

Economics 101 – Section 5

Lecture #26 – April 27, 2004

Chapter 15 – Market Failures pp. 453-466
Public goods

Notes

- Practice final exam
 - Exam and key on web (at the bottom of the page)
- Format for the final next Monday (9:45-11:45)
 - 100 mc
- Studying for the final
- Additional office hours
 - Wed April 28 10-11:00 AM and 2-3:00 PM
 - Thursday April 2-3:00 OM
- No new material next lecture Thursday April 29th – will essentially be a review session

Externalities

- Externalities
 - is a by-product of an action that affects someone who has not taken part explicitly in that action
 - Examples
 - Pollution
 - Innocent bystanders close to riots (tear gas)
 - Disruptive behavior in any class that affects those around you

Externalities

- Negative externalities (such as pollution)
 - A market with a negative externality associated with production or consumption will be inefficient
 - There will be too much consumption of the good
 - In market equilibrium the actual marginal cost (this includes the social cost) exceeds the marginal benefit
 - A tax equal to the difference between the marginal social cost and marginal private cost can correct a negative externality and make a market efficient

Externalities

- Positive externalities
 - A market with a positive externality from production or consumption of a certain good will also be inefficient
 - Too little will be produced
 - In the market equilibrium the marginal benefits to all parties exceeds the marginal cost
 - A subsidy equal to the difference between marginal social benefit and marginal private benefit can correct a positive externality and make a market efficient.

Public goods

- A public good
 - A good which is both non-rival and non-excludable
 - Ex: national defense, parks, air
- A private good
 - A good that is rival and excludable
 - Car, hamburger, newspaper, chair
 - Rival – when one person consumes a good then no one else can consume that same good at that particular moment in time
 - Hamburger, apartment
 - Non-rival – when many people can enjoy the same good without affecting anyone else's consumption of that same good
 - National defense, Leid rec center (as long as there are not too many people there), parks, air

Public goods

- Excludable
 - Can prevent others from enjoying that good if they do not pay for it
 - Leid rec center, country club, car, the subway
- Non-excludable
 - Cannot prevent others from enjoying that good
 - National defense, air, parks

Public goods

- If there is rivalry in consumption then it should be provided by the market
- Free rider
 - Is someone who does not contribute to paying for an excludable good but gets to enjoy the benefits
 - People who don't pay taxes free ride on national defense
 - Visitors from out of town free ride on local parks

Public goods

- The private sector will not provide goods which are non-excludable
 - These must be provided for by the government
 - Examples – Defense, basic research, most parks (the ones without a user fee)
- When a good or service is non-rival, the market cannot provide it efficiently
 - To achieve efficiency the good should be provided free of charge

Public goods

	Excludable	Non-excludable
Rival	<i>Private Good:</i> -The market will provide The good	<i>Mixed good</i> - The market will not provide enough of the good
Non-rival	<i>Mixed good</i> - The market will not provide enough of the good	<i>Public Good</i> - Market should not provide any of the good

Public goods

- Tragedy of the commons
 - The problem of overuse when a good is rival but non-excludable
 - Overuse of parks
 - Smog in cities – too many people driving or driving too much
 - Congestion on the web – using up too much bandwidth
 - Highways

Public goods

- Note – Just because a government provides a good does not necessarily mean that it is public
 - In the US the gov owns
 - land,
 - some utilities (at least in the past)
 - In other countries
 - Land, banks, media companies, newspapers, large corporations