Chapter 4	McConnell, Brue and Flynn 20th

Market Failures: Public Goods and Externalities

Competitive markets usually do a remarkably effective job of allocating society's scarce resources to their most highly valued uses. We begin the chapter by demonstrating how properly functioning markets efficiently allocate resources, introducing the concepts of consumer and producer surplus and the relationship to efficiency.

Then, what happens when markets don't function properly? What is efficiency loss, or deadweight loss? In some circumstances, economically desirable goods are not produced at all. In other situations, they are either overproduced or underproduced. We turn to focus on these situations, which economists refer to as **market failures.** In such situations, an economic role for government may arise. We will examine that role as it relates to public goods and so-called externalities—situations where market failures lead to suboptimal outcomes that the government may be able to improve upon by using its powers to tax, spend, and regulate. Implementing such policies can, however, be both costly and complicated. We conclude the chapter by noting the government inefficiencies can hinder government's efforts to improve economic outcomes.