES GO ↑

ó ↑ TAXES MIGHT NOT BE FAIR TO PEOPLE WHO DO NOT USE THE PUBLIC GOOD



AMERICAN CAPITALISM

HOW DO YOU SOLVE THIS ? WHAT ARE THE OPTIONS ?

É PUT IN TOLLS ?

ó COST IS LOW

ó IT ELIMINATES THE FAIRNESS PROBLEM BY HAVING PEOPLE PAY FOR USEAGE > THIS IS STILL A TAX, BUT IT MAKES THE CITIZEN



AMERICAN CAPITALISM

HOW DO YOU SOLVE THIS ? WHAT ARE THE OPTIONS ?

É PUT IN TOLLS ?

ó INTERNALIZE (FORCES YOU TO NEGOTIATE WITH YOURSELF) THE SOLUTION TO THE EXTERNALITY

É REGULATE THE ROAD BY PUTTING IN CAR POOL LANES ?



THE TRAGEDY OF
THE CONTRASTS

THE TRAGEDY OF THE CONTRASTS

THE TRAGEDY OF
THE CONTRASTS

AMERICAN CAPITALISM

ONE VERY BIG CHALLENGE FOR OUR SOCIETY IS TO BE ABLE TO RATIONALLY MANAGE THE SIDE EFFECTS CAUSED BY THESE GOVERNMENT INTERVENTIONS :

É SOCIAL SECURITY

É HEALTH CARE > MEDICARE

É UNEMPLOYMENT INSURANCE

É EARMARKS

É DISASTER RELIEF

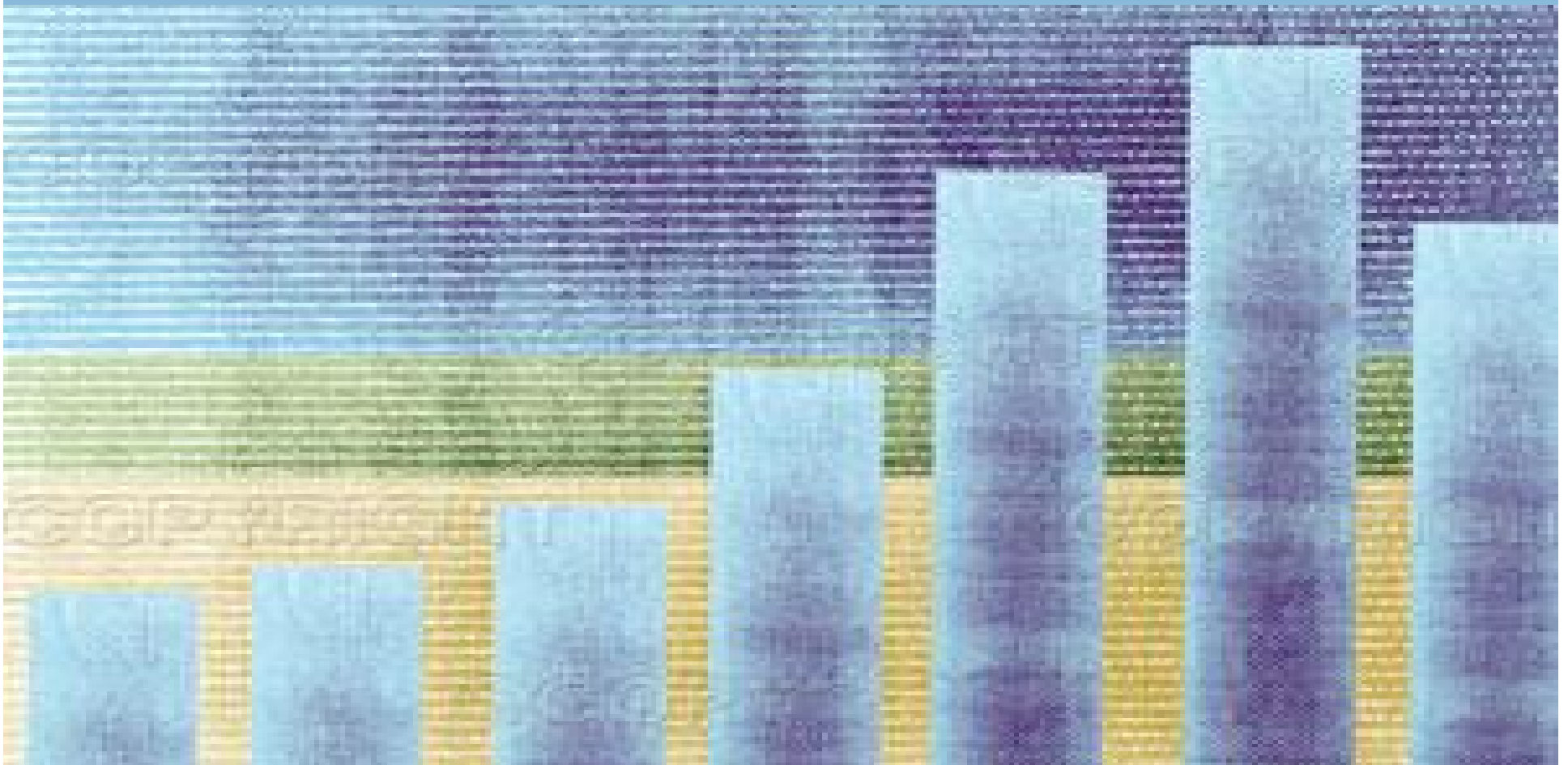
É CORPORATE / HOMEOWNER BAILOUTS

É ENVIRONMENT & SAFETY PROTECTION





AMERICAN CAPITALISM
HOW THE GOVERNMENT
SHOULD ENCOURAGE ECONOMIC GROWTH



AMERICAN CAPITALISM

*FOUR WAYS THAT THE GOVERNMENT
SHOULD ENCOURAGE GROWTH AND
STABILITY:*

*É COUNTERACT , THOROUGH EDUCATION
AND POLICY , THE ANTI – CAPITALIST
ATTITUDE THAT RISES PERIODICALLY*

*É MEASURE ALL ACTIONS ON THE TESTS
OF EQUITY AND EFFICIENCY*

*É PROMOTE ECONOMIC REDISTRIBUTION
CITIZENSHIP THROUGH
CIVIC PARTICIPATION*



AMERICAN CAPITALISM

***FOUR WAYS THAT THE GOVERNMENT
SHOULD ENCOURAGE GROWTH AND
STABILITY:***

***É CONTINUE TO MAKE STRATEGIC
INVESTMENTS TO ENCOURAGE
INNOVATION > EXAMPLES ; LAND
GRANT COLLEGES AND NASA***



AMERICAN CAPITALISM

SUMMARY

É WHAT IS THE DIFFERENCE BETWEEN THE PUBLIC AND PRIVATE SECTORS ?

É WHAT TYPE OF LAWS PROTECT OUR ECONOMIC FREEDOMS ?

É WHAT DO WE MEAN BY THE “PUBLIC INTEREST” ?

É WHAT IS THE DIFFERENCE BETWEEN A LAW AND A POLICY ?



AMERICAN CAPITALISM

SUMMARY

É PROVIDE SOME EXAMPLES OF POLICY ACTIONS

É PROVIDE AN EXAMPLE OF POSITIVE & NEGATIVE EXTERNALITIES

É PROVIDE SOME EXAMPLES OF HOW THE GOVERNMENT PROMOTES AND MONITORS ECONOMIC STABILITY AND GROWTH ?



A CLOSER LOOK AT THE TESTS OF EQUITY AND EFFICIENCY



WHY IT IS SOMETIMES DIFFICULT TO CLEARLY DETERMINE THE RESULTS OF EQUITY AND EFFICIENCY TESTS

***IT IS THE FAULT OF
THIS MAN !!***

***ALTHOUGH BEING A FREE
MARKET ECONOMIST,
MANY PEOPLE SAY HIS
THEORIES HELPED PUSH
OPEN THE DOOR FOR THE
SOCIALISTS !!***



VILFREDO PARETO

***UNFORTUNATELY PARETO MADE
EVALUATING EQUITY AND EFFICIENCY
MORE DIFFICULT FOR US***

PARETO INEFFICIENCY :

***AN ECONOMIC SYSTEM , OR
PUBLIC POLICY, IS CONSID -
ERED INEFFICIENT IF RESOURCES CAN
BE REALLOCATED TO MAKE SOMEONE
“ BETTER OFF ” , WITH NO OTHER
INDIVIDUAL BEING MADE WORSE OFF >
CAN THIS HAPPEN ?? WHAT ABOUT
TRADE OFFS ??***



PARETO EFFICIENCY / OPTIMUM :

***WHEN NO FURTHER “IMPROVEMENTS”,
OR CHANGES, CAN BE MADE WITHOUT
CAUSING HARM***

TWO PROBLEMS THAT HAVE ARISEN WITH PARETO OPTIMALITY :

***É IT HAS BECOME COMMON
TO COMPENSATE PARTIES
TO ACHIEVE PERCEIVED
EFFICIENCY GOALS***

***É BROAD OPTIMALITY OBJECTIVES, ARE
VERY DIFFICULT TO REACH***



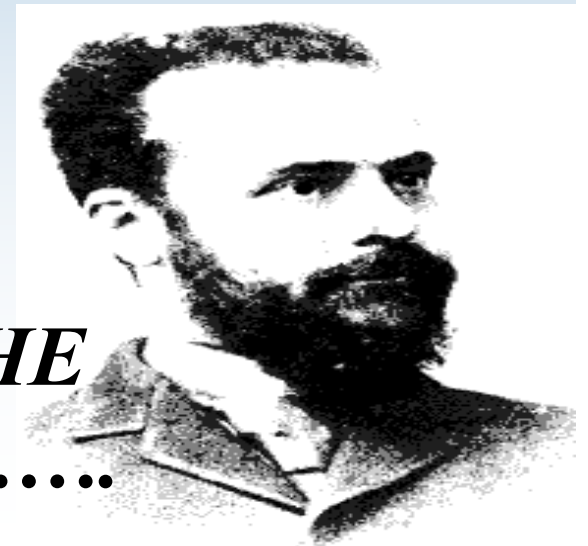
***PARETO EXAMPLE > TAXES GOING TO
HELP FUND WELFARE PROGRAMS :***

***É RATIONALE > IT IS IN THE PUBLIC'S
INTEREST TO HAVE A STABLE & PRO -
DUCTIVE POPULATION / WORK FORCE***

É FLAWS :

***ó COMPENSATION > SIGNIFICANT
COSTS TO BUSINESSES
LEAD TO OFFSETTING
TAX BREAKS***

***ó BROAD OBJECTIVE OF THE
COLLECTIVE WELFARE***



***PARETO EXAMPLE > TAXES GOING TO
HELP FUND WELFARE PROGRAMS :
É FLAWS :***

***ó ... SYSTEM IS IMPOSSIBLE TO REACH
WITHOUT CREATING SIGNIFICANT
PROBLEMS > SOME EXAMPLES :***

***É STIFLES GROWTH AND PROMOTES
ILLEGAL IMMIGRATION***

***É LACK OF COMPETITION PROMOTES
WASTE & WASTE PROMOTES RISING
COSTS = INABILITY TO AFFORD***

***É IMPOSSIBLE TO IMPLEMENT
GLOBALLY***

*SO THEN, WHAT WOULD BE THE
PARETO OPTIMAL SOLUTION TO THE
CURRENT WELFARE PROGRAM PROBLEM
(PARTICULARLY THE SOCIAL SECURITY
AND MEDICARE PROGRAMS) ?*

CUT COSTS / BENEFITS



A CLOSER LOOK AT EXTERNALITIES



EXTERNALITIES

PROBLEM



Assume that product X is produced in a perfectly competitive industry and that product X yields costs to individuals who are neither consumers nor producers of product X .

(1) Using one correctly labeled graph , show the industry output and price under each of the following conditions :

(a) The industry ignores the externality .

EXTERNALITIES

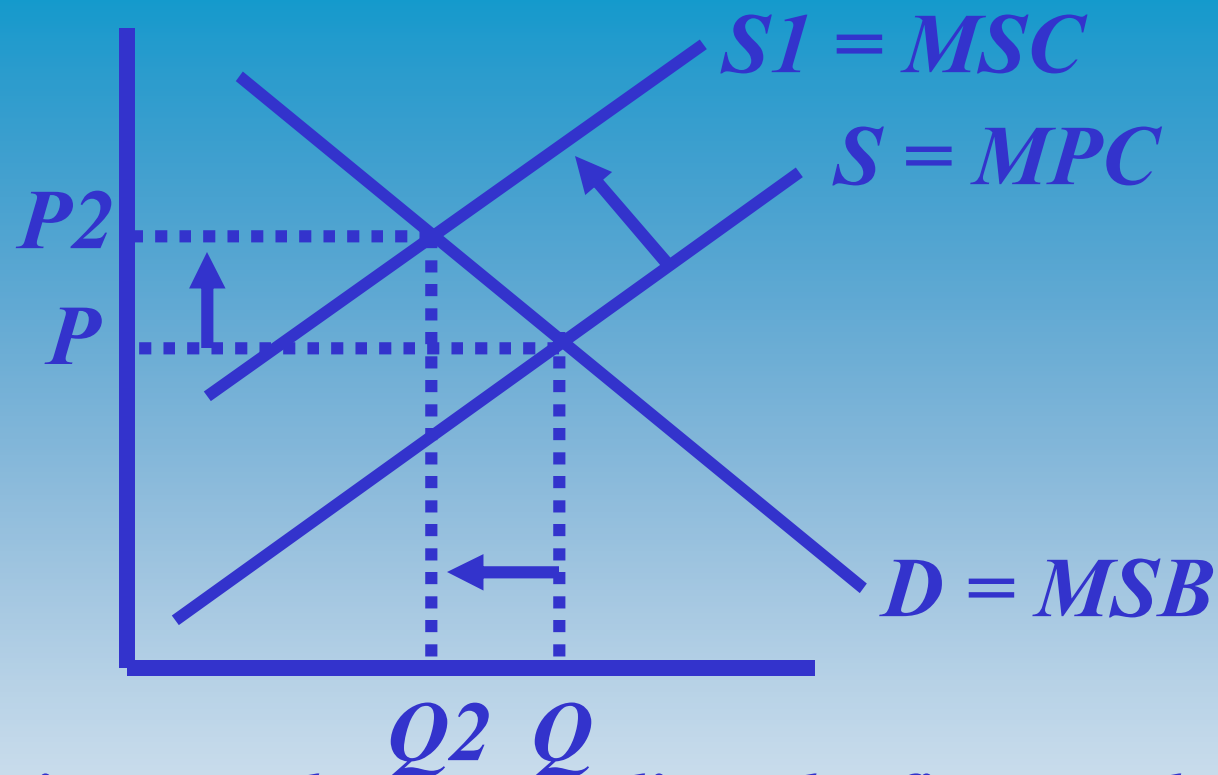
PROBLEM



(b) The industry produces the socially optimum level of output .

(2) Identify one policy the government might use to achieve the level of output you identified in (b)

PART 1



When a firm ignores the externality, the firm produces where the MPC (marginal private costs) are equal to Demand (marginal social benefits). However, since there are added costs placed on these individuals, these additional costs are added to the private costs to give the MSC (marginal social costs), increasing the price and decreasing the socially optimal level of output to $Q2$.

THEN WE SHOULD JUST PAY THIS

PART 2

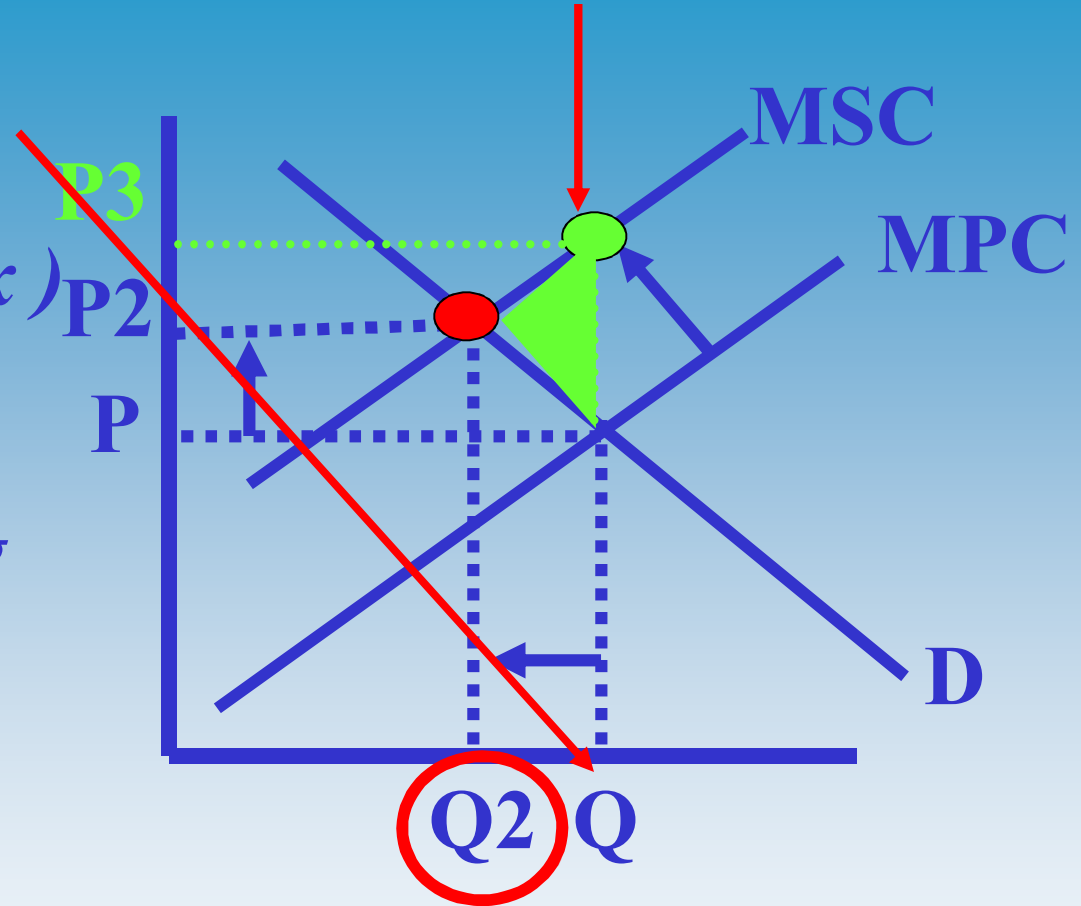
IF WE WANT THIS

É A tax (not income tax)

É Quantity restriction

É Effective price ceiling
at Q (not a price
floor)

É Pollution permits



***EXTRA CREDIT - WHAT DOES THE FOLLOWING
GREEN SHADED AREA OF THE GRAPH
REPRESENT ??***

DEAD WEIGHT COST TO SOCIETY !!!!