Big Question: what is wrong with markets?

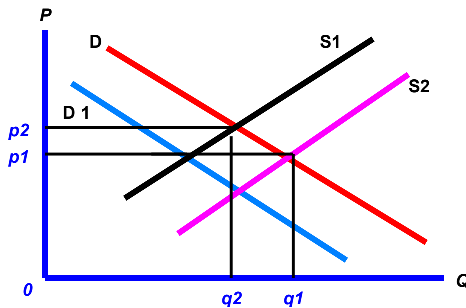
Syllabus Item(s):

14 + 17

Webnote 111

Resource Allocation
Syllabus reference 1.1
Price Mechanism: *disadvantages*

1. externalities



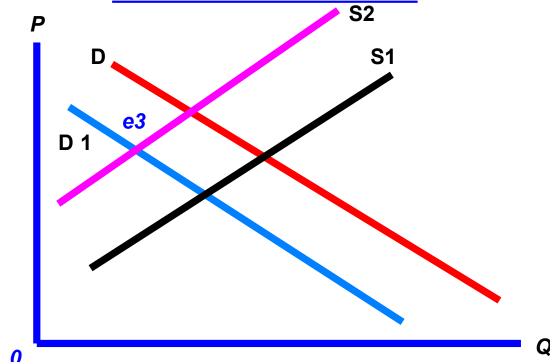
1. **The price system does not take into account the impact of externalities.**
2. **An externality is a cost or benefit which occurs as a result of production and which is external to the production process. A common example of a negative externality is pollution. Supply and demand does not automatically measure this cost. Private cost is found at p1 but social cost at p2. However government needs to intervene to bring about a price of p2p2.**

2. public/merit goods

1. The price system cannot provide or underprovides certain goods / services.

- Defence -**P**
- Law and order- **P**
- Education- **M**
- Health care - **M**

3. monopoly



1. A monopolist will attempt to keep prices high and output low. Monopoly is less likely to promote:

- Efficiency as there is no competition. Competition forces firms to seek lower cost methods of production
- Effective allocation of resources as monopolist controls either price or quantity. Monopolist prefers higher prices rather than reducing costs to achieve greater efficiency –e3

2. Governments therefore regulate monopoly