

Environmental Economics: Market Failures

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“Most environmental and natural resource problems arise because of market failure, therefore solving these problems could be easily achieved through the appropriate extension of markets.” Critically evaluate this statement with reference to specific examples of pollution, natural resources and environmental public goods.

The market represents a decentralized exchange mechanism that allows society to allocate resources efficiently. (National Oceanic and Atmospheric Administration, 2011)

An example of a perfect market for the supply and demand for oysters is shown in Figure 1. Assuming that the full cost is captured, the equilibrium point b will result in a pareto optimal outcome, efficiently allocating resource and maximizing economic benefits to society. (National Oceanic and Atmospheric Administration, 2011)

Markets fail when they are unable to protect the environment from which their resources come from. The full social costs of exploiting a natural resource is not captured, resulting in an inefficient resource use. There are three factors contributing to market failures. The first factor of market failure is that the market is not purely competitive. Secondly, the resource is a common property or an open access resource and lastly, when externalities

are present.

A monopoly ensues when the market for a resource is not purely competitive. In contrast, when there is pure competition, firms can purchase as many units of the resources as required at the market price. However, in the case of a monopoly, firms pay more to acquire the resources. As shown in Figure 2, the equilibrium price is raised higher as the controlling firm wants to maximize its profits.

Figu...

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...together. Hence, in order to combat environmental externalities and other forms of market failure, government agencies need to intervene using solutions like permits and taxes to correct these market imperfections and to protect the environment.

Works Cited

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