

## Free Market Breakdowns

### Free market decisions

Governments have to make decisions about the type of economic system they support. In the US, the underlying system is capitalism. Capitalism allows the interaction of consumers and businesses to determine the answer to the economic questions of what will be produced, how should goods and services be produced, who will produce the goods and services, and for whom will the goods and services be produced? The capitalistic/free market system can adapt to the changing needs of consumers, the technological advancements of businesses, and productivity enhancements of the work force.

But, there are situations when capitalism is flawed and the free market breakdowns. Recently, this has occurred in the financial markets. "Greed is good" was a famous quote from Gordon Gecko in the movie Wall Street. This saying was generally believed to be true when one considers the underlying nuances of capitalism. But, the last few decades of manipulating the laws to expand one's own net worth has brought the selfishness of capitalism into question. Is greed really good for our economy and the individual, or does greed lead to a series of market breakdowns, where economic agents search for loopholes to grow their own balance sheet at the expense of the general public and more specifically the tax payer?

The Free Market breaks down in the cases of monopolies, collusion, regulatory loopholes, public goods, externalities, and income disparities. In these circumstances, the government steps in to adjust market inequities.

The government's goal is to maximize the welfare of the general public. When the general public loses at the expense of an individual company, the government steps in and regulates the situation. The government looks out for the masses.

Another example of the government stepping in to help consumers is in the area of trade. Trade is the buying and selling of goods and services between countries. Trade is necessary because not all countries share the same resources. Therefore, trade allows countries with different resources to share with each, which allows their respective citizens to enjoy resources from two (or more) countries as opposed to one. Trade increases competition between companies that typically would not compete because they operate in different countries.

Take a look at the tables on the webpage below. You will be amazed with the amount of goods and services that are exchanged between countries.

[http://www.bea.gov/scb/pdf/2009/01%20January/0109\\_itq\\_tables.pdf](http://www.bea.gov/scb/pdf/2009/01%20January/0109_itq_tables.pdf)

Here are some sample questions regarding trade.  
What is a trade surplus?

What is a trade deficit?

Who is the US's largest trading partner?

What country does the US have the largest trade deficit with?

Which countries do the US have trade surpluses?

**How do we know the free market is working?**

If the free market is working well then prices and quantities produced will be determined by the interaction of consumers and producers.

**When the free market is working this is what will happen....**

On the demand side:

If consumers are not buying the product prices will \_\_\_\_\_ and quantities produced will \_\_\_\_\_.

If consumers are buying the product prices will \_\_\_\_\_ and quantities produced will \_\_\_\_\_.

On the supply side:

If it cost more for producers to make a product prices will \_\_\_\_\_ and quantities produced will \_\_\_\_\_.

If it cost less for producers to make a product prices will \_\_\_\_\_ and quantities produced will \_\_\_\_\_.

If more companies enter into the market prices will \_\_\_\_\_ and quantities produced will \_\_\_\_\_.

If some companies leave the market then prices will \_\_\_\_\_ and quantities produced will \_\_\_\_\_.

**Free market breakdowns occur when the natural adjustments of supply and demand do not occur.**

When something is blocking the market from operating efficiently the government should step in.

What are examples of the market operating inefficiently?

Monopolies – one seller of a good. This one seller has the ability to charge higher prices than if there were multiple sellers.

Collusion – when some sellers join together to act as one. These sellers have the ability to raise prices to consumers.

Public goods - are goods that if left up to the individuals they would be under produced. Some examples are national defense, roads, and education. These goods are important to society, but too expensive for one person to purchase.

## The top item is defense

- The world spends about \$1.4 trillion on military
- The U.S. is on pace to spend over \$700 billion this year.
- Over 50 percent of the world's defense spending is done by the U.S.



Income distribution – in the US the top wage earnings earn a high percent of the money. See sheet. The government believes without their assistant this problem would be even worse.

Percentiles Ranked by AGI	AGI Threshold on Percentiles	Percentage of Federal Personal Income Tax Paid
Top 1%	\$328,049	36.89
Top 5%	\$137,056	57.13
Top 10%	\$99,112	68.19
Top 25%	\$60,041	84.86
Top 50%	\$30,122	96.70
Bottom 50%	<\$30,122	3.30

Note: AGI is Adjusted Gross Income  
Source: Internal Revenue Service

See income data link on my web page.