**Externality**

Explain how the cost of steel reflects the scarcity of the resources used to produce it.

Identify some of the inputs a steel firm uses. Explain why those inputs would make up the firm’s Private Marginal Cost (PMC).

Explain why an industry supply curve would reflect the firms’ Private Marginal Costs.

price

Supply

S (=PMC)

$500

A

D (=PMB=SMB)

5

steel tons/month

Explain why the above diagram suggests point A is inefficient.

In the class example, why are the fish killed by the steel firms considered an external cost?

What is the definition of marginal damage?

**Social Marginal Cost (SMC) = private marginal cost (PMC) + marginal damage (MD)**

If MD equals zero, how much of the social cost of producing the good/service is recognized by the producing firms?

price

Supply

SMC

PMC

B

E

deadweight loss

$500

A

3.5

D (=PMB=SMB)

5

steel tons/month

In the diagram, PMC not equaling SMC suggests what?

Why would the unregulated market produce Q=5 tons/month?

Why is the market equilibrium (Q=5) considered “too much” steel?

In the above diagram, what costs (approximately) $500?

Are social net benefits maximized at the market established Q=5?

At Q=5, what is the relationship between SMC and SMB?

Why is Q=3.5 considered socially efficient?

Are there dead fish at the socially efficient Q=3.5?

What is the relationship between SMC and SMB at Q=3.5?

Which quantity is producing greater social net benefits, Q=5 or Q=3.5?

Define deadweight loss.

Why is the deadweight loss in the above example illustrated by the area EBA?

What is the relationship between deadweight loss and the social net benefits at Q=5 and Q=3.5?

[**Negative Consumption Externality**](http://milesfinney.net/433/handout/cig.jpg)

Within the example, how do we know the act of consumption is producing the negative externality?

Why is SMB<PMB in the diagram?

In the example, would an unregulated market produce too much smoking or too little?

Why is society worse off at Q1 than at Q2?