

Quiz 1 Answers

Q 1: Two problems with coal subsidies < incentives to use more coals / over-production
negative externality from burning coal ↑ / pollution ↑

- Q 2: **CASE A**
- i) Yes, negative externality from air pollution.
The costs of air pollution are not internalized in the firm's cost, so inefficiency arises when K Chemical overproduce ($> Q^*$) and create negative externality cost to Dream village.
 - ii) Yes, according to the Coase Theorem, if property rights are well designed and enforced without transaction costs, private negotiation between K Chemical & Dream village can lead to efficient outcome (at Q^*) regardless of who has the right.
 - iii) • Restrict production to Q^* through regulation
• Zoning areas for chemical production
• Impose tax on air pollutions.

CASE B

- i) Yes, increases in emissions raise negative externality costs to society
- ii) No, not possible to have private negotiation when there are too many people involved. (e.g. car owners)
- iii) Impose tax on pollutions applicable to whole country