DOES COMPETITIVENESS SOLVE MARKET FAILURES?

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Microeconomics Professor Jeffrey Ely from Northwestern University explains two reasons why markets can be inefficient. The first problem we face has to do with incentives. In any transaction*buyers and sellers in any market have incentives to manipulate prices* to get a good ask (higher the better) or buy (lower the better) price.

The second problem is caused by the *incentive for sellers to maximize their profits*. This means that by not looking at market efficiency, but rather at maximizing its benefits, some distortions can be caused in the market.

This can be avoided by having many buyers and sellers since if the competitiveness increases, the prices will be closer to those that are really efficient. Neither group will have much room to manipulate the price. Sellers will still want to maximize their profits but will have to take other sellers into account, driving prices ever closer to costs.

Jeffrey Ely explains it to us with a practical case such as ebay.

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