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The Economics of Health Externalities

Comprehension Questions

Indicate whether the statement is true or false, and justify your answer. Be sure to cite evidence from the chapter and state any additional assumptions you may need.

1. The Coase Theorem implies that there are no externalities.

   FALSE. The Coase Theorem says that, if certain conditions are satisfied, externalities do not prevent a market from reaching a socially optimal outcome. It does not argue against the existence of externalities.

2. Suppose Fred imposes negative externalities on Wilma when he engages in some otherwise productive activity (like yelling "Yabba Dabba Doo!" to encourage himself, for instance). Suppose further that Fred and Wilma know each other well, communicate effectively and trust each other, and generally have low costs from transacting with each other. In this setting, having the government impose a Pigouvian tax on Fred each time he yells "Yabba Dabba Doo!" is the only way to generate socially optimal levels of yelling.

   FALSE. The Coase Theorem would apply in this setting, because property rights are well-defined (people are legally allowed to yell) and transactions costs are low. This means socially optimal levels of yelling will be achieved even without a tax.

3. In the presence of externalities, private and social welfare tend to diverge.

TRUE. In the presence of externalities, what is good for one person's private welfare may not be good for the overall social welfare.

4. Herd immunity is a negative health externality.

   FALSE. Herd immunity is a classic positive externality: the social gain from each vaccination is greater than the private gain from that vaccination. Even unvaccinated people benefit when their neighbors, friends, coworkers, and family become immune through vaccination.

5. Every antibiotic taken causes a net social loss by contributing to antibiotic resistance.

   FALSE. The use of some antibiotic drugs are socially efficient. For example, the benefits of taking antibiotics for a person with a life-threatening case of necrotizing fasciitis caused by flesh-eating bacteria far outweigh the social costs of increased antibiotic resistance.

6. Pigouvian taxes always improve social welfare.

   TRUE. Unlike Pigouvian subsidies, whose net welfare effect depends on how they are funded, Pigouvian taxes unambiguously improve social welfare (as long as they are properly applied). Pigouvian taxes curb the overconsumption of goods with negative externalities, and the collected tax revenue can be put toward other public goods. This pair of benefits from Pigouvian taxes is known as the double dividend.

7. The Coase Theorem says that well-defined property rights and low transaction costs are needed in order for the social optimum to be guaranteed through bargaining.

   TRUE. The Coase Theorem argues that resources will be used efficiently to maximize social welfare, even in the face of externalities, if these two conditions hold.

8. Viable organs, while scarce, are readily accessible to extremely wealthy patients for a high price.

   FALSE. Organs available for transplant are exceedingly scarce. Even the richest people in the world may not be able to get an organ when they need one. For example, despite his vast wealth, it took Apple CEO Steve Jobs several months to secure one. Jobs also traveled to many regions in the U.S. to register on different organ waiting lists.

9. A Coasian approach may not succeed in achieving a socially optimal level of organ transactions.

   TRUE. Because property rights are difficult to define and enforce in the case of organs, and because bargaining costs seem prohibitively high regardless of property-rights assignment, a Coasian approach may not succeed in achieving a socially optimal level of organ transactions.

10. Most countries effectively impose an infinite tax on organ sales.

    TRUE. An infinitely high tax is economically identical to a ban on all organ sales. In real-world organ markets, this is the preferred policy adopted by most governments: an outright ban on any organ sales.

11. Subsidies that provide financial incentive people to become organ donors may lead to a decrease in donations.

    TRUE. Such subsidies may backfire. Providing an economic incentive might cheapen altruistic motivations (the Titmus effect). A financial payment might replace the charitable motivation to donate blood, and if the financial incentive is too low, the total amount of blood donations may decline.