Externalities

- An externality is an economic term referring to a cost or benefit incurred or received by a third party. However, the third party has no control over the creation of that cost or benefit. The costs and benefits can be both private—to an individual or an organization— or social, meaning it can affect society as a whole.

Types

Positive externalities: Positive externalities refer to the benefits enjoyed by people outside the marketplace due to a firm's actions but for which they do not pay any amount, e.g.

Getting a vaccination provides a benefit to other people in society because you do not spread infectious diseases. A decision to stop smoking causes benefits to other people in society who longer suffer passive smoking.

Negative externalities: Negative externalities are the negative penalty faced by outsiders due a firm's actions for which it is not charged anything by the market, e.g.

Air pollution from motor vehicles is an example of a negative externality. The costs of the air pollution for the rest of society is not compensated for by either the producers or users of motorized transport.