Demerit Goods

A demerit good is defined as "a good or service the consumption of which is regarded unhealthy, demeaning, or otherwise socially inappropriate due to the perceived negative impacts on the consumers themself" in economics; if left to free market forces, it might be over - consumed. Tobacco, alcoholic drinks, addictive substances, betting, unhealthy snacks, pornography, and prostitution are examples of demerit goods. Due to the obvious nature of these items, governments frequently impose taxes on them (particularly, sin taxes), as well as limiting or prohibiting their usage or advertisement. The topic has a very high chance of being asked as a UPSC Prelims Economy Question or as a Current Affairs Question, as it has been in the news recently.

Concept

A key conceptual distinction exists between a detriment good and a negative externality. Whenever the consumption of a commodity has observable negative implications on people who do not consume the good, this is known as a negative externality. The classic example of a negative externality is pollution (for example, due to vehicular usage). A demerit good, on the other hand, is regarded as undesirable since its consumption has bad repercussions for the consumer. Cigarettes have both the properties: they are a demerit good in that they harm the smoker's own wellbeing, but they also cause harm to others through second - hand smoke.

Welfarism as well as paternalism, two major views of welfare economics, vary in their conceptual interpretation of “demerit goods”. Simply put, welfarism views an individual's own sense of a good's utility as just the final judgement of that item's value for that individual, therefore eliminating the notion of a 'demerit good' (while letting the analysis of negative externalities). As an extreme example, if a heroin addicted person purchases heroin, it is assumed that they did so because heroin helps them feel better in some way, and hence this activity is viewed as a net social positive (supposing that the addicted person does not commit any other crimes because of the influence of the intoxicant).

Negative Externalities

Negative externalities arise when a good or service's product and/or consumption has a negative impact on a third party who is not involved in the transaction. A typical transaction contains two parties, the first and second parties in the transaction, which are referenced to as the first and second factions in the transaction, respectively. A third party is someone who isn't involved in the transaction but is interested in it.