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Unit - 2 - MARKET Failure

Concept of market failure →

⇒ It means market fail to allocate resources efficiently or It is a situation in which resources are misallocated. (utilize wrong of resource)

market failure

i) complete market failure
⇒ when market does not supply even when there is demand in the market.

2) partial market failure
⇒ when market produces wrong quantity & at wrong price.

Reasons for market failure :-
(4 Reasons)

- market power
- Externalities
- public Goods
- Incomplete information

i) Market power :
⇒ It is also known as monopoly power.

⇒ In case of monopoly producer produces Less and charges high price from the consumer. and Earn profit "These profit are not due to operating efficiency but due to market power or dominance"

→ Hence market fail to produce Right Qty at Right price.

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2. Externalities :

→ when consumption or production activity of one has indirect effect on others' consumption or production and such effect are not directly reflected in market price.

E.g → factory - Pollution

Two part

1. positive Ex.n ⇓ Benefits

2. Negative Ex.n ⇓ cost incure

Production Externalities

1. positive Externalities :

Eg → A firm which provide training to its employees for increasing their skills.

→ An individual raises a beautiful garden and a persons walking by enjoys them

2. Negative externalities :

Eg → untreated waste of factory released in rivers causing health risk on people.

→ River pollution reduces fishes which impact fisherman.

consumption Externalities

positive

→ Health club

Negative

→ public smoking

→ Loud music

→ undiscipline students

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How externalities cause in-efficiency & market failure.

① Externalities ignored in transactions :-
External cause / Benefit, affecting those beyond transaction are often overlooked by consumor & producers.

② Impact on efficiency & market :-
Externalities in production & consumption leads to in-efficiency & market failure.

③ private vs Social cost :-
private cost are firms cost of production & Social cost are borne by third parties.

$\boxed{\text{Social cost} = \text{pvt. cost} + \text{External cost}}$

④ market failure & Suboptimal outputs :-
Competitive markets ignoring externalities results in imperfect prices, causing over production & under-production leads to (market failure)

⑤ Public Goods :-
↳ collective consumption Goods.

→ pure Theory of public Expenditure,
paul Samuelson (1954)

Classification

MCQ Alert

~~public~~ private Goods	public Goods
① Scarce, purchased by paying a price.	① consumption is Collective.
② Excludable.	② Non - Rivalrous
③ Consumption is Rivalrous., mean one person's Consumption affects other person.	③ Non - Excludable
Eg - Car, movie ticket etc.	④ Total consumption is Same for each person.
	Eg - Highways, Defense, public Hospital etc.

Challenges with public Goods :-

⇒ free Rider problem (MCQ)
(बिना Tax pay किये अच्छा वस्तु इस्तेमाल करे)

⇒ profit maximissing firms won't produce public Goods.

④ Incomplete Information :-

⇒ perfect information implies that both buyers & Seller have Complete information about anything that may influence their decision making.

Assymmetric Information :

⇒ imbalance in information b/w buyers & Sellers. (When buyers know more than Seller or Seller knows more than buyer.

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Eg Landlords know more about the property than tenant.

→ A brower knows about their ability to repay a loan than lender.

Problem of information Gaps :-

Adverse Selection

→ ① Asymmetric information in transaction, where one party (x) possesses relevant information unknown to other party (y), leads to adverse Selection.

② → The party with more information can exploit the ignorance of other party potentially causing losses for less informed party.

Moral Hazard.

→ It happens when Someone can pass their Cost to others.

→ when a person know more takes advantage of Someone who known less through hidden action

→ In insurance moral Hazard occurs when having insurance makes people take more risk leading to increased losses.

Govt. intervention to minimize market power:

① Govt. intervenes by establishing rules & regulation design to promote competition.

Eg. Competition Act of 2002.

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(2) Anti trust laws in US & competition Act 1998 of UK are designed to promote Compation.

(3)

Other measures:

1. Market Liberalisation
2. Controll on merger & acquisition.
3. Consumer Association.
4. Reduction in import control.

Govt. plays a vital role in ensure a well function market by:

1. Physical infrastructure develop krna. Such as. Roads, bridges, airports.
2. Institutional infrastructure develop krna. Such as. Legal & Regulatory framework (Rights & Duties).

Govt. intervention to correct ~~control~~ Externalities:-

→ To improve overall well being it is important to consider both Social benefit & Costs.

→ When individuals account for External benefits or External cost in their decision making they internalise these externalities contributing to more balanced Societal outcome.

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Pollution Govt Use of Reran

Goverment initiative towards Negative Externalities :-

① Direct Control OR Regulations

② openly Regulate the actions of those involve in Negative Externalities

③ Market based policies

④ Provide economic incentive

① Direct Control OR Regulation :-

a) Emission Standards :-

→ Exceeding limits leads to monetory penalities and potential criminal libilities.

b) Licensing & Quotas :- (Limit laga diya) Govt. uses licensing & quotas (production). Govt. dictates acceptable production process.

c) Prohibitions :- complete ban on production & sale of certain commodities. (Single use plastic).

d) To-baco Regulation :- Stringent (daugh) rules in place of tabacco advertising, packaging & labelling.

e) Environmental Standards :-

- Environment protection Act of 1986.
- Specific Action to protect the Enviroment. Limiting pollutents, mandating pollution controll devices.

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f) Special bodies / Boards :—
- Ministry of Environment & Forests.
- Pollution Control Boards.

(Control) g) Abatement (pollution) Mechanism :—
Abatement mechanism
→ Device, New technology.

NOTE :— (MCQ)

→ Environmental taxes & cap & Trade use prices to encourage change.
→ Taxes on Goods help the government influence how people behave in the market.
→ Cap & Trade Sets limits on emission & Allows trade ~~limits~~ permits motivating industries to cut emissions. (pollution)
→ These approaches aims to make eco-friendly products more appealing in the market. This is achieved by :-
- → pollution Tax.
- → Cap & Trade.

→ Pigouvian Taxes ⇒ A.C. pigou

- Taxes go up when a Company pollutes more.
- Taxes of Goods with negative Externality Can decrease their Consumption & production.
- Implementing proper taxation

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Positive Externalities :-
↳ External Benefits.

Note :-

→ Though positive externality is associated with external benefits, we still call it market failure, because there will be less than optimal output.

1) Corrective Subsidies to the producers aim that increasing the Supply of the food.
2) Corrective Subsidies to the consumers aimed at increasing the demand for the Good.
3) Govt. directly enters the market producing and providing Services like education, health facility etc.

Govt intervention in Case of merit Goods :-

→ merit goods are goods that have positive externalities. Like - School, Education, Hospital part.

→ Subsidy
→ Directly involve
→ Combination of Govt. + put.
→ Laws pass - Helmet.
→ Encourage to use merit Goods.

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Govt. intervention in Case of De-merit Goods:-

De merit goods are Socially undesirable goods. Like - Sigret, Alcohol.

⇒ Govt. Should intervene to discourage its production & consumption.

Request
kara.
please)
गता रहा

- ⇒ Complete Ban (Drugs)
- ⇒ persuasion - Discourage consumption
- ⇒ Legislative Restriction - laws ban on Advertising of De-merit Goods.
- ⇒ market control & Limit access.
- ⇒ High Taxes.
- ⇒ minimum price fixing.

Govt. intervention in Case of public Goods:-

1. Govt. Regulation :- Regulates entry fees Ticket to ensure equitable distribution of welfare.
2. Key public Goods by Govt. → {Defense, legal System fire protection, disease protec
3. Excludable public Goods → parks. universities funded by entrance fees.
4. voluntary contribution → {Donation. NGO's}

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price intervention :-

→ It generaly takes place in the form of price controls which are legal restriction on price.
→ price restriction may takes place in the form of either {price ceiling price floor}
→ fixing of minimum wages & Rent controll.
→ MSP for farmers.
→ Govt. manages {buffer Stock}

Govt. intervention for correcting information failure :-

① Govt. makes it mandatory to have accurate labelling and content disclosures by producers.
E.g. cigrattes packets.
② mandatory discloser of information.
E.g → SEBI
③ Regulation of Advertising, (fairlovely)

Govt. intervention for Equitable Distribution :-

⇒ progressive Taxation.
⇒ Budget Allocation.
⇒ Social Security Schemes.
⇒ Intervention on Black money.