



The Fallacies of “Public Goods”

Guest: Jeffrey HERBENER

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WOODS: I’d like to talk today about the subject of public goods. I had Fred Foldvary on some time ago. I don’t know if you know him. He’s a Georgist who wrote a book some years ago on the subject of public goods. He showed how a lot of these public good problems can be resolved by having them supplied in public communities—not thinking in terms of how would one individual subscribe to a sewer service, but rather just make the unit larger than one individual, make it a community, and then the community provides the sewer service. There are a lot of ways to handle this.

First, I’d like to have you explain what a public good is. I want people to understand that the term has a technical definition in economics. It’s not just a good that the public uses—although it may be that, too—but there are precise characteristics that are supposed to characterize a public good.

HERBENER: Yeah, that’s right. A lot of people think of public goods as goods that the state in fact produces. Or they make some sort of general claim that somehow these goods are too important to leave to the market, or the market is not big enough to produce them, or something like this. But, in economics, public goods, as you say, has a technical definition. This was introduced by Paul Samuelson. And he said that a public good has two conditions. One, it’s non-rival in consumption, which means that no matter how many consumers you have for the good each one of them can consume the entire good without diminishing the consumptive value for other people. A simple illustration would be a movie shown in a movie theater. We can bring in another customer, and that customer can also watch the movie along with you and—if he’s not a jerk—it doesn’t diminish your consumption. And then the second condition that Samuelson stipulated is that public goods are non-excludable in access, so that anybody can just move in and out freely to consume the good, and an entrepreneur, then, or a private business, would not be able to charge the people. There could be free riders. This is the problem.

WOODS: Doesn’t it seem that in practice, in the analysis of public goods, it’s the free-rider issue that really gets the emphasis as opposed to the other issue?

HERBENER: Yeah, exactly. And this is because free riding, of course, could be identified in a multiplicity of different situations, not all of them, of course, meeting these two technical conditions of public goods. And so it’s a ready justification that people grab out of the hat to say the government is fine if they do this or if they do that. Even in intellectual circles there are many people who just use public goods like a talisman, they just sort of wave it in the air as if it is an obvious, self-evident justification for the government doing x, y, or Z.

WOODS: Of the two characteristics that you mentioned I can at least see the argument—I don't have to agree with it, but I can at least see the argument—when it comes to free-riding, that I can't exclude people, let's say, from national defense. If I'm going to defend your town that means I'm also going to be defending you as an individual. There's no way I can exclude you, and say that you haven't paid the national defense fee. And so people will realize, therefore, that if that guy doesn't have to pay to get protected I won't pay to get protected. Nobody will pay, and we won't have national defense. I at least see the argument there.

But what exactly is the problem that is being identified with the other characteristic—with the movie theater or fireworks display that if an additional person attends doesn't diminish the enjoyment of everybody else? Okay, so what? Isn't that just an interesting observation? Why should that mean that the government has to subsidize this?

HERBENER: Here the argument is that private provision would fail the sort of idealistic efficiency condition of production. So you have, in production, you have zero marginal costs, additional costs of satisfying another customer, and yet some of the potential customers are in fact excluded by private enterprise. The movie theater doesn't allow some people to come in even though it has empty seats, and you experience no marginal costs to enjoy the movie. So that's the claim, that there is some inefficiency involved in that kind of system of production.

WOODS: Okay. That's sort of what I assumed: given that it doesn't cost anything for the provider to have an additional person get basically free enjoyment then it's inefficient for those people not to get the free enjoyment. But, as I say, that doesn't seem to be the concern that keeps the proponents of public goods up at night. And when I say proponents of public goods I mean, basically, all economists. Right? Everybody is raised on Samuelson, right?

HERBENER: Absolutely. It permeates all of economics, just like market-failure arguments permeate all of economics.

WOODS: Now that we have laid it out, are there any flaws in the argument? Let's not go into "here's how you could provide national defense privately," because that's almost not the point. What we want to show is that there's something wrong with these characteristics, or they are too broad, or they don't actually describe actual public or private goods. In other words, these two characteristics don't seem to do what their proponents think they are doing, which is to exclusively identify particular goods that they will then conclude require government provision.

HERBENER: Yeah, that's exactly right. It's very easy to find a large number of historical cases and current examples of private enterprise providing goods that have both these characteristics, and one example off the top of my head is Internet access. [TW note: Professor Herbener is referring to individual website access: people can access most websites for free.] This is typically given free to people, and private enterprise can run their websites without any difficulty even though having another person come in with zero marginal cost, and excluding people isn't done by pricing the good to allow them access. And you can find, again, a huge number of these cases. And, of course, you can find also a huge number of cases of government provision of things that would be considered by Samuelson as private goods.

And so, as you say, this doesn't even seem descriptively to be a very valuable distinction to make between private and public. If it's true that private enterprise can produce the public goods just fine and thrive, earn profits, and stay in business and so on, then what exactly is the problem?

I would say the other aspect of this to see the economic analysis part of this is precisely this point that Mises liked to stress, that private enterprise and entrepreneurs are always appealing to economic calculation to make their production decisions. So they think about these questions, all these questions, and all the attributes of goods with respect to the effect on the net income that is generated by their production and sale and the effect on their balance sheet of acquiring assets for producing these things. And they can apply these techniques of economic calculation to goods regardless of whether they have these public characteristics or not. They simply find ways. It's just a matter of entrepreneurial innovation to find ways to generate revenue streams from goods where the customers can't be directly charged. So again we see this with the Internet now, we saw it with broadcast TV in the old days, that third parties would pay who are interested in getting access to the marketing to the customers. This then provides sufficiently efficient allocation of resources because it generates a revenue stream that entrepreneurs earn that they can use to cover the cost. Now to the contrary, when the government does this they do it outside the realm of economic calculation. And so we're in a land there where efficiency is completely out the window. And so what the argument [CHECK] is that private enterprise will fail to be efficient in production it's a market failure, then the government has no chance whatsoever of being efficient since their production never refers to economic calculation or follows the principles of profit and loss.

WOODS: I want to make sure everybody understands that term "economic calculation." If people have heard it they've likely heard it in the context of the socialist calculation problem, where the socialist planning board does not have prices for the means of production. So you can see that their allocation decisions are going to be completely arbitrary. Today, of course, we don't have governments that own the means of production—I don't know, maybe the remaining communist ones do, but the point is that today we don't have quite that calculation problem. But we do have the calculation problem that governments don't earn genuine revenues, so they have no direct responsiveness to the consumer. They do know the prices of the things that they are expanding resources on, but they have no way of knowing what it is that the consumer wants. So their decision as to what to produce, or how much to produce, and what way to produce it, is arbitrary. Am I getting to the heart of it?

HERBENER: Yeah, that's exactly right. And, of course, the other point is that even though they can know the prices of inputs and so they have a cost structure, they have no incentive to minimize their costs like private enterprise because they can't earn the net income from the production of the good.

WOODS: Okay. So there is no incentive to lose sleep, to spend time day and night thinking of ways to save money because, for one thing, as a bureaucrat who comes up with this idea of how to save money I don't in any way profit from this. I can't capture the additional income that now we don't have to spend because I cut the cost, so why would I bother doing it?

HERBENER: Right. And it's even worse than that, because the cost payouts become a kind of income for the bureaucrats. Just think of the cost structure for an alleged public good that are commonly produced by governments on infrastructure projects—like the roads here around Grove City right now are a mess, right? Potholes everywhere from the winter. Just imagine the possibilities for the bureaucrats that dole out these expenditures to their friends and favorites and to have cost overruns for their own personal consumption on the job, with fancy offices and higher salaries, and so on and so forth.

WOODS: And of course, with any bureaucrat or bureaucracy they all understand the way cost-cutting works. If you cut your costs, that means you apparently were over-budgeted. The budget for your department must have been too high if you were able to come in under cost, so we will cut the budget for your department next year. So therefore who is going to cut cost? That's a problem when dealing with

public goods provision. But another problem is the definition of public goods and the concept of free-riding. Those two things are so expansive that they could, if you're clever enough, be used and extended to apply to just about anything. So the examples that Hans Hoppe has given—playfully to be sure, but seriously at the same time—include: if I use deodorant, everybody gets a benefit from that without having to contribute to it. No one is subsidizing my deodorant to make me smell good. Or think about the etiquette courses that I took to make me into the wonderful human being I am today. Nobody subsidized that, and yet everybody benefits from what a wonderful person I am. So if we can get to matters that are so intimate as that and see how we could imagine there being free-riders, is there any conceivable limit as to how this public goods intellectual construct could be applied?

HERBENER: Absolutely not. There's no limit. And that's why it's a favorite argument of the proponents of big government, because the government can now be involved in almost anything. Another classic example in the literature, Mises used the example of a flower garden. Suppose you have this housewife and she has a beautiful flower garden around her house and passerbys get the benefit of free-riding on this. They get the benefit without paying. But as he points out, it might be that even if they subsidized her, even if the government forcibly extracted income from the passerbys and subsidize this gardener that she wouldn't change her garden. The social efficiency of the configuration of the garden is exactly as she wants it. Because she's the entrepreneur directing the production process. So it isn't even clear that in the case of having free riders that having them subsidize the producer would change things.

WOODS: Now what about the kind of commonsense objection to what we've been saying, which is that it may be that the analysis of public goods is all screwy, but the fact is that there are goods that it seems very difficult for an entrepreneur to be able to produce or earn a profit with, or even to earn an income stream for, and the classic old example, there are many, but the classic old example is the lighthouse. Then Ronald Coase had his paper showing that there had indeed been private provision of lighthouses, and then subsequent to that people began to say that even those lighthouses weren't purely privately established. Be all that as it may, it seems that it may be asking too much of the general public to say, "Well, when someday all the oceans are privatized then you'll see how part of that will be the provision of lighthouses." People might be a little impatient for that. How do you deal with a problem like that, a practical issue like that?

HERBENER: Particular practical problems can be posed that generate these sort of difficult cases. You know Larry Sechrest, in his article on maritime examples, pointed this out and did a study of lighthouses, or incorporated lighthouses into his study, and pointed out that it was much more widespread the private provision of lighthouses. But I think that the analytical point, and Hoppe makes this point, is that the configuration of different things depends upon the structure of organization of those things. So if the government is producing a particular configuration of things, we tend to see that as normal. Whereas if private enterprise had been in place from the beginning we wouldn't get this configuration. So think about, as a case of this, the electrical poles and the stringing of electrical wires in the U.S. for telephone service and things like this. So, of course, when private enterprise has developed a new system for phone service and say formally Third World countries like countries in Africa they don't string phone lines; they are all cell phones, and so they just build cell towers. And so if you have an example like this where you say well, no, private enterprise would never build this extensive network of telephone poles and so on, that's precisely right: private enterprise won't reproduce the inefficient system of the state. They'll produce some other configuration, entirely different, that we can only imagine. So we have to be able to see conceptually that there is a different path that private enterprise would take that would give us an efficient configuration but not one that is limited to the actual configuration of things that have been brought about by the state.

WOODS: Right. And of course that limits what our imagination is able to conjure because we tend to

reproduce in our minds what we see around us, as you say, as if that were normative. Now that Sechrest article you mentioned, I think that it's an unpublished paper and I will just tell people that if you Google him and lighthouses and the word maritime, you'll get a pretty good, interesting paper about the provision of numerous so-called public goods that are maritime in character.

But also on this general subject I think we ought to imagine a situation, just for the sake of argument, in which there is no parasitic state, there are just individuals, there are just human beings and their own voluntary associations. They need things like lighthouses. They need things like roads. And the proponent of public goods is in effect telling me that the only way they could conceive of to supply these things is to say that we've got all these voluntary associations, but nuts to that: let's pull out guns and start violently expropriating everybody, because that's the only way we can possibly get from our house to Sears. You're telling me that there would be a Sears store and the Sears operator and the potential consumer would both be scratching their heads as to how one would get to the other? No one would conceive of this? In this world where we have unbelievable invention and innovation constantly, we wouldn't know how to lay down some tar in a way that would pay? You could imagine merchants' associations pitching in for roads. You could imagine neighborhood associations pitching in for roads. You could imagine—you don't have to imagine because there are plenty of examples—private enterprise putting down roads. There are all kinds of possibilities here. So in other words, when people really, really need something, entrepreneurs figure out a way to supply it to them that does generate income streams. That's what an entrepreneur does.

HERBENER: That's absolutely right. It's just a question on the most abstract level, it's just a question of how we are going to organize ourselves into a proper division of labor. And there is no justification on the grounds of public goods that we need to organize ourselves by having the state and its coercive power. This organization can in fact be done by voluntary agreements.

WOODS: What would you say is the best Austrian treatment of the subject of public goods that people might read?

HERBENER: Well, we mentioned the Hoppe article already. That's a pretty good shorter piece that covers, I think, all the bases. Unless one's willing to read a book-length treatment that's probably the best single article.

WOODS: Do you remember the name of the article? I've read him and one of his books on it—

HERBENER: I think it's called "The Fallacy of Public Goods."

WOODS: Yes, something like that. I'll try and link to it, or if not you guys can try to Google it. In fact, if you just Google Hoppe and public goods I am sure the thing will come up.

Now Jeff, of course you teach the Austrian economics course over at LibertyClassroom.com. I think the best idea I have had—I have one good idea every 5 1/2 years, and I've expended it already in 2014, because it occurred to me that the standard textbook that somebody learns from and college is going to have a lot of conceptual apparatus that is not directly addressed or refuted in any of the Austrian treatises. In a major Austrian treatise there is little to no mention of even something like indifference curves. There is some cost curve analysis in Rothbard, but it could be extended, certainly. In other words, a lot of the conceptual apparatus that a young student is going to encounter is not going to be addressed directly or refuted or challenged in the Austrian literature that he will be familiar with; maybe in the journals somewhere. So I commissioned you to take a standard, very widely used college economics textbook, and go through

chapter by chapter, and explain what's good and what's bad, what are the fallacies from an Austrian standpoint. Nothing like this has ever been done before, to my knowledge. And you, having been a mainstream economist for a while, know their stuff inside and out, and you know the Austrian stuff better than anybody I know. I can't think of anybody who would do a better job. So people, if you're not joining [LibertyClassroom.com](https://libertyclassroom.com) you are missing out on the greatest innovation in the history of the Austrian school coming right up.