

Pareto Efficiency

The market economy is a wonderfully efficient institution in organizing the allocation of resources.

- Prosperity achieved in market economies is vastly greater than that achieved by other social structures.
- This feat is achieved by two forces of the mkt economy:
 - Alignment of incentives
 - Sensitivity to consumer preferences

Stupid Government Intervention—Fuel efficiency standards

Arguments for:

- Private market will not invest in fuel efficient technologies because firms don't value them as much as consumers (or some such yammering).
- Gas guzzling by some consumers drives up the price of gas for everyone else.

Fallacies:

- Consumers value cars that have lower operation cost. Firms will spend money on fuel efficiency up to the point where the cost of an extra mile per gallon is equal to the value placed on that by consumers.
- While true that gas guzzler drive up the price, it's their money. The whole idea of Pareto efficiency is that if Jack likes one thing while Jill favors something else, they get what they want by relatively outbidding each other in the market place. Gas guzzlers do indeed drive up the price of gas, but that just means that they value it more than people who drive around in Mini Coopers.

Less Stupid Reason

- Gas guzzling supports terrorism
- Not completely stupid, but still a bit of a stretch.

Market economy is imperfect on three margins:

Public goods– Common access resources – Externalities

Market system operates on the basis of property rights.

- Protection of property is essential.
- Defining a system of proper property protection is the most important function of government.
 - National defense.
 - System of jurisprudence.
 - Fair taxation and public expenditure.
 - Proper maintenance of the currency.
- There are many public goods. Not all public goods are produced by government. Not all goods produced by government are public goods.
 - Government should provide public goods when their private supply is limited by the free rider problem.
- Intellectual property is a public good.
 - Like movies, inventions, books, computer programs

- To some extent, works of art
- Systems of patents, copyrights, brand names, trademarks, and trade practices are government provided protection of the rights to these.
- This issue is not black and white.

Common Access Resources:

- Tragedy of the commons.
 - Over grazing, over pumping, over fishing, over shooting.
 - Free rider problem.
- Unification of the exploitation of the resource.
- Relative scarcity determines the price.
- Price as if the resource were owned in a competitive market.

Externalities

- Non-priced spillover effects
- Generally result from a common access problem.
 - Air pollution
 - Water pollution
 - Noise pollution.
- Proper management of the environment requires that scarcity be priced.