3. Market Failures & Economic Role of Government

Q:1 Define Market Failure. what are the Causes of market Failure ? OR
Explain Different Sources of Market Failures ?

(A) **Market Failure :-** Market Failure is found due to inefficiency in Production, Consumption and Distribution.

" Market Failure is a situation where market fail to Produce and Allocate Scarce resources in the most efficient way. "

(B) **Sources | Causes of Market Failure :-**

1. **Imperfect Competition :-** One of the important reason of Market Failure is Imperfect competitive market. These markets are not working efficiently. Here either buyer or sellers are able to control over Price of goods or quantity.

Example :- Monopoly, Monopsony, Oligopoly, Monopolistic Competition etc.

Under Imperfect Competition, Firms can raise the Price of goods above their Marginal Cost - it will reduce Consumers Satisfaction.

Thus when Competition is imperfect, there will be inefficient allocation of Resources which leads to market Failure.

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2) **Imperfect Information :-** The Role of Invisible Hand in a market is based on the assumption that consumers, firms, government, workers etc. have perfect information about market. They have full information about various goods and services, features of goods, different opportunities etc. But in Reality, the market participants are not perfectly informed. This imperfect information create the problem of - asymmetric Information

" Asymmetric Information is a market situation where One party in transaction has more information than Other party "

In many cases, sellers have better information about their goods than buyers.

Thus, Asymmetic Information will result in Poor Functioning of market which Leads to market failure.

3] **Externalities :-** Externalities exist when the actions of One Person affect the well-beings of Third Party. Third party may be individual, organisation or society.

There are Four Types of Externalities :—

i) Positive Consumption
ii) Positive Production
iii) Negative Consumption
iv) Negative Production

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Examples:- Air Pollution from motor Vehicle is an Negative Externality. But Benefit of Education is Positive Externality.

The main Problem of Externalities is that their Cost and benefits are not reflected in Market Price. To Solve this Problem government impose Taxes on goods that have Negative Externalities and Provide Subsidies on the goods which have Positive Externalities.

4) Public Goods :- A Public goods are special type of goods that can be consumed by every Person in the economy.

Example:- Street lighting, National and Domestic Security System, Defence, Police Services, Public Health, Education, Roads, Railways etc.

" Public goods or Services which has the feature of Non-rivalry and Non-Excludability and as a result would not be Provided by the Free market."

Since the benefits of Public goods are available to all, Consumers will not Voluntarily Pay For those goods. Hence market Failure occuring while Providing Public goods.

5] Merit Goods:- " Merit goods means a good which would be Under-Consumed in the Free Market economy"

Consumption of Merit goods Create Positive Externalities.

Example:- Health Services, Education, Public Libraries

Vaccination, work-Training etc.
Both Public Sector and Private Sector of the economy are Providing merit goods.

6] De-merit Goods :- "De-merit goods is goods or Services whose Consumption is Unhealthy or Undesirable due to Negative effects on Consumers"

Example :- Cigarattes and Alchohol, Tobacco etc.
Markets Fails to Control manufacturers of such goods.
Hence market Fails.

7] Inequality :- Market Failure is Found due to Inequality of Income and wealth. Market transactions reward Consumers and Producers with income and Profits but these rewards are in the hands of Few Rich People. Wide differences in income and wealth Leads to wide gap in Living Standards which results in market Failure.

8] Unstable Markets :- Sometimes we Observe Unstability in money market, Capital market and Foreign market etc. The Fluctuation in these markets and Trade Cycles will also result in Market Failure.

9) Missing Markets and Incomplete Markets :-

" A missing market is a Situation where resources are not allocated according to Competitive market "
Missing markets are nothing but Market failure.

"A Complete market Provide all the goods and Services at Low Cost of Production and Consumers are able and willing to Pay For it."
But when market Fails to Pay goods and services at Low Cost of Production and Consumers are willing to Pay then this market is Considered as Incomplete markets.

Example :- Insurance Sector. The Private Sector do not Cover many risk like- Crop insurance, Health and Unemployment insurance etc. In such Cases Govt. Plays an active role to Correct the market.

(10) **Unemployment and Inflation :-** Every economy is facing Problem of Unemployment and inflation which also Create Problem of market failure. These Problems Can be Solved with the government policy measures.

Q:2 Explain the Meaning of Market failure. what Role State Can Play in rectifying market failure?
OR Examine the economic Role of Government?

(A) **Market Failure :-** Same From Q:1

(B) **Economic Role of the Government :-** The government Plays an important Role to correct market failures and improve market conditions. There is need of Government intervention due to Following Reasons :-

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i) To Improve Market Efficiency.
ii) To achieve Equality in Income distribution
iii) To achieve Economic and Social Objectives.

Thus, Government Policy measures are needed to guide Correct and Support the Market Mechanism.

© Government Policy measures :-

1. To Correct Market Imperfections :-

Market Mechanism helps in proper allocation of resources. Goverment Regulations and measures are needed for efficient working of Market Mechanism.

Example :- Competition Act-2002 helps to maintain balance between Demand and supply forces and Controls Monopoly Power.

Government can Set up Regulatory Authorities to compel the Firms to Provide their financial Information.

Example → SEBI.

2. To Correct Problem of Imperfect Information :-

Asymmetric Information is a market situation where one Party in transaction has more information than other Party.

Example :- In the bank loans, borrowers know more about their Circumstances as compare to Lenders (banks) which result in Bad Loans. So Here Government has to make Provisions to protect banks from Bad Loans.

3. **To Provide Legal Structure :-** The government should provide necessary legal framework to protect all the buyers and sellers in the market. The contractual arrangements in the market must be protected with the proper legal structure.

4. **To Provide Public goods and Merit goods :-** Market fails in provision of public goods. In case of merit goods like- Education, when it is provided by market people there may be under-consumption of goods.
So the government provide public goods and merit goods at subsidised rate or provided free of cost. The public goods and merits goods are very important for economic development.

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5. **Correct Problems of Externalities :-** Sometime externalities may lead to market failure. Government has to correct the market failure by way of- Budgetory Policies, Subsidies or Taxation.

Example → i) Government can impose Taxes on goods that have Negative Externalities.
ii) Government Provide Subsidies on goods that have Positive Externalities.

6) **To Correct Unequal Distibution of Income and Wealth :-** In India, there is unequal distribution

OF Income and wealth due to —

i) Market system
ii) Transfer of Property rights through inheritance.

In most of countries income and wealth is Concentrated in the hands of few rich People. So the government has to work for Redistribution of income from Rich to Poor through →

i) Welfare Programmes
ii) Taxation Policy.

7) To Provide an Institutional Environment :-

The government has to Provide a Suitable Institutional Environment so that market should work efficiently. Good Economic Policies of government are necessary to bring —
- Macro economic stability
- Sustainable growth and development
- Economic and Social development etc.

Government Should act as Partner, and Facilitator of Market to improve their efficiency.

8) To Secure important Social Objectives :-

Government Policies Plays an important role in achieving Social Objectives like — Increase in income and employment Economic Growth and Development, Reduce Povesty etc.

9) To Provide Social Security :-

Market system do not Provide Social Security to People Suffering from Unemployment, Old age disability, etc. The government has

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to make Some Provision For Social security to its People.

10) To guide Use OF Natural Resources:- The Market Mechanism Cannot maintain better allocation of Resources between Present and Future. Here government Policies will guide the market Participants in proper Consumptions OF Natural Resources, Pollution Control etc.

11] Public Ownership:- IF the government feels that, Under Free market Conditions Some Producers Charge High Price to earn more Profits. Then Government Provide Public Utility Services at Low Price to Control Private Monopolies.

Example:- Postal Services, Railways, water supply, Electricity supply, Gas supply, Health services, Education etc.

Q:3 Select the most appropriate answer from the alternatives given and Rewrite the statement:-

1. Market Economy Suffers from **a- imperfections** which are responsible for Problems like inflation, Unemployment etc.
   a) Imperfections b) Lack of Resources c) inefficiency.
2. Imperfect information Posses the Problem of **a- asymmetric** information.
   a) asymmetic b) inefficient c) Lack of
3. Market Failure takes Place due to **b- Externalities**
   a) Perfect Information b) Externalities c) Private goods.

4) The goods having the Feature of Non-rival in Consumption and non-excludability are called
a- Public goods
a) Public b) Private c) Merit

5.) we can improve economic efficiency by Correcting
Market Failures
a) Market failures b) inflation c) Unemployment

6) In Case of goods with **Positive Externalities** the Firms Produce too Little of goods.
a) Negative b) Positive Externalities c) Zero.

Q:4 State whether the following statements are True or False giving reasons :-

1. Imperfect competition Leads to effecient allocation of Resources.

Ans:- **False. Reasons:- Q:1 - B Part - 1st Point**

2. Imperfect Information has the Problem of asymmetric information.

Ans:- **True. Reasons: Q:1 - B Part - 2nd Point**

3. Externalities are always Negative.

Ans:- **False. Reasons: Q:1 - B Part - 3rd Point**

4. Market Failure does not occur in the case of Public goods.

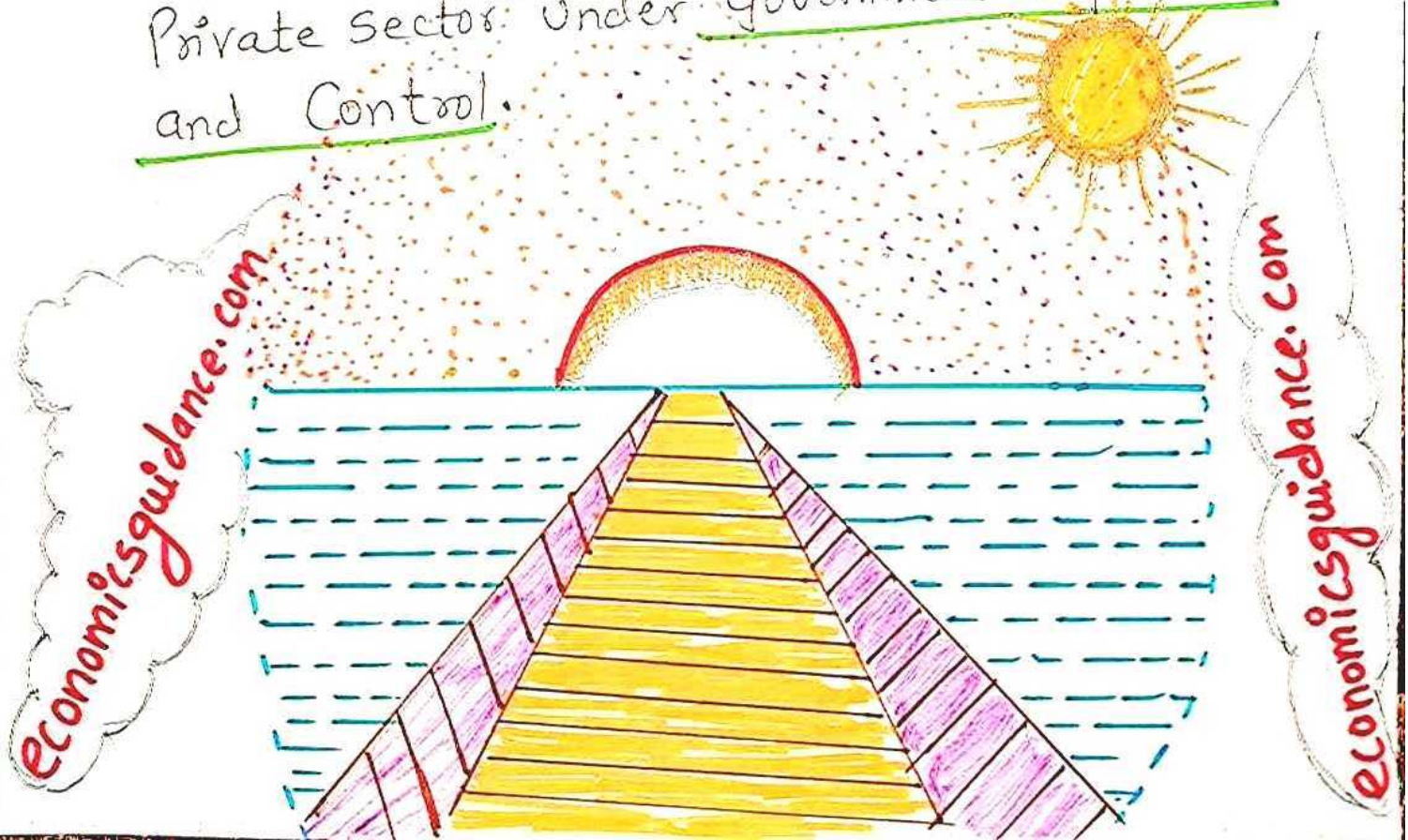
Ans. **False. Reasons:- Q:1 - B Part - 4th Point**

5. The Government Cannot Correct Market Failure.

Ans:- **False. Reasons :- Q:2 - B Part**

6. Government Policy is needed to correct and supplement market mechanism.

Ans:- True. Reasons : Q:2 C Part - 7th Point

7. The State Should be the Only Provider of all infrastructure and Social Services.

Ans:- False. Reasons: The Government/State need not be the only Provider of all infrastructure and Social Services. It can allow the Private Sector to Participate in the infrastructure. It will create Healthy Competition between Private and Public Sector. Government Provide Regulatory framework to protect Consumers and workers.
Government do not act as monopoly supplier of Public Utilities like - Electricity, Gas, Telecommunication etc. but these activities are carried with Private Sector under Government supervision and Control.