

# Why we need a Public Sector

2019-02-11

## Property Rights

### Tragedy of the commons and tragedy of the anticommons

Property rights are necessary for any market. The absence of property rights or non well-defined property rights mean that there are no adequate incentives of taking care the commonly owned resources.

**Example:** In the former communist countries, property rights were not well defined and people had insufficient incentives to maintain and/or improve their apartment. In market economies, the benefits of such improvements are reflected in the market price of the properties.

The tragedy of the commons, is term used to describe a situation within a shared-resource system where individual users acting independently according to their own self-interest behave contrary to the common good of all users by depleting or spoiling that resource through their collective action.

### Proposed Solutions

For a long time the common response to the problem of the commons was either conversion of common resources to private or the external regulation of these common resources.

- If the resource is converted to private property, the owner should have both the profit incentives and the property rights to manage the resource responsibly.
- If the resource is regulated by the government, rules could be imposed on individual users for the common good.

In 1999, Nobel Prize-winning economist Elinor Ostrom revisited these solutions as private control over previously public resources could create the usual problems of monopoly business practices, whereas external oversight could generate inappropriate and poorly implemented regulations.

- She noted a third response to the tragedy of the commons: Utilization of community social capital to devise creative and effective local solution.

## **The tragedy of the anticommons**

Michael Heller used the term tragedy of the anticommons to describe a problem where is not the lack of property rights, but the excessive private ownership of a community resource that prevents achievement of a desirable outcome for society.

**Example:** Patenting of genes

## **Contract Enforcement**

### **rights need protection**

If individuals are engaged in transactions with each other, the contracts they agree on must be enforced. If they are not and there are no consequences for breaking a contract then there will be no trust in the market. Government activities aiming at protecting citizens and property, enforcing contracts, and defining property rights provide the foundations on which market economies rest.

## **Market Failures**

When there is no invisible hand, or when the invisible hand is broken, or when the invisible hand points to the wrong direction

Markets are not Pareto efficient under six important conditions, which are known as market failures, and provide a rationale for government intervention.

1. Failure of competition
2. Public Goods
3. Externalities
4. Incomplete Markets
5. Information Failures
6. Unemployment, Inflation, and Disequilibrium

## **Failure of Competition**

For markets to result in Pareto efficiency, there must be perfect competition, in other words a sufficiently large number of firms that each believes it has no effect on prices (price-takers). However perfect competition is not always the prevailing norm.

Characteristic	Monopoly	Oligopoly	Monopolistic Competition
No of firms	Pure: One Working: >25%	Few dominant sellers	Many competing sellers
Type of product	Branded	Branded	Differentiated – many similar products
Barriers to entry	High especially with natural monopoly	High – protecting market power of established firms	Low – ease of entry and exit in the long run
Pricing power	High – limited by market demand	Strong – but interdependent	Some pricing power but high price elasticity
Supernormal profits in long run	High monopoly profits possible	High	Profits competed away by entry of new products

Figure 1: Overview of imperfect competition