

# Private vs. Social costs

## Divergences

- Market prices do not reflect opportunity costs
- Private = market prices
- Social = opportunity costs to society

# Reasons for Divergences

## 1. Market Failures

- Market power
- Externalities
  - Incomplete property rights
  - Including missing markets (non-exclusion, non-rival)

## 2. Distortions – result of policies that affect prices of commodities or factors

- Commodity taxes/subsidies
- Marketing restrictions/regulations
- Taxes on economic activities
- Etc.

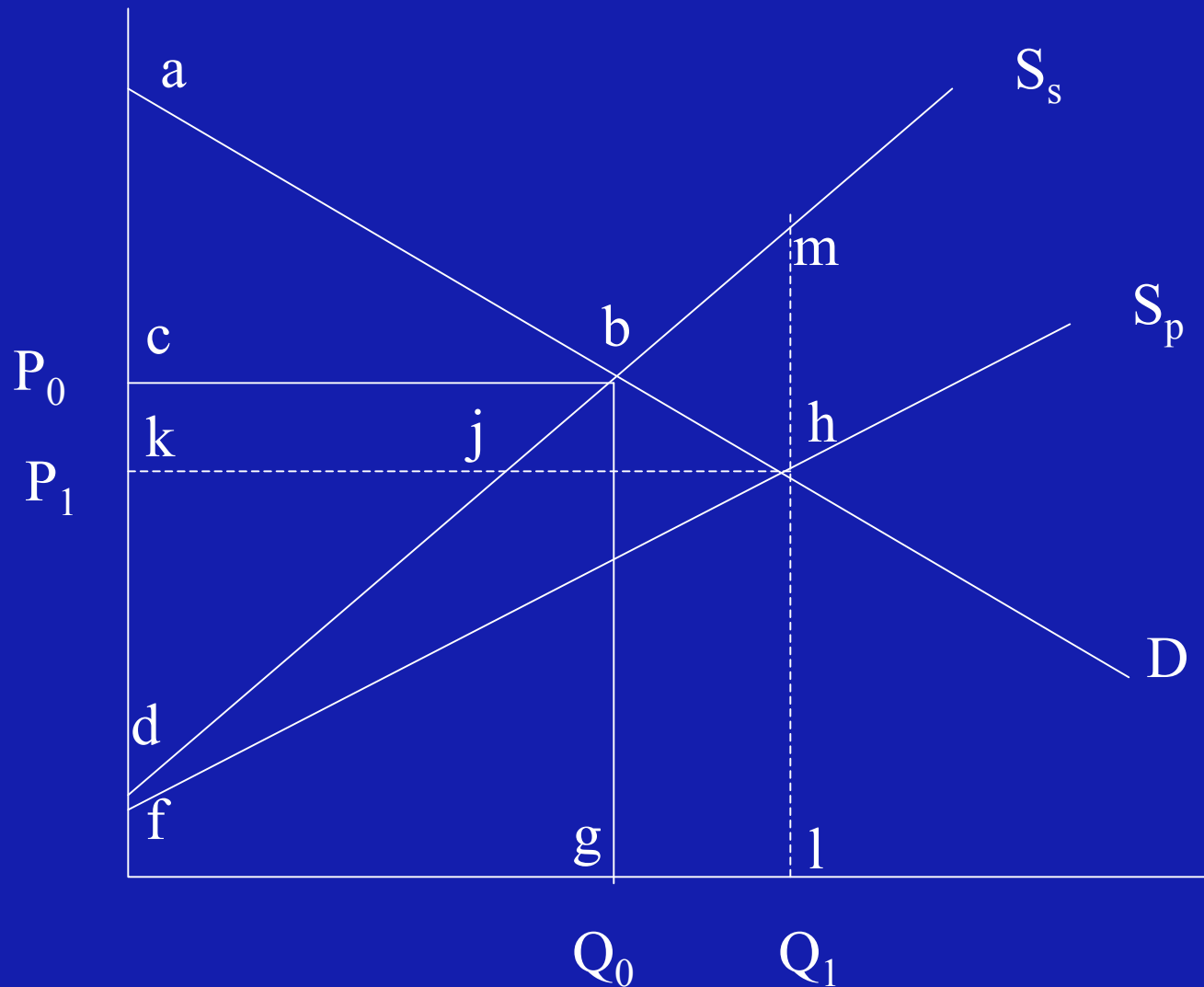
# Market analysis of divergences

- Need to consider effects on
- Consumers (CS)
- Producers (PS)
- Government budget (B)
- External effects or third-party costs (EE)

# Examples of market analysis

- Market failures
  - Market power
  - Externalities
- Market distortions (policies)
  - Domestic markets (no trade)
    - Commodity taxes/subsidies
    - Quantitative restrictions
  - International trade (small country)
  - International trade (large country)

## Welfare Effects of Negative Externality (Divergence)



$$CS_0 = abc$$

$$PC_0 = dbg$$

$$PS_0 = cbd$$

$$EE_0 = 0$$

$$CS_1 = akh$$

$$PC_1 = fh$$

$$PS_1 = khf$$

$$EE_1 = -dmhf$$

$$\Delta CS = +cbhk$$

$$\Delta PS = +djh - cbjk$$

$$\Delta EE = -dmhf$$

$$\Delta Net = -bmh$$

# Welfare Effects of Sales Tax (Distortion)

