

Unit II — Markets, Market Power, and Public Goods

Markets connect consumers and producers. They help determine what goods and services are produced, how much is supplied, and what prices people pay. Yet markets do not all operate in the same way. Some have many competing sellers, while others are dominated by only a few firms. Some goods are easily bought and sold by individuals, while others benefit entire communities and may not be provided adequately through private markets alone. This unit explains how markets work, how power affects market outcomes, and why some goods require collective provision.

Across the unit, readers will see that prices and competition are powerful tools for organizing economic activity, but they do not solve every economic problem. Market outcomes depend on institutions, information, bargaining power, and the kind of good being produced. Some goods can be allocated effectively through private exchange. Others require public financing, regulation, or collective action.

Chapters in this unit

Chapter 6 – Demand, Supply, and Market Equilibrium. Explains how consumers and producers interact in markets, how prices and quantities are determined, and how elasticity, shortages, surpluses, price controls, and market failures affect economic outcomes.

Chapter 7 – Market Structures. Examines how competition, barriers to entry, product differentiation, monopoly, oligopoly, monopolistic competition, and monopsony shape prices, consumer choice, innovation, and economic power.

Chapter 8 – Public Goods, Shared Resources, and the Role of Government. Distinguishes goods according to whether people can be excluded from using them and whether one person's use reduces what is available to others. It also explains why public goods may be underprovided by markets and why government or collective action is often needed.

Markets help coordinate production and consumption, but their outcomes depend on market structure and the nature of the good. Competition can expand choice and discipline firms, while public goods often require collective provision because markets alone may supply too little.

Government plays an important role in making markets work for the broader public interest. It establishes and enforces the rules that support fair exchange, protects consumers from unsafe products and deceptive practices, and prevents firms from abusing monopoly or buyer power. Government may also regulate prices and service standards in essential industries where consumers have few alternatives. When markets fail to provide enough public goods—such as national defense, street lighting, flood-control systems, disease surveillance, and reliable public information—government can finance or provide them through collective resources. Its task is not to replace markets in every situation, but to strengthen competition where possible, correct market failures, protect vulnerable groups, and ensure that essential goods and services are available even when private profit alone would not provide them adequately.

Chapter 6: Demand, Supply, and Equilibrium – How Markets Determine Prices

Comic strip idea: Prices are signals—but sometimes government policy, market power, or market failure distorts those signals.

On a busy market day, one vendor sells mangoes for ₱250 per kilogram while another lowers the price to ₱200. Buyers begin moving toward the lower-priced stall. The first vendor must then decide whether to maintain the original price or reduce it to avoid unsold produce.

This familiar scene illustrates how buyers and sellers respond to prices. Consumers generally buy more when prices fall, while producers are often willing to offer more when prices rise. Their decisions interact to shape market prices and quantities.

This chapter examines two central forces in markets: **demand** and **supply**. Their interaction helps determine the prices of goods and services and the quantities exchanged. The chapter also introduces market equilibrium, shortages, surpluses, government intervention, and situations in which markets may fail to produce efficient or socially desirable outcomes.

A. The Concept of Demand

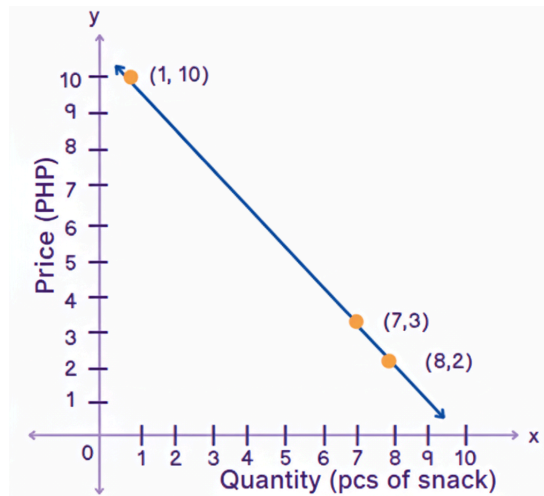
Demand is the quantity of a good or service that consumers are *willing* and *able* to purchase at various prices during a specific period of time. The word *willing* means that consumers actually want the product or have the desire to own or use it. The word *able* means that they also have the money or means to pay for it. Both willingness and ability must be present for true demand to exist. For example, a person may want a new smartphone but lack the income needed to purchase it at the current price. Desire alone does not constitute demand unless it is supported by the ability to pay.

The downward slope reflects the **Law of Demand**: as the price of a good rises, the quantity demanded generally falls; as the price falls, the quantity demanded generally rises, other conditions remaining unchanged. Higher prices usually discourage purchases, while lower prices generally encourage them.

Understanding the Demand Curve

Consider a snack sold at different prices. At ₱1, consumers purchase ten pieces. At ₱7, they purchase three, and at ₱8, they purchase two.

Price is placed on the vertical axis, while quantity demanded is placed on the horizontal axis. Each price-and-quantity combination forms a point on the graph. Connecting these points produces a downward-sloping demand curve.



The graph above shows the typical demand curve, where each point shows how much consumers are willing and able to buy at a certain price. When the price of a product is high, people buy less of it, but when the price goes down, quantity demanded rises.

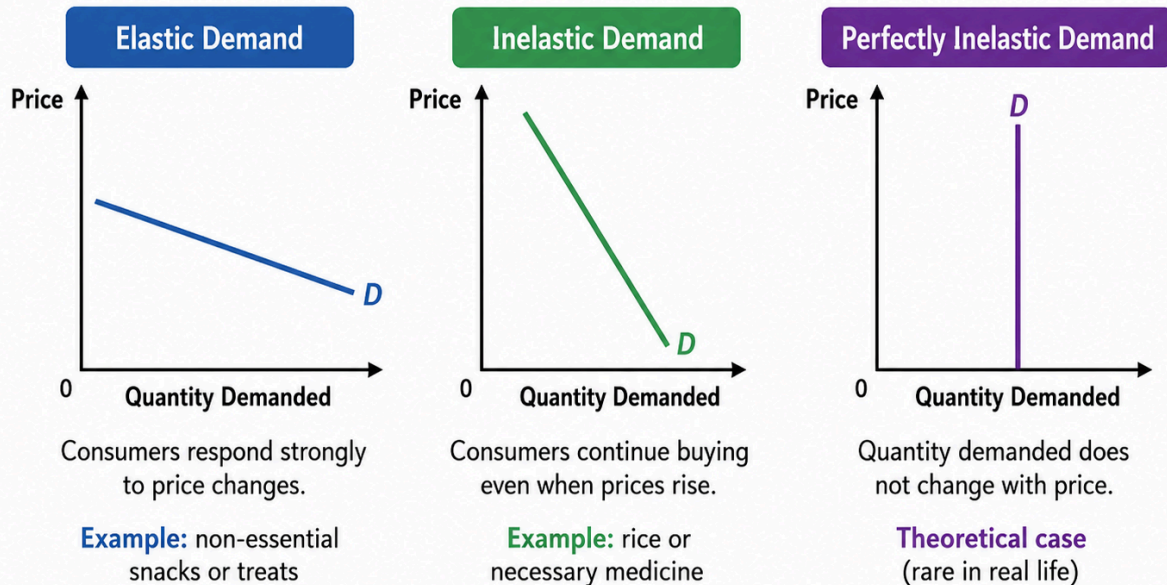
How sensitive is demand to price increases?

The law of demand says the higher the price, the less attractive the good is to buyers. But this sensitivity to price changes varies across products. In our snack example, increasing the price to ₱20 would probably mean very few consumers may be willing to buy it since only two snacks were sold when the price reached ₱8 per piece.

This happens because the snack is not a necessity. Consumers enjoy it, but they can easily skip it or find something cheaper if the price becomes too high. This kind of situation shows ***elastic demand***, where quantity demanded is sensitive to price changes.

Types of Demand Elasticity

How quantity demanded responds to changes in price



Key idea: The flatter the demand curve, the more responsive consumers are to price changes. The steeper the curve, the less responsive they are.

However, a limited-edition collectible may have less elastic demand among loyal buyers because close substitutes are difficult to find. Many fans would still buy it even if the price doubled or tripled. Essential goods such as staple food and necessary medicines often have relatively inelastic demand, particularly when consumers have few substitutes. These situations show **inelastic demand**, where quantity demanded changes very little despite large price changes. This is reflected in the middle graph.

Perfectly inelastic demand is a theoretical case in which quantity demanded remains fixed regardless of price. The demand curve is vertical. Real-world examples are rare because even essential goods usually face some limit imposed by income, access, or substitution. **Perfectly inelastic demand is when the quantity demanded of a good does not change at all, no matter how much the price increases or decreases.** In other words, consumers will buy the same amount regardless of the price. As you can see in the graph above, the quantity demanded remains the same even when the price increases or decreases. This creates a vertical demand curve (third graph on the right), showing that buyers do not respond at all to price changes.

A. The Concept of Supply

Supply represents the producer side of the market — the **sellers or producers**. Just as consumers decide how much to buy depending on price, producers decide how much to sell depending on what they can earn. **Supply** is the quantity of a good or service that producers are *willing* and *able* to offer for sale at various prices during a specific period of time.

The word willing means producers are ready to sell the product at a given price because selling at that price is expected to cover costs and provide an acceptable return. The word able means they have the resources such as workers, raw materials, and equipment to actually produce and sell the good.

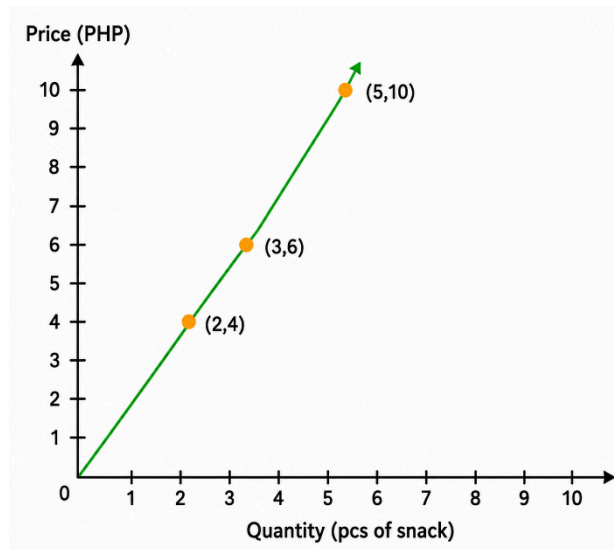
Both willingness and ability must be present for supply to exist. For example, a small bakery might want to sell more bread, but if it lacks flour or workers, it cannot increase its supply. In that case, the intention to sell more does not count as actual supply.

The **Law of Supply** states that *as the price of a good rises, the quantity supplied also rises; as the price falls, the quantity supplied falls, holding everything else constant*. Higher prices generally encourage producers to offer a larger quantity for sale, while lower prices may reduce the quantity supplied, other conditions remaining unchanged.

Understanding the Supply Curve

Consider sellers offering the same snack at different prices. At ₱2, they are willing to sell four pieces. At ₱3, they offer six, and at ₱5, they offer ten. Price is shown on the vertical axis and quantity supplied on the horizontal axis. Plotting the price-and-quantity combinations produces an upward-sloping supply curve. Here are the results: At a price of ₱2 per snack, consumers were only willing to sell 4 snacks. When the price increased to ₱3, they were willing to sell 6 snacks, and at ₱5, they offered 10 snacks for sale.

The plotting process is similar to what we did with the demand curve. The y-axis is for the price, and the x-axis is for the quantity, but this time from the seller's point of view. Each pair of price and quantity supplied is like a coordinate point. When we connect these points and draw a smooth line through them, we see the supply curve take shape.



How sensitive is supply to price increases?

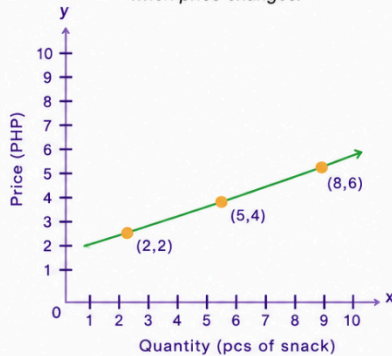
Just like consumers, producers also vary in how they respond to price changes. Some goods are easy to produce when prices rise, while others take time or more resources. When supply responds strongly to price changes, we call it **elastic supply**. When it responds only a little, we call it **inelastic supply**. Supply elasticity measures how strongly producers respond to changes in price. The response depends on production time, available capacity, access to inputs, technology, and the nature of the good.

TYPES OF SUPPLY ELASTICITY

The supply curve shows how much producers are willing and able to supply at different prices.

Elastic Supply

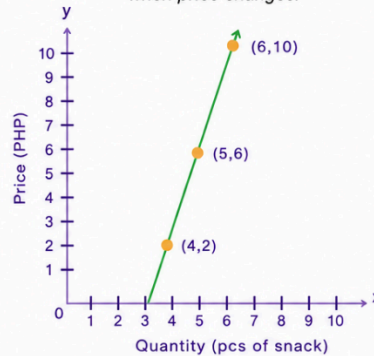
Quantity supplied changes a lot when price changes.



Key Idea: The curve is relatively flat. A small change in price leads to a large change in quantity supplied.

Inelastic Supply

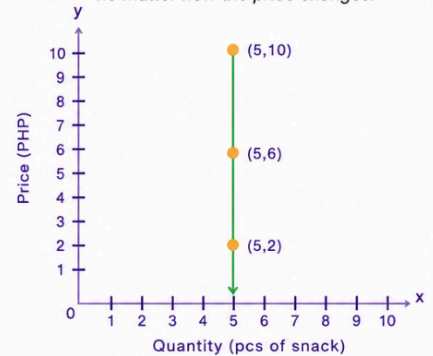
Quantity supplied changes little when price changes.



Key Idea: The curve is steep. A large change in price leads to a small change in quantity supplied.

Perfectly Inelastic Supply

Quantity supplied does not change no matter how the price changes.



Key Idea: The curve is vertical. Quantity supplied is the same at any price.



KEY IDEA:

The steepness or flatness of the supply curve shows how responsive producers are to changes in price.

- **Flatter curve** → elastic supply (producers respond a lot to price changes)
- **Steeper curve** → inelastic supply (producers respond little to price changes)

Consider these three examples.

1. Street food snacks (like fishballs or kwek-kwek) – These can be produced and sold quickly because ingredients are easy to find and cooking takes only a few minutes. If the price increases, vendors can easily make and sell more within the same day. This is an example of **elastic supply**, where producers can quickly respond to higher prices by increasing output.
2. Mangoes from local farmers – Mango trees take months to grow and bear fruit. Even if the price of mangoes suddenly doubles, farmers cannot instantly produce more. This represents **inelastic supply**, where the quantity supplied changes slowly or only slightly despite price changes.
3. Concert seats for a popular band performing in an arena – The number of seats in a concert venue is fixed. No matter how high the ticket prices go, organizers cannot add more seats beyond the venue's capacity. This is an example of **perfectly inelastic supply**, where the quantity supplied remains the same regardless of price.

Supply may be inelastic in the short run but become more elastic over time as producers expand capacity.

B. Equilibrium

Market equilibrium occurs when the quantity buyers are willing to purchase equals the quantity sellers are willing to offer at a particular price.

Buyers generally prefer lower prices, while sellers generally prefer prices that cover costs and provide a return. The interaction between these interests produces the equilibrium price and quantity. The place where these two forces meet — where what consumers want to buy equals what producers want to sell — is called **market equilibrium**.

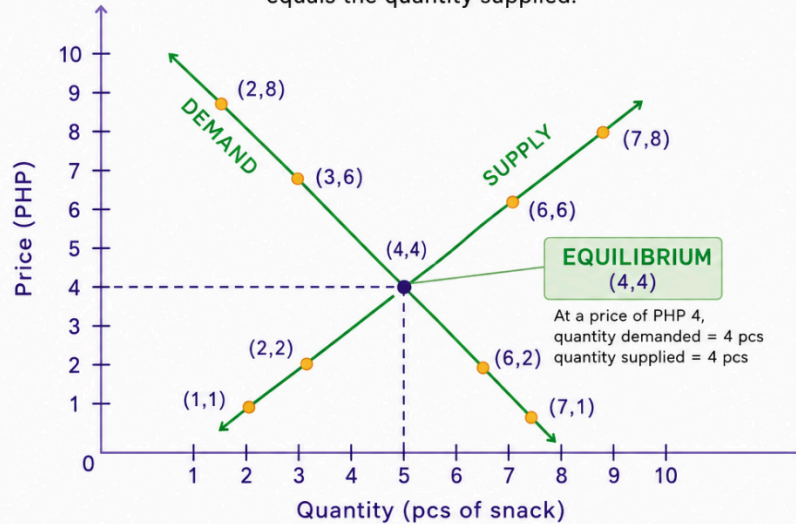
What is Market Equilibrium?

Market equilibrium is the point where the quantity demanded equals the quantity supplied.

On a graph, the equilibrium point is where the demand curve (downward-sloping) and the supply curve (upward-sloping) **intersect**. This means that at this point, the quantity demanded equals the quantity supplied at the prevailing price. At this point, the number of products consumers want to buy is exactly the same as the number of products producers are willing to sell. At this price, the market is balanced.

EQUILIBRIUM IN THE MARKET

Equilibrium is the point where the quantity demanded equals the quantity supplied.



KEY IDEA:

Equilibrium is the point where the supply and demand curves intersect.

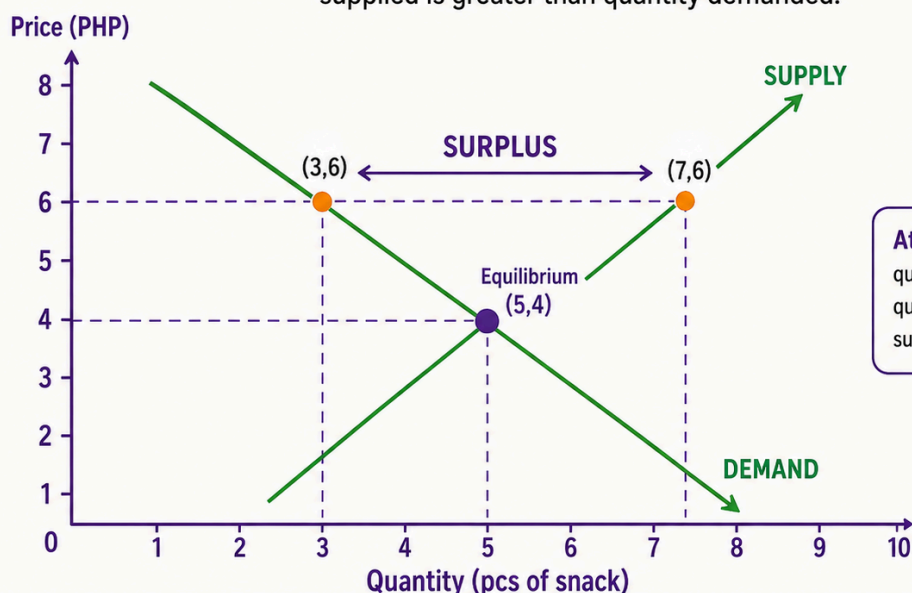
- At this price, buyers are willing to buy exactly what sellers are willing to sell.
- There is no shortage and no surplus.

To better understand market equilibrium, let's look at two scenarios:

Scenario 1 | **Surplus:** Assume that the snacks are priced at ₱10 per pack. At that price, producers have an incentive to supply more because they can earn a lot, so they bring many snacks to sell. But buyers think ₱10 is too expensive, so only a few buy. This creates a **surplus** — there are **more supplies available than people want to buy**. A surplus occurs when the market price is above the equilibrium price. At that price, producers offer more than consumers are willing to purchase. Unsold inventories create pressure on sellers to reduce prices, which tends to increase quantity demanded and reduce quantity supplied.

SURPLUS IN THE MARKET

A surplus happens when the price is above equilibrium, so quantity supplied is greater than quantity demanded.



At PHP 6:

quantity demanded = 3 pcs;
quantity supplied = 7 pcs;
surplus = 4 pcs.



KEY IDEA:

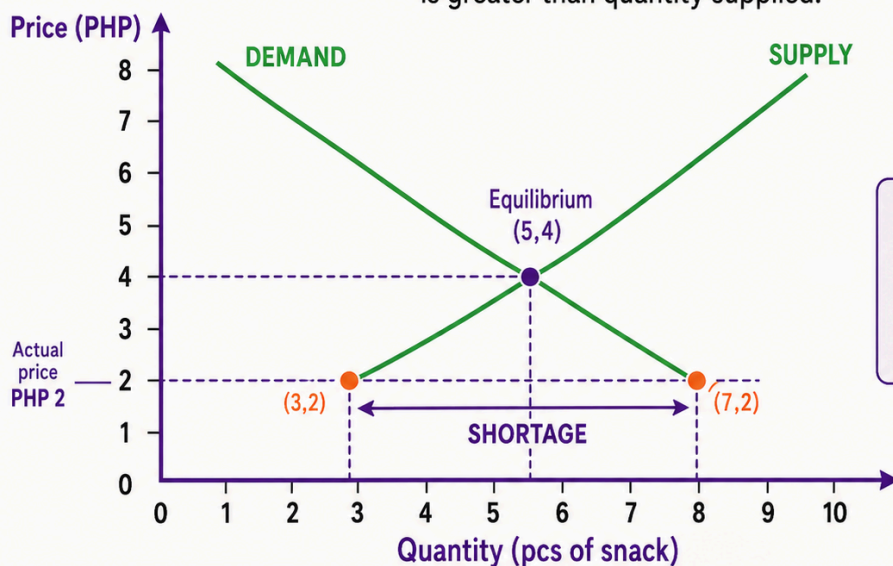
- When price is above equilibrium, sellers offer more than buyers want to buy.
- The result is unsold goods, or surplus.
- Surplus puts downward pressure on price.

Scenario 2 | **Shortage:** Assume that the snacks are priced at only ₱2 per pack. At this low price, quantity demanded increases because it's affordable. But the price may not cover costs — they earn too little profit, so they bring fewer snacks. This creates a **shortage** — **more people want the good than there are available**. A shortage occurs when the market price is below equilibrium. Consumers demand more than producers are willing to supply. Scarcity creates upward pressure on prices, which tends to reduce quantity demanded and encourage additional supply.

Shortages and surpluses create pressures for prices to adjust toward equilibrium. These price movements push the market back to equilibrium, where the quantity supplied equals the quantity demanded.

SHORTAGE IN THE MARKET

A shortage happens when the price is below equilibrium, so quantity demanded is greater than quantity supplied.



At PHP 2:

quantity demanded = 7 pcs;
quantity supplied = 3 pcs;
shortage = 4 pcs.



KEY IDEA:

- When price is below equilibrium, buyers want more than sellers are willing to sell.
- The result is scarcity, or shortage.
- Shortage puts upward pressure on price.

Case Study: The 2023 Rice Price Ceiling

Can Government Keep Prices Low by Setting a Maximum Price?

Rice is the main staple food of Filipino households, so increases in its price place immediate pressure on family budgets. In August 2023, retail prices were rising rapidly. Department of Agriculture monitoring showed that regular-milled rice in Metro Manila was selling for about ₱42 to ₱55 per kilogram, while well-milled rice was selling for roughly ₱48 to ₱56 per kilogram (Gita-Carlos, 2023).

To address the increase, President Ferdinand Marcos Jr. issued **Executive Order No. 39** on August 31, 2023. The order imposed nationwide maximum retail prices of:

- **₱41 per kilogram** for regular-milled rice; and
- **₱45 per kilogram** for well-milled rice.

The ceilings took effect on September 5, 2023 ("Executive Order No. 39," 2023).

Why Was the Price Ceiling Introduced?

The government intended to make rice more affordable and protect consumers from what it described as excessive price increases and possible manipulation by traders. By setting a legal maximum, it hoped retailers would sell rice below the prices then prevailing in many markets (Flores & Lema, 2023).

From the perspective of consumers, the policy appeared straightforward: if the price of rice was too high, government could prohibit sellers from charging more than a specified amount. However, a price ceiling does not directly reduce the costs faced by farmers, importers, wholesalers, transporters, or retailers. If the maximum legal price is below the cost of obtaining and selling rice, some sellers may be unable or unwilling to supply the same quantity.

What Happened to Retailers?

News reports at the start of implementation showed that some retailers had purchased stocks at prices close to—or even higher than—the mandated retail ceilings. Selling at ₱41 or ₱45 per kilogram therefore meant accepting a loss. Some retailers said they would sell their remaining stocks and then temporarily close rather than continue operating at a loss (Rita, 2023).

This illustrates the supply response predicted by the demand-and-supply model. When the legal selling price does not cover acquisition and operating costs, retailers may:

- reduce the quantity offered;
- stop carrying the controlled varieties;
- shift to rice varieties not covered by the ceiling;
- close temporarily; or
- sell outside formal market channels.

The lower official price may therefore be available only to consumers who can find rice being sold at that price. A low price does not help a buyer when the product is unavailable.

Did the Price Ceiling Stop Rice Prices from Rising?

The official ceiling temporarily limited the posted prices of the rice varieties covered by the order in participating outlets. However, national data show that the policy did not stop the broader increase in rice prices. Rice inflation rose from **8.7 percent in August 2023 to 17.9 percent in September 2023**, the month in which the price ceiling was implemented (PSA, 2023).

The ceiling was lifted on October 4, after operating for about one month. The government cited improving supply conditions and declining prices in some markets (Flores & Lema, 2023).

Yet the underlying pressures in the rice market continued. Rice inflation reached:

- **15.8 percent in November 2023;**
- **19.6 percent in December 2023;** and
- **24.4 percent in March 2024,** the highest rate in about 15 years (PSA, 2024).

These figures do not mean that the price ceiling alone caused all subsequent rice-price increases. Rice prices were also influenced by domestic production, import costs, international supply conditions, weather, transportation, inventories, and exchange-rate movements. The evidence does show, however, that the ceiling **failed to stop the underlying increase in rice prices.**

It also created a risk of reduced formal-market supply because some retailers could not profitably sell at the mandated prices.

Why Can a Price Ceiling Produce a Shortage?

A price ceiling becomes binding when it is set below the market-equilibrium price. At the lower controlled price:

- consumers want to buy more rice because it is cheaper;
- retailers are willing or able to sell less because their margins decline or disappear; and
- quantity demanded becomes greater than quantity supplied.

The result is a **shortage**.

The shortage may appear through:

- empty or partially stocked stalls;
- long queues;
- limits on how much each customer can buy;
- reduced product variety;
- informal or hidden sales above the official price; or
- sellers leaving the market.

The market price may therefore continue rising outside the controlled segment even while the government maintains a lower official ceiling.

Who Benefited and Who Bore the Cost?

Some consumers who successfully purchased rice at the controlled price benefited in the short term. The benefit, however, depended on whether sufficient stocks were available. Small retailers bore part of the cost when they were required to sell below their acquisition and operating costs. The government later provided financial assistance to affected retailers, meaning taxpayers also assumed part of the cost of maintaining the policy. Consumers who could not find rice at the controlled price may have faced fewer choices, longer searches, or higher prices elsewhere.

What Alternatives Could Government Have Used?

If the objective was to protect low-income households without discouraging supply,

government could have considered measures such as:

- targeted cash or food assistance;
- subsidized rice distribution for vulnerable households;
- timely importation when domestic supply is insufficient;
- faster release of public buffer stocks;
- support for transportation, storage, irrigation, and post-harvest facilities;
- investigation and prosecution of actual hoarding or cartel behavior; and
- transparent publication of farm-gate, wholesale, and retail prices.

These measures address either household purchasing power or the causes of limited supply rather than requiring all retailers to sell below their costs.

Economic Lesson

A government can legally set a maximum price, but it cannot eliminate the production and distribution costs behind that price. When a ceiling is set below the market-clearing level without measures to increase supply, the official price may fall while availability declines. Over time, the underlying market price may continue to rise.

The rice price-ceiling episode also illustrates the danger of **populist economic policies**. Populist policies often promise immediate and highly visible relief—such as lower prices—without adequately addressing the deeper causes of the problem. They may be politically attractive because their benefits are easy to announce, while their costs emerge later through shortages, weaker supply, losses among small businesses, or higher public spending.

This does not mean that government should ignore rising prices or the needs of low-income households. It means that public action should be based on evidence, careful diagnosis, and an understanding of incentives. Policies designed mainly to appear decisive can worsen the problem they are meant to solve when they suppress prices without expanding supply, improving productivity, or directly supporting vulnerable consumers.

The broader lesson is that good economic policy should not be judged only by its immediate popularity, but by whether it produces sustainable improvements in affordability, availability, and welfare.

The 2023 rice price ceiling demonstrates the difference between making a price **legally lower** and making a good **economically more affordable and widely available**. It also shows why government intervention must consider how consumers, producers, traders, and retailers will respond to new incentives.

Guide Questions

1. Why did some retailers reduce sales or consider closing when the price ceiling was introduced?

2. How can a low official price exist at the same time as a shortage?
3. Why does the increase in rice inflation after September not necessarily prove that the price ceiling was the only cause?
4. Who benefited from the policy, and who absorbed its costs?
5. Which alternative policy would have made rice more affordable without weakening the incentive to supply it?

C. When Market Outcomes are Inefficient: Understanding Market Failure

Throughout this chapter, we learned that markets use demand and supply to determine prices and allocate resources. Under appropriate conditions, markets can coordinate economic activity effectively. As prices change, buyers and sellers adjust their decisions, and markets move toward equilibrium. This allows goods and services to be produced and sold efficiently.

However, markets do not always produce the best outcomes for society. Sometimes markets produce too much of something harmful, too little of something beneficial, or fail to provide important goods and services altogether. In other situations, consumers may not have enough information to make good decisions, or a few firms may become so powerful that competition is limited.

Economists call these situations market failures. Market failure occurs when markets fail to allocate resources efficiently or produce outcomes that are beneficial for society as a whole. Market failure does not imply that markets are generally ineffective or that government should replace private exchange. It identifies specific conditions in which market outcomes may be inefficient or socially undesirable. Instead, it reminds us that while markets are powerful, they sometimes need rules, institutions, or government action to ensure that resources are used efficiently and fairly.

There are many kinds of market failure. In this chapter, we will examine four common examples.

1. Public Goods: Goods Everyone Benefits From

Some goods and services are difficult for private businesses to provide because everyone can benefit from them, even if they do not pay. Economists call these public goods. A public good is generally **non-rival**, meaning one person's use does not significantly reduce its availability to others, and **non-excludable**, meaning it is difficult to prevent non-payers from benefiting.

Examples include:

- national defense
- street lighting
- public parks
- flood control systems

Assume a private company builds streetlights in your neighborhood. Once the lights are turned on, everyone can use them, including people who did not help pay for them. Because businesses cannot easily charge every person who benefits, they have little incentive to provide these services. As a result, governments usually provide public goods using tax revenues.

Example:

Flood control projects help protect entire communities from flooding. Since everyone benefits, it would be difficult for private companies to collect payment from every household. This is why flood control is usually financed and maintained by government taxes and fees.

Economic Insight: Markets work well when buyers can pay directly for goods. Public goods are different because everyone benefits, making private provision difficult.

2. Externalities: When Other People Are Affected

Sometimes the actions of buyers or sellers affect people who are not directly involved in a transaction. Economists call these effects externalities.

Externalities may be:

- negative, when they cause harm
- positive, when they create benefits

Negative Externalities

A mining company may provide jobs and earn profits, but if mining pollutes rivers, nearby communities also suffer from contaminated water and damaged ecosystems.

A factory may produce affordable products, but smoke from its operations can affect the health of surrounding residents.

These environmental and social costs are not always reflected in market prices. Goods that generate negative externalities may be overproduced because part of their social cost is not included in the market price.

Positive Externalities

Some activities benefit not only the individual but also society.

For example:

- education
- vaccinations
- tree planting

When more children receive quality education, society gains a more productive workforce. When more people receive vaccinations, diseases spread less easily. Positive externalities may be underprovided because producers and consumers do not capture all of the social benefits.

3. Market Power: When Competition Is Limited

Markets work best when many buyers and sellers compete fairly. Competition encourages businesses to improve quality, lower prices, and develop better products. However, sometimes only one or a few firms dominate a market. When this happens, businesses may have enough market power to influence prices or reduce consumer choice.

For example, if there is only one company providing electricity or water in a particular area, consumers have few alternatives. Even if prices increase or service quality declines, customers may have no choice but to continue purchasing from that company. Market power can reduce the benefits of competition. This is one reason why governments establish competition laws and regulate certain industries. The next chapter examines how different market structures create varying degrees of market power.

Healthy competition encourages efficiency and innovation, while excessive market power can reduce consumer welfare.

4. Information Problems: When Consumers Cannot Make Informed Choices

Markets assume that buyers and sellers have enough information to make good decisions. In reality, this is not always the case. **Information asymmetry** occurs when one party to a transaction knows more than the other.

Consumers may unknowingly purchase:

- counterfeit medicines
- fake electronic products
- unsafe food
- misleading online products

When consumers lack accurate information, they may buy products that are unsafe or poor in quality. Likewise, honest businesses may struggle to compete against sellers who provide misleading information. To reduce these problems, governments establish consumer protection laws, product standards, and labeling requirements.

Example

The Consumer Act of the Philippines (Republic Act No. 7394) protects consumers by ensuring that products meet safety standards and that advertisements do not mislead buyers.

Bringing It All Together

Markets are one of society's most effective ways of organizing economic activity. Through demand and supply, they help determine prices and guide producers on what goods and services to provide. However, markets are not perfect. Public goods, pollution, market power, and information problems show that markets sometimes fail to produce outcomes that are efficient or beneficial for everyone. In these situations, governments, businesses, and citizens all have important roles in improving how markets function. Rather than replacing markets, well-designed policies can help markets work better by promoting competition, protecting

consumers, preserving the environment, and ensuring that essential goods and services are available to all.

Think Like an Economist

Before deciding whether government should intervene in a market, economists often ask:

- What problem is government intervention intended to address?
- Is the problem caused by market power, externalities, public goods, or inadequate information?
- Who bears the costs and who receives the benefits?
- Are there less costly alternatives?
- Could the policy create shortages, weak incentives, or new barriers?

These questions remind us that economics is not only about understanding how markets work, but also about thinking carefully about when and how they can be improved.

E. Approaches to Addressing Market Failure

Market failure occurs when markets do not allocate resources efficiently or fairly. This may happen because prices do not reflect social costs, firms have too much market power, consumers lack information, or some goods and services are not sufficiently provided.

Government can respond in different ways. The most appropriate approach depends on the source of the problem, the seriousness of its effects, and the government's ability to implement the policy.

1. Providing information

Some market failures arise because buyers and sellers do not have equal information. Consumers may not know whether a product is safe, whether a loan is expensive, or whether a service provider is qualified.

Government can require labels, warranties, price disclosures, safety warnings, and truth-in-advertising rules. These measures help consumers compare products and make better decisions. However, information alone may not be enough when it is too technical or when consumers have little bargaining power.

2. Setting rules and standards

Government may regulate activities that can harm workers, consumers, communities, or the environment. Examples include food safety standards, building codes, pollution limits, and workplace safety rules.

Standards can prevent harm before it occurs. However, they must be practical and enforceable. Rules that are too costly or complicated may discourage small businesses or encourage non-compliance.

3. Using taxes and charges

Taxes and fees can be used when an activity imposes costs on others. Pollution charges, congestion fees, and taxes on harmful products are examples.

These policies make harmful activities more expensive and encourage people and firms to change their behavior. However, the burden may fall heavily on low-income households. Government may need to combine such policies with targeted support or better public services.

4. Providing subsidies and incentives

Government may support activities that produce wider social benefits. Education, vaccination, renewable energy, public transport, research, and recycling may receive subsidies.

Subsidies lower the cost of socially beneficial activities and encourage greater participation. However, they require public funds and should be carefully targeted to avoid waste or unfair advantages.

5. Direct public provision

Some goods and services may not be adequately provided by private markets. Government may therefore provide or finance public education, healthcare, flood control, street lighting, scientific research, and disaster warning systems.

Direct provision can ensure access to essential services. Its success depends on adequate funding, competent management, and clear accountability.

6. Promoting competition

When a small number of firms control a market, they may charge high prices, reduce quality, or prevent new firms from entering.

Government can enforce competition laws, review mergers, investigate cartels, and regulate natural monopolies such as water or electricity providers. The goal is to protect consumers while maintaining incentives for investment and innovation.

7. Clarifying rights and responsibilities

Some market failures arise because ownership, access, or responsibility is unclear. Government can establish rules for land, forests, fisheries, water, pollution, consumer warranties, and waste management.

Clear rules can reduce conflict and prevent overuse. They must be fairly designed and properly enforced.

8. Expanding social protection

Markets distribute income according to employment, ownership, and purchasing power. They do not guarantee access to food, education, healthcare, housing, or income security.

Government can respond through progressive taxation, cash transfers, pensions, unemployment support, public healthcare, and other social programs. These policies address the unequal effects of market outcomes.

9. Supporting collective action

Communities, cooperatives, unions, and professional organizations can also help address market failure. They can manage shared resources, improve bargaining power, spread risk, and provide services.

Collective action is often useful when local knowledge is important. It must still be transparent and inclusive.

10. Combining policies

Many market failures require more than one response. Plastic waste, for example, may be addressed through producer responsibility, recycling systems, packaging standards, public information, and waste collection. The choice of policy should be guided by evidence.

Policymakers should identify the problem, compare possible solutions, estimate the costs and benefits, and consider who will gain or lose.

Government failure

Government intervention can also produce poor results. Policies may fail because of weak information, corruption, regulatory capture, poor implementation, or unintended effects. A price ceiling may create shortages. A subsidy may benefit firms that do not need support. A complicated licensing system may protect established businesses from competition. For this reason, government intervention should be monitored and reviewed. Policies should be adjusted when they do not achieve their intended goals.

Key Idea: Market failure can be addressed through information, regulation, taxes, subsidies, public provision, competition policy, social protection, and collective action. The best approach is the one that directly addresses the problem, can be implemented effectively, and produces greater social benefits than costs.

Let's Review

- Demand describes how much consumers are willing and able to buy at different prices.
- Supply describes how much producers are willing and able to sell at different prices.
- Quantity demanded generally falls as price rises, while quantity supplied generally rises.
- Elasticity measures how strongly buyers or sellers respond to price changes.
- Equilibrium occurs where quantity demanded equals quantity supplied.
- Prices above equilibrium tend to create surpluses; prices below equilibrium tend to create shortages.
- Government intervention may address affordability or market failure, but poorly designed policies can create unintended effects.
- Markets may fail because of public goods, externalities, market power, or information problems.
- Market failure occurs when markets do not allocate resources efficiently, such as when there are externalities, public goods, market power, or unequal information.
- Government failure occurs when government intervention creates poor results because of weak design, limited information, corruption, regulatory capture, or unintended consequences.

Key Takeaways

Demand and supply explain how prices and quantities are determined in markets. Equilibrium provides a useful model of how buyers and sellers interact, but actual markets may be affected by regulation, unequal power, limited information, externalities, and public goods. Understanding both market coordination and market failure helps us evaluate when markets work well and when institutions or government action may be needed.

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