Government And Market Failure

DEMAND FOR A PUBLIC GOOD

Problems of Revealing Preferences

Quantity	Adams' Willingness to pay (price)		Benson's Willingness to pay (price)		Collective Willingness to pay (price)
1	**$4**	**+**	**$5**	**=**	**$9**

DEMAND FOR A PUBLIC GOOD

Problems of Revealing Preferences

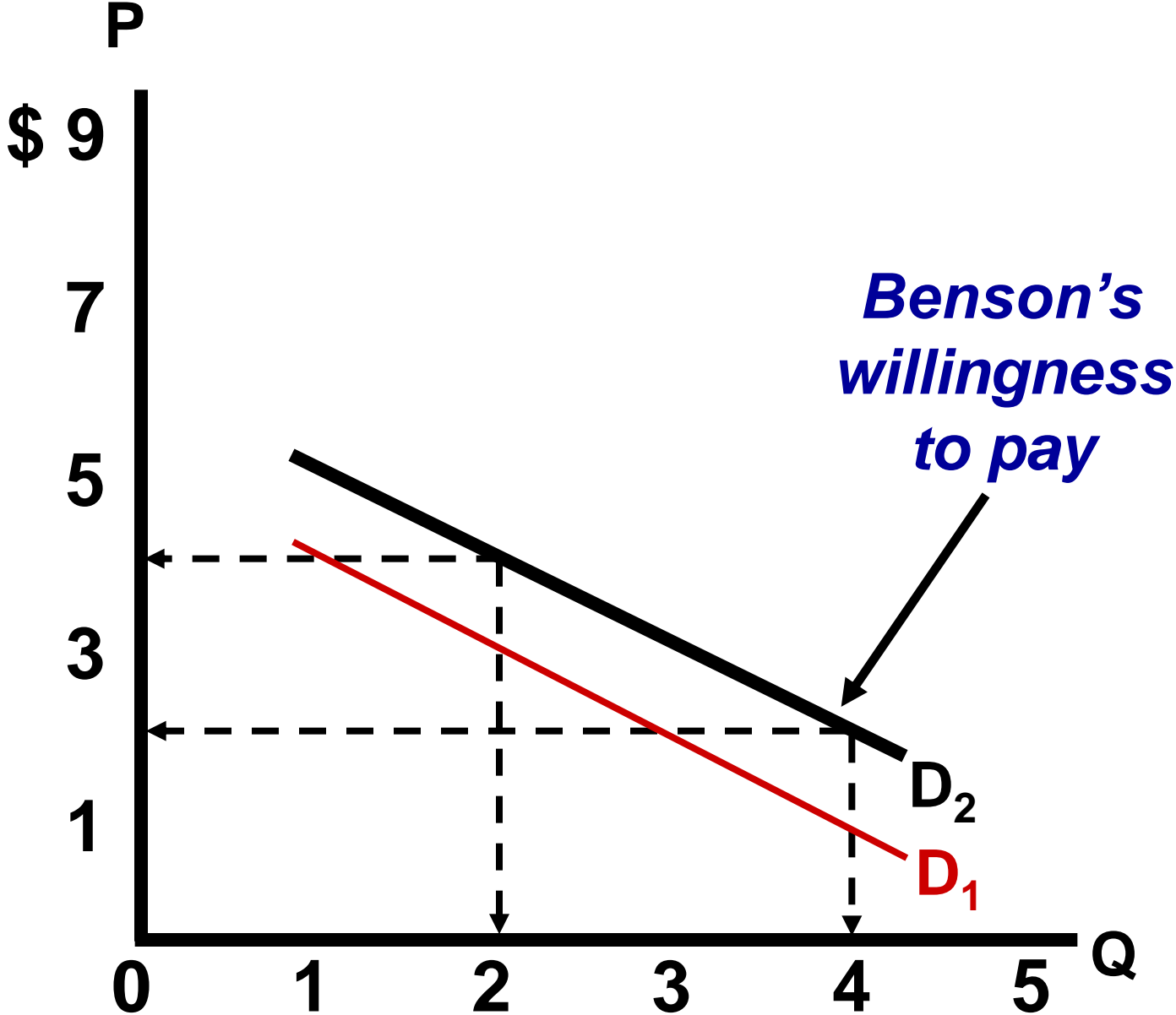| Quantity	Adams' Willingness to pay (price)		Benson's Willingness to pay (price)		Collective Willingness to pay (price)
1	$4	+	$5	=	$9
2	3	+	4	=	7

DEMAND FOR A PUBLIC GOOD

Problems of Revealing Preferences

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1	$4	+	$5	=	$9
2	3	+	4	=	7
3	2	+	3	=	5

DEMAND FOR A PUBLIC GOOD

Problems of Revealing Preferences

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3	2	+	3	=	5
4	1	+	2	=	3

DEMAND FOR A PUBLIC GOOD

Problems of Revealing Preferences

Quantity	Adams' Willingness to pay (price)		Benson's Willingness to pay (price)		Collective Willingness to pay (price)
1	$4	+	$5	=	$9
2	3	+	4	=	7
3	2	+	3	=	5
4	1	+	2	=	3
5	0	+	1	=	1

OPTIMAL AMOUNT OF A PUBLIC GOOD
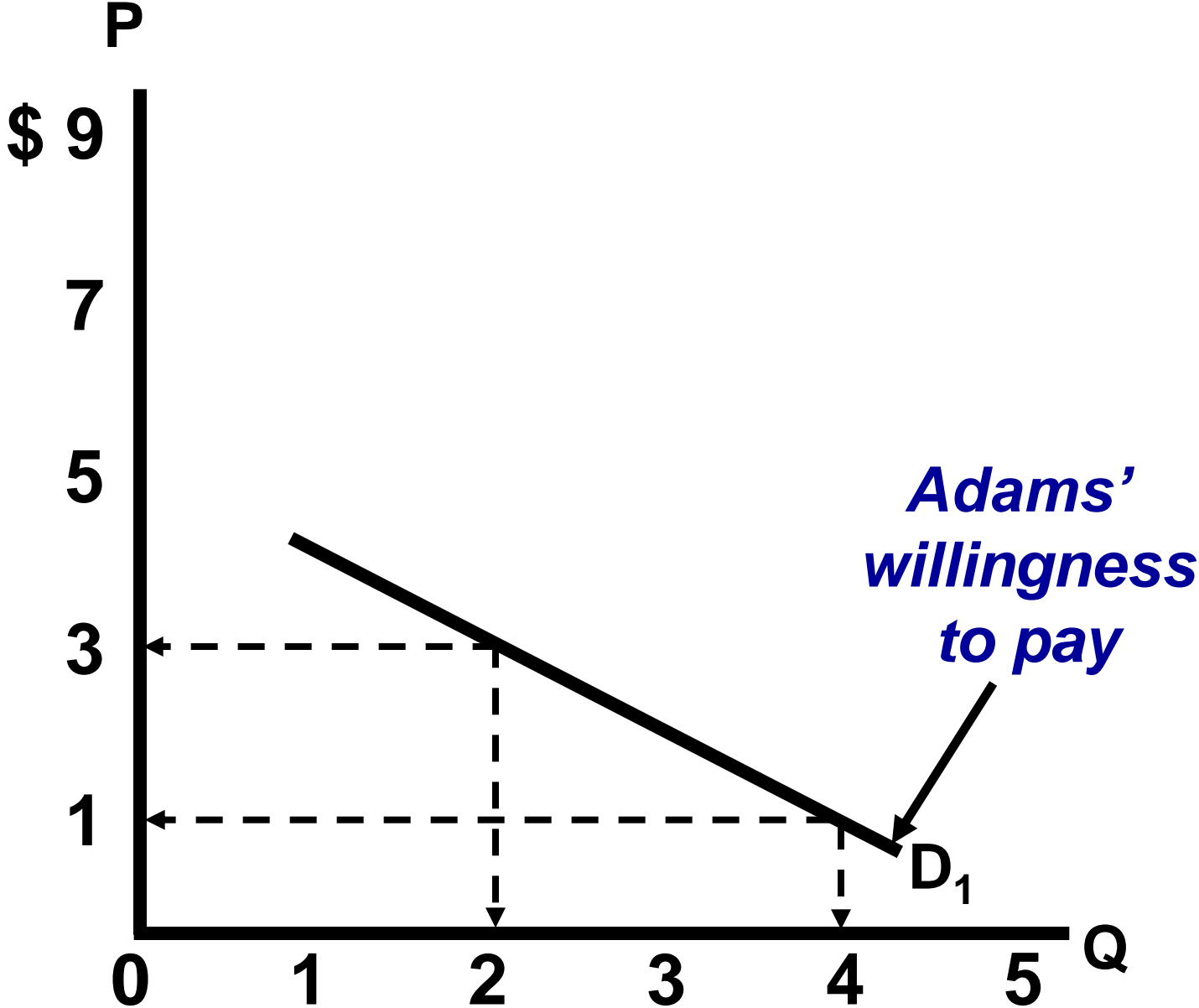
OPTIMAL AMOUNT OF A PUBLIC GOOD

P

$ 9

7

5

Benson's willingness to pay

3

1

0   1   2   3   4   5   Q

D_2

D_1

OPTIMAL AMOUNT OF A PUBLIC GOOD

OPTIMAL AMOUNT OF A PUBLIC GOOD

P

$ 9

7

5

3

1

0   1   2   3   4   5   Q

S

The public good's
marginal cost

as shown by S

D$_C$
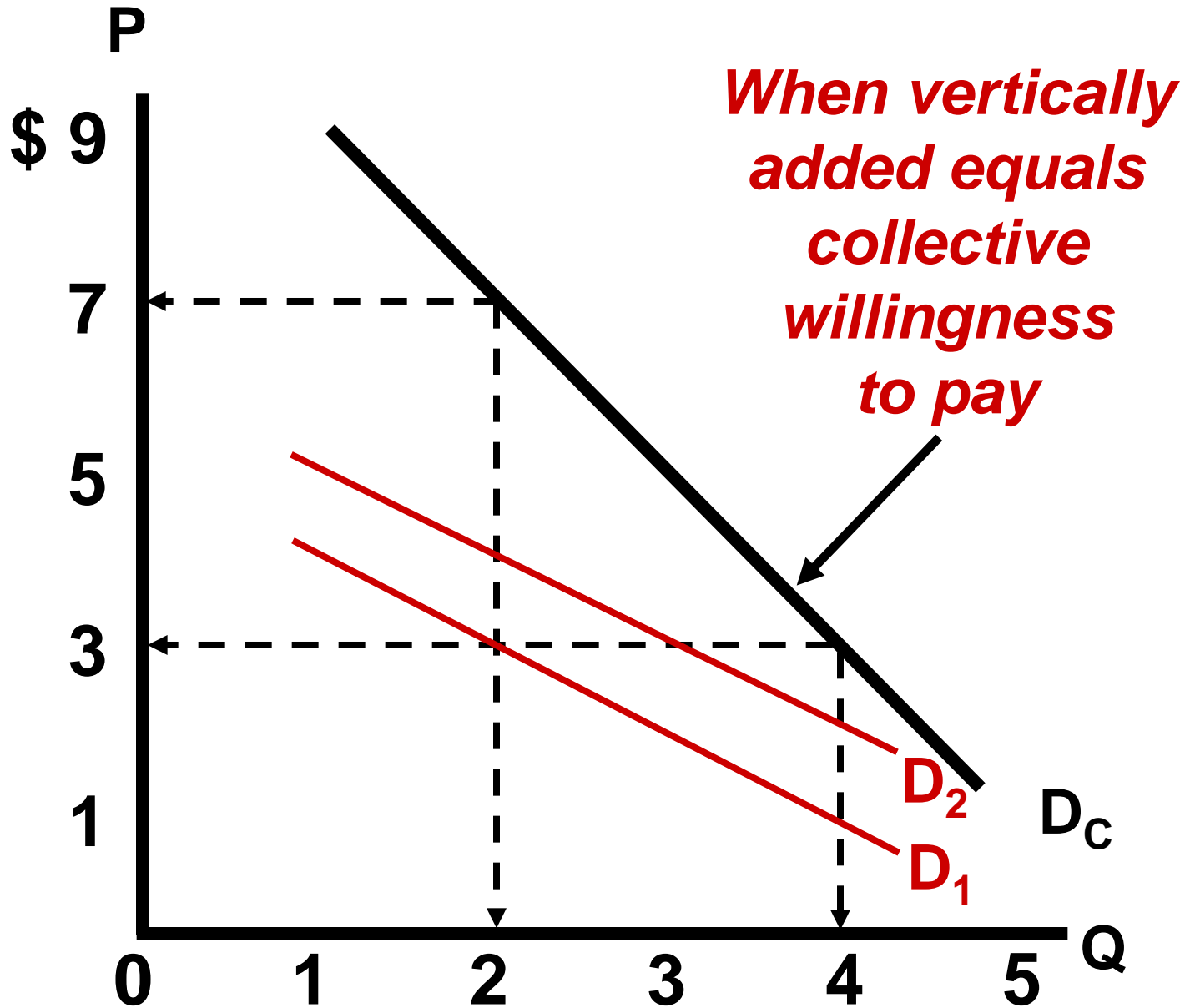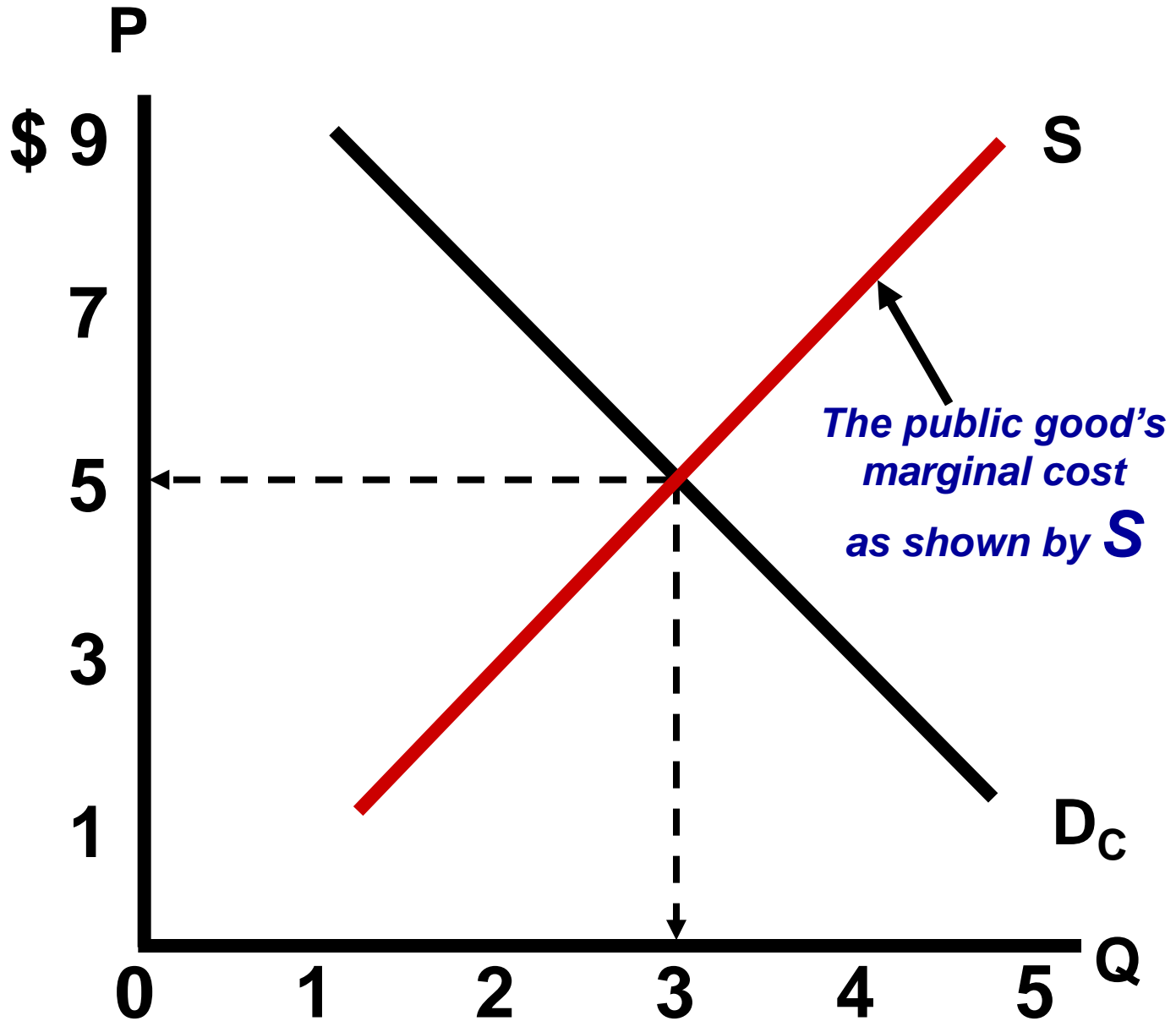
OPTIMAL AMOUNT OF A PUBLIC GOOD
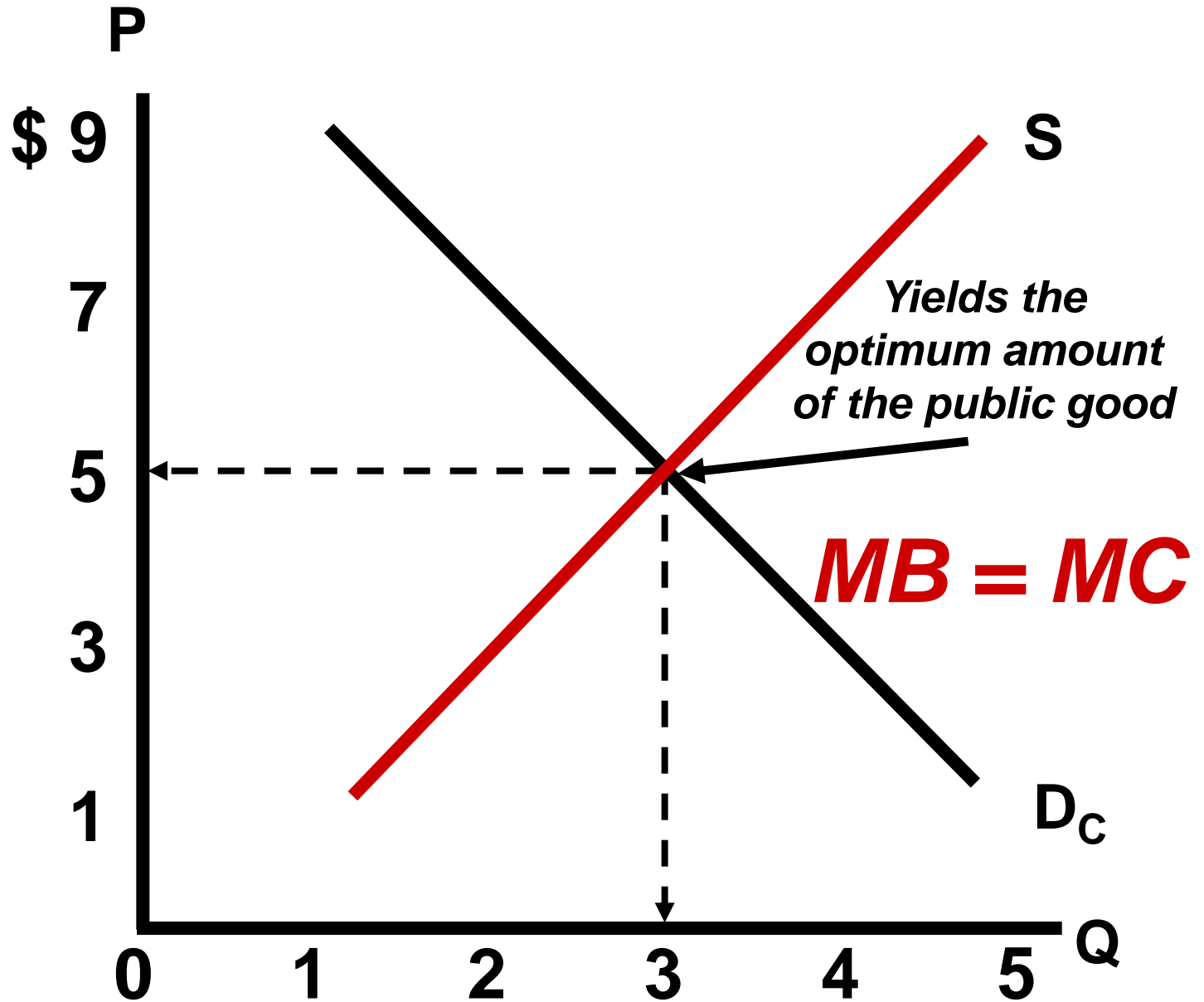
COST-BENEFIT ANALYSIS

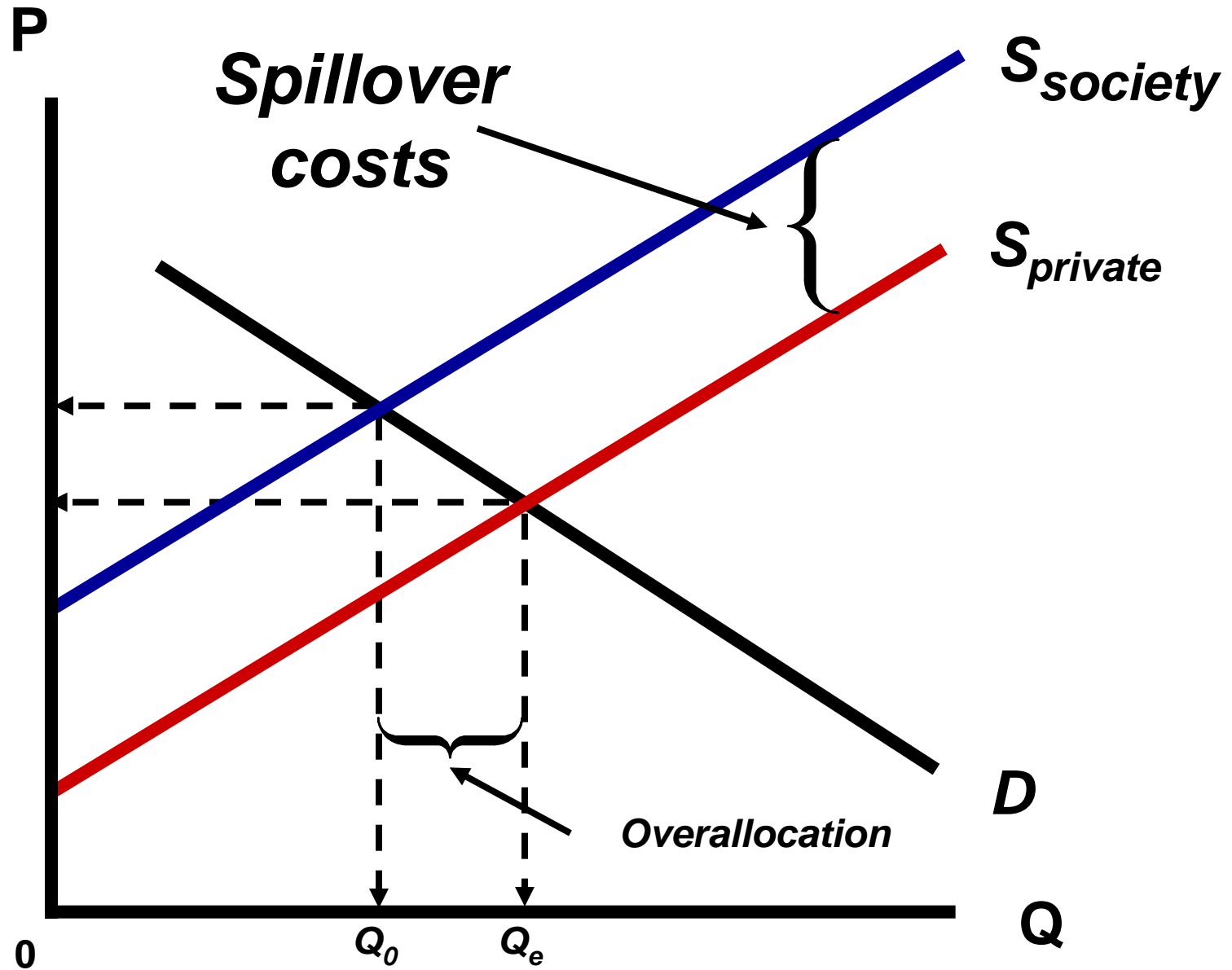*Marginal Cost = Marginal Benefit Rule*

Externalities

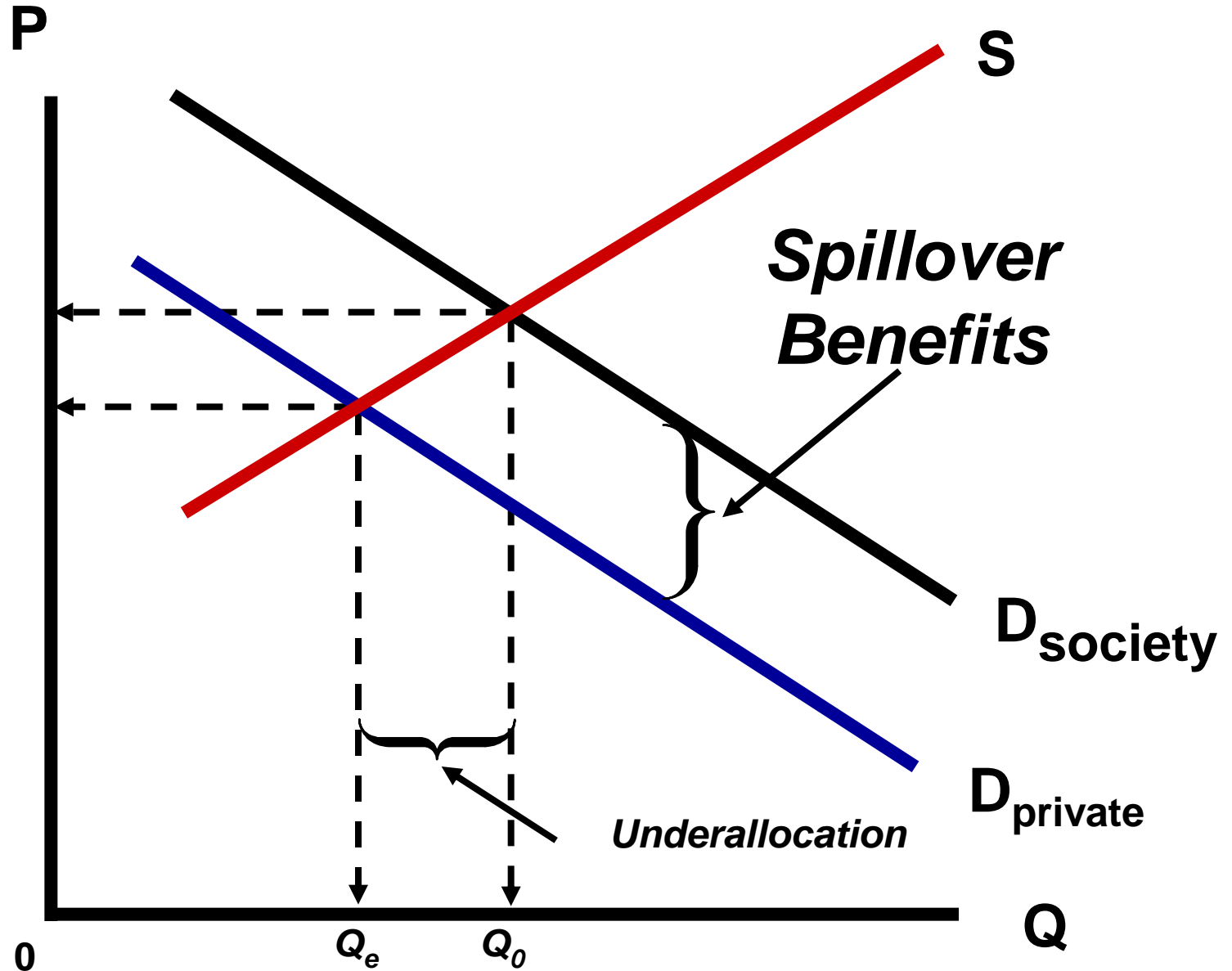### Spillover Costs

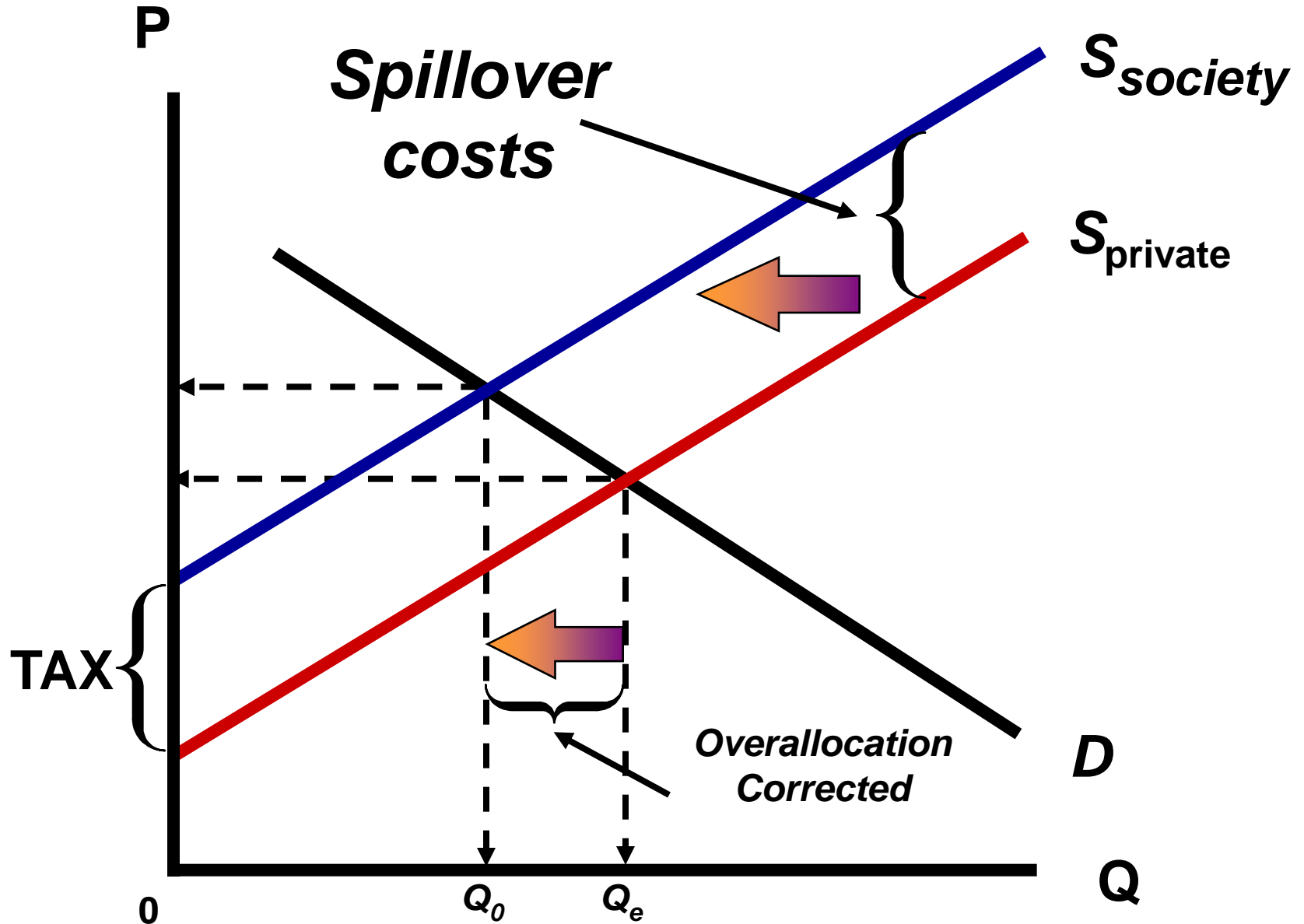*Overallocation*

Spillover Benefits

Underallocation

SPILLOVER COSTS AND BENEFITS

SPILLOVER COSTS AND BENEFITS

CORRECTING SPILLOVER COSTS

$S_{society}$

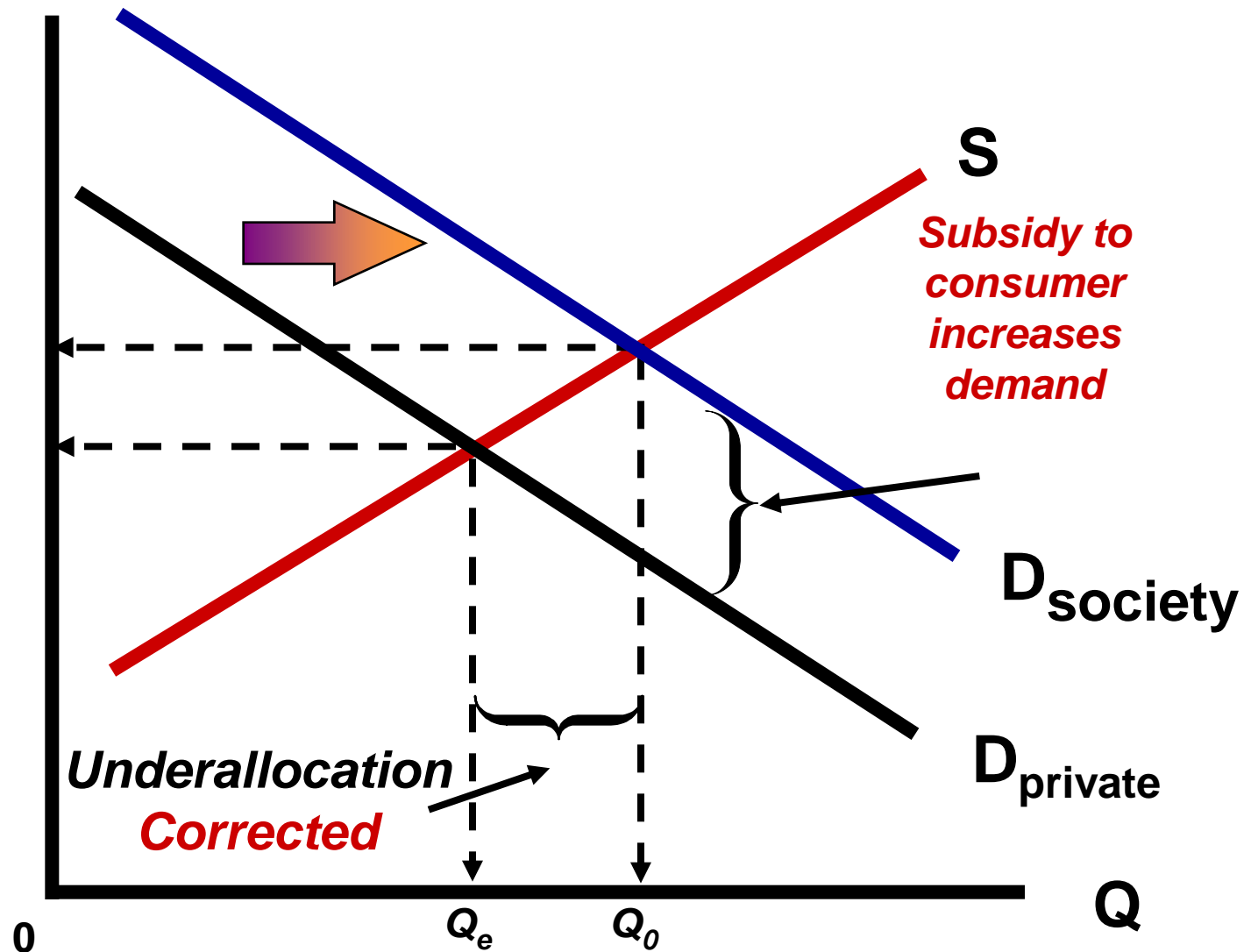Spillover costs

$S_{private}$

TAX

Overallocation Corrected

D

Q_0 Q_e

P

Q

0

CORRECTING SPILLOVER BENEFITS
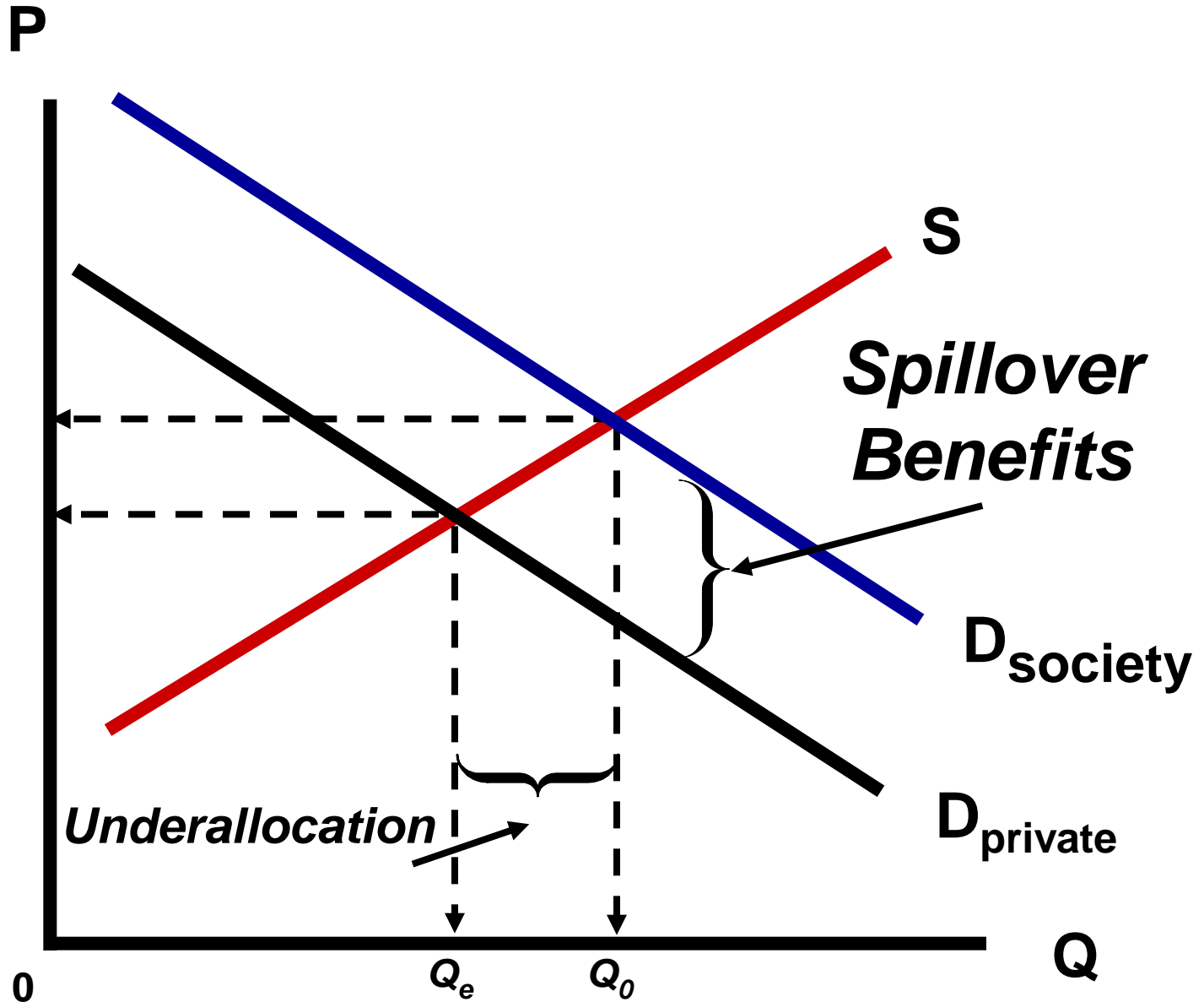
CORRECTING SPILLOVER BENEFITS

P *Correcting by Subsidy to Consumers*

S

Subsidy to consumer increases demand

D_society

D_private

Underallocation
Corrected

Q_e Q_0

0

Q

CORRECTING SPILLOVER BENEFITS

Correcting by Subsidy to Producers

P

Subsidy to producers increases supply

$S_{private}$

$S_{society}$

Underallocation Corrected

D

0

Q_e

Q_0

Q
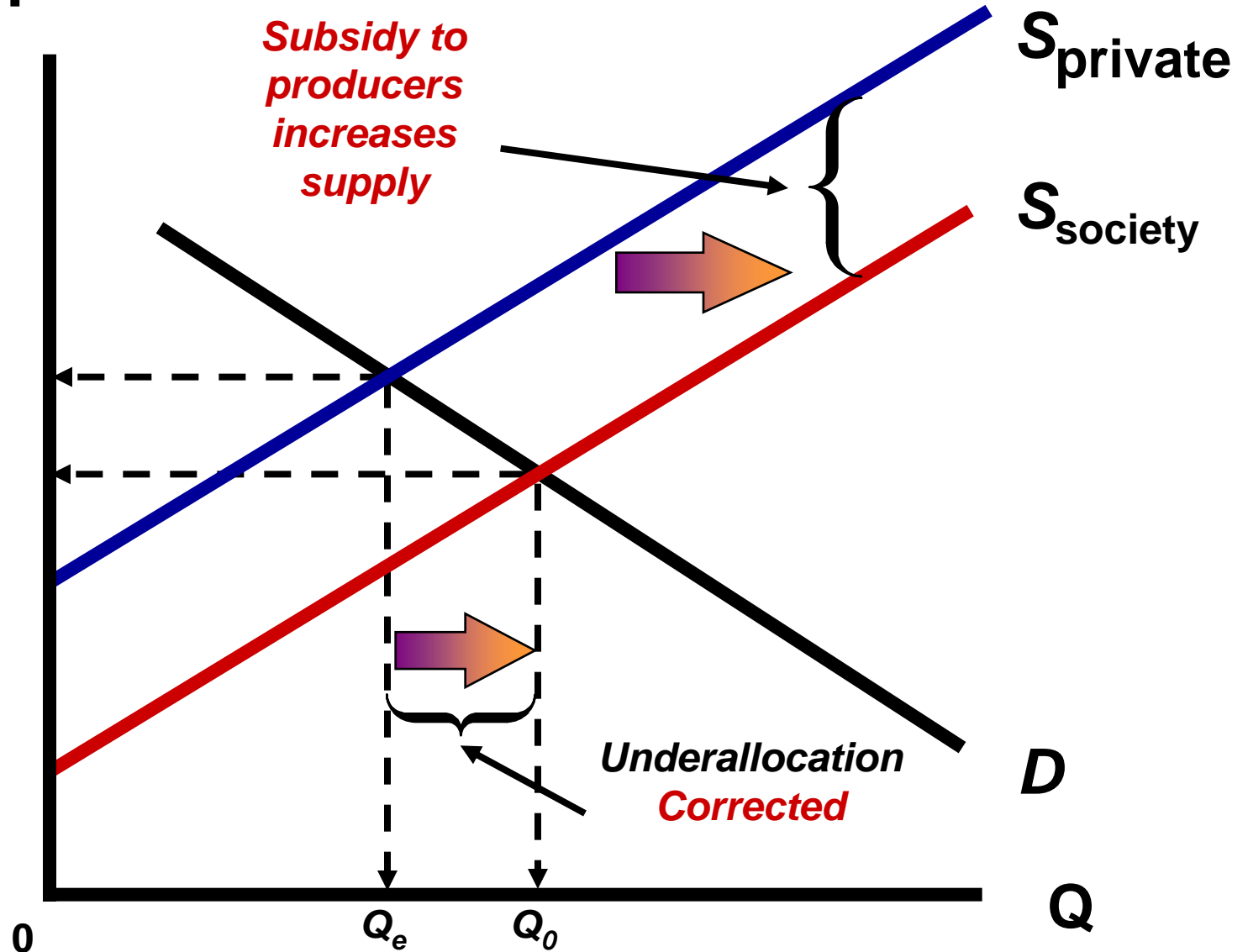
SOCIETY'S OPTIMAL AMOUNT OF EXTERNALITY REDUCTION

MC = MB Rule

MC, MB Equilibrium

Optimal Reduction of an Externality

Shifts in the Curves