

Reasons of market failure economics essay



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Market efficiency is the property of society maximizes the benefits it achieves from the use of its scarce resources. When the production is efficient, the economy will obtain all it can from the scarce resources that is available and there is no way to produce more than a good without producing less of other goods. Market failure is a circumstance which a market will overlook its own fails to allocate resources efficiently. Thus, there are several possibilities that can cause market failure such as externalities, market power and public goods as well as incomplete information.

Externalities are based on the impact of an individual action on the well-being of a bystander. Hence, they enforced people other than the consumers and producers of goods and services. Thus, externalities are also described as spillover effects. Third parties are refer as people except consumers and producers who are affected by these side-effects of market exchanges.

Externalities may be either positive or negative which it may cause beneficial or disadvantageous to the third party. For instance, we are off to bed and our neighbour is having a dancing party with high volume rock music. The action of our neighbour is imposing negative externality toward us and the third parties who are trying to sleep. As the results from annoyance of our neighbour's playing the music, this is an example of a consumption externality.

However, externalities are also an external positive externality too; by the way, negative externalities are only caused by market failure. On the other hand, the production externality is generated, for examples, depletion of natural resources are caused by atmospheric pollution from factories and the long-term environmental damage. The factories expel harmful gases such as

CFC, carbon monoxides, hydrocarbons from the chimney that causes bystander health. The externality is considered to be an important factor contributing to economic growth.

Market power is also one of the reasons of causing market failure. Market power, which refers to a firm, can influence the price by exercising control over its demand, and supply. It does not exist when there is a perfect competition, but it does when there is monopoly, cartels, or monopolistic competition. The invisible hand of the market leads to an allocation of resources that makes total surplus larger as it can be. As monopolies can lead to an allocation of resources unlike from a competitive market, the monopolists keep its prices and profits high by using its market power to restrict output below the socially efficient quantity. The monopolists choose the profit-maximizing quantity of output at the intersection of the marginal-cost curve and the marginal-revenue curve. It is not at the lowest point of the average total cost curve, intend that the available resources are not fully use and it will fail to produce an efficient allocation of resources. The inefficiency of monopoly also can be measured with a deadweight loss triangle area between the marginal-cost curve and the demand curve, which reflects the total surplus loss and the costs of the monopoly producer. Buyers who have willingness to pay less than the price will not buy it. It is the reduction in economic well-being that fall out from the monopoly's use of its market power. Microsoft market shares in PC operating system in the natural monopoly are one of an example because everyone is using their products. It would also leads to an increase in competition and variety as well as cheaper products for consumers. Moreover, after determining the

level of Microsoft's market power, we know that the relevant market is the licensing of all Intel-compatible PC operating systems world-wide. In addition, some consumers may not interest on some types of application, they might seek for others, such as Apple Company.

Other than those reasons above, the reason which will cause market failure happen is public goods. Public goods can define as goods that will not reduce the availability of it for consumption by others after people making consumption. By the way, once public goods are available, no one can be withheld to consume them for free. Public goods are usually provided by the government examples like protection provided by police, fire departments, and the military. Public goods may provide free rider problem, which means the private organizations cannot get all the benefits of the public goods which they have produced, there would be no incentive for them to voluntarily provide public goods; consumers can take advantage of public goods without contributing sufficiently to their creation. This situation can produce inefficiency and a resulting market failure.

When markets failure occurs, it will eventually affect economic recession, social unemployment rate to increase, financial deficits, and inflation and so on. In order to seek full employment, price stability, maintain economic growth and international revenue as well as expenditure in balance; government will launch a series of economic policies to intervene the market economy and to correct market failures. Government policy is a kind of coercive force which is a noticeable act that controlled by individuals and organizations' performance during the trade. Moreover, the government

policies are divided into three parts, which consist of taxes, price control and subsidies.

Tax is an imposed manner which the burden of a tax is shared among participants in the market. When a tax is imposed on goods, this will affect supply curve to shift upward by the amount of the tax. In addition, taxes can directly and indirectly affect on other area such as cigarettes, petrol, and alcoholic drinks.

According to the text above it has already shows out that an increase in tobacco tax is the best means to reduce tobacco uses, particularly to prevent young people to become smokers. The price of tobacco products has increased by 70%; it can avoid 1/4 of smoking death rate in the world. In addition, an increase in tobacco tax will not only help or reduce in tobacco production and consumption; it will also be a great solution to the shortage of national financial revenue problem. In high-income countries, 10% of the rate increase in tobacco products can reduce a consumption of tobacco by 4%. Whereas, in low-income countries it can reduce about 8% but tobacco taxes but will increase by almost 7%. For example, in the U. S. government make the federal tobacco tax from 39 cents per pack to \$ 1. 01, which is by far the most significant U. S. government to raise the federal tobacco tax. Select a recession in the domestic tobacco tax increase to help smokers to quit and this will be “ great power”. Britain is the world’s that has highest tobacco tax. However, in 2009, the United Kingdom has doubled up the tobacco tax.

Price control is the import and export of goods or services on the enforcement of price-fixing measures. At the equilibrium price, there will be no shortage or surplus. The government may prefer to keep prices above or below the equilibrium. There will be a shortage, if government sets a maximum price below the equilibrium price. Price will not be allowed to rise to get rid of this shortage. This is called a 'price ceiling'. There will be a surplus, if government sets a minimum price above the equilibrium price. Price will not be allowed to fall to get rid of this surplus. This is called a 'price floor'.

For instance, fluctuation in weather can affect the crops. If industry demand is price inelastic, prices are possibility to fluctuate severely at a minimum price that can prevent a fall in producers' incomes that would accompany periods of low prices. Whilst, if government sets a maximum prices to prevent them from rising above a certain level. This will generally be done for reasons of fairness. In wartime, or times of famine, the government may set maximum price for fundamental goods so that poor people can afford to buy the goods. Government keeps prices down for the consumers.

Besides that, subsidies are also other forms of public policies to overcome market failure. Government policies are very common in countries and it is benefit a lot of industries. Other than that, agriculture, education, free school meals, employment, state benefits, transport, working tax credits, regional development, housing are also some examples of the subsidies from government.

In the Egyptian economy, food subsidies can be affected in various sectors. A major objective of a research was done in order to examine the agricultural policy-making in the environment of a growing foods subsidy system. In addition, misallocation and in efficiencies of resources in agriculture take place when food subsidies are hidden costs of such systems. Nevertheless, it is a vital to divide out from the entire bundle of policy goals and relate it with those instruments that are directly or indirectly related to food subsidies. A complete quantitative evaluation of a country`s agricultural policy and its determinants can be provided by its basis. Furthermore, commodities that are strictly controlled on the production section are also strictly rationed at a fixed price on the food distribution are such as sugar and rice.

Product such as maize, wheat and meat are non-rationed or not strictly rationed commodities. Moreover, products that are not strictly rationed commodities are considerably to have less interference in allocation and marketing. The input and output prices of agricultural are distorted in different ways. Tax are usually taxed or given under the field of crops.

Whereas, the production of milk and meat has been protected by the supply of subsidized and by import restrictions. Food policy may cause a consumer-to-producer to transfer and a producer-to-producer to transfer when a special situation for livestock or feed has been point out, in which it accompanies redistribution of income among the production sectors in an agriculture sectors.

In conclusion, as market failure will arise and government will established several policies to improve the market allocation. According to the cases as stated above, obviously, subsidies is the best effective policies that can be

under take by market inefficiency. As it is the one of a positive solution and it can encourage producers to put more effort on producing and fully used the resources. The producers have no hesitation about accepting the government most generous offer. They are willing to produce maximum outfit by using subsidies that had given from the government. Hence, subsidies are no way to compare with other policies.