A-LEVEL ECONOMICS • EXERCISE SHEET

3.1 Government microeconomic intervention: reasons

Name: ____________ Class: _________ Date: __________ **Total: 26 marks**

KEY WORDS demerit good 劣值品 • merit good 优值品 • externality 外部性 • market failure 市场失灵 • negative externality 负外部性

Objective

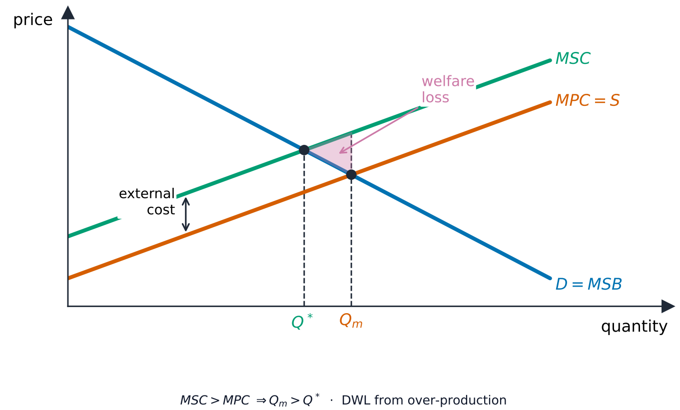
Build the skills to answer exam questions on the **reasons for government intervention** 政府干预的原因 — **market failure** 市场失灵 from **externalities** 外部性, **public goods** 公共物品, **merit/demerit goods** 优值品/劣值品, **monopoly power** 垄断势力 and **asymmetric information** 信息不对称.

You must be able to:

- define market failure and externalities (private, external and social cost/benefit)
- draw the externality diagram and identify the welfare loss
- explain the other sources of market failure

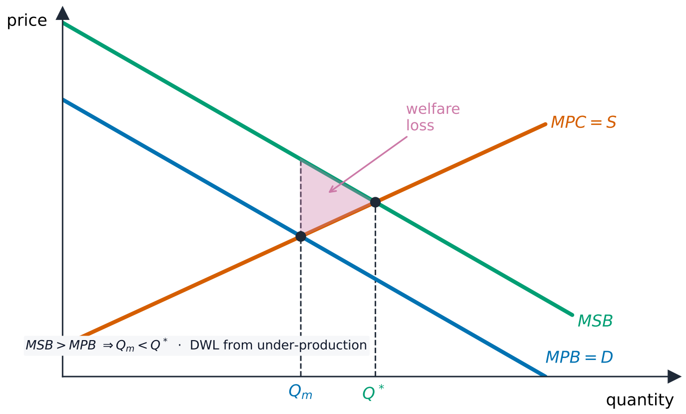
1 Worked examples

■ Externalities and market failure



A negative externality: the market produces Q_m, above the social optimum Q^*; the triangle is the welfare loss

- **Negative externality** 负外部性: **social cost** 社会成本 > **private cost** 私人成本 → market makes **too much**.
- **Positive externality** 正外部性: social benefit > private benefit → market makes **too little**.



A positive externality: the market under-produces, below the social optimum Q^*

- Other failures: **public goods** (free-rider), **merit/demerit goods** (information failure), **monopoly power**, **asymmetric information** 信息不对称.

Answer shapes: an **Explain [up to 8]** answer should use a labelled externality diagram (AO3); **Discuss** [**12**] adds a judgement (AO4).

2 Practice

2.1 Define the term *negative externality*. [2]

2.2 State the relationship between social cost and private cost when there is a negative externality. [1]

2.3 State two sources of market failure other than externalities. [2]

3 Exam-style questions

3.1 A negative externality of production means that: [1]

A | B
C | D

A marginal social cost is below marginal private cost
B marginal social cost is above marginal private cost
C marginal social benefit is above marginal private benefit
D the good is under-produced

3.2 Using a diagram, explain why a good with a negative externality is over-produced by a free market. [8]

3.3 Discuss whether externalities are the most serious cause of market failure. [12]