Adapted from https://www.lsrhs.net/sites/raffelj/files/2013/03/Markets-Inefficiency.pdf

# Market Failure

As discussed in class, the following conditions must exist for markets to be efficient:

1. Rational decision makers
2. Perfect competition
3. Goods that are excludable and rival
4. No externalities
5. Sufficient information

When some or all of these conditions do not exist, the market for the good/service will not function well and may even collapse. As we have seen, government steps in to provide goods when these goods are nonexcludable and nonrival (public goods). And very few markets are perfectly competitive. In this lesson we will focus on externalities and insufficient information to show how market efficiency can be challenged and restored.

An externality is a positive or negative outcome that is outside the buyer-seller relationship. Or, as defined by your textbook, an externality is “an effect felt beyond those whose decisions caused the effect” (310). Externalities can be positive or negative.

* An example of a positive externality is...

Education/health care/tree planting

* An example of a negative externality is…

Cigarettes/factory pollution/car exhaust

# Externalities: A Scene from *Erin Brockovich* (2000)

**About the film**: Julia Roberts won Best Actress for her portrayal of *Erin Brockovich*. The film is based on the true story of Brockovich, a single mother with no formal education, few prospects for a job and down on her luck. Eventually, she got a job as a file clerk for a small law firm. There she begins to investigate (on her own) illnesses in a small town caused by the illegal dumping of deadly toxic waste by Pacific Gas and Electric (PG&E). As a result of her efforts, the law firm she works for becomes involved in one of the largest class action lawsuits in history, resulting in a settlement of over $300 million!

The scene we will watch revolves around an offer from PG&E. Ed Masry (Albert Finney) and Erin Brockovich meet with a representative of Pacific Gas and Electric to discuss a settlement offer from the firm. The company offer compensates the claimants for the value of the land they own, but not for medical damages as a result of the toxic poisoning. Erin

Brockovich believes that many of the health problems in the affected community can be traced to the introduction of poison into the groundwater. However, PG&E counters that the condition of the residents is a result of lifestyle choices, heredity and bad luck.

1. PG&E decided to dump the toxic poison, rather than clean it up. How did this decision lower their costs?

They do not need to spend their money on hiring people to clean it up or pay the taxes for it.

1. What chemical did PG&E use? What effects did this chemical have on people living in the surrounding community?

Chromium. They can cause serious health problems and even lead to death.

1. Why did PG&E pay for the doctor the family in the movie saw?

So that the doctor will not tell them the fact that their health problems are caused by chromium.

1. What options do governments have to correct for negative externalities? (HINT: Think about the reading.)

Set more strict regulations

Check these big companies frequently.

Increase public awareness by education.

**Externalities and Government Regulation: A Class Comic Book!**

# “U.S. Ties Farm to Salmonella; Town is Tense,” by Monica Davey, August 27, 2010 available at: http://www.nytimes.com/2010/08/27/us/27eggs.html

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| **Directions**: You are going to read one article from the *New York Times* about the recent outbreak of Salmonella in many eggs across the United States. For the passage you (and your group) are assigned you are to:   1. Make a drawing summarizing the main idea of the passage 2. Write 1-2 sentences explaining whether the passage describes a **positive externality**, or a **negative externality**. |

|  |  |  |
| --- | --- | --- |
|  | **Positive Externalities:** | **Negative Externalities:** |
| 1 |  |  |
| 2 |  |  |
| 3 |  |  |
| 4 |  |  |
| 5 |  |  |
| 6 |  |  |