EXTERNALITY

This is an example of a negative externality and its solution

S= Marginal social Cost (MSC)

S= Marginal private Cost (MPC)

Price

P* where
MSC=MSB

P1

D = Marginal Social Benefit (MSB)

Q* Q1
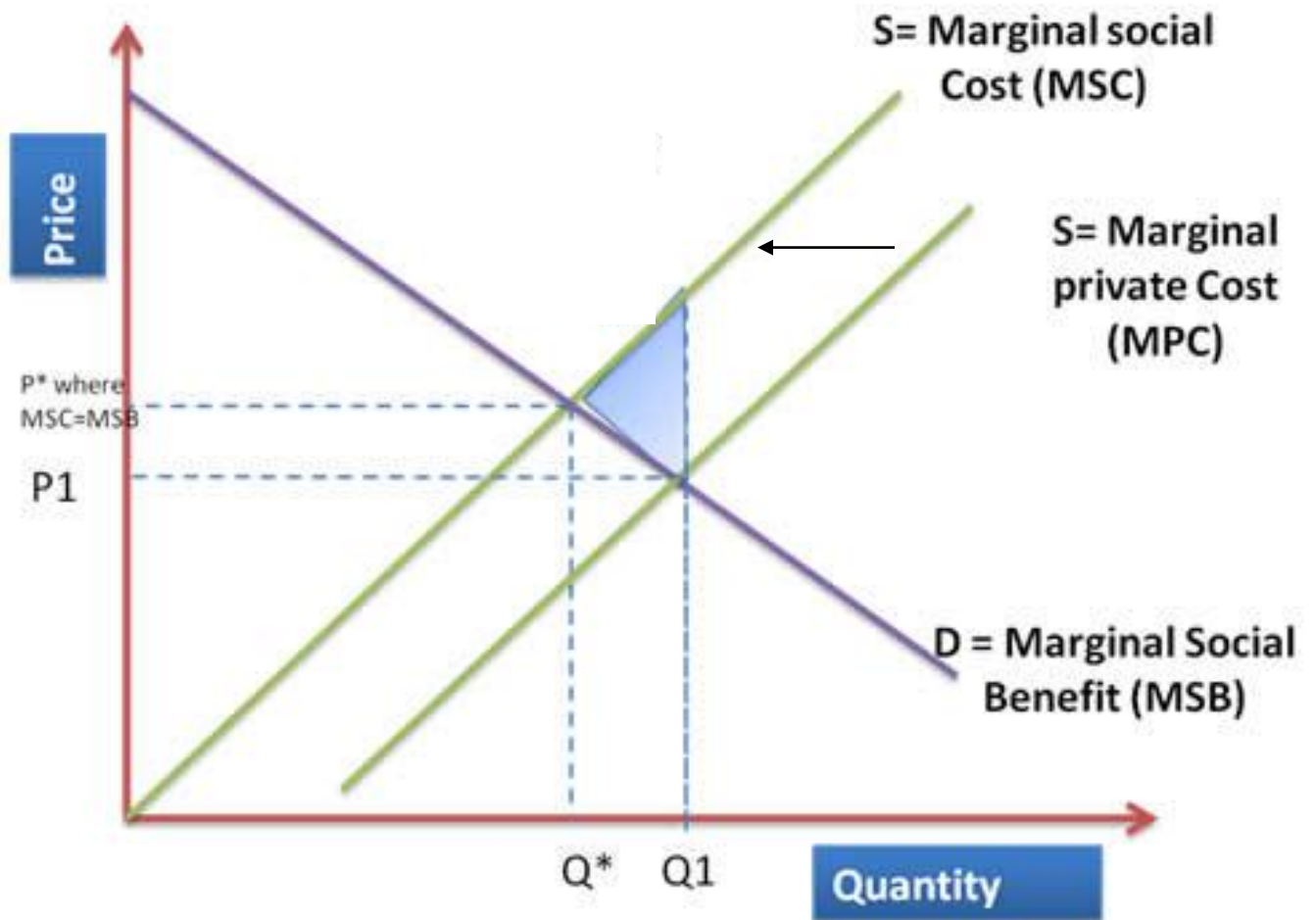
Quantity

| Q* is optimal equilibrium quantity after tax | Q1 is equilibrium quantity in free market before tax |

(triangle in graph represents a welfare loss or you could say it shows market failure)