DEPARTMENT OF EDUCATION

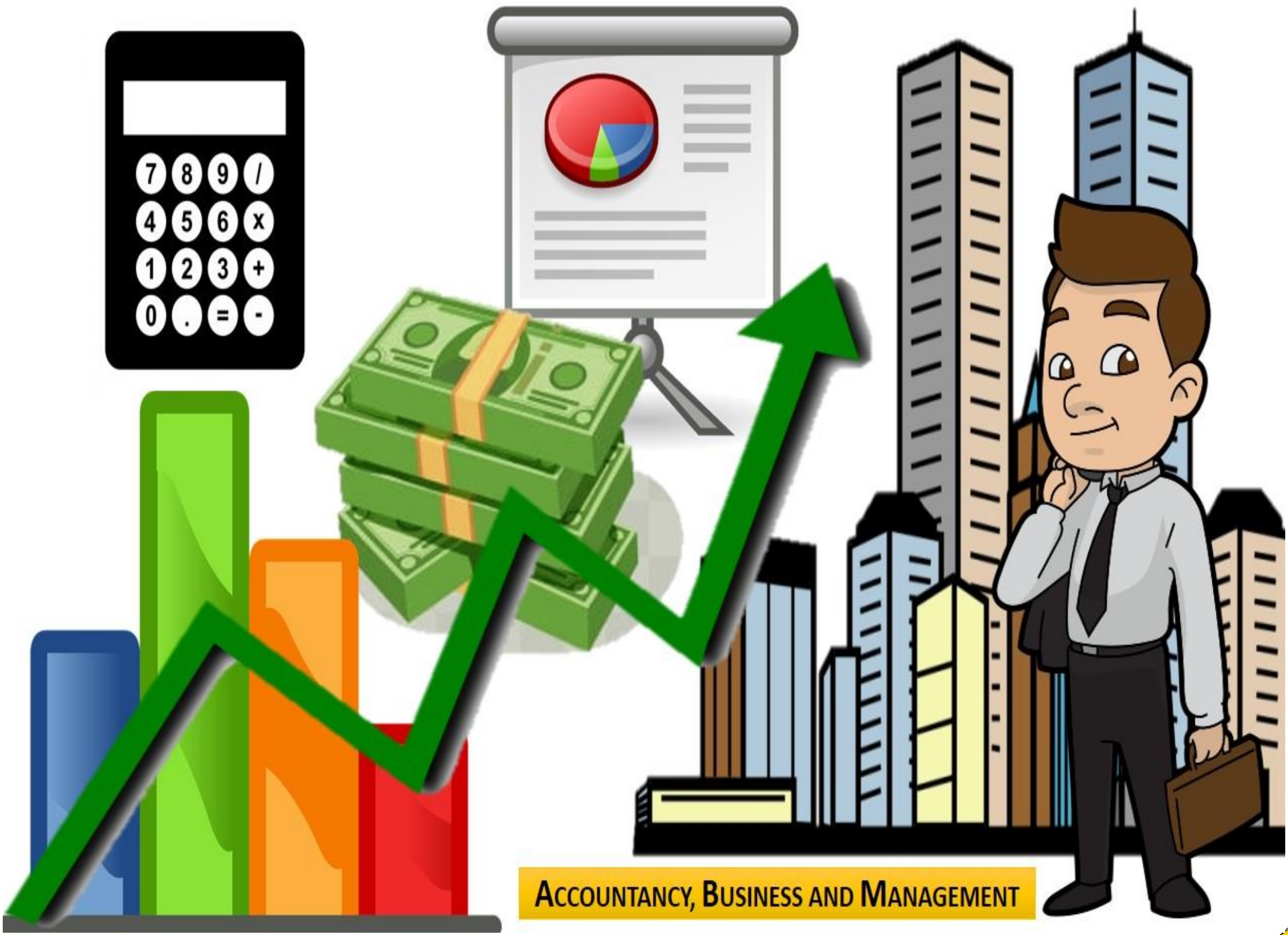
Applied Economics

SENIOR HIGH SCHOOL

Impact of Business on the Community: Market Failure

Self-Learning Module 14

Quarter 4



Applied Economics
Quarter 4 – Self-Learning Module 14: Impact of Business on the Community: Market Failure
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Impact of Business on the Community: Market Failure

Introductory Message

For the facilitator:

Welcome to the Senior High School – Applied Economics Self Learning Module on Impact of Business on the Community: Market Failure!

This Self-Learning Module was collaboratively designed, developed and reviewed by educators from the Schools Division Office of Pasig City headed by its Officer-in-Charge Schools Division Superintendent, Ma. Evalou Concepcion A. Agustin, in partnership with the City Government of Pasig through its mayor, Honorable Victor Ma. Regis N. Sotto. The writers utilized the standards set by the K to 12 Curriculum using the Most Essential Learning Competencies (MELC) in developing this instructional resource.

This learning material hopes to engage the learners in guided and independent learning activities at their own pace and time. Further, this also aims to help learners acquire the needed 21st century skills especially the 5 Cs, namely: Communication, Collaboration, Creativity, Critical Thinking, and Character while taking into consideration their needs and circumstances.

In addition to the material in the main text, you will also see this box in the body of the module:

Notes to the Teacher

This contains helpful tips or strategies that will help you in guiding the learners.

As a facilitator you are expected to orient the learners on how to use this module. You also need to keep track of the learners' progress while allowing them to manage their own learning. Moreover, you are expected to encourage and assist the learners as they do the tasks included in the module.

For the learner:

Welcome to the Applied Economics Self Learning Module on Impact of Business on the Community: Market Failure!

This module was designed to provide you with fun and meaningful opportunities for guided and independent learning at your own pace and time. You will be enabled to process the contents of the learning material while being an active learner.

This module has the following parts and corresponding icons:

Expectations - This points to the set of knowledge and skills that you will learn after completing the module.

Pretest - This measures your prior knowledge about the lesson at hand.

Recap - This part of the module provides a review of concepts and skills that you already know about a previous lesson.

Lesson - This section discusses the topic in the module.

Activities - This is a set of activities that you need to perform.

Wrap-Up - This section summarizes the concepts and application of the lesson.

Valuing - This part integrates a desirable moral value in the lesson.

Posttest - This measures how much you have learned from the entire module.

EXPECTATIONS

After going through this module, you are expected to:

1. define market failure;
2. identify the common market failures; and
3. explain the government interventions to address market failures.

PRETEST

Directions: Choose the letter of the best answer and write it on a separate sheet of paper.

1. It is an economic situation defined by an inefficient distribution of goods and services in the free market.

   A. Economic Failure

   B. Market Failure

   C. Price Failure

   D. Business Failure

2. It is an effect on a third party that caused by production or consumption of a good or service.

   A. middleman effect

   B. cost effect

   C. externality

   D. none of the above

3. It is a negative spillover effect on third parties.

   A. negative externality

   B. bad spillover effect

   C. negative spillover

   D. none of the above

4. This problem means someone benefiting from resources or goods and services without paying for the cost of the benefit.

   A. free rider

   B. good spillover effect

   C. negative externality

   D. none of the above

5. Below are the reasons for the market failure, EXCEPT:

   A. environmental concerns

   B. lack of public goods

   C. abuse of monopoly power

   D. taxation

RECAP

Directions: Differentiate allocative efficiency and productive efficiency. Write your answer in the table below.

Productive Efficiency	**Allocative Efficiency**

LESSON

Market Failure

Market failure is the economic situation defined by an inefficient distribution of goods and services in the free market. In market failure, the individual incentives for rational behavior do not lead to rational outcomes for the group.

Prior to market failure, the supply and demand within the market do not produce quantities of the goods where the price reflects the marginal benefit of consumption. The imbalance causes allocative inefficiency, which is the over- or under-consumption of the good.

The structure of market systems contributes to market failure. In the real world, it is not possible for markets to be perfect due to inefficient producers, externalities, environmental concerns, and a lack of public goods. An *externality* is an effect on a third party which is caused by the production or consumption of a good or service.

Causes of Market Failure

Market failure occurs due to inefficiency in the allocation of goods and services. In order to fully understand market failure, it is important to recognize the reasons why a market can fail. Due to the structure of markets, it is impossible for them to be perfect. These are the reasons for market failure:

1. Positive and Negative Externalities

An externality is an effect on a third party that is caused by the consumption or production of a good or service. A positive externality is a positive spillover that results from the consumption or production of a good or service. For example, although public education may only directly affect students and schools, an educated population may provide positive effects on society as a whole. A negative externality is a negative spillover effect on third parties. For example, secondhand smoke may negatively impact the health of people, even if they do not directly engage in smoking.

2. Environmental Concerns

Effects on the environment as important considerations as well as sustainable development.

3. Lack of Public Goods

The public goods are commodities or services that benefit all members of society, and which are often provided for free through public taxation. Public goods are the opposite of private goods, which are inherently scarce and are paid for separately by individuals. An important issue that is related to public goods is referred to as the *free-rider problem.* Since public goods are made available to all people, regardless of whether each person individually pays for them, it is possible for some members of society to use the good despite refusing to pay for it. People who do not pay taxes, for example, are essentially taking a "free ride" on revenues provided by those who do pay them, as do turnstile jumpers on a subway system.

4. The Underproduction of Merit Goods

A merit good is a private good that society believes is under-consumed, often with positive externalities. For example education, healthcare, and sports centers.

5. Overprovision of Demerit Goods

A demerit good is a private good that society believes is over consumed, often with negative externalities. For example cigarettes, alcohol, and prostitution.

6. Abuse of Monopoly Power

Imperfect markets restrict output in an attempt to maximize profit.

Government Interventions for the Market Failure

When a market fails, the government usually intervenes depending on the reason for the failure. Below are the following government interventions to address market failures.

1. Legislation – enacting specific laws. For example, banning smoking in restaurants, or making high school attendance mandatory.

2. Direct provision of merit and public goods – government controls the supply of goods that have positive externalities. For example, by supplying high amounts of education, parks, or libraries.

3. Taxation – placing taxes on certain goods to discourage use and internalize external costs. For example, placing a ‘sin tax’ on tobacco products, and subsequently increasing the cost of tobacco consumption.

4. Subsidies – reducing the price of a good based on the public benefit that is gained. For example, lowering college tuition because society benefits from more educated workers. Subsidies are most appropriate to encourage behavior that has positive externalities.

5. Tradable permits – permits that allow firms to produce a certain amount of something, commonly pollution. Firms can trade permits with other firms to increase or decrease what they can produce. This is the basis behind cap-and-trade, an attempt to reduce pollution.

6. Extension of property rights – creates privatization for certain non-private goods like lakes, rivers, and beaches to create a market for pollution. Then, individuals get fined for polluting certain areas.

7. Advertising – encourages or discourages consumption.

8. International cooperation among governments – governments work together on issues that affect the future of the environment.

ACTIVITIES

Activity 1: The Effects of Market Failure

Directions: Enumerate the possible effects of market failure on you, society, and economy.

Effects on Me	Effects on the Society	Effects on the Economy

Activity 2: My Intervention for the Market Failure

Directions: Create a policy that would tamper the market failure. Choose any of the government interventions above. Write your policy in the box.

WRAP-UP

To summarize what you have learned in the lesson, answer the following questions:

1. What is the market failure?
2. What are the causes of market failure?
3. What are the government interventions for market failure?

VALUING

Reflect on this!

"Failure is not the opposite of success; it's part of success."

— Arianna Huffington

POSTTEST

Directions: Read each statement carefully. Write **T** if the statement is correct, otherwise write **F**.

____________1. The normal goods are goods where the total cost of production does not increase with the number of consumers.

____________2. A free-rider problem means someone benefiting from resources or goods and services without paying for the cost of the benefit.

____________3. A demerit good is a private good that society believes is under consumed, often with positive externalities.

____________4. Subsidies are most appropriate to encourage behavior that has positive externalities.

____________5. A merit good is a private good that society believes is over consumed, often with negative externalities

KEY TO CORRECTION

PRETEST	POSTTEST:
1. B	1. F
2. C	2. T
3. C	3. F
4. A	4. T
5. D	5. F

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