Outline of Lecture 14: Public Goods and Institutions

1. Public goods

   a) Characteristics
      - indivisibility: radio, cable TV, national defense
      - non-excludability: radio, national defense, fish in open sea

   b) Free-rider problem
      - once public good provided, everyone gets it
      - personal contribution costly, overall impact very small
      - why contribute?
      - individually rational actions lead to socially suboptimal outcomes
      - under-provision due to market failure

   c) Provision of public goods
      - coercion (IRS, but U.S. problems in getting NATO contributions)
      - convert to club good (toll roads, intellectual property rights)
      - selective rewards (North Korea and non-proliferation)
      - hegemon (British Navy/piracy, U.S./financial stability 1944-71)
      - self-enforcing agreements in repeated interaction

2. Transaction costs

   a) Repeated interaction
      - long-term relationship must be valuable
      - concern with future bad consequences encourages cooperation
      - conditionality and reciprocity

   b) Need to overcome costs associated with
      - monitoring: verify compliance (information)
      - enforcement: incentives to carry out punishment (credibility)
      - coordination: multiple possible bargains (negotiation)

3. Institutions and organizations

   a) Social, humanly-designed constraints on behavior
      - creation: who has bargaining power?
      - function: self-enforcing agreements (explicit or implicit)
      - must provide incentives to uphold institution itself

   b) Informal (norms) and formal (organizations)
      - transparency (information): UN, IMF, World Bank, OECD
      - commitment/coordination: Paris/London Clubs, NATO
      - future interaction: UN, GATT
      - standards: WTO, IMF, OPEC