Coase Theorem Encyclopedia Article

Coase Theorem

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Coase Theorem

An economic theorem that is sometimes used in discussions of external costs in environment-related situations. The standard welfare economic view states that in order to make the market efficient, external costs—such as **pollution** produced by a company in making a product—should be internalized by the company in the form of taxes or fees for producing the pollution. Coase theorem, in contrast, states that the responsibility for the pollution should fall on both the producer and recipient of the pollution. For example, people who are harmed by the pollution can pay companies not to pollute, thereby protecting themselves from any potential harm.

Ronald Coase, the economist who proposed the theorem, further states that government should intervene when the bargaining process or transaction costs between the two parties is high. The government's role, therefore, is not to address external costs which harm bystanders but to help individuals organize for their protection.