# 3 Market failure – Part 2 —Answers

## Answers

**3.1** (a) supply shifts to the left (falls); (b) the price rises.

**3.2** A merit good (e.g. education) or a good with a positive externality, to encourage more of it to be made and used.

**3.3** A shortage —the quantity demanded is greater than the quantity supplied.

**3.4** Excess supply (a surplus) —the quantity supplied is greater than the quantity demanded.

**3.5** Any one: a maximum price creating a black market; a tax or subsidy set at the wrong level because of poor information; high cost of running the policy. (Any clear example.)

**3.6** The tax raises firms' costs, shifting supply left and pushing the price up —so the quantity demanded falls. But cigarettes are addictive, so demand is very *inelastic*: the higher price cuts the quantity only a little, so the tax may not reduce smoking much (it mainly raises tax revenue).