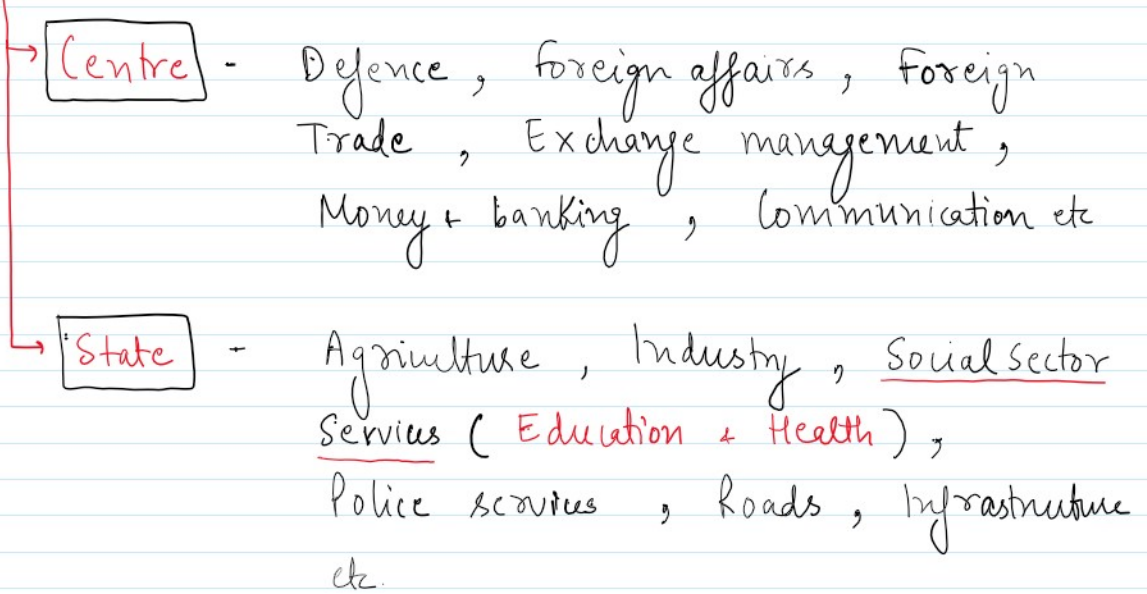


- 1) Income distance
- 2) Population
- 3) Area
- 4) Demographic performance
- 5) Forest & ecology
- 6) Tax & fiscal efforts.

* Responsibilities



CH 7 Unit 2

MARKET FAILURE

(inefficient allocation of resources)

Complete Market failure

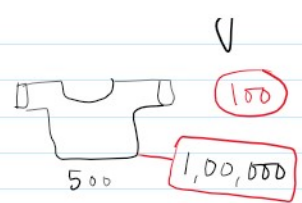
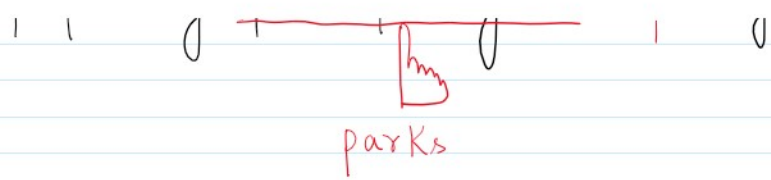
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This is a case of " missing markets " and occurs when the market does not supply products at all despite the fact that such product or service are wanted by the people eg pure public goods.

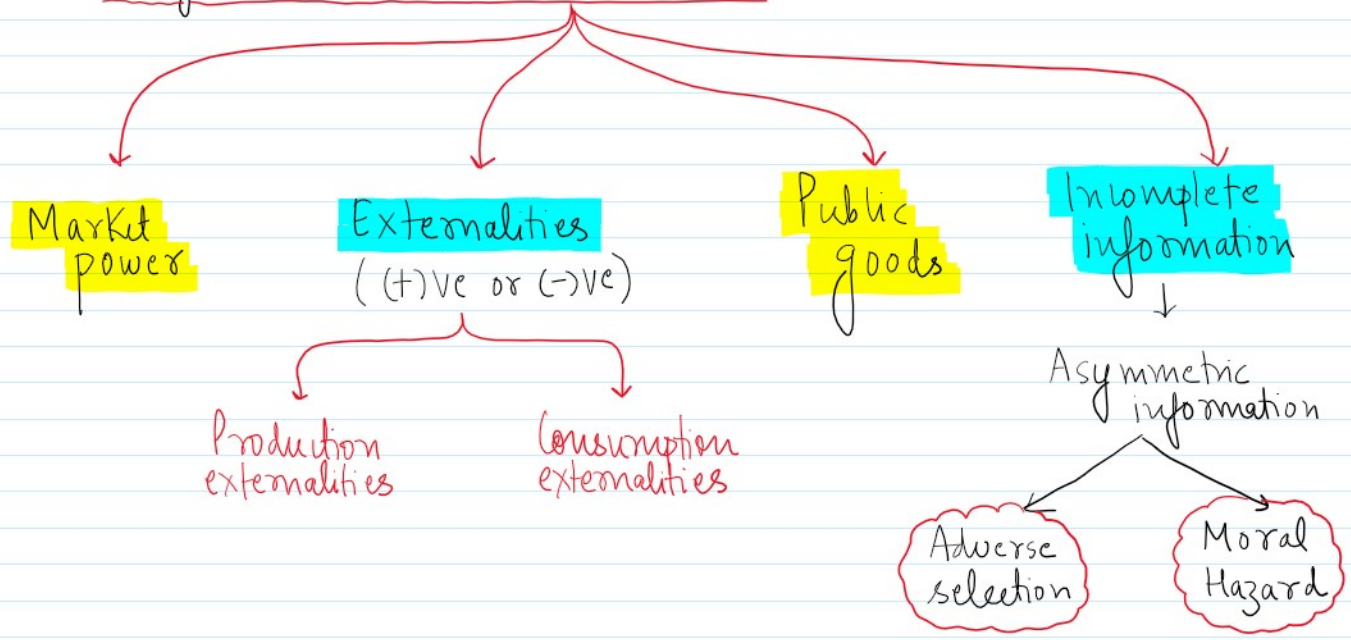
Partial Market failure

↓

Failure occurs when the market does actually function, but it produces either the wrong quantity or at the wrong price. This results in loss of economic welfare



* Why do Markets Fail ??



GOVERNMENT Intervention in all these above

I Market Power

- Market power or Monopoly power is the ability of a firm to profitably raise the market price of a good or service over its marginal cost.
- Excessive market power causes the single producer or a small number of producers to restrict output
- Thus, market fails to produce right quantity of goods & services at the right price.

II EXTERNALITIES

- Externalities are cost (नकारात्मक / negative externalities)

→ Externalities are **costs** (negative externalities) or **benefits** (positive externalities), which are not reflected in free market prices.

नुकसान


नुकसान

→ Externalities are also referred to as

- Spill over effect
- Neighbourhood effect
- Third party effect
- Side effect

→ Production externalities

(+)ve
A firm offering **trainings** to its employees

(-)ve
factory produces wastes or pollution


→ Consumption externalities

+ve
• Consumption of the service of health club.
• people get immunized against contagious diseases.

(-)ve
• smoking cigarettes in public place.
Fav. Act of undisciplined students talking and creating disturbance in class.

* How externalities cause market failure?

→ Private cost - cost of production incurred by

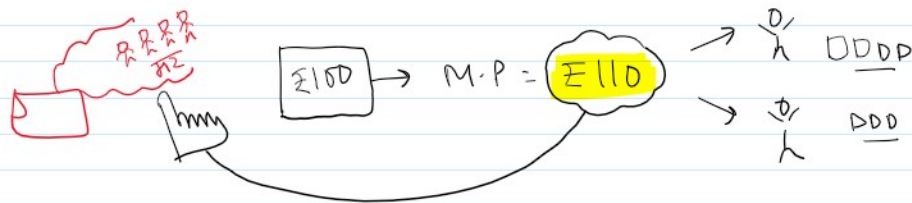
→ **Private cost** - Cost of production incurred by firm. eg wages, raw material etc

→ **Social cost** - **total cost** to the society on the amount of production


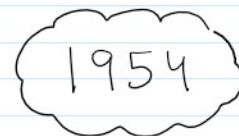
$$\text{Social cost} = \text{Private cost} (+) \text{Negative externalities}$$

or $\text{Social cost} = \text{Private cost} (+) \text{External cost}$

→ The market price determined without incorporating externalities are not ideal. Such prices send incorrect signals to the producers & consumers and cause either over production or under production.

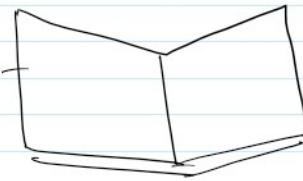



III PUBLIC GOODS / SOCIAL GOODS

 Paul A. Samuelson 

The Pure theory of Public expenditure

(first economist to introduce public goods)



Private Good → 

 **Public Good**

- No **free rider** problem
- These are **excludable**
- Consumption of private good is **rivalrous**

- free rider problem is there.
- Non-excludable
- Non-rivalrous
- Indivisibility.

good is 'rivalrous'

• INDI-VIDU-AL

• Indivisibility

• More vulnerable to externalities + other issues

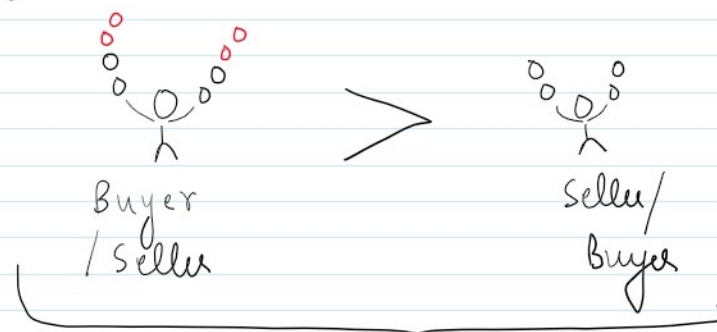
→ Producers are not motivated to produce socially optimal amount of products if they cannot charge a positive price for them or make profits from them. Thus, there is market failure in the case of public goods.

IV INCOMPLETE INFORMATION

- Perfect information implies that both buyer & seller have complete information about anything that may influence their decision making. However, this assumption is not fully satisfied in real markets because of :-

- doctor
surgery
consumer
producer
- Complexity of product / service
 - Difficulty of getting correct information
 - Deliberate misinformation by interested parties

→ Asymmetric information

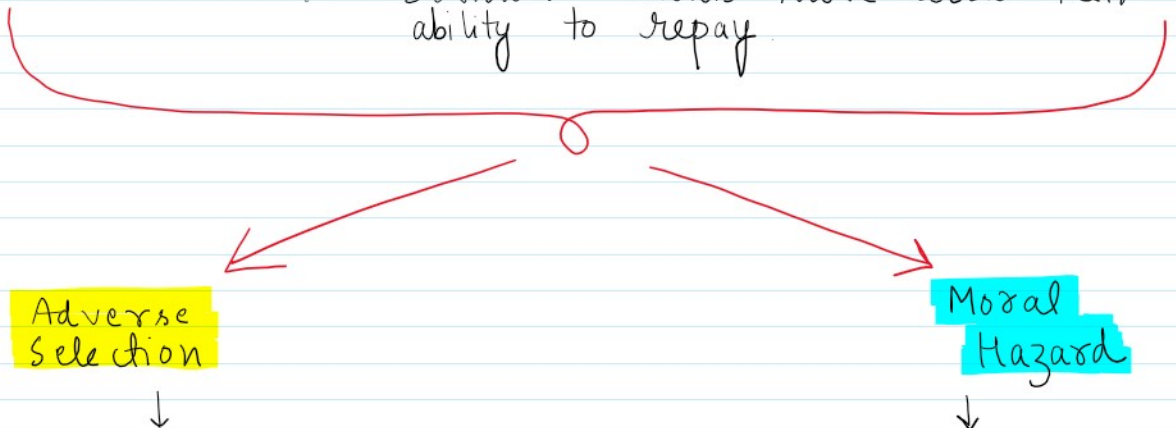


it occurs when there is an imbalance in information between the buyer & seller.

eg :- Landlords know more about their

eg :- Landlords know more about their property

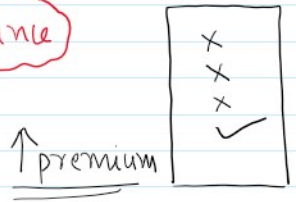
:- Borrower knows more about their ability to repay.



Adverse Selection

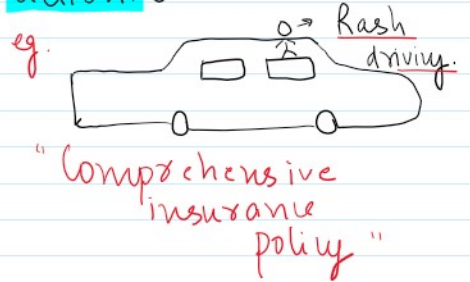
The party which has more information (let say Mr X) may take advantage of other's ignorance (let say Mr. Y). Here Mr. Y will be at loss.

eg. Insurance



Moral Hazard

Moral hazard arises when there is externality. It is about the opportunism characterised by an informed person's taking advantage of a less-informed person through an unobserved action.



* Thus, asymmetric information leads to elimination of high quality goods from the markets. Economic agents end up either selecting sub-standard product or leaving the market altogether

* GOVERNMENT INTERVENTION

① TO MINIMISE MARKET POWER

① To MINIMISE MARKET POWER

- Competition Act, 2002 (as amended by Competition (Amendment) Act, 2007)
- Market liberalisation
- "Control" on Merger + Acquisition
- Price Capping
- Patronage to consumer associations
- Reduction in Import controls
- Nationalisation

Support

* However sometimes government give patents and copyrights & protect monopoly position of a firm 😞

② To Correct Externalities

Reduce effect of negative externalities

Government initiatives

(i) Direct Control (Command Solutions)

- Fix emission of pollutants (penalties for exceeding limits)
- Licensing
- Make laws

(ii) Market Based Policies

[environmental taxes and Cap and Trade] i.e. setting price

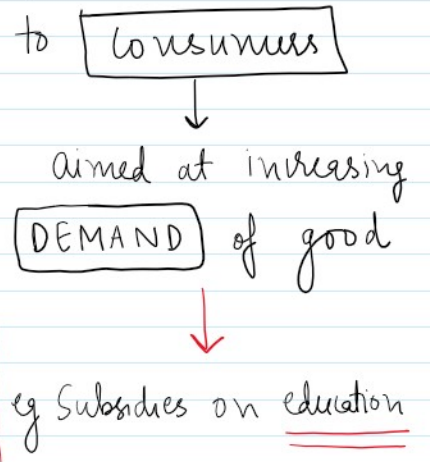
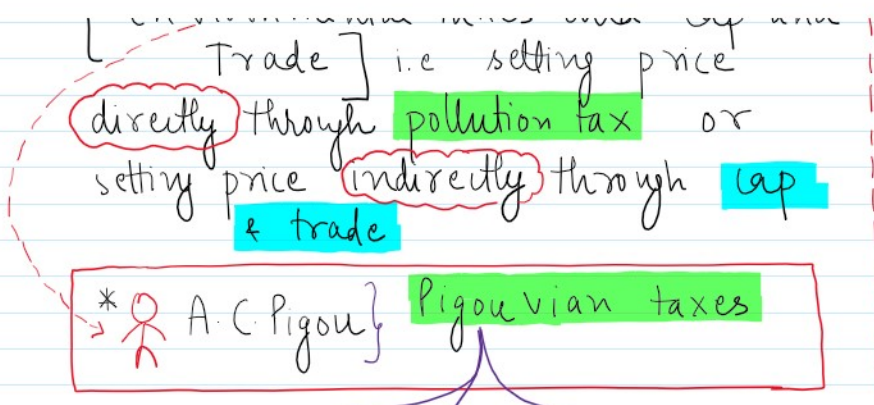
Promote positive externalities

(i) Corrective subsidies to producers

aimed at increasing SUPPLY of good

eg Subsidy on Fertilizers

(ii) Corrective Subsidies to consumers

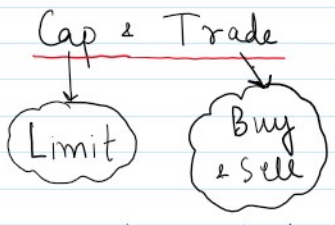


It is difficult to determine

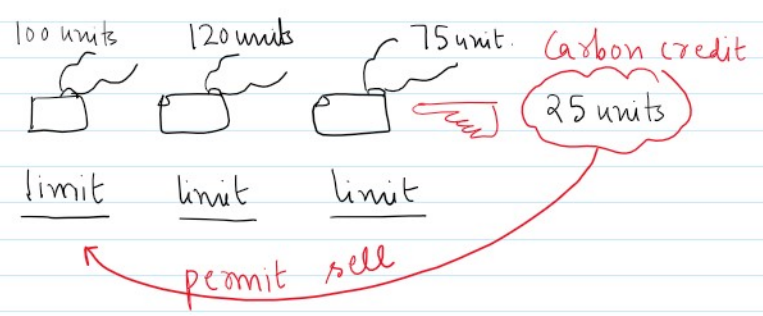
If demand is inelastic then these taxes may not be effective

Adverse effect on Employment

- * Also government engage in :-
- a) Afforestation
 - b) Reforestation
 - c) protection of water bodies etc



- Total pollution allowed to be emitted during each period.
 - concept of Permits + concept of Carbon Credit
- Buy sell



Tradeable permits have been used since 1980s in US.

In India - Perform Achieve & Trade (PAT),
RPO (Renewable Purchase Obligation)
REC (Renewable Energy Certificate)
Energy Conservation (Amendment) Bill, 2022

③

In case of Merit Goods

- Compulsory Insurance protection
- Compulsory immunization
- Use of legislation (eg use of helmets, seatbelts)
- Free education / Free medical services

④

In case of Demerit Good → Alcohol, Tobacco, drugs, cigarettes

- Complete Ban → Hidden market is there.
- Negative advertising (persuasion)
- Prohibit advertisement of these goods.
- Restriction in public areas
- Imposing high taxes

Demand of these products are generally **INELASTIC**, so increase in price due to high taxes have very less effect on demand (Also, sellers can shift the tax on consumers)

☞ Disclaimer : "Do not touch."

⑤

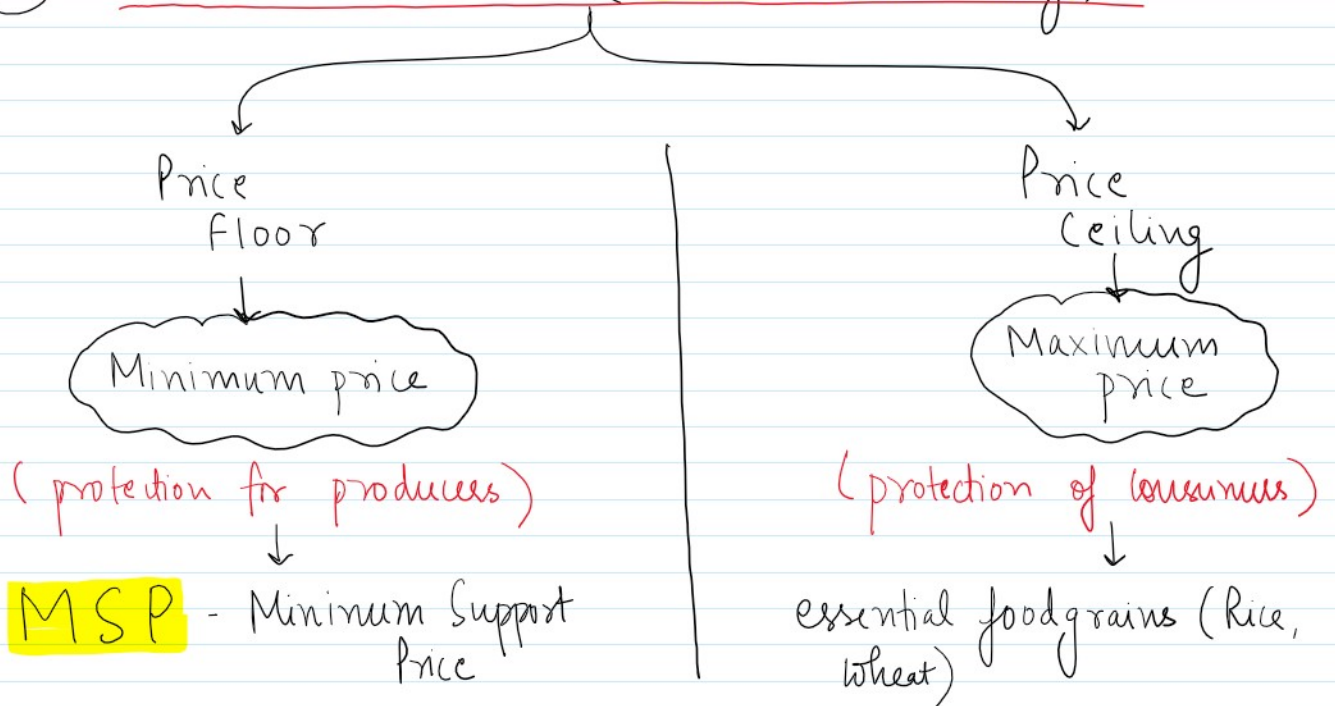
In Case of Public Goods

- Defence, legal system, fire protection, disease prevention etc are provided

disease prevention etc care provided by government

- Parks or museums can be financed through "entry fees"
- Government may grant license to private firms to build good public facility
- Government may invite voluntary contributions and private donations.

⑥ Price Intervention (Non Market Pricing)



⑦ For Correcting Information Failure

- Government makes accurate labelling mandatory
- Mandatory disclosures (eg - SEBI makes it compulsory for companies)
- Public dissemination → प्रचार

- Regulation on Advertising

⑧ For Equitable Distribution

- One of the most important activities of government is to redistribute incomes so that there is equity & fairness in the society
- Progressive taxes
- Unemployment allowances
- Job reservations
- Land reforms
- Gender sensitive budgeting
- etc.

but sometimes Government failure occurs when:-

- Intervention is ineffective causing waste of resources
- Intervention produces fresh & more serious problems

x ————— x ————— x ————— x ————— x ————— x ————— x

CH-7

Unit 3

Process of Budget Making

① Introduction

→ Government all over the world have to perform manifold functions from protecting territories, maintaining law & orders, provision of public goods and implementation of comprehensive plans for economic & social welfare of its citizens.

→ A budget is a statement that presents the details of where the money comes from and where