

# Merit Goods

**AS Economics Presentation  
2005**

# Merit Goods

- Merit Goods are those goods and services that the government feels that people will **under-consume**, and which ought to be **subsidised** or provided free at the point of use and funded by the government sector
- Both the public and private sector can and do provide merit goods & services to consumers
- The consumption of merit goods is believed to generate **positive externality effects** - where the social benefit from consumption exceeds the private benefit
- A merit good is a product that society values and judges that everyone should have regardless of whether an individual wants them

# Examples of merit goods

- Good examples of merit goods include
  - Health services
    - Primary and secondary health care
    - Health awareness programmes
  - Education
  - Work / business training programmes
  - Environmental improvement schemes
  - Public libraries and museums and other cultural facilities
  - Citizen's Advice Bureaux and Social Services
  - Inoculation programmes for children and students

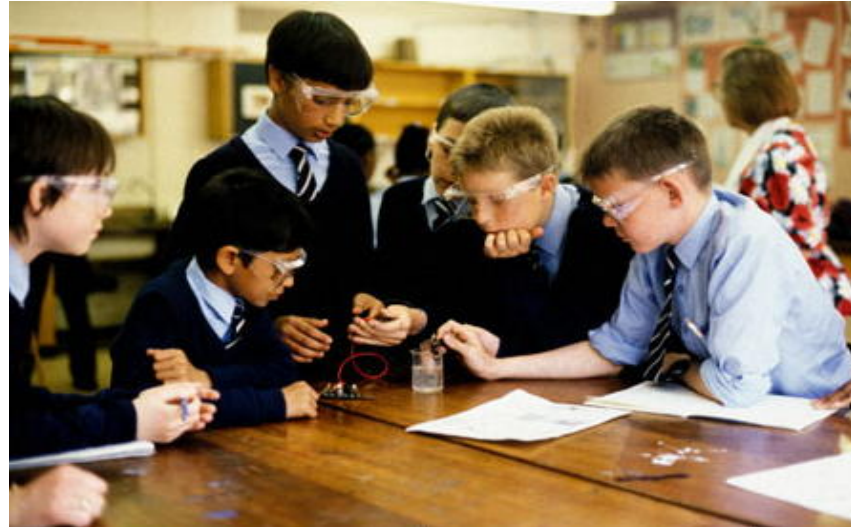
# Social benefits from merit goods?



# Merit goods and value judgements

- When defining a merit good we are inevitably use value judgments
- Our views are on what is 'good' or 'bad' for consumers and producers involve **value judgments** and state (government) **paternalism**
- Does the government has **sufficient information** to place an accurate and complete value on socially desirable goods such as health and education?
- Should we give greater **freedom to market forces** to provide merit goods?
- The state normally provides some merit goods free of charge because they consider it unacceptable that people on low incomes may be unable to afford them – this is the **equity argument**

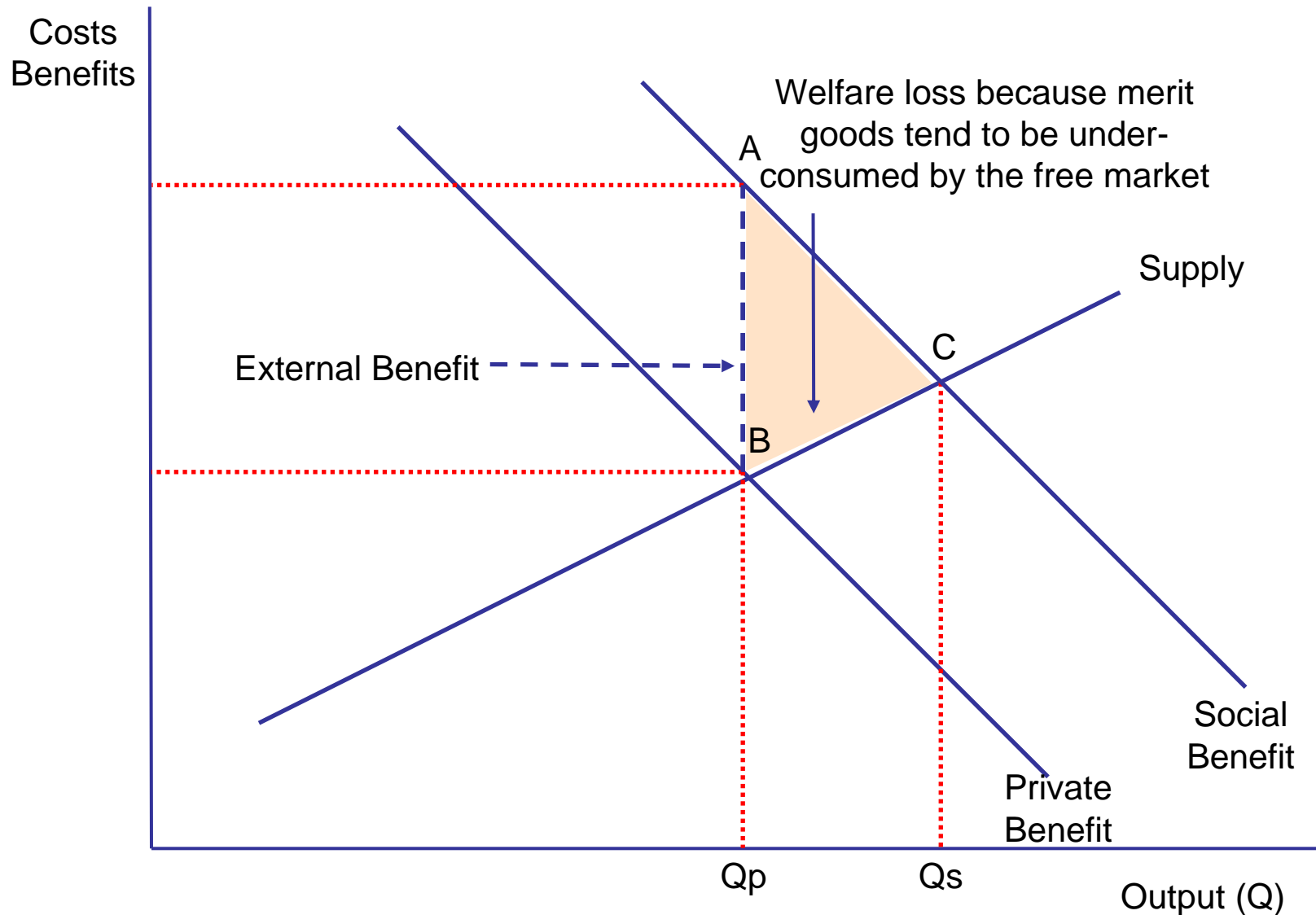
# Is Education a merit good?



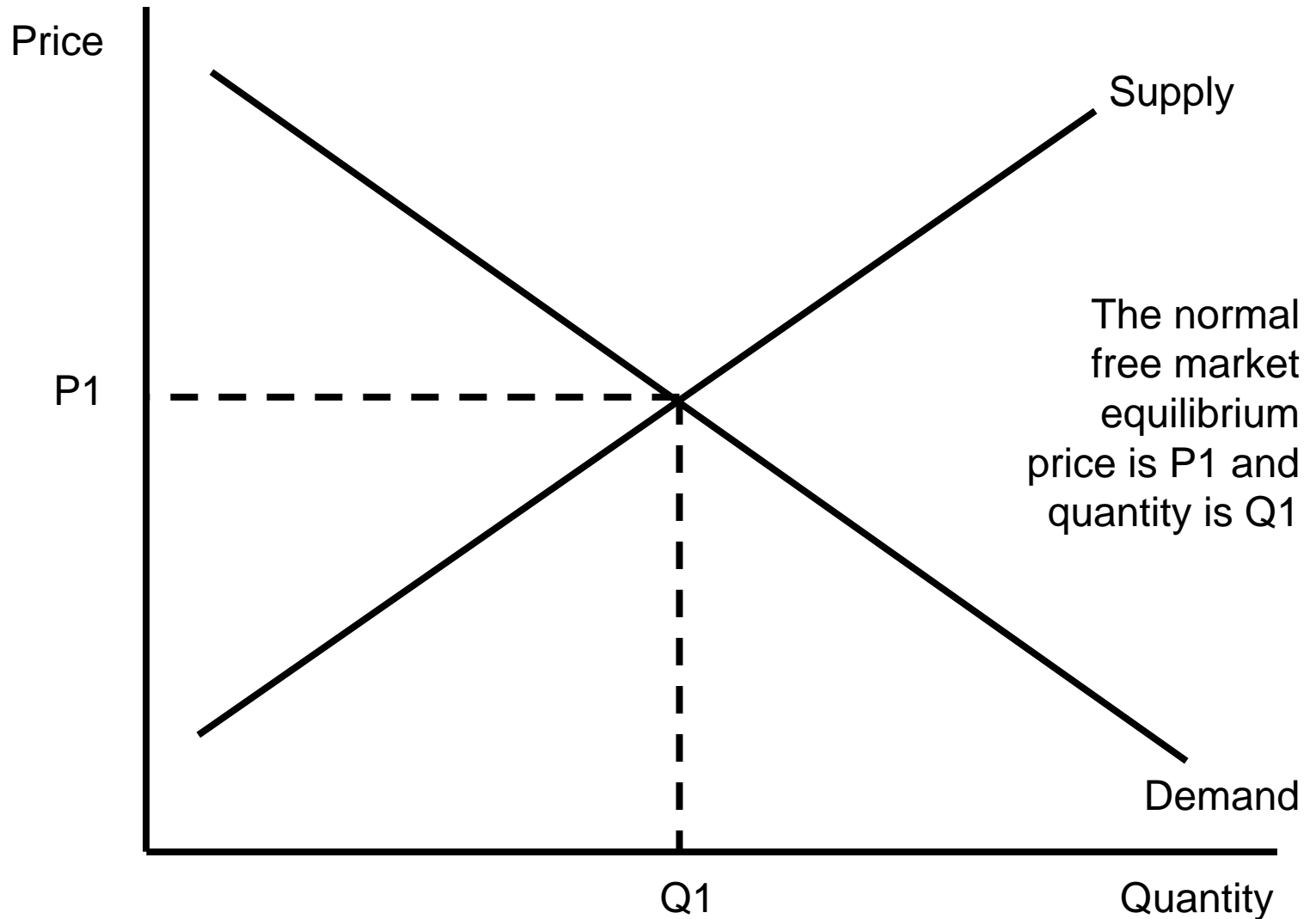
# Education and training as a merit good

- What are the private benefits of someone “buying” or “consuming” some education and training?
  - The individual is accumulating more human capital
  - Should lead to higher expected lifetime earnings
  - Personal satisfaction and utility from experiencing further and higher education
  - Reduced risk of unemployment – greater occupational flexibility
- What are the external benefits of providing education and training?
  - Skilled workforces have positive impacts on high-level economic aims, such as raising productivity and enhancing a country's GDP growth
  - Higher productivity and employment will provide the government with a greater long-term flow of tax revenues

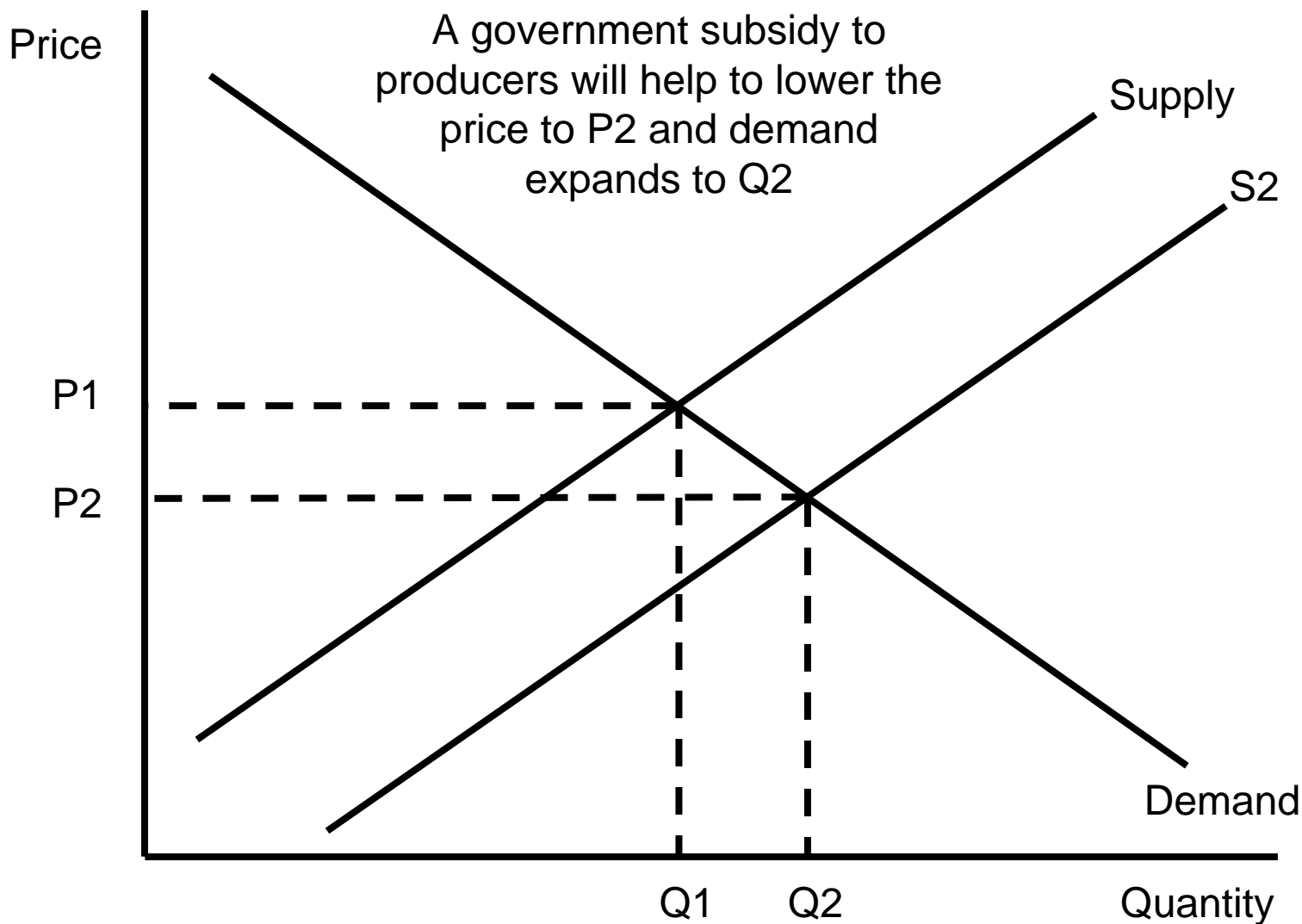
# Merit goods and market failure



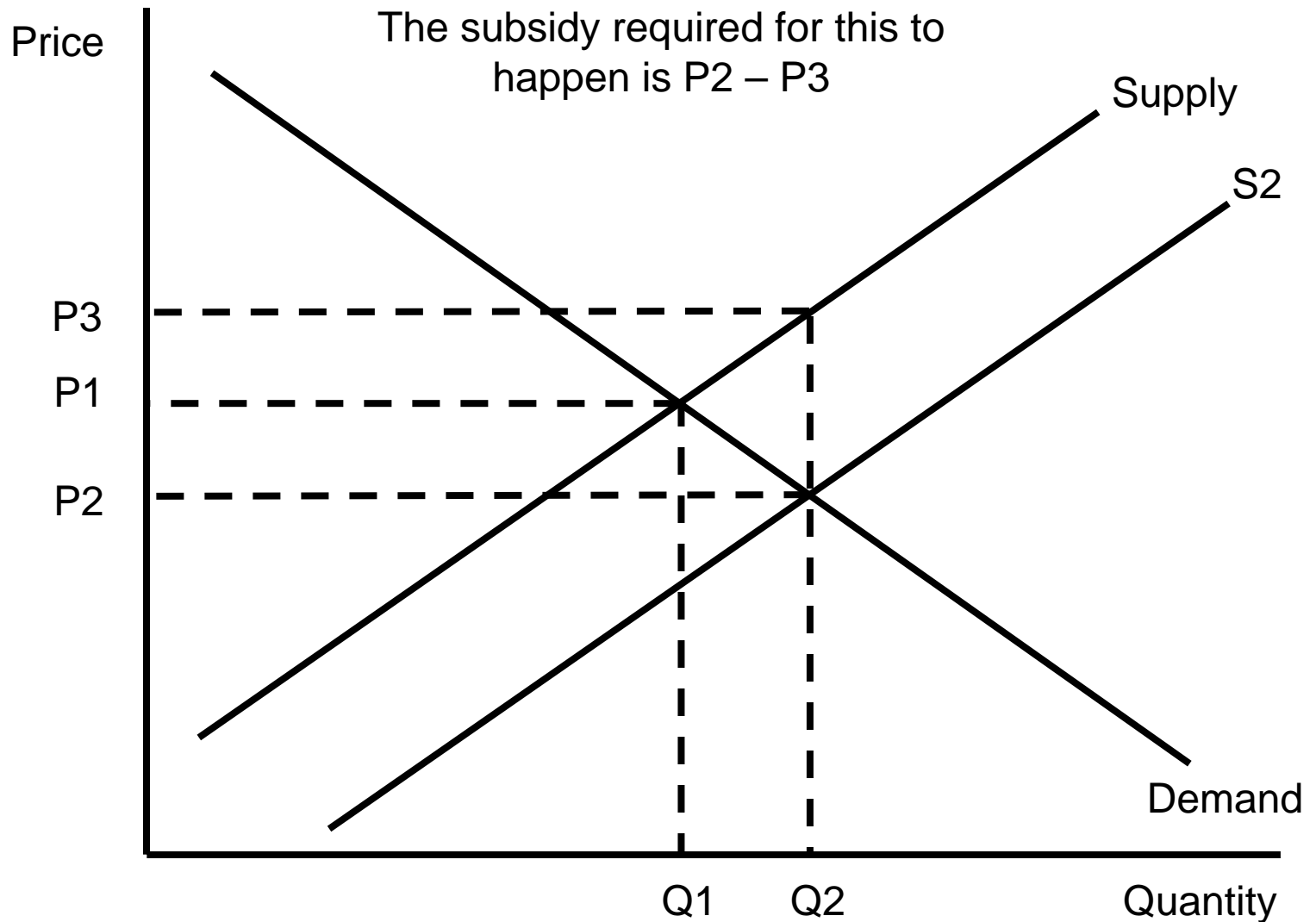
# Encouraging consumption of merit goods



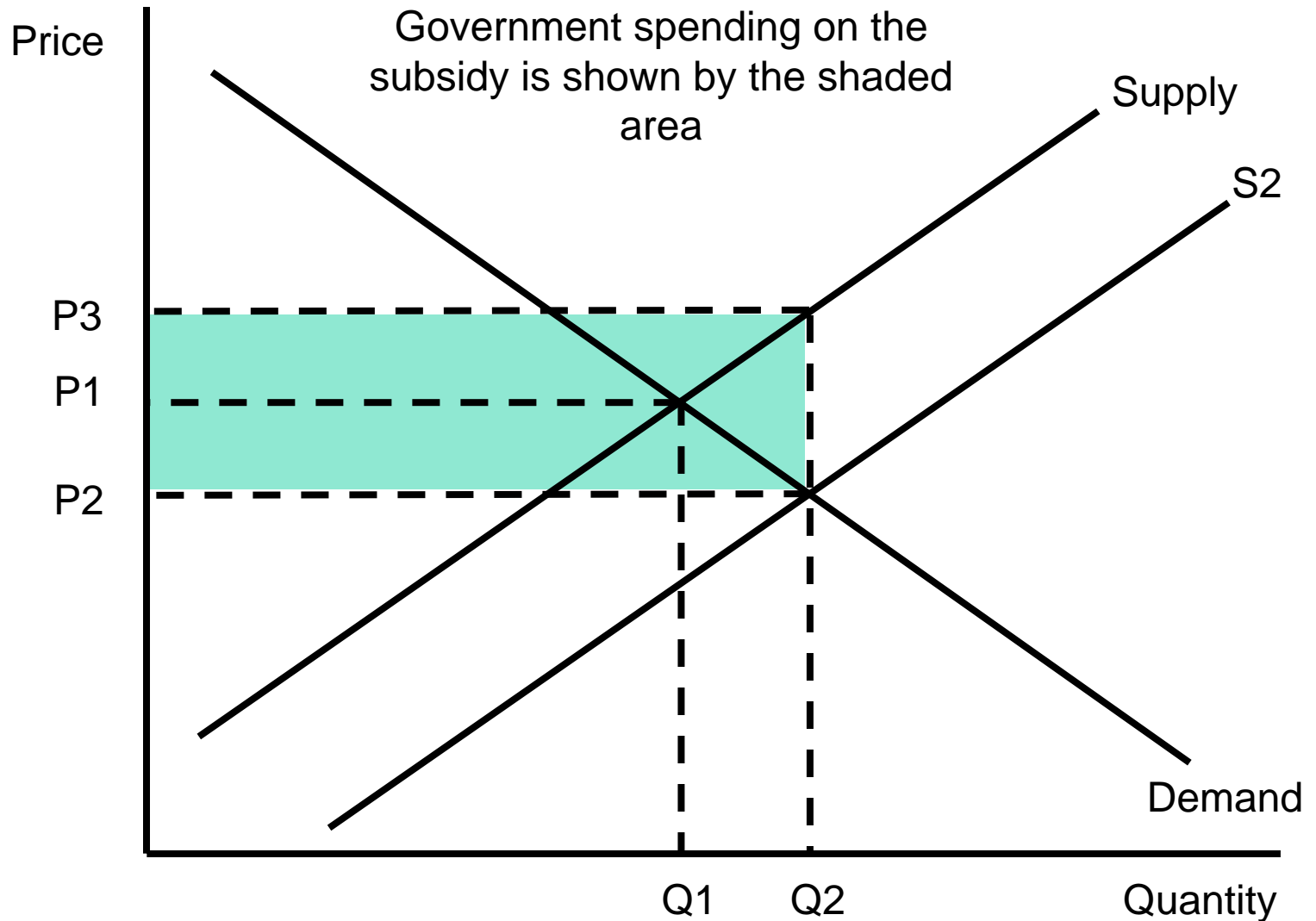
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# Market failure in business training

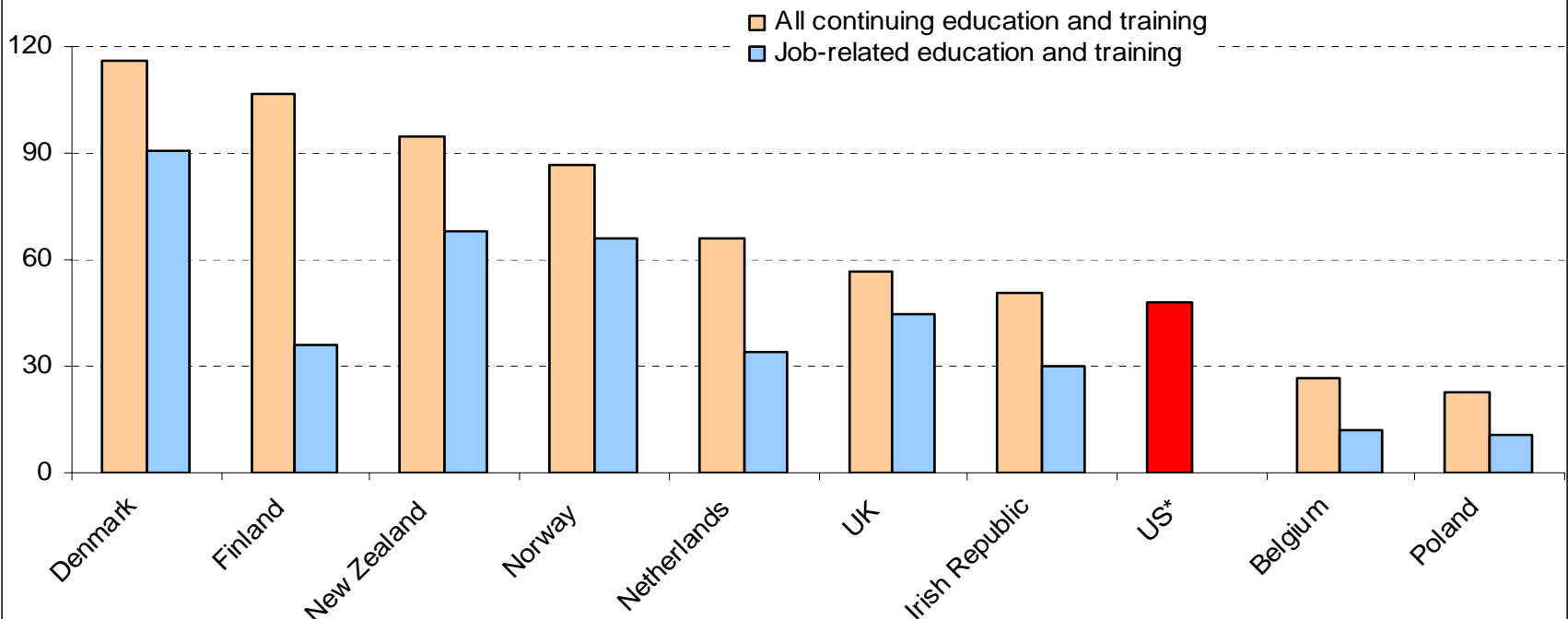
- Free-rider problem can lead to under-investment in training
  - Firms are concerned that once trained, an employee will leave the firm before the firm has recouped its investment. Unless training pays off very quickly, firms are therefore reluctant to provide training to their workers
- Imperfect information leading to employees (workers) being unable to judge the quality of their training or appreciate the benefits to themselves
- Credit market imperfections
  - Training is a costly business, but individuals expect to obtain higher wages from training in the long-term – but low-paid employees in particular are likely to be "credit constrained" and unable to obtain loans to pay for training

# The training and skills gap in the UK?

## Average hours of continuing education and training, by type of training

Selected OECD country comparisons, 1994-1998

Mean number of hours, adult population aged 25-64



Source: International Adult Literacy Survey, and national surveys

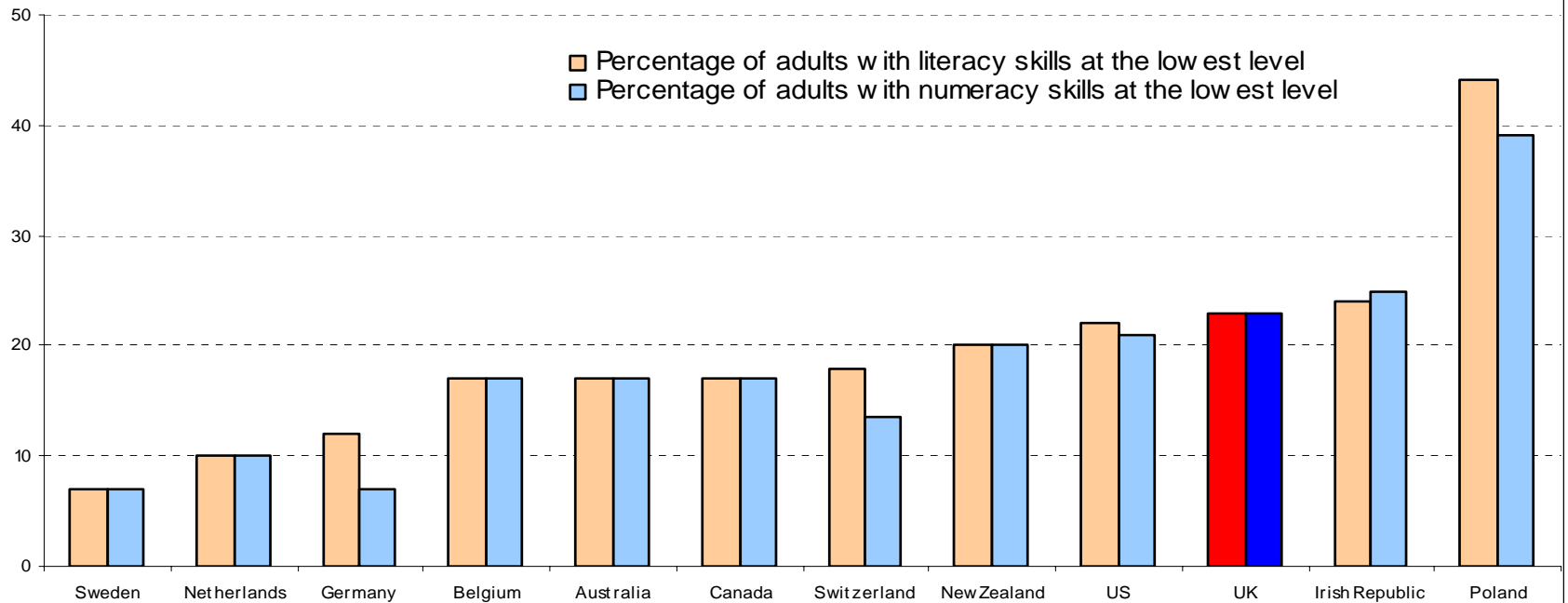
\*US 1999

# Literacy levels

## Adults with literacy and numeracy skills at the lowest level

Selected OECD country comparison, 1997

Per cent of adult population



Source: Literacy Skills for the Knowledge Society, OECD

# Strategies / policies to boost training

- Market failures mean that the level of training provided by the market is likely to be inefficiently low from society's point of view
- Possible government intervention
  - Increased funding for education and training programmes within the public sector (e.g. within the education and health sectors)
  - State funded modern apprenticeships and expansion of vocational exams
  - Tax credits for businesses that invest in training programmes
  - Regulation
  - The Industrial Training Levy (2002)

# Example: Museums – the case for free entry

- Museums provide external benefits to society – i.e. positive externalities – which leads to an improvement in social welfare
- Free entry would benefit families of children on low incomes who might not otherwise be able to afford visits
- Provide a boost to the UK tourist industry – with multiplier effects for other businesses including hotels, taxis and retailers

# Museums – case against free entry

- Higher visitor numbers raises costs e.g. staffing and maintenance
- People who visit enjoy a private benefit – they should be willing to make some contribution towards the cost
- Imbalance in location of museums towards the south east – high transport costs for those wishing to travel e.g. to London museums
- Museums have missed out on opportunities for additional fund raising – they may become dependent on government financial support

# Rural Post Offices – a merit good?

- Rural post offices are under threat
- Rising income levels which affect among other things, car ownership levels and the demand for online banking and other financial services
- The changing pattern of accessing cash. It is estimated that by 2010, over 70 per cent of the population will rely on online banking
- The rapid expansion of large scale retailers who can offer a full range of food and non-food shopping, post office services and other banking services



The Government provides an annual £150 million subsidy to support the existing rural post office network. In 2002-03 the post office network made a loss of £195 million (an average loss of £15,000 - £20,000 per branch) it is clear that without government support, the fabric of our post office network would be in severe danger.

# The case for a post office subsidy

- The arguments rest on the issues of **externalities** and **equity**
- Post Offices provide important access to cash and a range of central and local government services
- Important community focal point and are part of the infrastructure needed to sustain a (seasonal) tourist industry
- Support for elderly and low-income households, many of whom do not have access to private car transport
- Mailing facilities for emerging small businesses and for people who choose to work at home
- They reduce travel costs and helps to cut down on fuel consumption and pollution emissions
- They provide a means by which cash is injected into the local economy

# The government's view

- “Post offices play a vital role in many rural communities. They are much more than simply providers of mail services. In many places the post office is also the village shop, the local community centre, the business exchange and the bank.”
- “The rural post office network continues to face real challenges. For many individual offices, the number of customers they serve is simply too small to make the business attractive or sustainable.”
  - Patricia Hewitt, Trade and Industry Minister