



## Positive Externalities

### AS Microeconomics

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### A quick recap on externalities

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- ▶ An externality exists when the action of one agent unavoidably affects the welfare of another agent.
- ▶ The affected agent may be a consumer, giving rise to a consumption externality, or a producer, giving rise to a production externality



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## What are positive externalities?

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- ▶ Positive externalities create **benefits** to third parties
- ▶ Activities said to generate positive externalities include:
  - ▶ Social returns from investment in education & training
  - ▶ Benefits from high quality public service broadcasting
  - ▶ Positive benefits from health care and medical research
  - ▶ Benefits from vaccination and immunization programmes
  - ▶ Flood protection systems & [fire safety equipment](#)
  - ▶ Restored historic buildings and monuments
  - ▶ Social benefits from protecting environmental resources
  - ▶ External benefits from usage of public libraries and museums
  - ▶ Externalities from inward migration of population

## Social benefits

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- ▶ Where there are positive externalities the social benefit of production and/or consumption exceeds the private benefit

## Social benefits explained

<b>Private Benefits</b>	<b>+</b>	<b>External benefits</b>	<b>=</b>	<b>Social Benefits</b>
Benefits to individual consumers or firms of their economic activity		Benefits to others of individual consumers or firms economic activity		Total benefits to society of a given economic activity
<b>Benefits to first parties - individuals</b>		<b>Benefits to third parties - others</b>		<b>Total benefits to society - everyone</b>

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## Positive spill-overs?



Flood protection schemes, immunization and galleries and museums all provide external benefits



Left to itself, would the free-market fail to provide sufficient products that yield positive externalities?

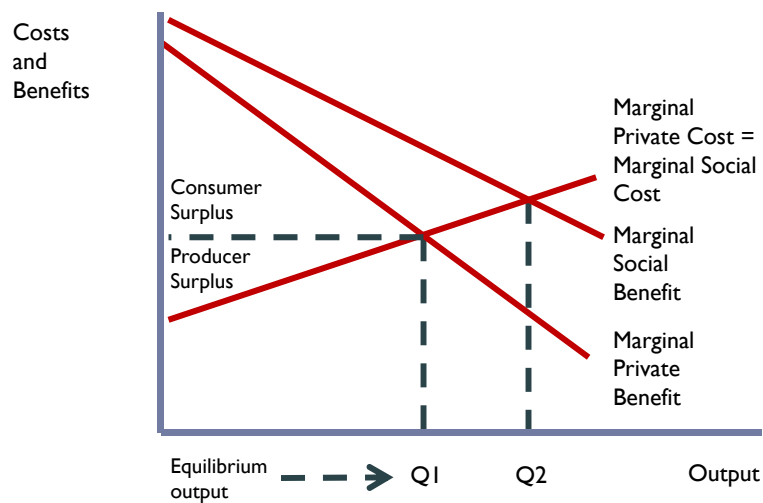
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## Positive externalities from education and training

- ▶ Improved social skills and awareness of citizenship
- ▶ Greater long-term contribution to the economy
  - ▶ Higher productivity
  - ▶ Diffusion of knowledge and understanding
  - ▶ Improved employability / reduced risk of structural unemployment
- ▶ Impact on international competitiveness from an improvement in human capital
- ▶ All of the above should help to contribute to a higher trend rate of growth
- ▶ Higher expected earnings might provide increased tax revenues for the government

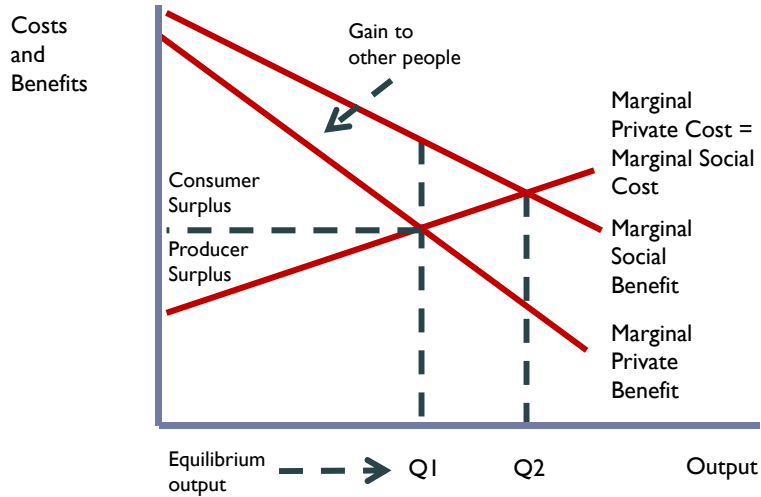
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## Positive externalities and market failure



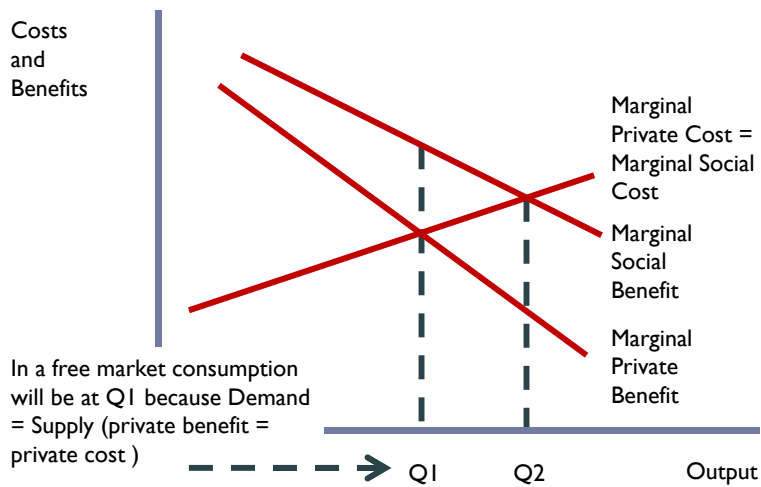
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### Positive externalities and market failure

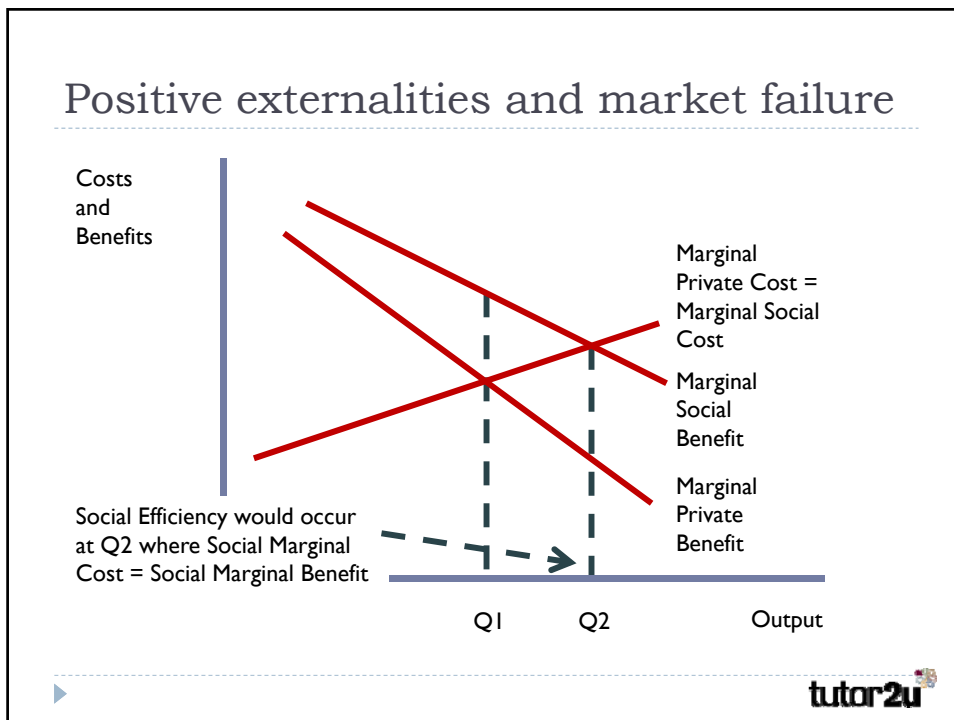
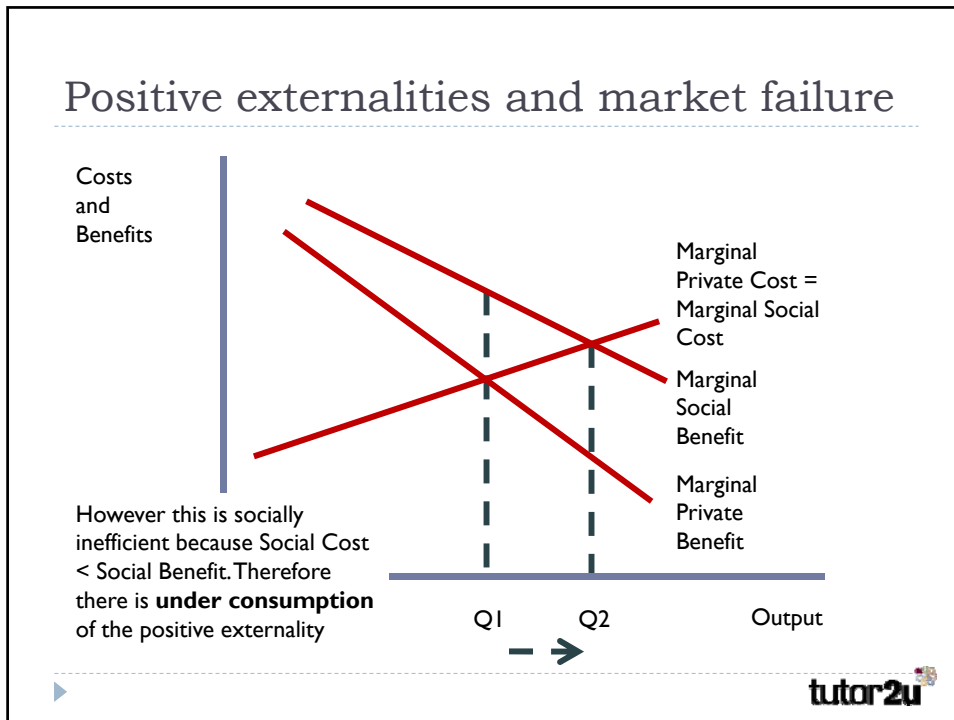


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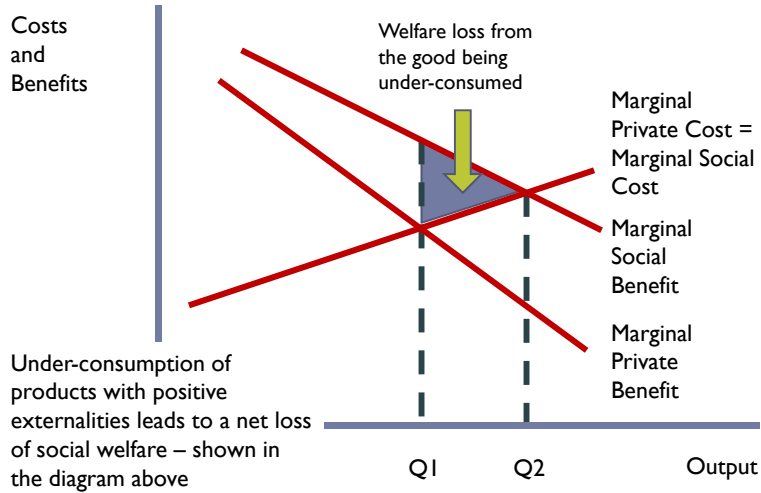
### Positive externalities and market failure



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## Positive externalities and market failure



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## Encouraging supply to reap social returns



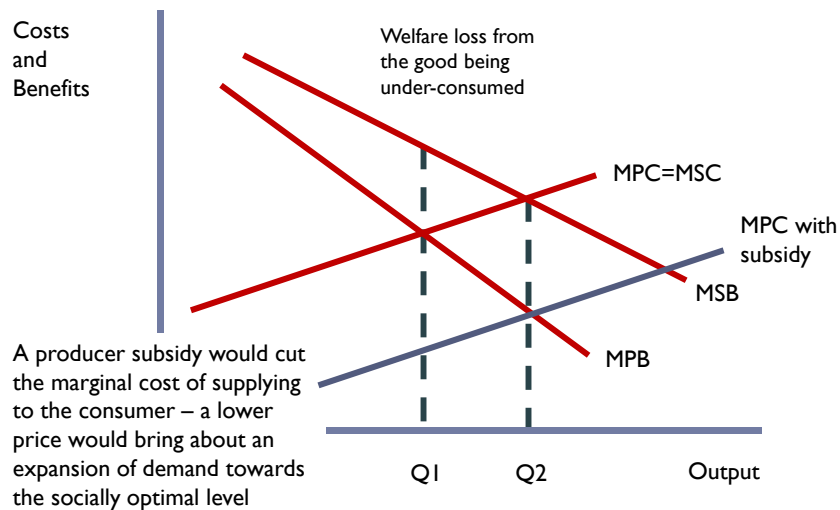
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## Government intervention options

- ▶ **Government subsidy either to producer or consumer**
  - ▶ Reduce private cost of consumption or reduce cost of supply
  - ▶ Lower costs should cause an expansion of demand
  - ▶ E.g. Student grants and low-cost loans?
  - ▶ Subsidies to fund free entrance to museums and heritage sites
  - ▶ Providing free vaccines at the point of use
- ▶ **Command and Control techniques**
  - ▶ Minimum school leaving age
  - ▶ Compulsory health immunisation programmes
- ▶ **Improved information flows to potential consumers**
  - ▶ Health awareness programmes
  - ▶ Goods with positive externalities are often public goods – e.g. Investment in reduction programmes for communicable diseases

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## A subsidy to the producer



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## Evaluation points

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- ▶ Often difficult to identify the positive externalities and then put a market value on them
- ▶ People/organisations may have an incentive to over-estimate the spill-over benefits when lobbying for financial assistance
- ▶ Providing services 'free at the point' of need may cause over-consumption
- ▶ Subsidies always carry an opportunity cost
- ▶ Regulation consumption involves a cost too

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