

# Public goods: From market efficiency to democratic effectiveness

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## Introduction

This contribution examines the concept of public goods, responding to calls to rethink public goods given a changed context (Desai, 2003: 73) and widening global scope (Kaul et al, 2003; Kaul, 2006). The first section explores public goods as a concept framed in terms of economic 'efficiency' and 'market failure'. The next section notes a transition from market-failure to state-failure theory, leaving public goods at an impasse. The discussion compares differing perspectives and assumptions about the role and character of individual and collective action, public service and government. It examines the contention that 'efficient markets may not do' (Bator, 1958; Bozeman, 2002), contrasting mainstream economics concerns with 'market failure' with alternative ideas of 'public-value failure' (Bozeman, 2002; Haglund, 2010) and 'obnoxious markets' (Kanbur, 2001). The following section identifies alternative economic traditions and looks to a new conceptualisation of public goods. Adapting global public goods theory, a 'new public goods' approach represents a departure from conventional economics. It supplements the ideas of an alternative, or 'other', economic canon with democratic concerns and questions of 'public value'. The conclusion considers proposals for public goods based on this new approach and some policy implications that might follow.

## Public goods and market failure

Samuelson's 'pure theory of public expenditure' (1954) is the conventional starting point for defining a special economic category - 'collective' or public goods, distinct from 'private goods'. Public goods require public expenditure as they are subject to 'market failure'. They are characterised by 'non-rivalry' and 'non-excludability'. Non-rivalry means that the consumption of the good by one person does not reduce the quantity available for consumption by another person (Samuelson, 1954: 387), while non-excludability means that no person can be excluded from the benefits or effects of that good, or at least not without great difficulty and cost. The theoretical debates about public goods focus on three main issues: i) preference revelation – knowing what goods the public wants and their willingness to pay for them; ii) political bargaining – deciding which goods, how much to provide



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*Shared space, finite resources (pictured: Malé, Maldives)*

and who are entitled to them; and iii) production of these goods by governmental or private agents (Desai, 2003: 64). Public goods present a 'market failure' problem because rational, utility-maximising individuals are not expected to reveal their 'true preferences' for a public good. Instead, they will 'free ride', leaving public goods under-priced, under-provided and over-consumed. Even a theoretically 'perfect' free market would fail to be the 'best', i.e. most efficient, mechanism for allocating goods, maximising welfare and creating just outcomes. The implication was that all three issues would have to be solved by state action – determining preferences, resolving political bargaining and providing public goods.

Public goods were distinguished from private goods, but they were treated in an analogous way to them (Desai, 2003: 64). Public goods theory did not reflect 'the public value of public things', but internalised assumptions about private goods as the conceptual norm and reflected the private value of public things (Bozeman, 2002: 146). Such assumptions reflected the 18th-century tradition of economic thought advocating 'efficient' markets as the answer to government failure. Government intervention was seen as undesirable and only legitimate in cases where the market proved inefficient in allocating resources according to the principle of 'Pareto optimality' (only allowing one individual to 'gain' as long as no other individual 'loses'). In general, public goods theory did not

address situations where a government could legitimately intervene for reasons other than 'efficiency' (Bozeman, 2002: 146). Bozeman suggests that economic efficiency continues to dominate public decision-making because the alternatives 'lack analytic precision' and 'offer few practical guidelines' (2002: 157). Yet he rejects the domination of efficiency criteria in policy deliberations 'simply by force of available analytical tools'. Haglund points out that other publicly important criteria might be justice, inclusion and sustainability (2010: 23).

Samuelson later acknowledged that the scope of 'publicness' was potentially very wide. A 'public good' is one that 'enters two or more persons' utility'. This leaves 'a knife-edge pole of the private good case, and with all the rest of the world in the public-good domain by virtue of involving some "consumption externality"' (1969: 107–108). Most goods have a dimension of 'publicness' or 'joint consumption' (Bator, 1958: 371). The ubiquity of publicness, or 'semi-publicness' means that many goods potentially warrant interventions to regulate or modify markets. Conventional economics assumes that markets are constituted by one-off transactions, however public goods concern longer time-frames and multi-generational stocks. Examples include historical carbon emissions, radioactive waste, biological genetic resources or disease organisms, 'reputational stocks' like monetary systems, and 'institutional stocks' in the form of market and democratic systems (Nordhaus, 2005: 1–5).

## From market failure to state and public value failure

Public goods theory was an artefact of the 'golden age' welfare capitalism (Marglin and Schor, 1990), which assigned a strong positive role to the state in deciding what public goods to provide and financing them through the public purse. The Keynesian consensus supported strong state planning and intervention across the ideological spectrum. In the mid-1970s, the economic and political consensus shifted away from market failure and state action, returning to neoclassical economics and concerns that state failure should be remedied by market action. Since the 1980s, the 'policy space' has been dominated by market ideals and privatisation policies, including contracting-out and the creation of quasi-market instruments for allocating public goods (such as health or education 'vouchers' or tradable pollution credits). The public sector has been internally transformed by the formation of government-private sector 'hybrids' and the penetration of business culture and management techniques through public sector reform. The culture shift has been towards market efficiency ideals and state-failure theory.

'Public choice' and 'social choice' theories analyse the interactions between economics and politics. They approach collective action from a micro-economic perspective, applying classical economic assumptions about self-interested individual behaviour using mathematical methods of analysis. Public choice theory assumes that government

is non-benevolent and that public policies do not embody public interest but are 'gamed' according to the private interests of politicians, bureaucrats and 'rent-seeking' lobbies. This approach supports the theory of 'government failure' and argues that the state should be limited and politicians constrained (Skidelsky, 2009: 108–109). Public choice theory considers neither questions about what constitutes the public interest, nor the problem of provision. It addresses aspects of political bargaining from an efficiency perspective. Yet provision is the pressing problem. New types of public goods are emerging and the scope is widening, but governmental and taxpayer support for public goods remains problematic (Desai, 2003: 73).

Bator remarks that markets are not necessarily an 'ultimate' value in themselves. 'Constitutional' choices define the scope for market operation and government intervention (Marmolo, 1999). In the case of 'true' public goods, individuals do not only wish to 'free-ride', they retain an interest in actually being able to consume a certain quantity of the good, whether their 'revealed preference' reflects the 'right price' for it or not. Political and social values are possibly better served by 'non-efficient' market institutions (Bator, 1958: 378–379). As one distinguished economist observed, 'a society can be Pareto optimal and still be perfectly disgusting' (Sen, 1970: 22). Contra public choice theory, government organisations could be said to be distinct from market organisations because they work in the public interest, create value and enable the efficient exchange of political rights (Bozeman, 2002: 146–147).

Research on 'public interest motivation' amongst government workers identifies motivations such as 'commitment to the public interest', 'self-sacrifice', 'compassion' and 'attraction to the public and politics' (Bozeman, 2002: 148). 'Public values' may be seen as constitutive of particular organisations or political cultures. For example, Denmark's 'public values' are said to include due process, accountability and welfare provision (Jorgensen, 1997: cited in Bozeman, 2002: 49). Bozeman identifies 'public failure', where neither markets nor the government sector succeed in providing the goods and services required to achieve 'core public values'. He identifies seven reasons for public failure: 1) insufficient mechanisms to aggregate public values; 2) imperfect monopolies; 3) benefit hoarding; 4) scarcity of providers; 5) short time horizon; 6) reliance on 'substitutability', endangering resources and 'the greatest public failure'; and 7) threats to basic subsistence and human dignity.

Kanbur (2001) observes that 'certain markets evoke popular discomfort, distrust and even outrage'. Society would not accept completely 'efficient' markets in certain goods like arms, drugs, toxic waste, child labour or body parts. 'Obnoxious markets' are characterised by extremity, agency and inequality. The more extreme the outcomes of a transaction, the greater the distance between the market actor and the persons bearing the consequences, and the greater the inequality of market relations, the more

discomfort or 'obnoxiousness'. Obnoxious markets demand judicious regulation, plus measures to address the underlying issues directly – cushioning extremity using safety nets, strengthening agency through information and ameliorating inequality through redistribution.

Haglund (2010) examines the case for market efficiency versus state inefficiency in relation to the privatisation of two key monopolistic sectors: water and energy. She finds the promise of market efficiency to be both theoretically and empirically doubtful, arguing that well-designed public institutions may be no less efficient and are likely to be more effective (2010: 29). Economic efficiency and cost-effectiveness are the principles driving privatisation. Within a global 'competition society', cost-cutting is the key tool for achieving efficiency. However, cost-cutting can seriously threaten service quality and cause key aspects of the service to collapse. The drive for efficiency can lead to too much competition, resulting in overcapacity, inequity and forms of exclusion that are difficult to legitimise politically or socially. Providers will compete to capture lucrative high-end markets while exiting less profitable sectors – rural transport, health care services and health insurance markets provide examples where politically and socially undesirable outcomes have been observed.

### Alternative conceptions – from the 'German historical school' to a new theory of public goods

A historical analysis (Pickhardt, 2005; 2006) enables the recognition of alternative economic approaches to public goods and public action. An alternative economic tradition is associated with development economics and policy, theories of uneven development, evolutionary economics and the economics of innovation. The so-called 'German historical school' of economics and public administration rejected the classical emphasis on individuals and theoretical market efficiency as an approach that privileges precision over relevance: it 'would rather be accurately wrong than approximately correct' ('The Other Canon', no date). The 'other canon' is more interested in social change, national development and social reform than in theoretical equilibria, and relates the economy to questions of ethics, psychology, customs and law. Pickhardt (2005) highlights the importance of '*Gemeinsinn*', the 'sense of community' or 'public spirit', to this approach, noting that it underpins the social-market economy that is still important in continental Europe today. The German historical school regarded public benefit and cooperation as essential preconditions and supplements to the private economy. Individual self-interest was counterbalanced by the needs of the nation as a whole, 'and in the case of Knies also a sense for justice, propriety or fairness' (Pickhardt, 2005: 278).

A historical and comparative view of economic thought highlights the absence of an a priori consensus about how public goods should be approached. Building on discussions

about global public goods, new public goods theory suggests an approach comprising three main dimensions: i) democratic procedures; ii) protection and provision of public goods; and iii) concern for rights and equality. Moving away from efficiency-oriented market formalism enables us to turn towards constitutional questions, drawing upon recent innovations in global public goods theory to help think about public policy, regulation and co-operation.

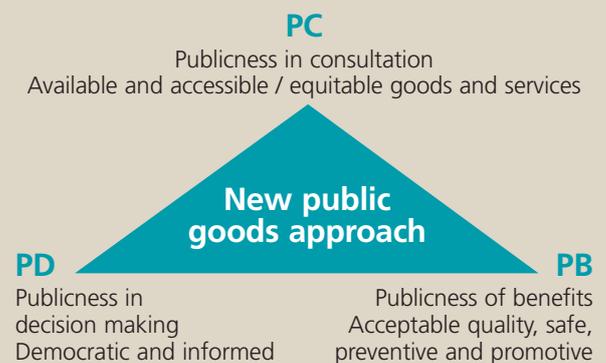
A new theory of public goods brings together and balances three main faces of 'publicness':

- i) Democratic publicness of decision-making, involving accountability and active participation
- ii) Fairness and equity, reflected in system-wide availability and accessibility without discrimination. This fits well with Kanbur's calls to ameliorate extremity and inequality (2001), addressing questions of essential need and rights-based approaches to public goods and services
- iii) Publicness of benefits, guaranteeing safety, acceptability and quality of services. This includes educative, preventive and promotive aspects, together with the criteria of sustainability

New public goods theory draws upon the theoretical work of Kaul and others on global public goods (Kaul, 2001; Kaul et al, 2003; Kaul, 2013). Figure 1 provides a diagrammatic illustration of new public goods, comprising three faces of 'publicness'. These criteria must be 'triangulated', meaning that a balanced approach must include participatory democracy, equity in enjoyment of services and system-wide quality, cost, sustainability and safety considerations. Democratic participation is necessary but insufficient. The principle of societal equity and scientific and technical consensus on the public interest and harm prevention (safety and quality) are also needed. Knowledge, information and educative efforts are crucial to help the public reach decisions where values and interests conflict, and to maximise the value of public investments.

**Figure 1: What is 'public'?**

#### A new public goods approach to the 'publicness' of public goods



*Adapted from Kaul, 2001: 14–15*

## Conclusion

There is a growing recognition that public goods require both theoretical and policy innovation. Despite the lasting conceptual distinction between private and public goods, few goods are 'purely' private and most involve negative or positive 'externalities' and 'spillover effects'. Public goods are central to the theme of this volume – achieving fair and effective public service in both mature and developing democracies. The lingering under-provision of public goods is escalating into a global crisis, with inaction bearing significant costs (Kaul, 2013: 14). A new public goods approach takes national and global public goods beyond the theoretical impasse of market failure versus state failure. However, it does not provide easy answers and involves opening up the 'black box' of public values in politics. People need to be directly involved in debating the public value of goods such as disease control, financial market regulation, pollution control, peace and security, and human rights protection. The technical and often complex nature of these topics means that adequate levels of investment in expertise, public education, information and participation are required, in order to ensure forms of 'publicity' that unite people into a focused collectivities (Adut, 2012: 245) with the capability to reach democratic, fair and beneficial decisions. There are current proposals to shape the post-Millennium Development Goals agenda for international co-operation with public goods at the centre (Kaul, 2013). In the international sphere, the publicness of provision can be positively or negatively affected by international co-operation policies. National and global governance must create the right incentives for various actors to contribute the fair shares needed to achieve adequate and effective public goods provision. This involves rewarding public service motivations, addressing public value failure and regulating obnoxious markets. Public goods require multilevel governance, policy interdependence and integration with national and global development policies. Divergence can be addressed by well-designed public policies that incentivise public goods. A theory of public goods that effectively balances democratic participation, fair access to essential goods and public benefits offers an important alternative to the conventional paradigm of free-rider individualism and cynical government, thus recovering possibilities for the public value of public things.

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