Economics, a Comprehensive Guide

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Part 1: Microeconomics

Scarcity, Opportunity Cost and Economic Efficiencies

Scarcity means that society has **limited resources** and **unlimited wants**

Resource Allocation in Competitive Markets

Firms and How They Operate

Market Failure

What is Market Failure?

Market Failure is defined as the following:

> Market Failure is the failure of the **free market** to allocate resources in a fashion that **maximises societal welfare**.

This is the justification for government intervention. The very fact that the free market is failing to maximise societal welfare means that the government has to step in and take measures, which will be explored later, to correct the market failure.

Causes of Market Failure

Market failure occurs because of various reasons, all of which fall under these broad-based categories:

1. Public Goods
2. Positive and Negative Externalities
3. Merit and Demerit Goods
4. Imperfect Information
5. Immobility of Factors
6. Inequity of income and wealth
7. Market Dominance

Note: "Inequality" is a mathematical concept ($\geq$ and what not), while "inequity" is the social/moral concept, and the latter is what economics in this context wants

Public Goods

There are two defining characteristics of a public good: **non-rivalrous** and **non-excludable**.

Non-rivalrous A good is non-rivalrous when *an individual consumer does not reduce the quantity of the good available to other consumers*. That is, the marginal cost of providing the good to one more consumer is 0. In mathematical terms $MC = 0$.

> Make a mental note that this MC is not the marginal cost of *producing* the good, but the marginal cost of *consuming* the good.

Examples of non-rivalrous goods are: radio signals, light from street lamps etc.

Non-excludable Non-excludable goods are either *impossible* or *prohibitively costly* to exlucde non-payers from consuming the good. That is, the goods are excludable *NOT by choice*. For example, a library can easily be made excludable by prohibiting people from entering, so a library is not a public good.

How Public Goods Lead to Market Failure The combination of non-rivalry and non-excludability leads to what is famously known as the **free rider problem**. Since it is impossible to exclude someone from consuming a good, rational consumers will choose to free ride from someone who possesses the good. Because the good is not "used up" upon free-riding, the ability to free ride the good can persist in the long run.

This results in all consumers unwilling to pay for the good. i.e.

$$P = MC = 0$$

Prices can be seen as the value the consumer places on the good in question, but the price signal sent by consumers would then be zero in the case of public goods. The price signal does not reflect the value the consumers place on the good (which is a positive price), and this incorrect signal results in the failure of the price mechanism.

Positive and Negative Externalities

Merit and Demerit Goods

Imperfect Information

Immobility of Factors

Inequity of Income and Wealth

Market Dominance

Chapter 3

Part 2: Macroeconomics

Key Economic Indicators

Macroeconomy and How It Works

International Economics