Big Question:
Big Question: what is wrong with markets?

Syllabus Items:

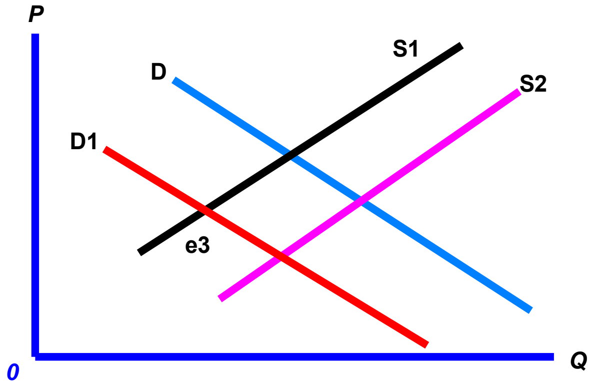
14+17

Webnote 111

Resource Allocation
Syllabus reference 1.1
Price Mechanism: dis*advantages -part 2*

4. income/wealth distribution

DEMAND + SUPPLY CURVES



1. The price system does not take into account the importance of social issues. A fair or equitable distribution of income is not a concern of supply and demand. Governments often intervene to raise taxes either to reduce consumption of certain non-desirable goods or simply to raise government revenue.
2. The price mechanism is one which operates on the basis of the 'invisible hand' as outlined by Adam Smith in the Wealth of Nations . The focus is upon profit and loss. If firms fail to make a profit they exit the industry and resources are therefore allocated to more profitable uses. At lower prices – e3 – some firms will exit. These firms will be unable to sufficiently reduce their costs of production and therefore exit the industry.

NOTE: the recent Financial Crisis of 2008 appears to contradict this allocative model. Government intervention and takeovers have prevented firms from leaving the market place

5. factor immobility

1. Allocation of resources appears relatively easy. This is often not the case. Why? Factor Immobility

- Training may required in transferring factors of production (resources) from one industry to another. Think of capital and labour. Unemployment may result.
- Mobility of labour is often difficult. This is especially true in DC's.
- Government intervention is therefore often required or the firm must pay to train its workers
- The result may in fact be higher costs to the firm – if the firm pays for the retraining itself-and the supply curve of the firm may shift accordingly s2-s1.
- If the government pays to retrain workers indirect taxes may increase and the end result is the same s2 to s1