

Chapter 3

The Private Property System, Public Goods and Market Failure

The fundamental characteristic of a private property system is that it assures that if an individual causes a good to be produced, she is the owner. A person may give up her ownership rights in advance. She may sell someone her rights to a good she is planning to produce or help to produce. This is basically what happens when employees accept a production job. They turn over to the employer the rights to the product they expect to help produce. Similarly, a person may give up her right to the good *after* it is produced. In a market economy, people acquire ownership rights to goods and resources through buying and selling. For example, a person may obtain the rights to an apple by producing or helping to produce bananas, (b) obtaining money from selling the bananas or from an employer, and then (c) using the money to buy apples.

We can distinguish between a *private* property system and a *communal* property system. In a communal property system, a good does not belong to the person who causes it to be produced but to “the community.” More completely, a communal property system is one in which all items and actions that are considered goods and resources belong to “the community.” To put such a system into effect, government officials would have to decide precisely what it means for the community to own

a good or resource. Consider a forest containing animals that can be hunted and killed for food. Government officials may permit unlimited access by imposing a severe penalty on anyone caught hindering the activities of any hunter. If the population is large, the result will most likely be over-hunting and the extinction of animals that are more desirable as prey. On the other hand, government officials may permit only limited access. One way to achieve this is a licensing system that requires hunters to have a license. The officials can limit access by limiting the number of licenses. Another way is to restrict the number of animals that can be killed during a given time. Each of these methods requires resources to be used for enforcement.

A system in which government officials decide on who owns all goods and resources and how they can be used is typically called pure *socialism*. Most people in the world

Communal property system: a system in which goods and resources belong to "the community." In practical terms, this means that government officials must decide who will be allowed to use the goods and resources and how they will be used.

today seem to agree that the private property system is preferable to pure socialism. The reason is that the private property system is a prerequisite for a market economy, which gives people incentives to produce what they regard as great wealth. However, people do not believe that the market economy is perfect. They believe that "markets can fail." When modern economists try to conceive of a situation of market failure, they are not trying to find a justification for socialism or for government intervention. They are merely showing that the market outcome is not as good as they can conceive of it being.

We have already used Hume's meadow as an example of market failure. Other market failures include public goods and monopoly. The purpose of this chapter is twofold. The first is to show why the private property system tends to generate wealth. The second is to identify the sources of market failure. Part one describes the system and the next three parts are concerned with market failure. Part two discusses the public goods problem. Part three deals with the special problem associated with buying large tracts of contiguous property. Part four identifies other sources of market failure. Part five concludes with a discussion of the monitoring problem that arises when agents are hired to decide on the supply of public goods.

A word of caution is perhaps in order. The economic literature contains much debate on the idea of market failure. In theory, it is fairly easy to reason that market failures of particular types have occurred in the past.

We know that if people had anticipated these failures and had taken certain actions, they would have been better off, by their own accounting. We cannot be so confident about the future. We are dealing with human beings. Human beings are creative. They can discover problems and solutions to them previously not conceived. To decide whether a market will fail in the future, we must use our imagination and judgment. We must try to imagine the ways that individuals can find and take advantage of potential gains from trade. We must then judge whether they will actually discover those ways or other ways that are beyond our ability to conceive at the moment. There is a lot of uncertainty here. So we should not be surprised to learn that intelligent people disagree. At the moment, most professional economists appear to think that market failures are important, that individuals in the market economy cannot find ways to solve them, and that the government in some cases can do a better job. However, this opinion is not universal¹ and it is quite possible that it will change in the future.

This book is not about the possibly shifting opinions of professional economists. It is about the prospect that democratic government can effectively supply services for which people believe that the benefits are greater than the costs. Since most people believe that such services fall into the category of correcting market failure, we must identify the types of market failure first. If these are, in fact, not really failures – that is, if we can expect individuals in a free market to discover means of overcoming them – then our need for government would derive solely from a desire for national defense and the establishment and enforcement of the private property system.

¹See, for example, Tyler Cowen (1992); Mitchell and Simmons (1994); and Fred Foldvary (1994).