
# Chapter 3: American Free Enterprise
## Section 3

Prentice Hall

ECONOMICS

PEARSON

In Partnership With

THE WALL STREET JOURNAL

CLASSROOM EDITION

# Objectives

1. **Identify** examples of public goods.
2. **Analyze** market failures.
3. **Evaluate** how the government allocates some resources by managing externalities.

# Key Terms

- **public good**: a shared good or service for which it would be inefficient or impractical to make consumers pay individually and to exclude those who did not pay
- **public sector**: the part of the economy that involves the transactions of the government
- **private sector**: the part of the economy that involves the transactions of individuals and businesses
- **infrastructure**: the basic facilities that are necessary for a society to function or grow

# Key Terms, cont.

- **free rider**: someone who would not be willing to pay for a certain good or service but who would get the benefits of it anyway if it were provided as a public good
- **market failure**: a situation in which the free market, operating on its own, does not distribute resources efficiently
- **externality**: an economic side effect of a good or service that generates benefits or costs to someone other than the person deciding how much to produce or consume

# Introduction

- Why does a society provide public goods?
  - The government provides society with certain public goods because it would be inefficient or impractical for a free market economy to provide these goods on its own.

# Public Goods

- A public good is a shared good or service for which it would be inefficient or impractical to make consumers pay individually and to exclude those who do not pay.

# Public Goods, cont.

- In the case of most public goods it is simply not practical for a private business to provide the service, charge those who benefit, and exclude non payers from using the source.

Maintaining street signs and traffic lights is one economic role of government.

# Public Goods, cont.

- Public goods can be used by any number of consumers without reducing the benefits to any single consumer.

- Public goods are financed by the public sector.
  - Firefighters are an example of a public good.

# Costs and Benefits

- Checkpoint: What two criteria must be present for a public good?
  - The benefit to each individual is less than the cost that each individual would have to pay if it were provided privately.
  - The total benefits to society are greater than the total cost.

# Costs and Benefits, cont.

- The government pays for public goods through taxes.
- Thus, the financial burden on each individual is significantly less than if a few people decided to fund a project privately.

# Free Riders

- One issue associated with public goods is known as the “free-rider problem.”
- Free riders are people who are not willing to pay for a particular good or service but would benefit from it if it were offered as a public good.
  - The free-rider problem suggests what would happen if the government stopped providing public goods: People would refuse to pay and many services would be eliminated.

# Market Failures

- Checkpoint: Why are public goods an example of a market failure?

  – Public goods are examples of a market failure, where the free market does not distribute resources efficiently.

    - For example, the free market would not be able to build roads efficiently because building roads does not meet the criteria for a properly functioning market system. Thus, road construction is a market failure.

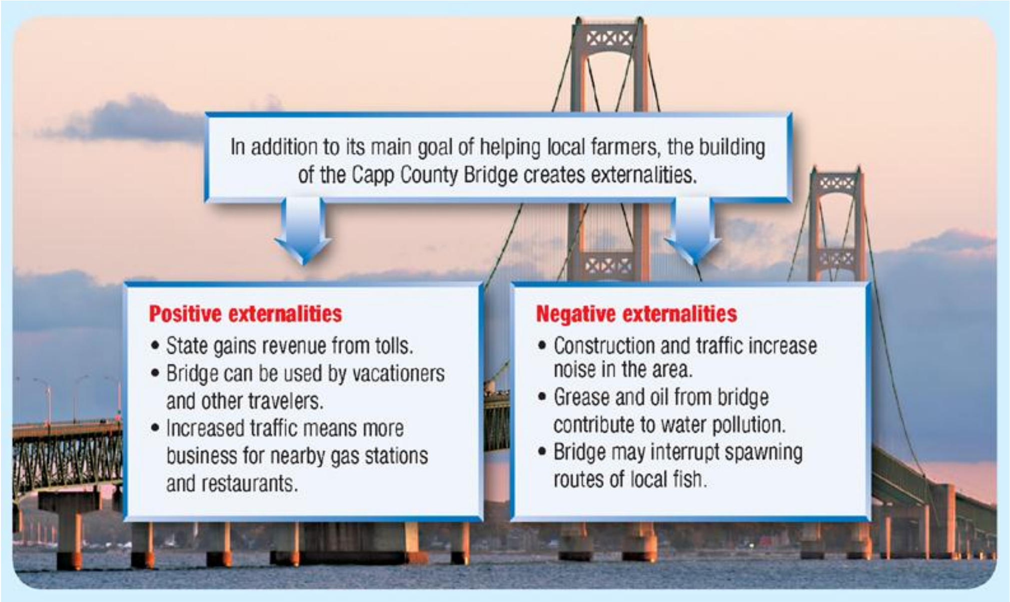
# Positive Externalities

- Public goods involve externalities, which may be either positive or negative.

- Positive Externalities
  - Represent the beneficial side effects of public goods.
  - Can also be generated by the private sector.
  - Allow someone who did not purchase a good to enjoy part of the benefits of that good.

# Negative Externalities

- Negative externalities cause part of the cost of producing a good or service to be paid for by someone other than the producer.




Why would increased car traffic be considered a positive externality by some people and a negative externality by others?

# Government's Goals

- Understanding externalities helps us see more roles that the government plays in the U.S. economy.
  - The government may take action to create positive externalities, such as improving education.
  - The government aims to limit negative externalities like pollution.

# Government's Goals, cont.

- Many economists feel that the private sector produces more positive externalities that the government does.
  - This belief shows itself in the debate over how to stop pollution to the environment.

# Review

- Now that you have learned about why a society provides public goods, go back and answer the Chapter Essential Question.
  - What role should government play in a free market economy?