



# **MICROECONOMICS - Market economic system**

By Kru P'Eve and Kru P'Da Knockout.Economics

# Overview

1. Recap market economic system
2. Advantages and Disadvantages of market economic system



# 1. Recap market economic system

- Meaning market economic system

: Market forces, that is, supply and demand, determine the allocation of resources.

(Price mechanism)

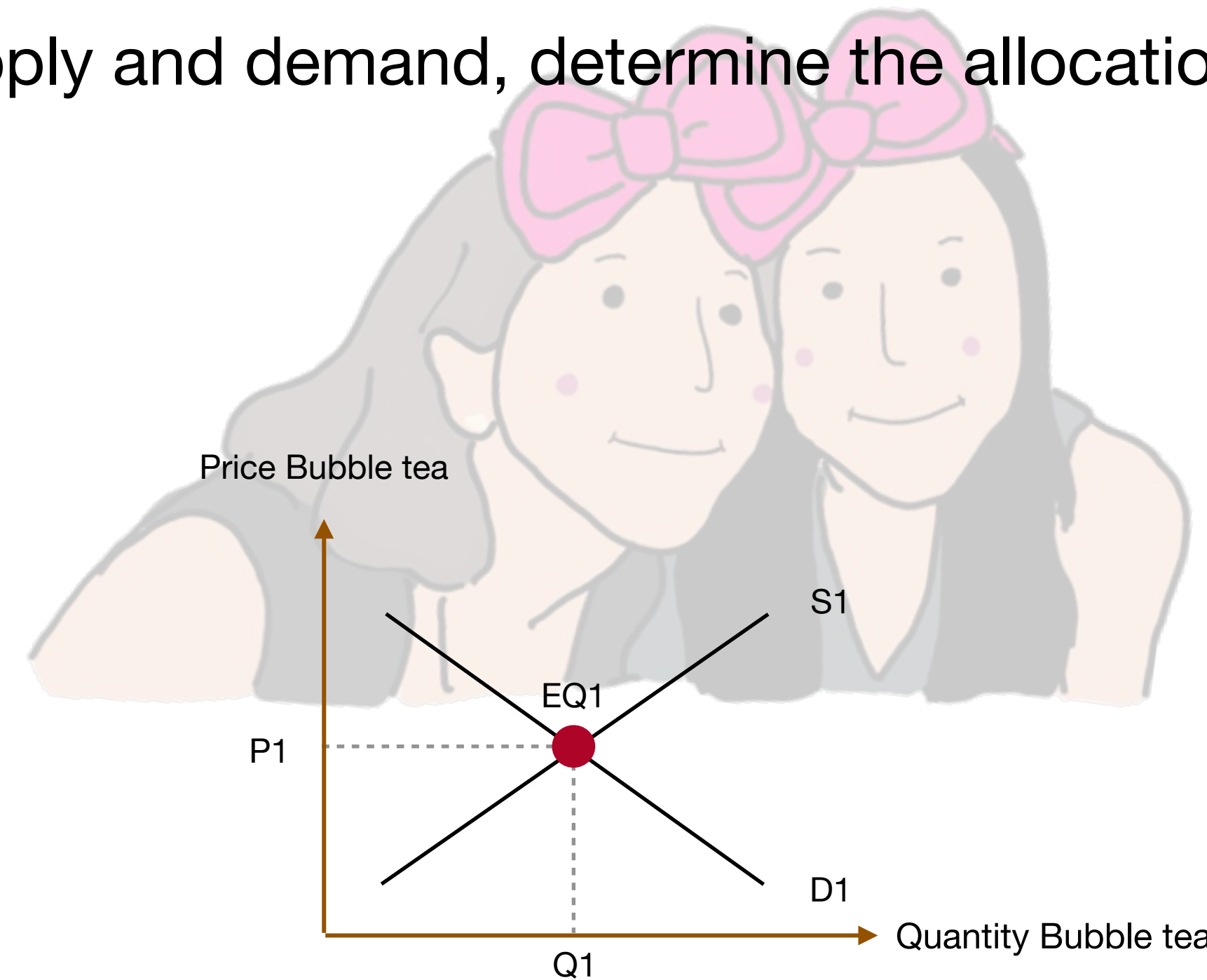
For example :

- Demand for Bubble Tea

- Price

- Profit

- Firms switch their resources (Labour, Capital) to produce bubble tea



## 2. Advantages and Disadvantages of market economic system

### Advantages

- **Resources change automatically and quick adjustment to changes in consumer demand.**
  - ➔ Price mechanism
- **Market economic system can promote efficiency.**
  - ➔ Producers will produce goods and services that consumers want and are prepared to pay for, in the right quantities
  - ➔ As a profit motive, firms would reduce cost of production as low as possible and earn more profit.
- **Consumer sovereignty**
  - ➔ Consumers can influence what to produced.

### Disadvantages

- **Market Failure**
  - ➔ Is a situation in which the allocation of goods and services by a free market is not efficient.
- **Consumers and producers may consider costs and benefits to only themselves (not to third parties)**
  - ➔ Overconsumption or overproduction of demerit goods ( eg. Alcohol, Cigarettes etc.)
  - ➔ Underconsumption or underproduction of merit goods (eg. Vaccine etc.)
- **Some goods will not be provided (Public goods)**
  - ➔ Eg. National defence, Street light etc.
  - ➔ People can act as “free riders”, someone who consumes goods and services without paying for it.

## 2. Advantages and Disadvantages of market economic system

### Advantages

- **Wide range of choice for consumers**
  - ➔ Consumers can choose which products to buy or which producers to buy from.
- **High quality of product and improvement of technology**
  - ➔ Since there will be high competition in the market
  - ➔ Firms have incentive to gain more revenue and profit
  - ➔ Therefore, firms will try to improve their products / produce high quality products to attract more consumers

### Disadvantages

- **Information failure**
  - ➔ There may be a lack of information or inaccurate data.
  - ➔ Or it could be asymmetric information (Information between consumers and producers is not equal)
- **Abuse of monopoly power**
  - ➔ Monopoly : only one firm dominates in the market
  - ➔ Consumers will have no choice, even if the price of product is high or low quality.
- **Immobility of resources**
  - ➔ Resources could be occupational or geographical immobility.

# Knockout Economics



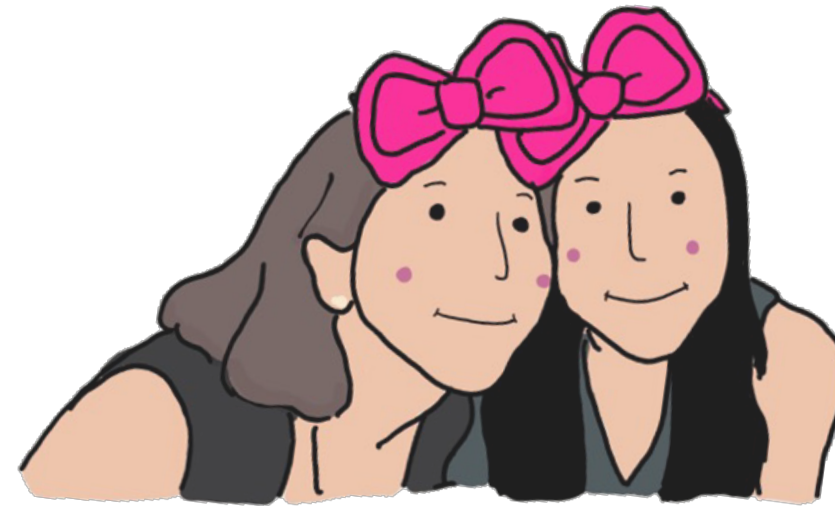
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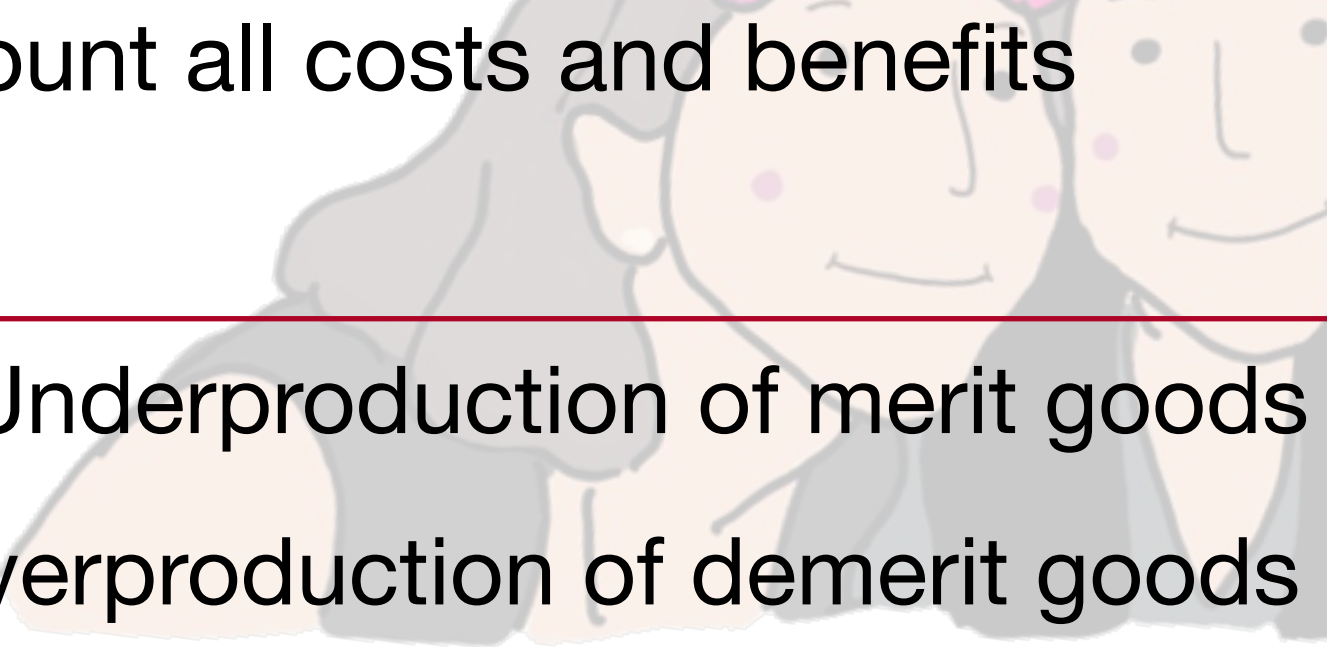
# **MICROECONOMICS - Market Failure**

By Kru P'Eve and Kru P'Da Knockout.Economics

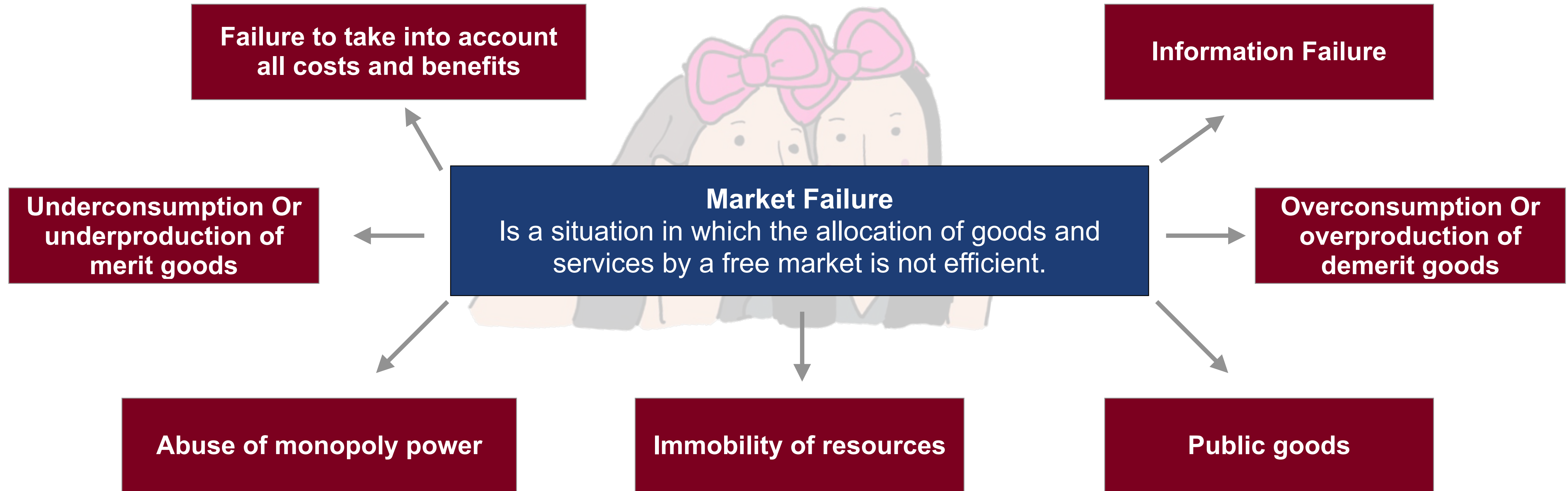
# Overview

## 1. Overview - market failure

## 2. Market failure

- 
- I. **F**ailure to take into account all costs and benefits
  - II. **I**nformation failure
  - III. **U**nderconsumption or Underproduction of merit goods
  - IV. **O**verconsumption or Overproduction of demerit goods
  - V. **P**ublic goods
  - VI. **A**buse of monopoly power
  - VII. **I**mmobility of resources

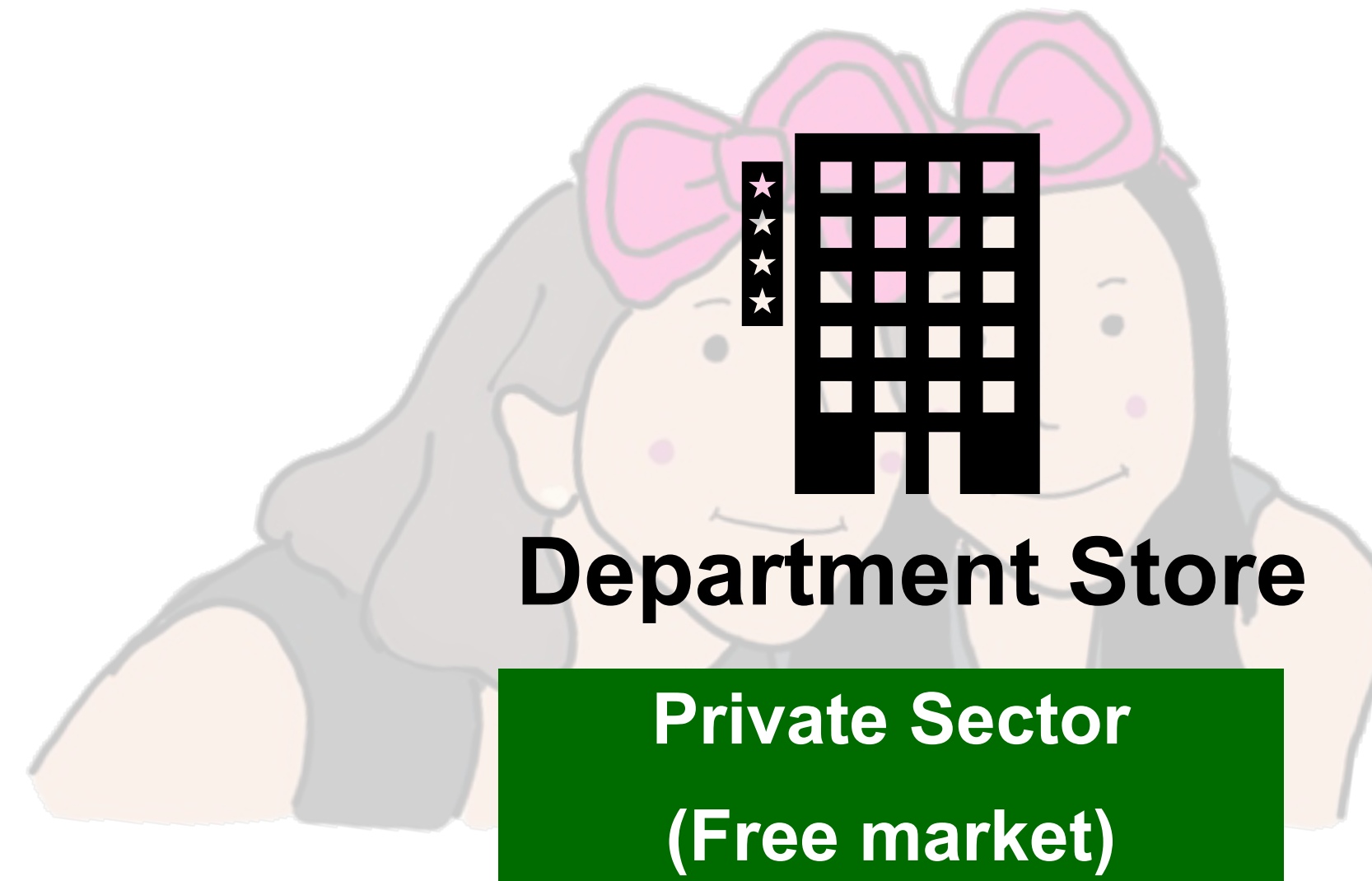
# 1. Overview - market failure



# 2. Market Failure

## 2.1 Failure to take into account all costs and benefits

For example :



### Private Cost

Is any cost that consumers or producers pays in order to consume or produce goods and services

Eg.

### Private Benefits

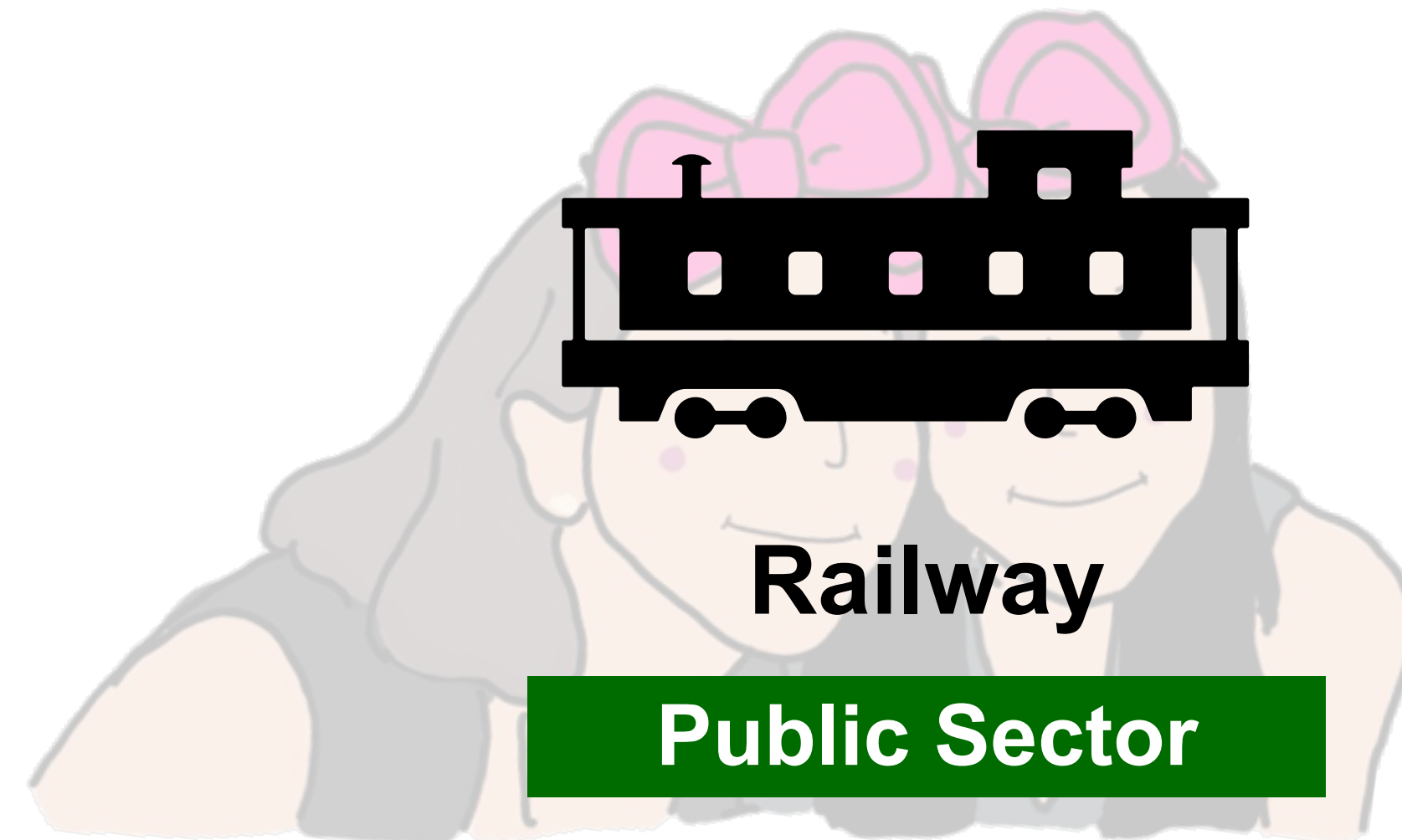
Is any benefits that consumers or producers receives directly from consumption or production of goods and services.

Eg.

# 2. Market Failure

## 2.1 Failure to take into account all costs and benefits

For example :



**Social Cost**

**Social Benefits**

**Private Cost**

**+**

**External Cost**

**Private Benefits**

**+**

**External Benefits**

Is any cost that consumers or producers pays in order to consume or produce goods and services

Cost to third parties who are not involved in consumption and production activities of others directly.

Is any benefits that consumers or producers receives directly from consumption or production of goods and services.

Benefits to third parties who are not involved in consumption and production activities of others directly.

Eg.

Eg.

Eg.

Eg.

# 2. Market Failure

## 2.1 Failure to take into account all costs and benefits

For example :



University degree courses

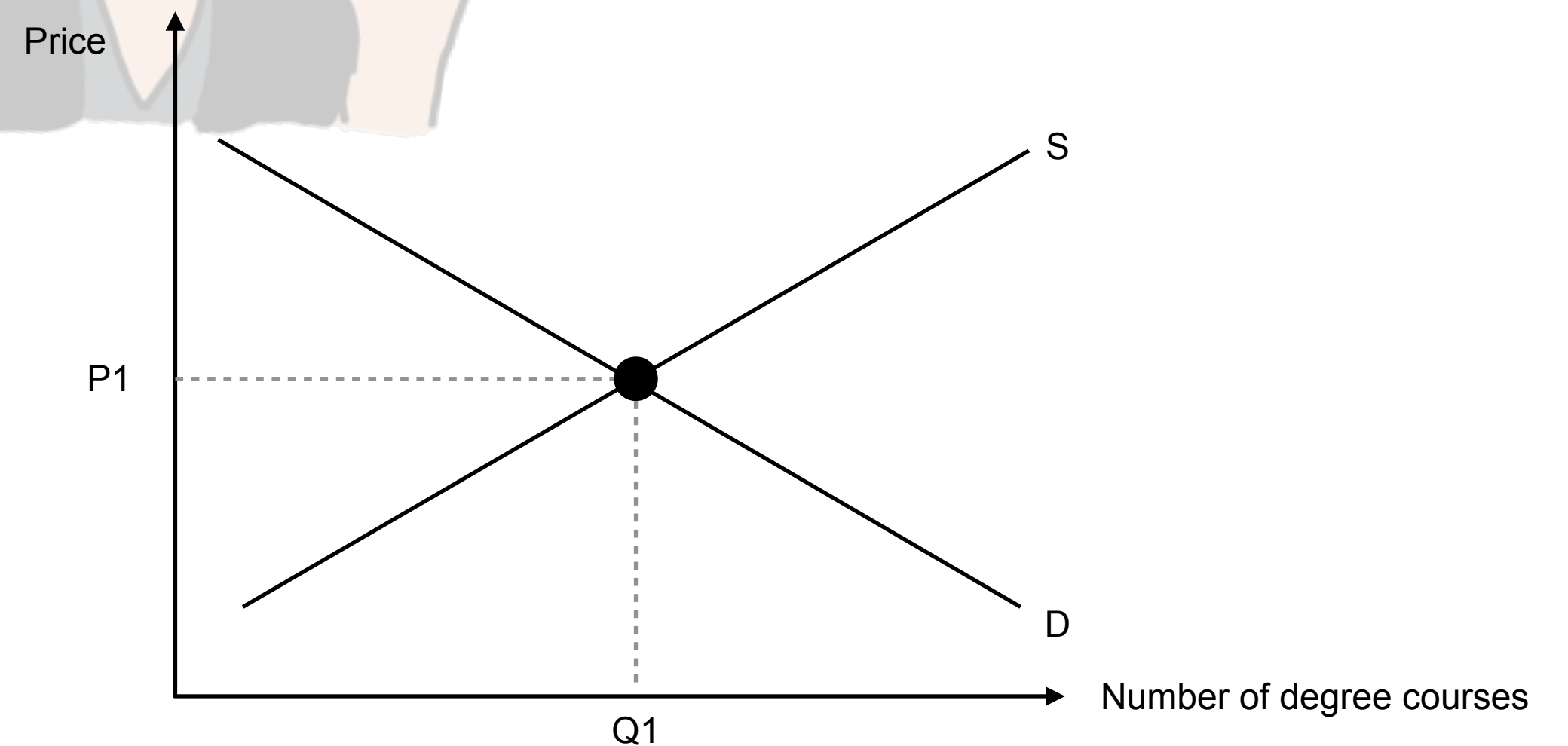
Private Sector

Private Benefits

Private Cost

External Benefits

Benefits to third parties who are not involved in consumption and production activities of others directly.



# 2. Market Failure

## 2.1 Failure to take into account all costs and benefits

For example :



**Smoking**

**Private Sector**

**Private Benefits**

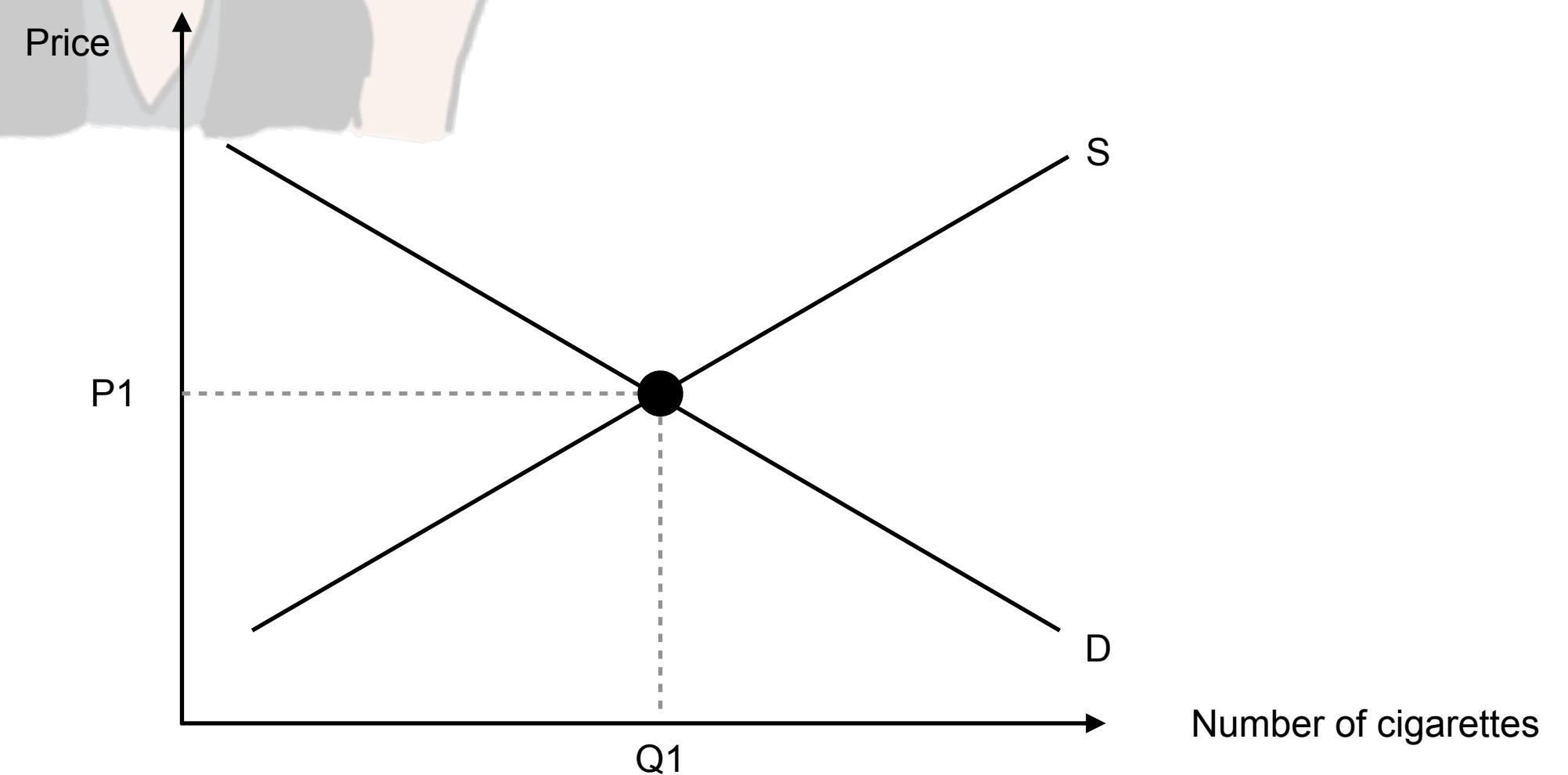
Eg.

**Private Cost**

Eg.

**External Cost**

Cost to third parties who are not involved in consumption and production activities of others directly.



## 2. Market Failure

### 2.1 Failure to take into account all costs and benefits

#### Summary :

Private Sector  
(Free market)

Private Benefits

Private Cost

Public sector  
(Government)

Social Benefits

Social Cost

Private Benefits

External Benefits

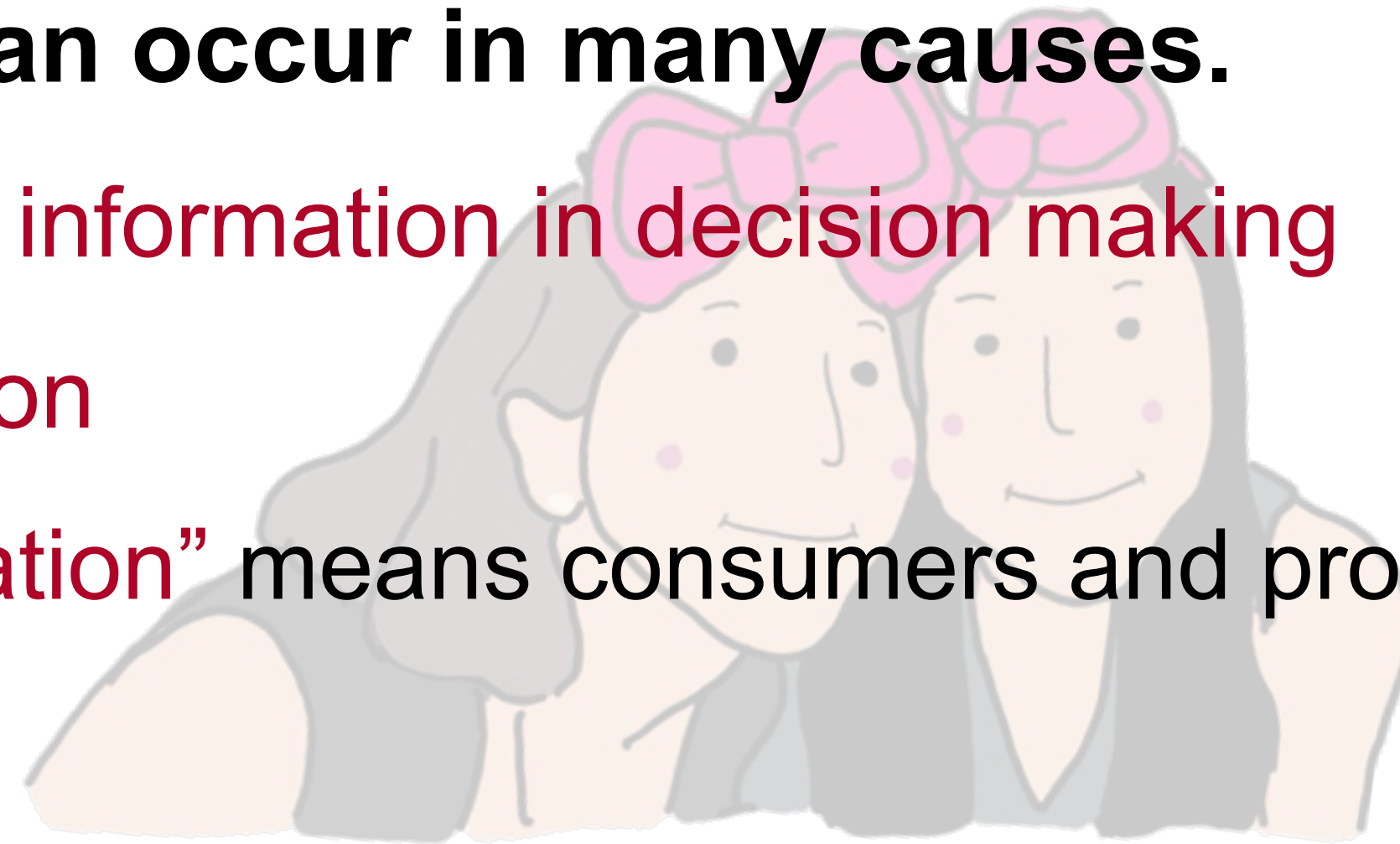
Private Cost

External Cost

## 2. Market Failure

### 2.2 Information failure

- **Information failure can occur in many causes.**
- There may be a **lack of information in decision making**
- Or **inaccurate information**
- Or **“asymmetric information”** means consumers and producers do not have equal access to information.
- For example,



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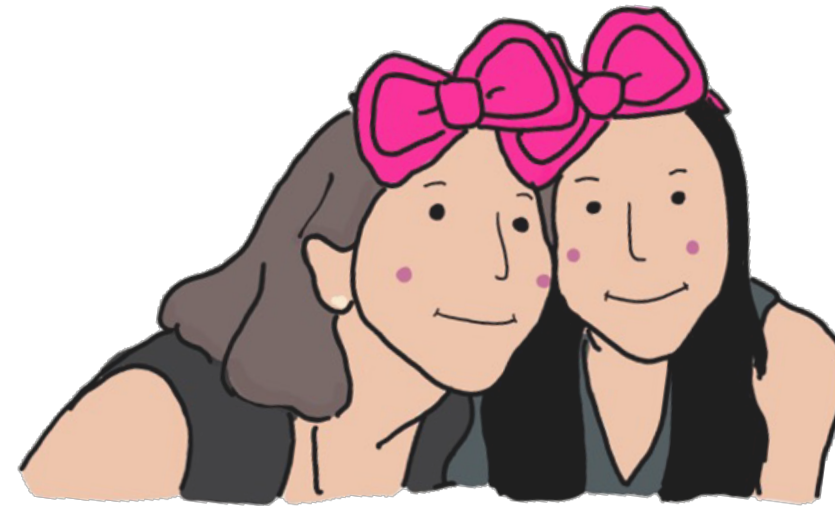
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# **MICROECONOMICS - Market Failure (Continue.)**

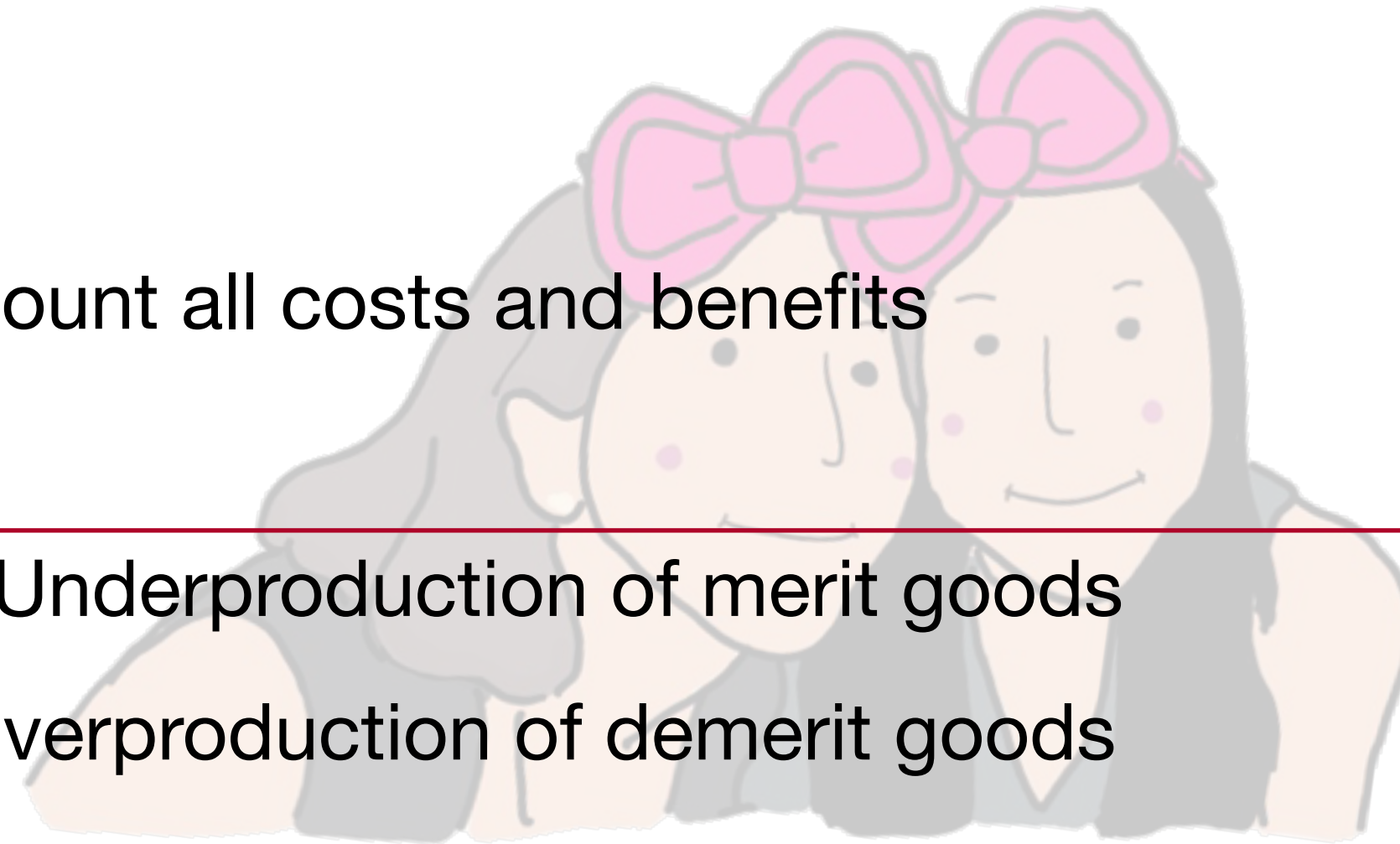
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# Overview

## 1. Overview - market failure

## 2. Market failure

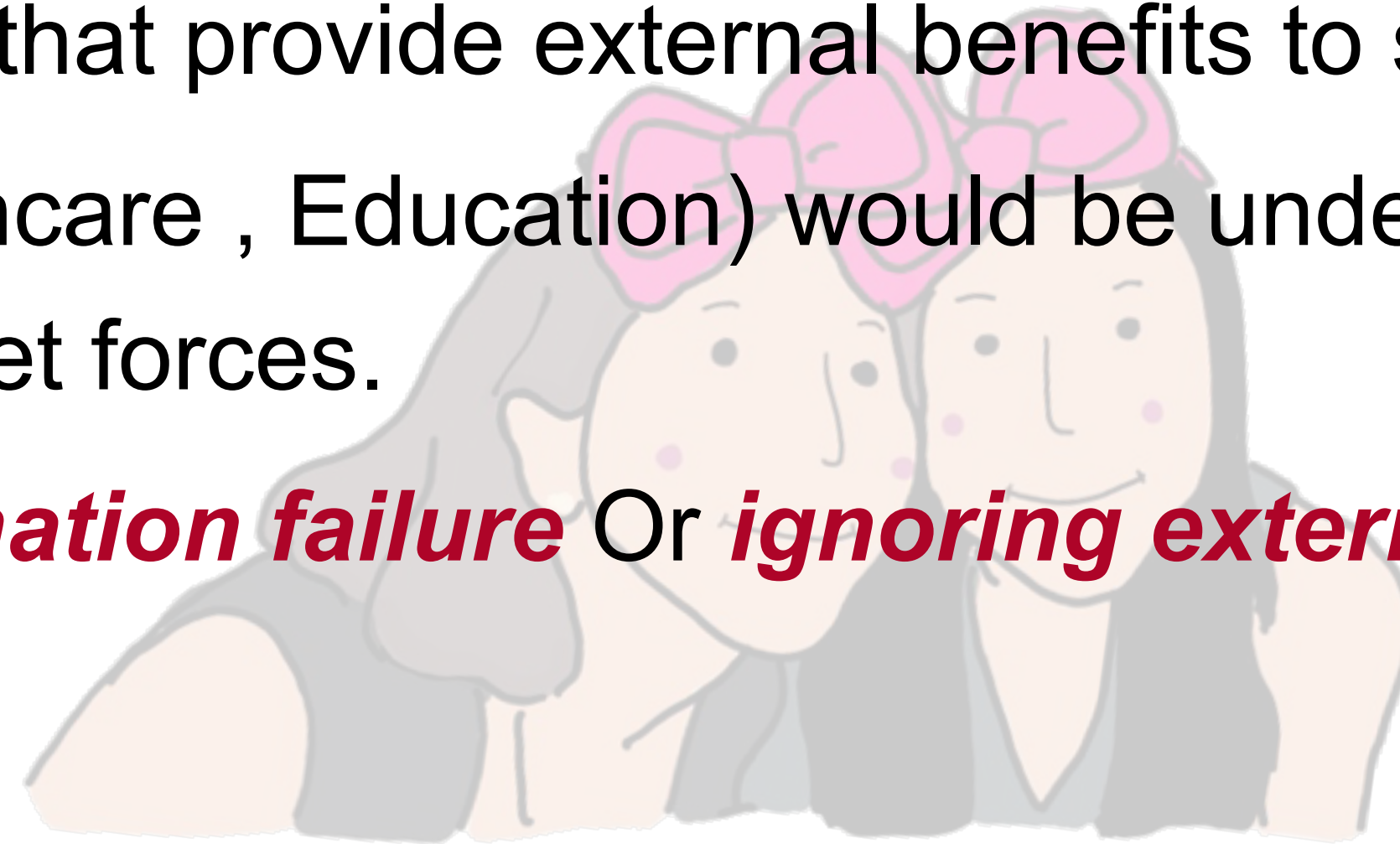
- I. **F**ailure to take into account all costs and benefits
- II. **I**nformation failure
- III. **U**nderconsumption or Underproduction of merit goods
- IV. **O**verconsumption or Overproduction of demerit goods
- V. **P**ublic goods
- VI. **A**buse of monopoly power
- VII. **I**mmobility of resources



## 2. Market Failure

### 2.3 Underconsumption or Underproduction of merit goods

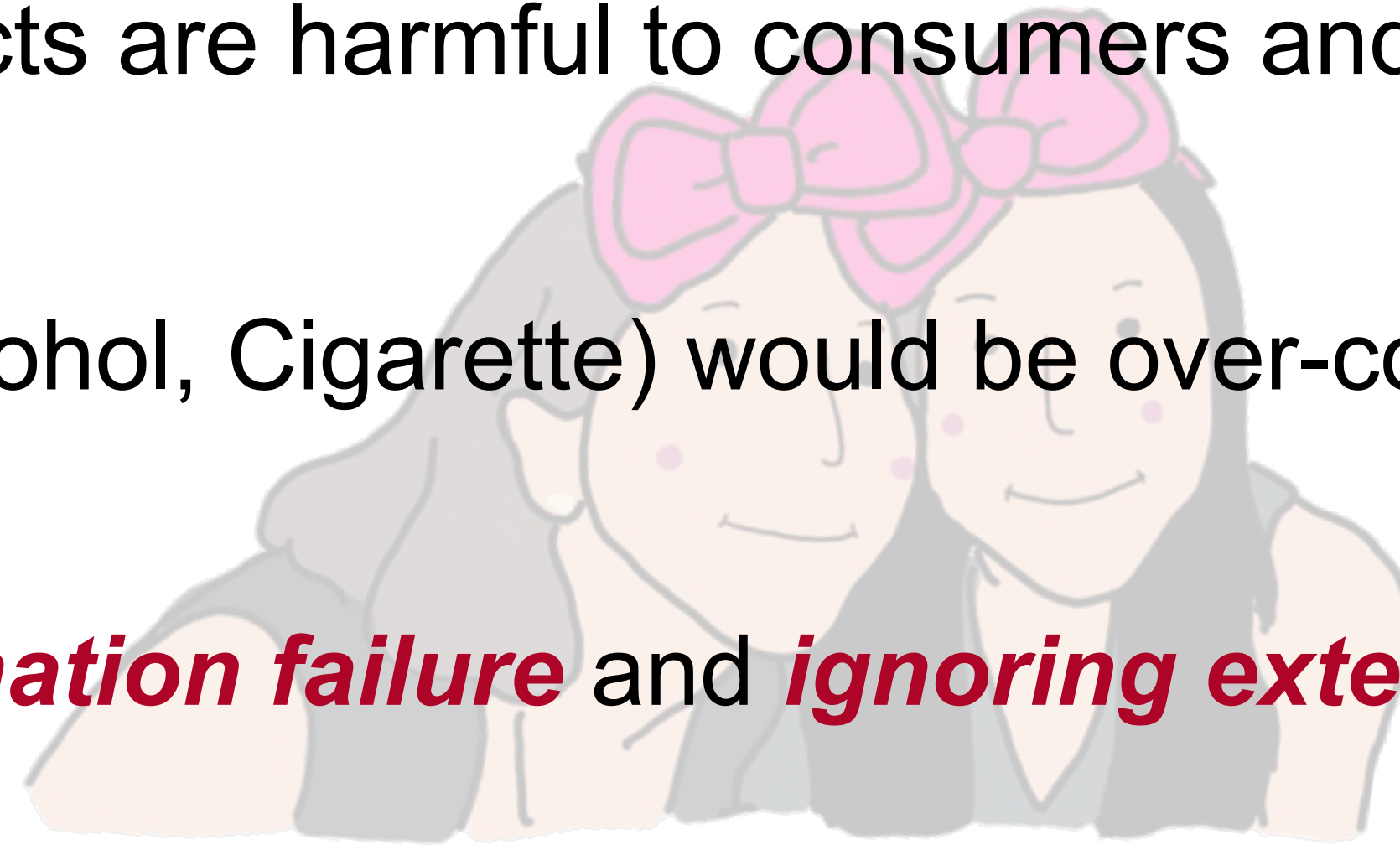
- Merit goods : products that provide external benefits to society.
- Merit goods (eg. Healthcare , Education) would be under-consumed and under-produced, if left to market forces.
- This is because **information failure** Or **ignoring external benefits**
- For example,



## 2. Market Failure

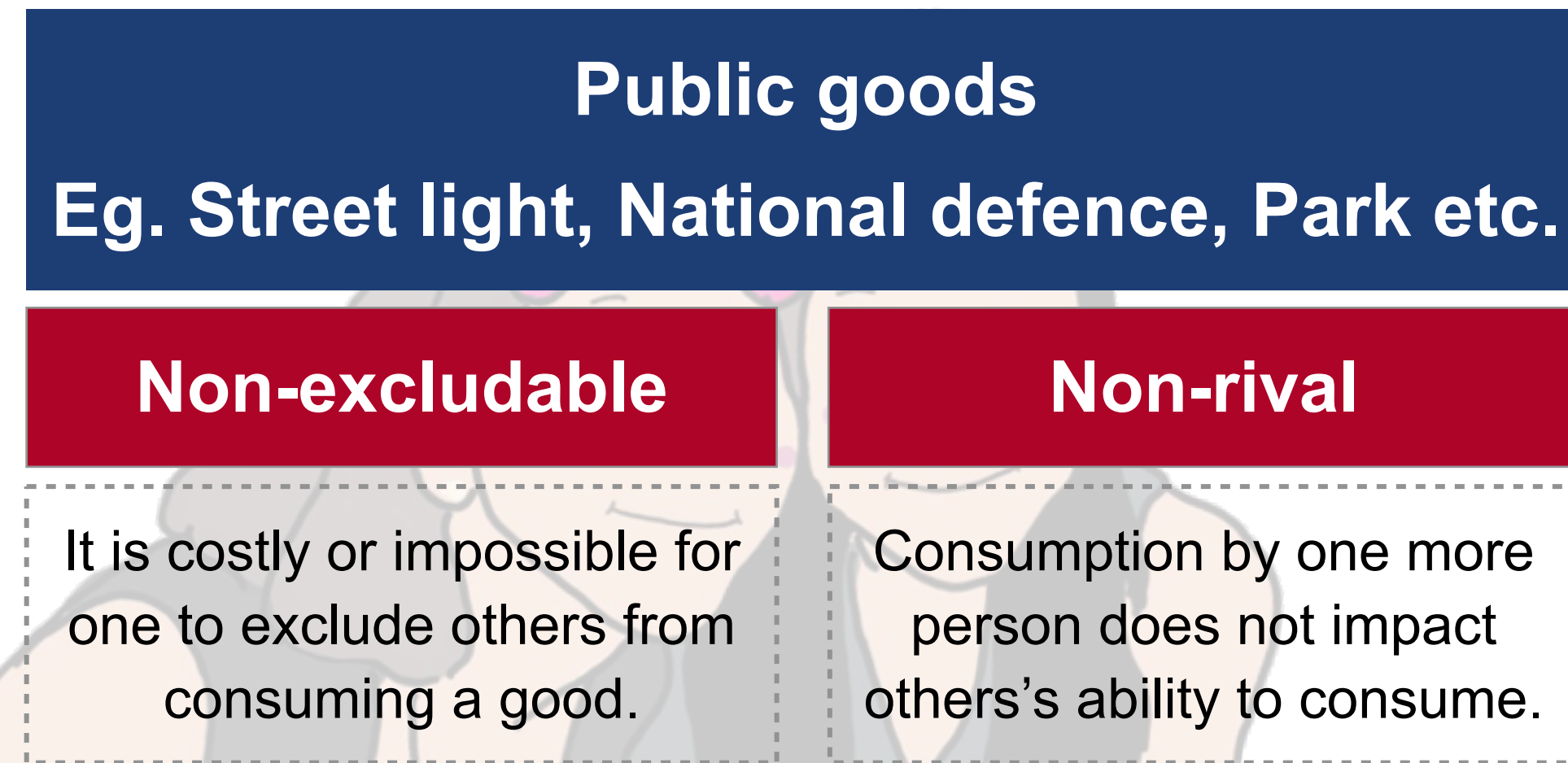
### 2.4 Overconsumption or overproduction of demerit goods

- Demerit goods : products are harmful to consumers and also provide external cost to society.
- Demerit goods (eg. Alcohol, Cigarette) would be over-consumed and over-produced, if left to market forces.
- This is because **information failure** and **ignoring external costs**
- For example,



## 2. Market Failure

### 2.5 Public goods

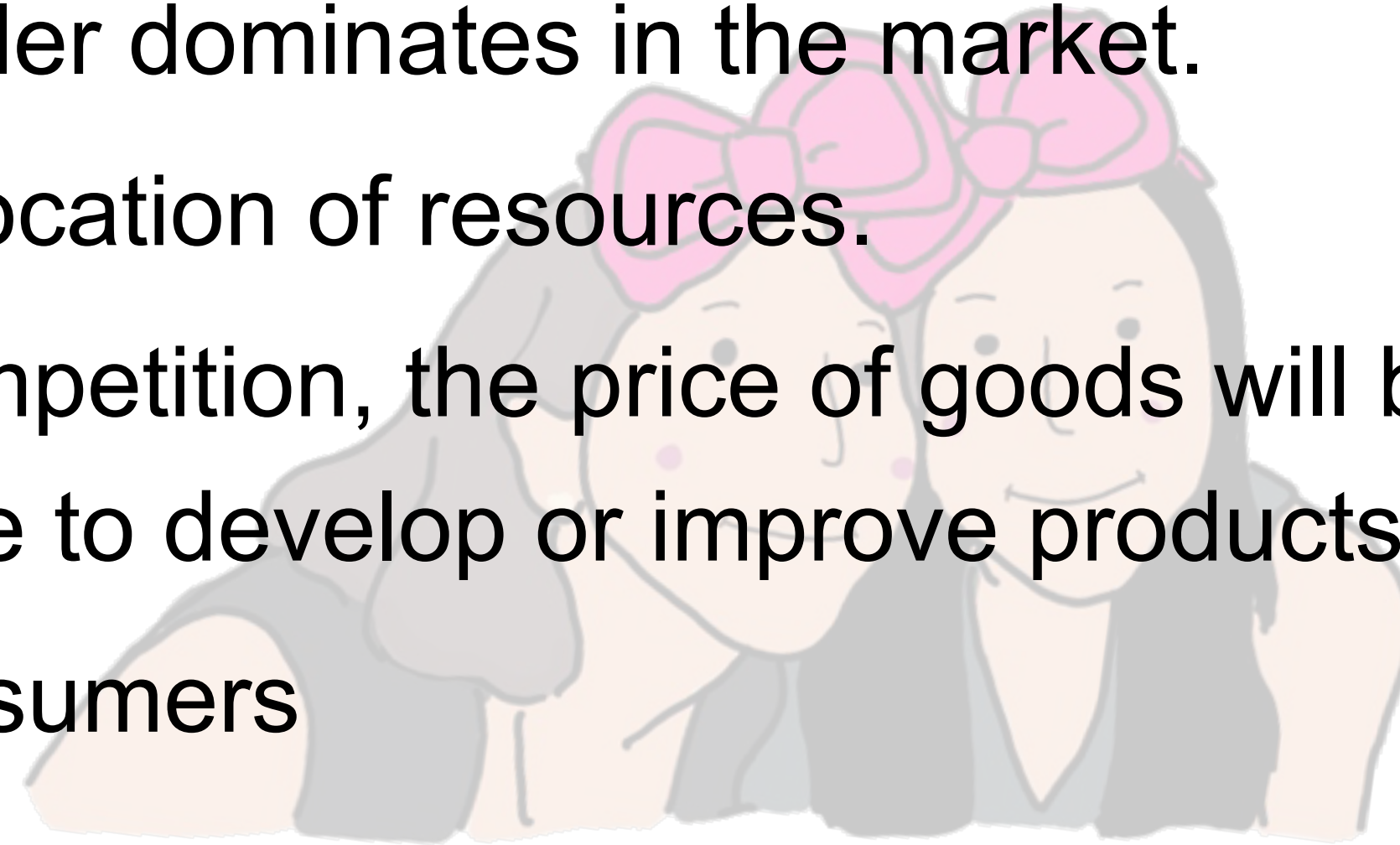


- Private firms will not make goods that they cannot charge for or cannot generate profit.
- Public goods : impossible to exclude non-payers from taking advantage of the benefits of the goods such as front light.
- If public goods are provided by someone, others can use benefits without paying for them. (Free rider problem)

## 2. Market Failure

### 2.6 Abuse of monopoly power

- Monopoly : A single seller dominates in the market.
  - It may be inefficient allocation of resources.
- ➔ Because of lack of competition, the price of goods will be high and low quality of goods and less incentive to develop or improve products to respond demand
- ➔ Also no choice for consumers



## 2. Market Failure

### 2.7 Immobility of resources

- Some resources are **occupationally** and **geographically** immobile.

For example:



# Knockout Economics



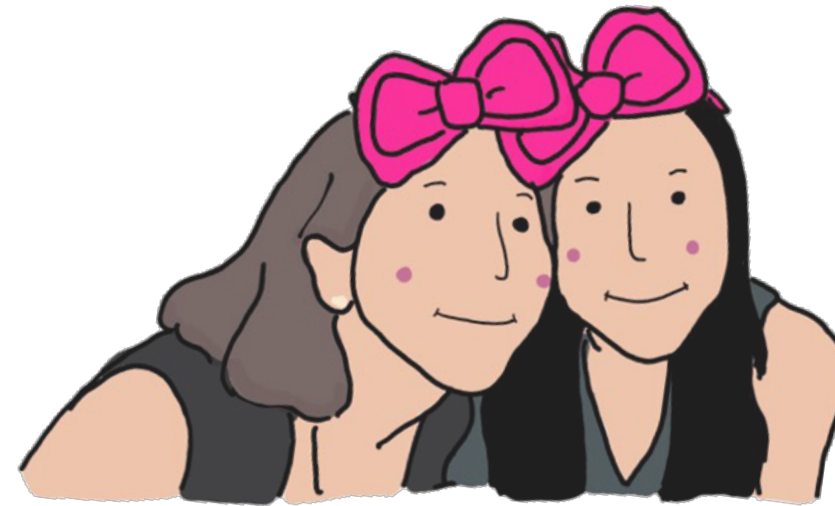
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# **MICROECONOMICS - Exercise - Market economic system and Market Failure**

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## Exercise: MCQ

**1. Country A is implementing free market reforms. What is a likely advantage of this?**

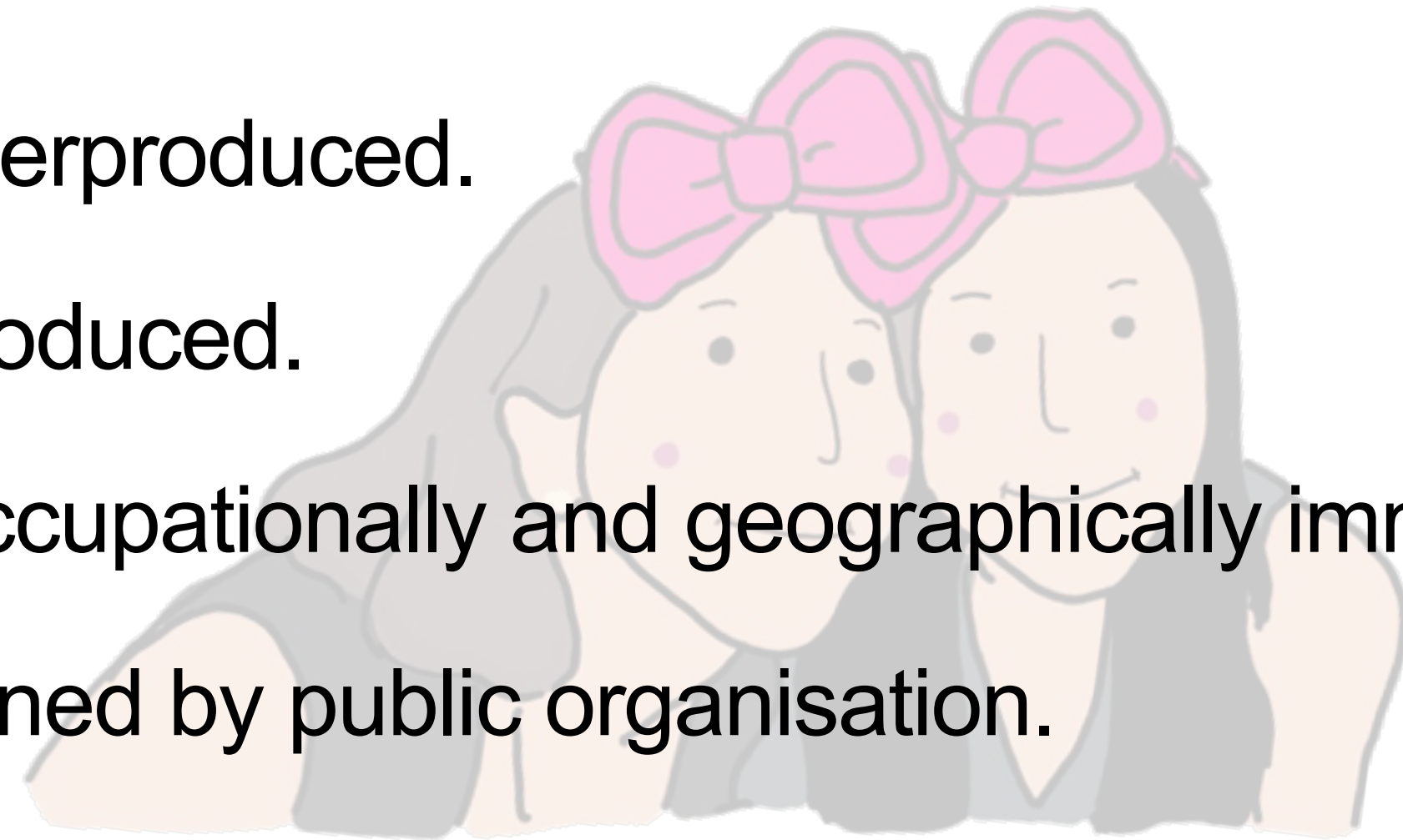
- A. Abuse of monopoly power
- B. Better redistribution of income in society
- C. Less consumption of demerit goods
- D. A wider choice of goods and services for consumers



## Exercise: MCQ

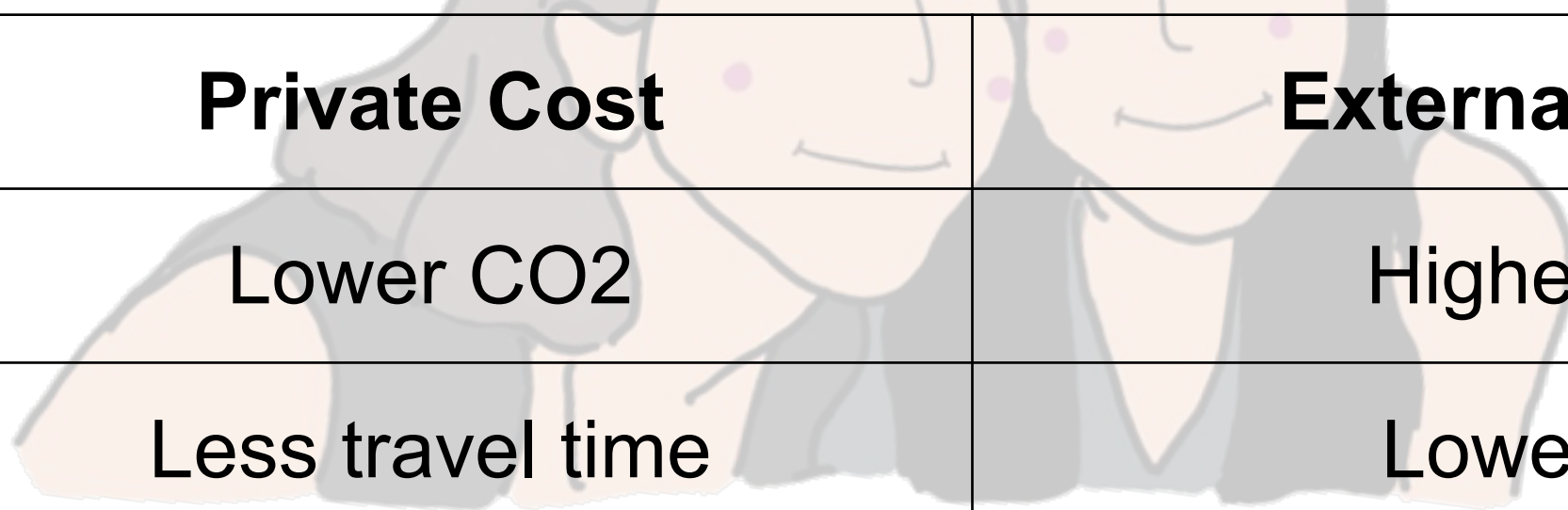
### 2. Why might a free economy fail to achieve the best use of scarce resources?

- A. Demerit goods are underproduced.
- B. Merit goods are overproduced.
- C. Some resources are occupationally and geographically immobility.
- D. Most resources are owned by public organisation.



## Exercise: MCQ

3. Railway upgrades its services by providing new technology of machines. This railway company claims it will reduce carbon (CO<sub>2</sub>) emission ;however; passengers need to pay extra fares?



	Private Cost	External Benefit
<b>A</b>	Lower CO <sub>2</sub>	Higher fares
<b>B</b>	Less travel time	Lower CO <sub>2</sub>
<b>C</b>	Higher fares	Lower CO <sub>2</sub>
<b>D</b>	Higher fares	Less travel time

# Exercise: Essay

## 1. Discuss free market always benefits to economy. [8 marks]

**Command Word:**

**Discuss: Set out both sides of an argument (For and against)**

**Knockout Tips: For / Against + Supporting details**

**For**

**Against**

# Knockout Economics



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