Market failures

Business

Introduction According to Bowles (2004), a market failure occurs when a free market fails to allocate resources efficiently or effectively. Callan & Thomas (2010) asserts that market failures often occur in various forms, and should be corrected using government intervention.

During market failures, Mankiw (2009) points out that the nature of the market is not Pareto efficient. Pareto efficiency is a scenario whereby an improvement in one sector is likely to result in a corresponding harm to other sectors. For instance, if the management of a coffee processing plant opts to lower the price of its final processed coffee, it would benefit the consumers; however, it would be compelled to pay coffee farmers a lower price, thereby resulting in harm. At Pareto efficiency, the market is operating an optimum level with no imbalances. Mankiw (2009) highlights the various forms of market failures, which include productive and allocative inefficiency, monopoly power, missing markets, unstable markets, information failure, inequality, negative externalities, demerit goods and incomplete markets. Whenever the forces of supply and demand do not allocate resources efficiently or effectively, there is said to be some form of market failure and interventionists use these instances to justify government failure in creating a balance in the market (Myers, 2012).

When these failures arise, government intervention is always necessary to correct the situation. For example, when agricultural based firms experience market failure, the government is expected to step in with policy decisions aimed at resolving the issue. Having provided an overview of the concept of market failures, the author of this paper discusses how governments can attempt to correct market failure. How Can Governments Intervene to

Correct Market FailureTucker (2010) argues that government intervention is justified when market failures do occur; this is because governments can rationalize their involvement in the market dynamics by stating that its intervention serves the interest of the public because market failures do not result in market efficiency (Wilkinson, 2005). In this regard, the government should adopt strategies aimed at correcting the distortions resulting from the market failures and enhance the efficiency of the market operations.

This can be achieved by a number of strategies including the indirect taxation, subsidy, using tradable pollution permits, extending property rights, regulation, using buffer stock schemes, deploying minimum prices, and renewable energy certificates. Subsidy refers to a grant offered by the government with the main objective of encouraging the consumption and production of a given good or service that has substantial external benefits such as education and health. Financial incentives such as subsidies promote industrialisation and lure multinational corporations to set up businesses locally. Weimer & Aidan (2004) assert that subsidies decrease the cost of production as well as the cost of acquiring a commodity, which, in turn, increases the demand of that particular commodity. Through subsidies, governments can correct market failures relating to merit goods.

Governments can also use regulations to correct market failures. Regulations involve directing or controlling market activities according to the rules. Wilkinson (2005) asserts that economic regulations maintain relatively competitive markets. Social regulations control other behaviours of individuals and firms, such as non-discrimination laws, safety standards and laws requiring consideration of physically challenged people in alll aspects

income generation. In addition, legal controls, standards and regulations play an instrumental role in eliminating environmental pollution.

Governments can enact business laws and regulations that require businesses and individuals to conform to certain standards or business culture. Legislations can change behaviour if they are well implemented, resulting in market characteristics that create market efficiency (Welch & Welch, 2010). Governments can also make use of buffer stock schemes to address market failures; this strives to mitigate price fluctuations of a given commodity and ensure that producer incomes are stable. A government agency can establish a target price range for a given commodity and intervene to make sure that the price of the commodity is within the established price range without any instances of unexpected changes in supply or demand. The minimum pricing scheme can also be used by the government to address a market failure, which involves stabilizing the prices of commodities and producer incomes by setting up a definite minimum pricing scheme (Wilkinson, 2005). Conclusion A market failure occurs when a free market fails to allocate resources efficiently or effectively.

When the market fails, the nature of the market is not Pareto efficient. Government intervention is justified when market failures occur; this is because governments can rationalize their involvement in the market dynamic by stating that its intervention serves the interest of the public because market failures do not result in market efficiency. This can be achieved by a number of strategies including indirect taxation, subsidy, using tradable pollution permits, extending property rights, regulation, using

buffer stock schemes, deploying minimum prices, and renewable energy certificates.