

Two Scenarios Of Market Failure And The Possible Reasons

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Summary

In economic terms, market failure is described as a market situation where the goods or services supplied do not meet the demand for those goods and services, accounting for several ideal factors that affect the equilibrium. In this paper, we discuss two scenarios of market failure and the possible reasons why and how these situations failed the market. Additionally, the paper will include possible solutions to the problems after detailed analysis and evaluation. The discussion points are as follows:

- Understanding market failure and its consequences.
- It is important to analyze the social benefits and social costs of every economic activity to avoid market failure.
- National defence is a public good.
- Public goods are nonexcludable and nonrivalry.
- Negative externalities result in market failure, which requires being addressed.
- Lack of information on the benefits of public goods is the major reason behind the failure of the market.

Introduction

Market failure can occur due to productive and allocative inefficiency. This is when the market fails to produce and allocate the limited resources demanded by the market inefficiently, which results in increased wastage, a decrease in the standard of living and several other economic issues (Weeden, K. A., & Grusky, D. B. 2014).

Moreover, market failure can result in negative externalities, production of demerit goods, failure to meet the demand for certain products and services, a monopoly in the market, inequality of income, and unstable markets. The causes of market failure are usually the lack of information in the market for the consumers, employees and the business. Some businesses that fail to conduct good market research and evaluate the requirements of consumers also result in the disequilibrium of the market, while other firms charge extremely high prices and fail to provide choices for the consumer. On the other hand, the government fails to use and allocate its scarce resources efficiently to maximize productivity, which is caused by the corruption and exploitation of the tax revenue from the public.

Situation 1:

Firm 'A' produces cement sifters. The process includes the melting of metals and chemicals, which give the sifters strength. In the production process, waste is produced and released into the river that runs alongside the plant.

Analysis

The production process of the firm 'A' ensures the strength of the cement sifters, which includes melting metals and chemicals. It is reported that the production process creates waste, which is dumped into the nearby river. These chemicals are extremely harmful and dangerous for the river life and may result in a hazardous atmosphere, which will jeopardize the fish, the animals that drink river from the river, and the people living near the river. This is because such wastage not only contaminates the river but also damages the surrounding environment and releases harmful chemicals into the air due to the evaporation process and the water supply from the river.

This is a perfect example of market failure, where the private benefits exceed the external benefits and the social costs are greater than the social benefits of the economic activity, which has resulted in negative externalities. While the firm contributes to the economy in the form of income, producing output, and creating employment in society, it also harms third parties, i.e., the people who are indirectly affected by the activities of the firm. When they release their waste into the river, it damages the surrounding environment, which is an alarming situation for third parties. The firm fails to allocate its resources efficiently to reduce wastage and adopt effective methods to avoid dumping the wastage into the river. This results in market failure.

Evaluation

Firm 'A' requires catering to the issue of market failure and the damage to their company image, which has resulted in a decrease in the demand for their product, and possible strikes are expected to occur. The government needs to consider the actions of Firm 'A' and other similar firms that are damaging the environment and contributing to global warming. Every economic activity requires a proper analysis of the social benefits and costs. The environment needs to be the priority at this stage. Hence, firm 'A' should adopt new production methods that are more efficient and effective, which results in little to no wastage. In case the wastages are unavoidable, the firm can install a purifying plant that eliminates the hazardous chemicals from the wastages and avoids releasing them into the river.

The government should charge huge fines on businesses that pose a severe danger to the environment and jeopardize the lives of the people around them. Nevertheless, it is crucial to consider the external benefits and costs of economic activity. The priority should be the externalities

of the activity as it results in market failure.

Situation 4:

The President of the United States has determined that the cost associated with the national defence has become too expensive. In an effort to reduce costs and balance the budget, the President has asked the public to voluntarily pay for their fair share of the costs associated with national defence. One of his advisors insists that this would not work; another advisor thinks it is a good policy. Which advisor is correct?

Analysis

National defence is a public good that benefits and protects the country's interest and the general public, but they can't be charged directly for this service provided by the government as it is their basic right. Tyler Cowen (2006) describes public goods as goods or services with two distinct features, i.e. non-excludability and nonrivalrous consumption. This means that everyone enjoys the benefits of the good or service whether they have paid for it or not, which also generates the term of 'free riders.' Free riders refer to people who are unwilling to pay for a service they can otherwise get for free. Additionally, public goods are non-rivalry, which means that such goods are not limited and do not impose competition on another consumer. Everyone gets an equal opportunity to receive the benefits.

Hence, if the President of the United States expects American citizens to pay for the defence voluntarily, it will result in a market failure. This is because people will be unwilling to pay for a service that they can enjoy for free. Moreover, voluntary payment is a concept that fails due to the lack of 'excessive' income people can generate to pay for the national defence. The national income taxes are already collected from the public and allocated to different goods and services. This also shows that the government has been allocatively inefficient. The population does not always consider national defence as the most important good or service provided by the government.

Evaluation

The policy might be effective if there are effective awareness campaigns arranged about the significance of national defence and the need for the protection of the people. This might result in a few nationalists contributing to the funds; however, a majority of the population will refuse to pay for a service that should be provided to them from the tax revenue collected in the first place. This will result in market failure as the market forces will not meet and create disequilibrium. Additionally, the people might also consider other things that they believe are more important than national defence, such as creating employment, improving infrastructure, education, and healthcare, and improving the living standards of the country. Hence, the President of the United States will be required to consider

a policy that effectively addresses the demands of the consumer, i.e., the American citizens.

References

Cowen, T. (2006). The concise encyclopedia of economics. The Library of Economics and Liberty, <https://www.econlib.org/library/ENC/PublicGoodsandExternalities.html>.

Weeden, K. A., & Grusky, D. B. (2014). Inequality and market failure. *American Behavioral Scientist*, 58(3), 473-491.