**PREP 1: Introduction to ‘Pure Public Good Theory’ or ‘Missing Markets’**

**‘Goods’ and ‘Bads’**

A ‘good’ in economics is a resource or finished product that is consumed/sold/traded. Consumers are prepared to pay a price to gain the benefits of a good such as a TV set. Equally they are prepared to avoid consuming a ‘bad’. ‘Bads’ in Economics refer to things such as household rubbish disposal or the effects of factory emissions on the health of society or CO2 production to provide us with energy.

**Introduction to ‘Private Goods’ and the concept of ‘Property Rights’**

Property rights determine how a private good is owned or used. Resources can be owned by individuals (economic agents). Therefore if someone has the right to ‘property’ then they have….

* the right to use the private good
* the right to earn income from the private good
* the right to transfer the private good to others
* the right to enforce property rights and claim what is theirs

Therefore property rights are usually considered to be the ownership of a private ‘good’. This is a good that has the following characteristics:

* ‘Rival’ (i.e. my consumption restricts your consumption – so if I eat an apple, you cannot eat it as well)
* ‘Excludable’ (i.e. I can prevent you from having claims to my property – through physical barriers or legal means. So if you stole my apple from me, I could appeal to the law of the land and the police to charge you as a criminal!)

Many economists argue that property rights of private goods need to be fixed (often in Law). Therefore, property rights must be:

* Defined (who owns what)
* Their use must be monitored
* Possession of rights must be enforced

Proponents of ‘Free Market’ Economics claim that every good is considered to be ‘private’ and the free market through private profit motivated firms will provide these goods if the consumer demands them (is willing to pay a price as the consumer see value in the good/service).

**Introduction to Public Goods**

In distinguishing between private and public goods, it is useful to introduce two characteristics of these goods: exclusion ability and rivalry in consumption. Exclusion ability is a characteristic where a consumer can be prevented from using that good. Obviously, private goods have this quality. If you buy food at the supermarket, then it is yours to eat. You can exclude everyone else from eating it through physical strength (!) or the backing of the law of the land (police?) to prevent others consuming the good you now own (as private property). Rivalry in consumption is a quality where the consumption of the good diminishes the availability for others. If you chop down a tree on public land to supply your fireplace, then that is one less tree for everyone else. Equally, if you eat an apple, then that apple cannot be consumed by someone else at the same time. A private good is both excludable and rival in consumption, a public good is neither (so non-excludable and non-rival).

Some ‘goods’ are free (i.e. have a price of zero), either because they occur naturally (and are arguably plentiful - such as sand on beaches and well stocked fish supplies in the ocean), or because they have to be provided by the government (such as military protection or streetlights because the market would not provide them as consumers would ‘free ride’ – there would be a missing market). From an economic standpoint, there is a problem in analysing these free goods, which are often referred to as public goods, since they are freely available to all and consumers will ‘free ride’ on their consumption. This will lead to the natural public ‘goods’ being abused (tragedy of the commons – see RWS 10) and man-made public goods not being provided by private firms in the free market (and so having to be provided by Government intervention).

Pure public goods are considered to be both non excludable and non-rival. An example might be streetlighting for example. Another example is a countries nuclear deterrent through Trident in the UK. If it was provided by a private firm, the firm would find it very hard to exclude people in the UK from the benefits enjoyed from preventing other countries from dropping nuclear bombs on us. Equally, my ‘consumption’ of not being obliterated does not affect your chances (or benefit)….and so it is non-rival…and that non-rivalry arguably means the good is no longer scarce because once provided it can provide for everyones wants (be it being able where you are going at night or to prevent a nuclear attack against the UK!).

Non-excludability leads to ‘public goods’ being free (or valued at 0) not because they are not in demand (everyone wants protection from nuclear attack!) but because consumers will free ride once the good/service is provided (i.e. be able to not pay for the good but still benefit). Therefore firms are unable to charge a price even though consumers place a value on the good. Equally, non-rivalry suggests the good is ‘unlimited’ as my consumption does not affect yours once the nuclear deterrent is provided and so there is no sense of scarcity and an unlimited supply will mean the good is essentially a ‘free good’.

**TASK: please write answers to the following questions below after reading the excerpt above (you might have to re-read it several times):**

QUESTION: Explain why ‘street lighting’ could not be produced by a private firm in a free market using concepts of ‘non-excludability’, ‘non-rivalry’ and the ‘free rider’ problem. This could be the equivalent of a 9 mark question in terms of how much you should write below. Please write in ‘proper English’ – sentences, paragraphs etc.

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QUESTION 2: Explain why the market is failing in this example and why these goods are sometimes called ‘missing markets’

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