CIE Economics AS-level

Topic 1: Basic Economic Ideas and Resource Allocation

g) Classification of goods and services

Notes

Public goods

- **Public goods** are missing from the free market, but they offer benefits to society. For example, street lights and flood control systems are public goods.

- They are **non-excludable** so by consuming the good, someone else is not prevented from consuming the good as well, and they are **non-rival,** so the benefit other people get from the good does not diminish if more people consume the good.

- The non-excludable nature of public goods gives rise to the **free-rider** problem. Therefore, people who do not pay for the good still receive benefits from it, in the same way people who pay for the good do. This is why public goods are underprovided by the private sector: they do not make a profit from providing the good since consumers do not see a reason to pay for the good, if they still receive the benefit without paying.

- Public goods are also underprovided because it is difficult to measure the value consumers get from public goods, so it is hard to put a price on the good. Consumers will undervalue the benefit, so they can pay less, whilst producers will overvalue, so they can charge more.

Private goods

- **Private goods** are rival and excludable. For example, a chocolate bar can only be consumed by one consumer. Moreover, private property rights can be used to prevent others from consuming the good.

- **Economic goods** benefit society, have the problem of scarcity and have an opportunity cost. Since they are scarce, they have some value, so consumers will pay for them, and they can be traded.

Free goods

- **Free goods** have no opportunity cost, because there is no scarcity of the good. For example, air and water are free goods. These goods are not traded because they are freely available.

Merit and demerit goods

- Negative externalities are caused by **demerit goods.** These are associated with information failure, since consumers are not aware of the long run implications of consuming the good, and they are usually overprovided. For example, cigarettes and alcohol are demerit goods. The negative externality to third parties of consuming cigarettes is second-hand smoke or passive smoking.

- Positive externalities are caused by **merit goods.** These are associated with information failure too, because consumers do not realise the long run benefits to consuming the good. They are underprovided in a free market. For example, education and healthcare are merit goods. The positive externality to third parties of education is a higher skilled workforce.