SECTION 5

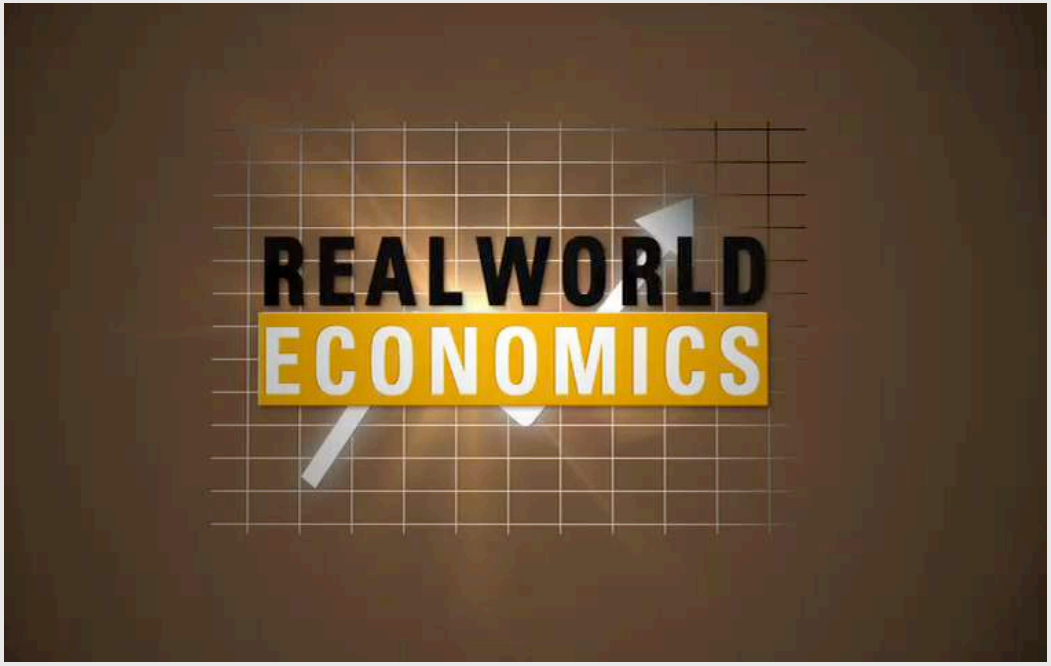
Public Goods

Learning Objectives

In this chapter, you will learn to:

1. Define the study of microeconomics
2. Describe the difference between positive and normative statements
3. Assess if an exchange will happen
4. Identify and describe how three factors of production form the basis of the circular flow of income
5. Describe how households and firms interact in two markets
6. Describe the concept of opportunity costs using the examples of guns and butter
7. Plot a production possibility curve using two examples of scarce resources
8. Describe the differences between public goods and private goods

RWE Video 1.4 Public Goods - 3 mins 49 s



Dr. Gray examines how public goods and private goods differ, including issues and factors that affect pricing, determination of optimal quantity and financing.

This video reviews pricing and how to determine the optimal quantity for a public good, such as green space in the middle of a university's campus.

Public goods are unlike private goods in that it is much more difficult to determine what the equilibrium price is, and what the equilibrium quantity will be.

Green space is a public good. Everybody loves green space and wants to have more green space on campus. But, there is a problem. It is difficult to determine the optimal level of green space because land, that could be used for green space, has an opportunity cost. The land could, potentially, have better uses and, since green space is a public good, pricing the land is a problem.

There are differences between public goods and private goods. Consumption of a public good is non-rivalrous. On the other hand, consumption of a private good isrivalrous.

Rivalrous consumption means that two people cannot consume the same good at the same time, whereas non-rivalrous consumption means that two people can consume the same good at the same time.

The characteristic of excludability also differentiates public goods from private goods. Public goods are non-excludable, meaning that people cannot be prevented from using the public goods if they want to use them. In contrast, private goods are excludable.

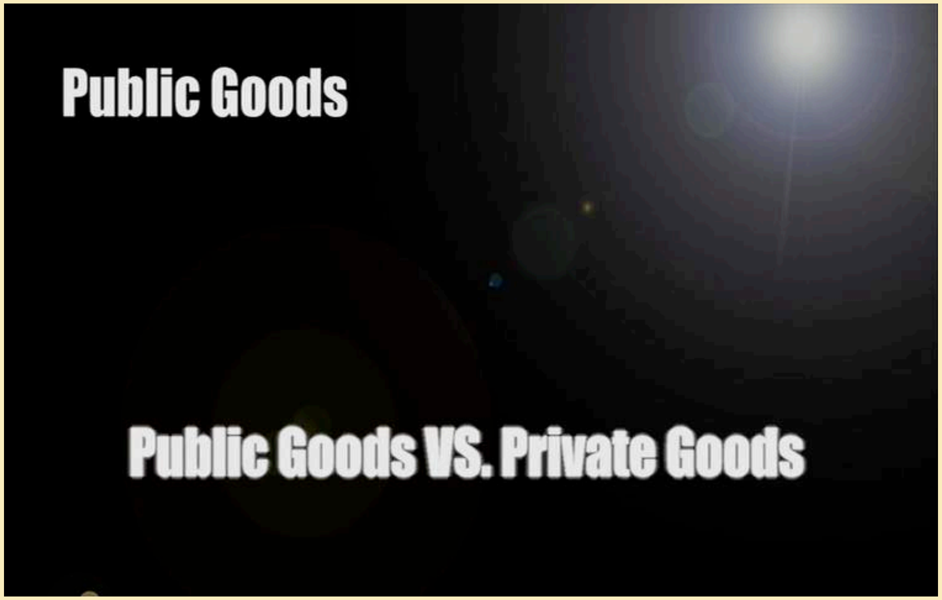
It is easy to exclude people from benefiting from private goods. A person who pays for the private good can consume it. The person who cannot pay for the private good cannot consume it.

It can be difficult to finance the provision of a public good, since nobody can be prevented from consuming it. This also makes it is easy for people to understate their preferences. For example, it is easy for someone to say that green space does not mean much to them and that they do not want to help pay for it, knowing that he or she cannot be prevented from enjoying the green space.

Economists call this behavior "Free Riding Behavior". People use the public good without paying for it. Typically, the problem is avoided by not attempting to charge people for the use of the green space. Instead, the green space is financed through compulsory taxation.

Compulsory taxation is often used to finance the provision of a public good.

Key Concept 1.3
Differences Between Public and Private Goods - 1m 12 s

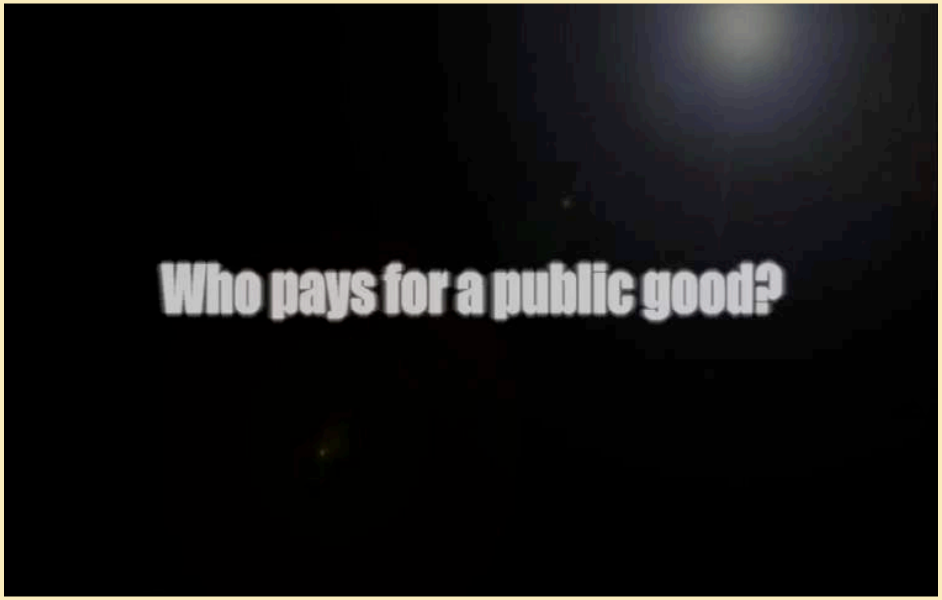


Public goods are unlike private goods in that it is much more difficult to determine what the equilibrium price is, and what the equilibrium quantity will be. For example, green space is a public good. Everybody loves green space and wants to have more green space. Unlike a private good though, it is difficult to determine the optimal quantity of green space because the land that could be used for green space, has an opportunity cost.

Consumption of a public good is non-rivalrous. On the other hand, consumption of a private good is rivalrous. Rivalrous consumption means that two people cannot consume the same good at the same time, whereas non-rivalrous consumption means that two people can consume the same good at the same time.

The characteristic of non-excludability also makes public goods different from private goods. Public goods are non-excludable. This means that people cannot be prevented from using the public goods if they want to use them. In contrast, private goods are excludable. It is easy to exclude people from benefiting from private goods by making them pay for them.

Key Concept 1.4
Differences Between Public and Private Goods - 1m 12 s



It is very difficult to finance the provision of a public good, since nobody can be prevented from consuming a public good. A "free rider" is someone who benefits from a good, service or resource without paying for it. The "free rider" problem is often avoided by financing public goods through compulsory taxation.