[Frequently Asked Questions]

Market Failure

Subject:	Business Economics
Course:	B. A. (Hons.), 2nd Semester, Undergraduate
Paper No. & Title:	Paper – 201 Microeconomics-II
Unit No. & Title:	Unit – 5 Market Failure
Lecture No. & Title:	Lecture – 1 Market Failure

Frequently Asked Questions

Q1. What does the concept of market failure say?

A1. The situations under which market fails to achieve economic efficiency or maximum social welfare is called market failure.

Q2. What are the major reasons for market failure?

A2. Market failure occurs mainly due to four reasons. They are (i) presence of externalities, (ii) consumption of public goods (iii) asymmetric information and (iv) common property resources.

Q3. How will you define risk?

A3. Risk is an uncertainty that arises whenever there is imperfect information about something that affects benefits or costs.

Q4. Can economic efficiency be achieved in a situation of asymmetric information?

A4. The equilibrium in a market with asymmetric information may not be economically efficient.

Q5. In a market with asymmetric information whether marginal cost equals marginal benefit?

A5. At equilibrium in a market with asymmetric information the marginal benefit does not equal marginal cost. Therefore the quantity traded is not economically efficient.

Q6. Under which market situation the adverse selection takes place?

A6. Adverse selection arises in situations of asymmetric information. In adverse selection, the party with relatively poor information draws a selection with relatively less attractive characteristics.

Q7. What does the concept screening say?
A7. Screening is the initiative of a less-informed party to indirectly understand the other party's characteristics. Screening is an indirect way to resolve asymmetric information. It works only if less informed party can identify and control some variable that the better-informed parties are differentially sensitive to.

Q8. How would you define the concept of signaling?
A8. Signaling is an action initiated by the better-informed party to communicate its characteristics in a credible way to the less-informed party.

Q9. What do you mean by imperfect information?
A9. Imperfect information is the absence of certain knowledge. A person can have imperfect information about something, but if that does not affect her benefits or costs, it does not impose any risk on him.

Q10. Can a market be perfectly competitive when buyers and sellers have imperfect information?
A10. A market could be perfectly competitive even when buyers and sellers have imperfect information, as long as they all have the same imperfect information.