

Public Goods

Market Failure

- Market Failure - this is a situation where the market cannot efficiently allocate resources

Market failure occurs when:

- 1) Monopoly Power exists
- 2) Externalities exist
- 3) Public Goods

Public Goods

- So far this semester we have just looked at PRIVATE GOODS - goods that are:

- 1) consumed by a single individual
- 2) rival in consumption
- 3) excludable

Rival in consumption - consumption by one person decreases the consumption by another person

Excludable - it is possible to prevent someone from benefiting from that good

(Pure) Public Goods

- goods/services that are non-rival in consumption and non-excludable
- ex. Lighthouse, National Defense
- Note:
 - 1) Not all publicly (Government) provided goods are pure public goods - they have elements of excludability or rivalry (ex. highways)
 - 2) Not all "public" goods are provided by the government - they can be privately provided (ex. Education, police protection, television programming)

- So, why does market failure arise when public goods are present?

Nonexcludability of the good – can't prevent people from taking advantage of the good if they didn't pay

Because of this, a profit-maximizing firm WOULD NOT supply these goods. This forces the government to provide these goods

In general, the more non-rival or nonexcludability that is associated with the good - the less perfectly competitive markets tend to provide of that good
(UNDERPROVISION) (INEFFICIENT MARKET)

FREE RIDER PROBLEM

- This does not arise when goods are "private" goods

With private goods - you "reveal" your preferences for the good by consuming that good. But, with public goods, this is not the case.

- 1) Non-excludability
- 2) Governmental provision/taxation

- Free Rider Problem - people seek to consume a good/service without paying for it.
- Would anybody pay for these public goods?
- In general, rational self interest can lead to an inefficient outcome for society.

PUBLIC GOOD PROVISION

- Since rational self-interest tells us that no one would wish to pay for these goods, how are they provided?

-Generally, through tax revenue. Also, how much should be provided?

PUBLIC CHOICE - made by voting

VOTING OVER PUBLIC GOODS PROVISION

- Simple Majority
- Political Equilibrium - agreement on the quantity of the public good to be supplied
- Median Voter Theorem - political parties will pursue policies (provisions) that appeal to the median voter
