

Program Bachelor of Arts. Third year B.A. subject economics

semester 5 course code ECT.115 course title

environmental economics one.

Title of the unit economy and the environment. Module name

market failure module number 3. My Name is Doctor Sharmila Desai,

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In this particular subtopic that is market failure, we

will be studying first the meaning of the market failure

and Secondly will be studying the causes of market failure.

Now at the end of the subtopic you will understand.

The concept of externalities and student will also able to analyze the causes of

market failure.

Now what is market failure?

Market failure is the economic situation defined

by an inefficient distribution of goods and

services in the free market.

In market failure, the individual incentives for

rational behavior does not lead to rational outcomes of the group.

In other words.

Each individual makes the correct decision for himself

or herself, but those proved to be the wrong decisions for the group.

Market failure occurs when the individual acting in rational self interests produce a less than optimal or economically inefficient outcome.

A market failure exist when resources do not attain their highest social value.

For environmental goods and Natural Resources, markets fail when benefits and costs cannot be allocated accurately across and within nations and generations.

Market fails when private self interest states actions.

Could be.

Improved on relative to collective goals.

Market failure comes about when people cannot define property rights clearly.

Market fail when we cannot transfer rights as well as when we cannot exclude others from using the good or when we cannot protect our rights to use the good.

Under these conditions of free exchange does not lead to socially desirable outcome, cause private actions provide too many bad such as pollution or too few

goods such as open space.

Since everyone owns the right to clean air and biodiversity,  
nobody owns the right.

This makes it a challenge for the market to operate  
effectively.

Does the market system is incomplete and there is a  
problem of missing markets?

Now next we'll be studying what are the various causes  
of market failures?

One of the most important cause of market failure is  
externalities.

Now what is externality?

Externality is the most important cause of market  
failure and externality can arise when the market price or  
cost of production excludes its social impact, cost or benefit.

Externality can be either positive or negative.

A negative externalities is any difference between the  
private cost of an action or decision to an economic  
agent and the social cost.

A negative externality is anything that causes an  
indirect cost to individuals. An example is

the toxic gases that are released from industries or mines. These gases cause harm to the individuals within the surrounding area and have to bear the cost. That is an indirect cost.

To get rid of that harm.

On the other hand, a positive externalities is any difference between the private benefit of an action or decision to an economic agent, and the social benefit.

A positive externality is anything that causes an indirect benefit to individuals.

For example, Planting trees make individuals property look beautiful and it also cleans the surrounding areas. Now the second cause of market failure is public goods. Now what are public goods? Provision of public goods is in fact another reason for market failure.

A public good exists when a person cannot be excluded from its benefits or cost that is non excludability. And when one person consumption of the good does not reduce its availability to anyone else, that is nonrival consumption.

Public goods can be either pure or impure public goods.

The difference is that a pure public good is both non excludable and Nonrival.

Whereas impure public goods might be either non excludable or nonrival, but not both.

For example, climate change protection, the ozone layer and biodiversity are examples of pure public goods in which benefits accrue to all those people around the globe.

Common property and club goods such as rivers, local parks and lakes are impure. Public goods cause benefit can be excluded from non members of the group that owns the resource.

The potential problem with the using the market to provide pure the public good is free riding.

Since he or she cannot be excluded from same amount of good, each person has the incentive to let someone provide the public good. Everyone has an incentive to free ride off the fact efforts of others.

Now the third reason or the third cause for market failure is common property.

Existence of common property is another main cause of market failure.

Here an example can be cited of Open Access resources.

In case of Open Access Resources, people cannot be excluded from assessing a resource such that one person's use. Arrivals and others you and others use.

If a person's use of particular resource reduces the total resource available to all, everyone has an incentive to capture the benefits before someone else gets it.

These open access resources that belong to all leads to inefficient use of resources.

For example,

In case of fishing activity.

Each Fisher has an incentive to catch as many fish as possible before someone else catches the same fish.

He has no incentive to value the scarcity of the Fish, 'cause if he does not catch, catch them, someone else will catch the fish.

His decision to let the fish be is not respected by others.

Because they have as much right on fish as he does.

This leads to market failure because as he starts expanding efforts and in doing so his efforts is such that his marginal costs end up exceeding.

His marginal revenue.

This violates the standard of efficiency condition that says that net benefits are maximized when marginal revenue equals marginal cost.

4th.

Cause of market failure is nothing but hidden information.

Market failure occurs when people cannot observe either the actions or types of other people. Specially moral hazard create a problem for smooth operation of market forces.

Moral hazards occur when an entity has an incentive to increase its exposure to risk because it does not bear the full cost of that risk.

For example. When a Corporation is insured, it may take on higher risk knowing that its insurance will pay the associated cost.

adverse selection frustrates the market because a person cannot observe the hidden cost example.

Whether a farmer has high or low opportunity cost for increasing biodiversity on his or her Lane, or the hidden

quality of some good or service example, whether or not a loaf of bread is organic.

Both types of hidden informations slow the creation of markets that could be used to allocate resources to efficient use.

Such as the product, reduction of environmental risk.

So these states that there are various reasons or causes for the market failure if we don't take care of these causes and if we allow these things to operate in an economy just like that as they are operating, then definitely the market will not operate efficiently and we will not be able to produce socially desirable and economically efficient output in a market.

So because of that reason we have to. Takes steps whereby we can reduce. The.

Intense intensity of market failure. So now for further reference you have two books.

From which you can obtain the.

Further information on this particular topic thank you.