Market Efficiency

29. the concept of market efficiency in a competitive market

INTRO

- This dotpoint introduces you to the concept of **efficiency.**
- A combination of the **One Note** and **textbook** reading is necessary for this topic
- Understanding of **Demand and Supply Diagrams** is vital, as the concepts now become a little more technical.

What is efficiency?

Efficiency, is a broad economic interpretation of the word, meaning:

'making the best possible use of resources'.

'indicates the absence of overproduction or underproduction.'

'when all goods and factors of production in an economy are distributed or allocated to their most valuable uses and waste is eliminated or minimized'

In the real world efficiency is about eliminating waste and using the least amount of resources for maximum output

For example, an inefficient washing machine operates at high cost, while an efficient washing machine operates at lower cost, because it's not wasting water or energy. An inefficient company operates with long delays and high costs, while an efficient company is focused, meets deadlines, and performs within budget.

LET'S JUST KEEP IT SIMPLE

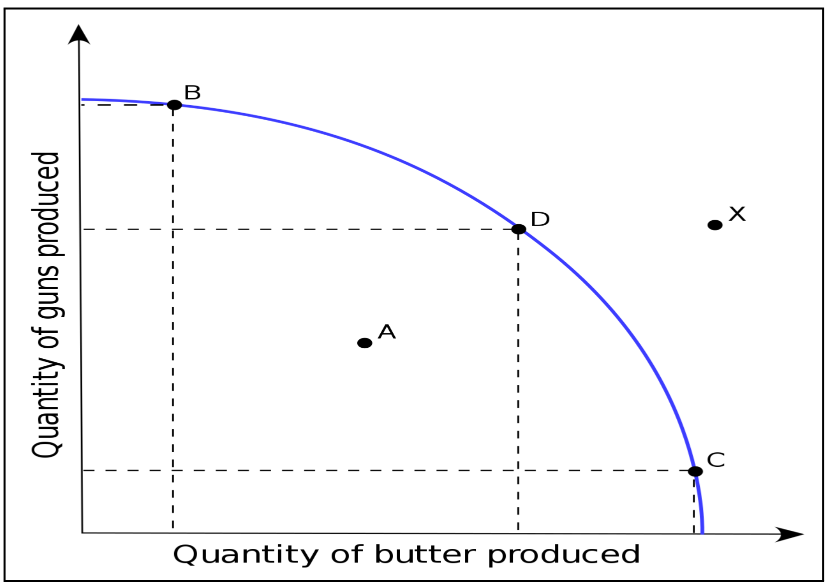
<u>You need to know about two types of efficiencies,</u>

We can distinguish between **productive efficiency** and **allocative efficiency.**

Productive efficiency refers to producing goods using the fewest possible resources, which implies producing at the lowest possible cost. If firms are producing at the productively efficient level of output, then we can assume they are combining their resources as efficiently as possible and resources are not being wasted by inefficient use.

The economy is producing on the Production Possibility Frontier (or Curve).

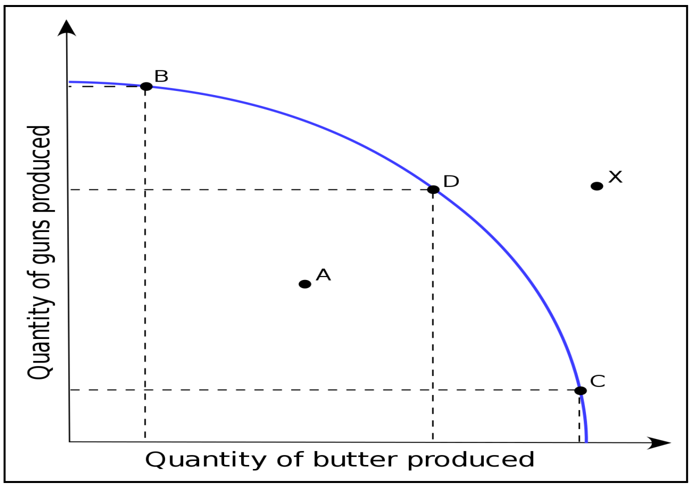
Any point inside the PPF is not using resources to the fullest potential and not showing productive efficiency.



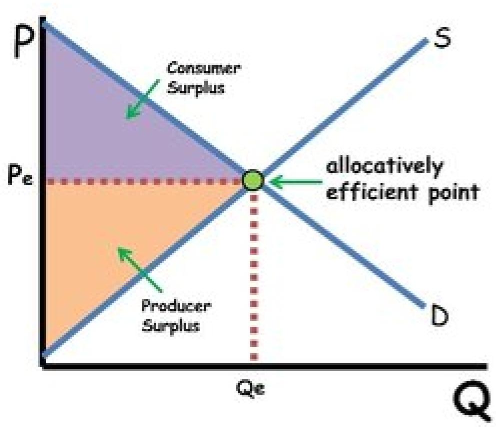
- **Points B, D, C represent productive efficiency.**
- **Point A is showing productive inefficiency.**
- **Point X is not possible with the given level of resources**

Allocative efficiency has all the same conditions as productive efficiency, but it is not enough in itself. Firms must not only be producing at their lowest possible cost, they also need to be producing the correct combination of goods that the society prefers, i.e. **the best combination of goods from the society's point of view.** This is situation is also called **Pareto Optimality**

A competitive market results in allocative efficiency, which implies productive efficiency. This is also known as **economic efficiency.**



Let's assume that this economy is at war, and prefers or needs gun production more than butter production. Points B, D, C are all showing productive efficiency. However B represents allocative efficiency



A more precise way of looking at allocative efficiency is to look at it using demand and supply graphs. This time though with some different terminology and concepts. This will be covered in the next dotpoints.