Common Pool Good: A good or service that is rival but not excludable, such as water from an underground pool.

Externalities: The side effects of market transactions that affect the well-being, costs, or prices of third parties that have no voice in the transaction.

External Benefits: An increase in third-party well-being or a reduction in third-party costs resulting from a market transaction between other parties. Synonyms are positive externality and external economy.

External Costs: A decrease in third-party well-being or an increase in third-party costs resulting from a market transaction between other parties. Synonyms are negative externality and external diseconomy.

Free Rider: One who receives the benefit of a good/service without contributing to its costs. Public goods that generate external benefits offer people the opportunity to become free riders.

Informational Asymmetry: A situation in which buyers or sellers have important information about the product/service that is not possessed by the other side in a potential transaction. Generally this causes a market failure.

Marginal Social Benefit (MSB): The gain to society from a one-unit increase in some market activity. MSB is the total of marginal benefits to buyers of the good (marginal private benefits, MPB) and marginal benefits to third party consumers (marginal external benefits, MEB).

Marginal Social Cost (MSC): The value to society of what is given up to get a one-unit increase in some market activity. MSC is the total of marginal costs to producers of the good (MPC or simply MC) and marginal external costs on third-party producers (MEC).

Market Failure: The failure of the market system to attain allocative efficiency. This means that potential gain exists from adjusting the quantity of some goods and services, but that this gain is not realized in equilibrium.

Nonexcludable: describes a good with characteristics such that it is impossible or prohibitively expensive to limit its consumption to a select group of consumers, for example, clean air.

Nonrival: Describes a good whose consumption by one person does not affect the consumption of the same good by another person, for example, an uncrowded highway. A good is nonrival if the marginal cost of letting another person consume it, given that it has been produced, is zero.

Pecuniary Externality: Occurs when a market transaction affects the prices at which third parties trade. Pecuniary externalities do not cause market failure.

Public Goods: Collectively consumed goods. When produced by anyone, a group of individuals can simultaneously enjoy the quantity produced. Divided into Pure Public Goods (nonexcludable and nonrival) and Excludable Public Goods (nonrival). National defense, poetry, and national parks are all public goods.

Technological Externality: Occurs when a market transaction affects the well-being of third-party consumers or the costs of third-party producers. Technological externalities generally cause market failure.

Toll Good: A good or service that is non-rival but excludable, such as an uncongested highway.

Transactions Costs: The costs of doing business through a particular institutional arrangement, for example, through contracting out versus in-house provision of services.
EXERCISES

1. Identify positive or negative externalities associated with the following services that might be provided by a nonprofit organization or social enterprise. In each case, indicate what financing and organizational arrangements you would prescribe to increase efficiency:
   (a) Books for children in low income families.
   (b) Prenatal health care.
   (c) Emergency relief after natural disasters such as storms and earthquakes.
   (d) Shelters for the homeless.
   (e) Low-cost wireless coverage in low-income communities.
   (f) Language education for refugees.

2. Analyze the following nonprofit and social enterprise management functions in terms of the “free-rider” concept and describe a strategy for dealing with the problem in each case:
   (a) Organizing a board of trustees for a new organization.
   (b) Mobilizing start-up capital for a new social venture.
   (c) Carrying out a membership drive for public radio.
   (d) Managing a team project involving staff from different departments of an organization.
   (e) Establishing a “community watch” crime-prevention program in an urban neighborhood.

3. Classify the following goods and services as Private Goods, Common Pool Goods, Toll Goods, or Pure Public Goods. In each case, indicate what this classification implies for how the good or service is most efficiently organized or financed. Which ones are best provided by private, nonprofit organizations or social enterprises, and which ones are not? Why?
   (a) Bagels.
   (b) The Internet.
   (c) Major league baseball.
   (d) Protecting whales.
   (e) An open-air concert on Public Square.
   (f) Prevention of terrorism.

4. A museum employs an “honor system” to charge visitors. In this system, visitors are asked (by a sign at the door) to put a specific fee into a locked box at the entrance. Use the ideas of transactions costs and free riders to compare the efficiency of such a system to each of the following alternatives:
   (a) A conventional system in which payments are enforced through a toll collector or controlled-access ticket machine.
   (b) A system that simply asks for donations.
A system with a toll collector who asks each visitor to pay what he or she thinks is right.

5. The board of a small volunteer-based nonprofit environmental advocacy organization is contemplating contracting out for its financial management services rather than hiring a regular permanent staff member or continuing to rely solely on volunteer effort. Identify and discuss the considerations that the members of the board should weigh in this decision.

6. The director of the Association of Stamp-Collecting Clubs would like to induce member clubs to authorize more funds to lobby against pending legislation that would reduce government support for the Post Office. The director sees this as a long-term threat to the members of the association. Member clubs agree in principle but seem indifferent to taking action and are more interested in getting the latest information on the new stamps that will be coming out this year. Analyze the director’s concerns as a market-failure problem and make a recommendation to address the issue. How can the director stamp out this problem without going postal?

7. Modern medicine requires the supply of various bodily organs for transplantation. In what ways is the “market” for vital organs similar to, and different from, the donation of blood? What are the issues in organizing this market and what institutional arrangements seem preferable?

8. In what ways are the market failure issues associated with nursing homes for the elderly similar to those associated with day care for children? How are they different? What recommendations would you make in deciding on a market structure in each case, and why do you offer this advice?