

Chapter 2

The Significance of Public Goods in Market Failure Debates: The Role of Public Goods on Market Failure From the Perspective of Schools of Economic Thought

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ABSTRACT

Before the emergence of the neoclassical economic approach, the idea that market instabilities are temporary and markets are spontaneously able to reach equilibrium was prevalent. However, with the neoclassical economic thought the idea that market economy alone is far from attaining equilibrium and there is a need for public economy. This is also known as market failure theory. There are many reasons of market failure. One of them is public goods. Public goods are generally regarded as an example of market failure and seen as a problem requiring government intervention. However, when main stream public goods theories are analyzed in-depth, it is seen that there is no agreement on the properties of public goods which may create a reason to the government presentation and public presentation is not approved in general. Therefore, the aim of this study is to make a comparative analysis of the approaches of different economics schools of thought which have contributions to the subject of public goods.

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INTRODUCTION

Individuals always seek for utility maximization and as a result of this effectiveness and efficiency of the competitive capitalist system increase. This economic approach had been dominant until the first half of the 19th century, however beginning from this period it paved the way for a new economic thought as it couldn't find solutions to social problems. This economic thought which is called as the neoclassical economic thought is based on the concepts of rationality and maximum utility in which consumers are in a struggle for utility maximization and producers are in a struggle for profit maximization (Menard & Shirley, 2005). Besides, unlike classical economic thought, neoclassical economic thought proposes that the market is not always in equilibrium and may deviate from equilibrium, in other words market may fail. Market resource allocation may fail or may be inadequate to fulfill its functions in this approach which is expressed as the market failure (Le Grand, 1991). There are some factors disrupting optimal resource allocation of the market. These are imperfect competition markets, public goods, externalities, natural monopolies and asymmetric information. Economic schools of thought have different approaches on the factors disrupting resource allocation of the market. Particularly, there are various approaches on the theory of public goods. There are many questions to be answered on the theory of public goods by the schools of economic thought. However, this has been a much debated topic in theory due to some unanswered questions or some of the answers to this questions were not clear enough.

Despite the theory of public goods is a long standing issue, it came to the fore systematically for the first time with an article (1954, 1955) written by Samuelson in the mid-50's. These are the years corresponding to a period in which Keynesian policies are adapted both in national and international level, unemployment levels were highly decreased, growth rates increased rapidly, welfare state implementations became widespread due to cold war, developing countries realized development initiatives. Neoclassical synthesis which combines Keynesian macroeconomics (widely accepted in the academic world between the years 1945 and 1970) and Marshallian microeconomics was concretized in the studies of P. Samuelson and R. Musgrave. This is a period in which public goods are considered as market failure and there are theories on the necessity of production of goods and services by the benevolent government in order to eliminate this market failure. With this period, the function of the government was started to be criticized along with the issue of public goods. Hence, economic crises at the end of 1960's, political and social chaos encountered with the high inflation and unemployment broke the confidence on the effectiveness of Keynesian policies and government intervention. In this period, government was considered as the source of the problems and from 1970's,

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