The mixed economy and externalities

Edexcel IGCSE Economics 4EC1 sections 1.1.5-1.1.6 full package

The mixed economy and externalities

- distinguish the private and public sectors by ownership, control and aims;
- explain how a mixed economy answers the questions what, how and for whom to produce;
- explain **market failure**, **public goods** and the **free-rider problem**;

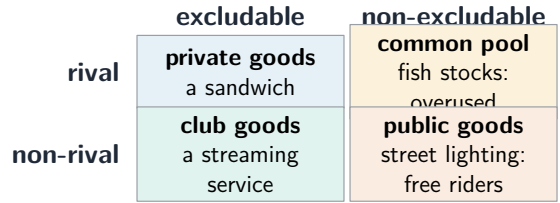
The mixed economy and externalities (2)

- evaluate the effects of privatisation on consumers, workers, firms and the government;
- explain **external costs** and **external benefits**, and calculate social costs and benefits.

The mixed economy

- **non-excludable** : nobody can be stopped from using them once they exist;
- **non-rival** : one person's use does not reduce what is left for others.

Figure: The mixed economy



non-rival + non-excludable $\longrightarrow$ free-rider problem $\longrightarrow$ the market under-provides or provides none

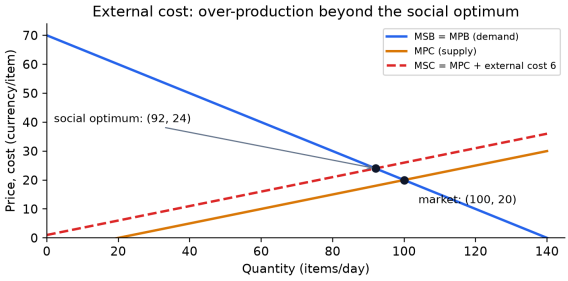
- Goods sorted by rivalry and excludability: **public goods** are **non-rival** and **non-excludable**, so the market fails to provide them.
- Match each part of the diagram to the text.

Externalities

- A paper mill pays 50 yuan in wages, wood and energy to make each tonne of paper. Its waste water harms fishing downstream by 20 yuan per tonne. Social cost $= 50 + 20 = 70$ yuan per tonne.
- A vaccination is worth 100 yuan to the person who receives it, and it protects others by a further 60 yuan. Social benefit $= 100 + 60 = 160$ yuan.

$$\text{social cost} = \text{private cost} + \text{external cost}$$

Figure: Externalities



- The social cost curve (private cost + 6) meets demand at a quantity of 92; the market's 100 is over-production.
- Match each part of the diagram to the text.

Data-response practice

- (a) Define *__external cost__*. [2]
- (b) Calculate the approximate number of single-use bags handed out by the seven largest supermarkets after a 97% fall from 7.6 billion. [2]
- (c) Explain why a free market produces too many plastic bags. You may use a diagram. [4]

Data-response practice (2)

- (d) Explain **one** advantage of a charge compared with a complete ban on plastic bags. [3]
- (e) Evaluate whether a charge is the best way to reduce plastic waste. [9]

Common errors

- Defining a **public good** as "a good provided by the government". Use the two features: **non-excludable** and **non-rival**.
- Saying the public sector aims for profit. Its main aim is providing services and welfare.
- Listing only benefits of privatisation. Consider consumers, workers, firms and the government, both ways.

Common errors (2)

- Calling any bad effect an **external cost**. It must fall on a **third party**, outside the sale.
- Writing social cost = external cost. Social cost is private cost **plus** external cost.
- Saying the market produces too much of a good with **external benefits**. It produces too little.

Key terms

- **Mixed economy**: an economy with both a private and a **public sector**.
- **Market failure**: an inefficient allocation of resources by the free market.
- **Public good**: a good that is **non-excludable** and **non-rival**.

Key terms (2)

- **Free-rider problem**: people use a good without paying, so the market will not supply it.
- **Privatisation**: transferring ownership of a firm from the public to the **private sector**.
- **External cost / external benefit**: a cost / benefit that falls on a **third party**.
- **Social cost**: private cost + **external cost**.

Check yourself

- 1.
- Give one difference in aims between the **private sector** and the **public sector**. 2.
- Explain why a lighthouse is a **public good**. 3.
- Give one possible benefit and one possible cost of privatisation for workers. 4.