Why Markets Fail? The Economics of Covid-19

Part 3: The Market Failures

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The Role of Government

What is the role of government in a pandemic?

What are the market failures?

- Asymmetric information
- Externalities
- Market frictions
- Public Goods
- Uncertainty and Social Insurance

Social Insurance

Is it reasonable to tax future consumers in order to help current consumers? Why?

- Providing such social insurance is challenging for private markets, but easier for governments.
- Sometimes even simple flood and storm insurance is provided only by governments.

Externalities

Many economic and personal decisions have external impacts on others. What are some externalities associated with Covid-19 and the response to it?

- What Covid-related behaviors do we do too much of because we ignore negative externalities?
- What Covid-related behaviors do we do too little of because we ignore positive externalities?

The market failure:

- We may ignore the benefit to each other when we take actions that prevent or reduce transmission.
- Our insurance companies (and our friends and family) also benefit directly from our staying healthy.

Vaccines and Testing
Individual Versus Social Incentives

The individual's incentive for testing, social distancing, treatment and vaccination is small compared to the social incentive.

- What would you pay to be tested every day for Covid-19 and know the results?
- What would you pay to have everyone you know or meet tested every day and know the results?

- How much would you pay for a vaccine against Covid-19?
- How much would you chip in for others to get a vaccine against Covid-19, particularly if you were not eligible for a vaccine?

Public Goods

- What Covid-related public goods might we be under-investing in?
- How should governments increase these investments?

Innovation

- Innovation can significantly reduce illness, save lives, and restore the economy.
- Both treatment and vaccines have large positive externalities.
- Markets underinvest in goods with positive externalities.
- Markets also underinvest in innovation when they can't capture all the benefits of the innovation, even if there are no externalities, because innovation is a public good.
- Patents (or other property rights) help by allowing innovators to capture some value, but they are imperfect. They increases prices.
- Governments can also increase investment by directly subsidizing innovation or through prizes.

Asymmetric Information

- Asymmetric information costs are much higher
- Harder to observe financial strength and financial risks
- Hard to observe risky behaviors
- Many incentives are distorted

Lessons

- Subsidize testing, contact tracing, vaccines, and treatment have positive externalities.
- Use mandates to reduce behaviors with negative externalities
- Use mandates to increase behaviors with positive externalities
- Innovation is a public good - subsidize private innovation
- Social insurance - borrow from the future with deficit spending
- Reduce asymmetric information
- Shutdowns can reduce long-run costs by reducing future shutdowns and improving expectations