

Chapter 13 Market Failures, Government Failures and Rent Seeking

- **Economic freedom**- the degree to which private individuals are able to carry out voluntary exchange without government involvement.
 - linked to standards of living.

Market Failure

- **Market failure**- occurs when the market outcome is not the socially or economically efficient outcome, some action by the government is sometimes necessary to ensure that the market work well.
 - Market failure has to do with something interfering with the optimization of agents through the market process.
 - If the market provides a result we don't like, doesn't mean there was a market failure

Private Property Rights

- **Private property rights**- the rights of individuals to own property.
 - When private property rights are secure, others are not allowed to steal or damage your private property.
 - Crucial to a market.

Private, Public, and Club Goods

- **The principle of mutual exclusivity**: the owner of private property is entitled to enjoy the consumption of that property privately.
- **The principle of rivalry states**: when one consumes or uses a good or service, less remains for others.

- **Private good**- a good that is both excludable and rivalrous.
- **Club good**- a good that is excludable but non-rivalrous
- **Public good**- a good that is non-excludable and non-rivalrous.
- **Commons good**- a good that is rivalrous but non-excludable.

	Excludable	Non-Excludable
Rivalrous	Private Goods Examples: Food, Clothing, Toys, Furniture, Pizza	Common Goods Examples: Fish, Water, Air
Non-Rivalrous	Club Goods Examples: Cable TV, Private golf courses	Public Goods Examples: National Defense, Free-to-air TV,

Free Rider

- When goods are non-excludable, an individual has an incentive to be a free rider.
- **Free rider**- a consumer or producer who enjoys the benefits of a good or service without paying for that good or service.

Externalities

- **Private costs and benefits**- those that are borne solely by the individuals involved in the transaction.
- **Externality**- a cost or benefit of a transaction that is borne by someone who is not directly involved in the transaction.
- If externalities exist, it means that those involved in the demand and supply in the market are not considering all the costs and benefits when making their market decisions.
 - As a result, market fails to yield optimal results.

Positive and Negative Externalities

- **Positive externality**- may result when some of the benefits of an activity are received by consumers or firms not directly involved in the activity.
- **Negative externality**- may result when some of the costs of an activity are not borne by consumers or firms not directly involved in the activity.

Social Cost

- **Social cost**- total social cost of a transaction is the private cost plus the external cost.
 - If all costs of a transaction are borne by the participants in the transaction, the private costs and social costs are the same.

Externalities and Market Failure

- When there is a divergence between social costs and private costs, the result is either too much or too little production and consumption.
- In either case, resources= not being used in their highest-valued activity & market failure may occur.