

Exercise walk-through

2.9

Market failure

IGCSE Economics

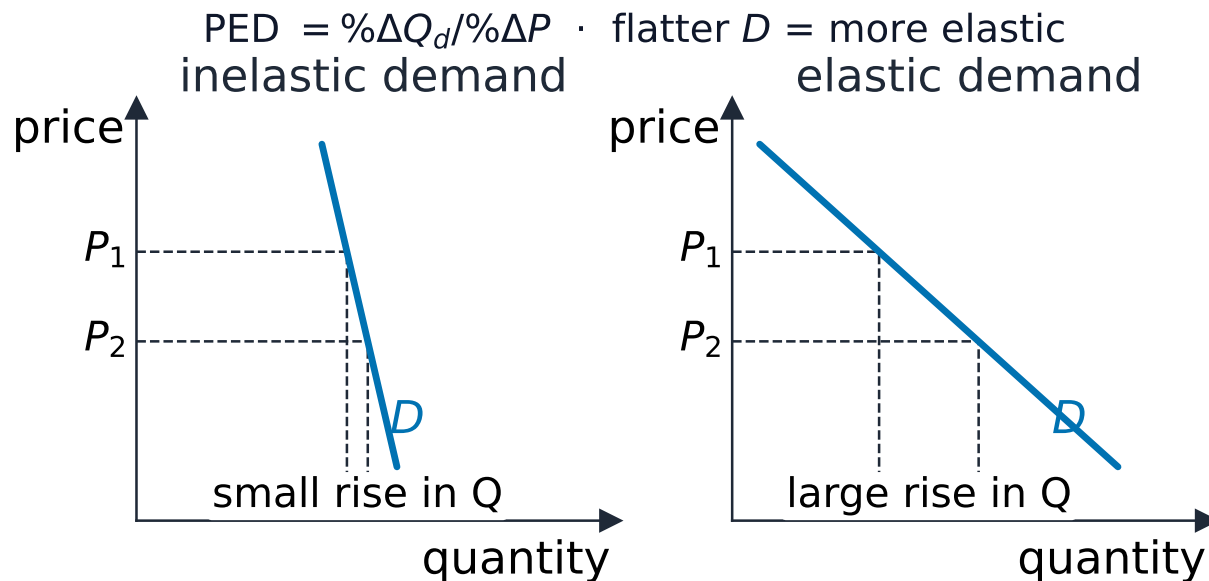
Price elasticity of demand

Price elasticity of demand
price.

measures how much quantity responds to

- **inelastic** – little response
- **elastic** – big response

Price elasticity of demand, in detail



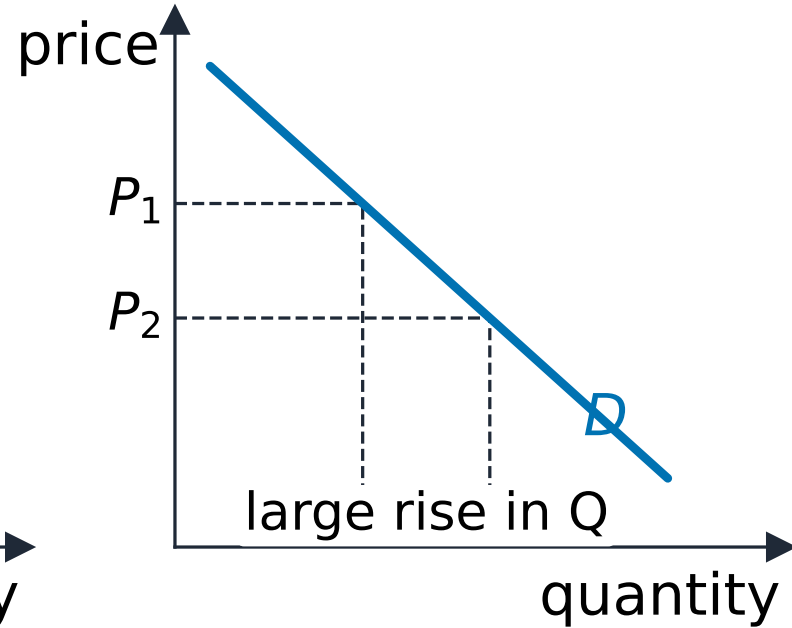
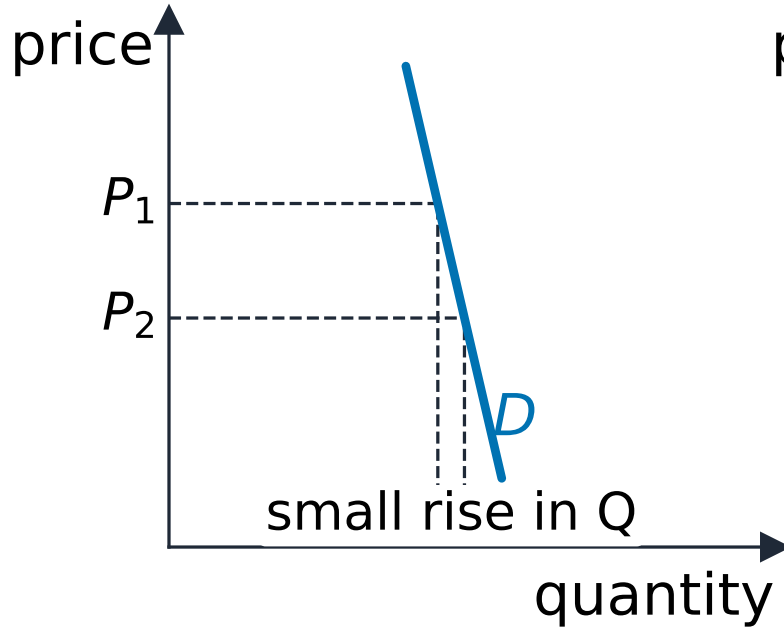
When demand is inelastic (steep) a price change barely changes quantity; when it is elastic (shallow) the same change moves quantity a lot.

Reading the elasticity value

- $PED > 1$: **elastic**
brand of crisps.
 - quantity changes by a large %. Many substitutes, like one
- $PED < 1$: **inelastic**
petrol, salt.
 - quantity barely moves. Needs with few substitutes:
- $PED = 1$: **unit elastic**
.

Reading the elasticity value, in detail

$PED = \% \Delta Q_d / \% \Delta P$ · flatter D = more elastic
inelastic demand elastic demand



Steep is inelastic; shallow is elastic

Elasticity decides what a price rise does to revenue

If demand is **inelastic**, raising the price raises revenue – customers stay. If it is **elastic**, raising the price **lowers** revenue, because enough customers leave to outweigh the higher price.

Exercises 2.1-2.3

2.1 Define the term *external cost*.

[2]

2.2 State the difference between a *merit* and a *demerit* good.

[2]

2.3 Define the term *public good*.

[2]

Exercises 2.1-2.3

2.1 Define the term *external cost*.

[2]

2.1

- an **external cost** is a cost of an activity that falls on a **third party**, not the person doing it (K)

2.2 State the difference between a *merit* and a *demerit* good.

[2]

2.2

- a **merit good** is under-consumed because people undervalue its benefit (education) (K)
- a **demerit good** is over-consumed because people underestimate its harm (cigarettes) (K)

2.3 Define the term *public good*.

[2]

2.3

- a **public good** is one everyone can use and no one can be stopped from using, so the market provides none (e.g. street lighting) (K)

Exercises 3.1·3.2

3.1 A factory that pollutes a river is an example of:

[1]

☐

A an external benefit

B an external cost

C a public good

D a merit good

3.2 Explain why a free market produces too much of a demerit good.

[4]

Exercises 3.1-3.2

3.1 A factory that pollutes a river is an example of:

[1]

☐

A an external benefit

B an external cost

C a public good

D a merit good

3.1 B

- pollution from a factory is an **external cost** (K)
- A is a benefit to others; C and D are types of good, not this spillover

3.2 Explain why a free market produces too much of a demerit good.

[4]

3.2

- buyers of a demerit good think only of their **private benefit**, not the harm (K)
- they value it too highly, so they consume **too much** (An)
- the market **over-produces** it (An)

Exercise 3.3

3.3 Analyse why public goods are not provided by a free market.

[6]

Exercise 3.3

3.3 Analyse why public goods are not provided by a free market.

[6]

3.3

- a public good is **non-excludable** and **non-rival** (K)
- people can use it without paying (**free riders**), so a firm earns no revenue (An)
- it makes no profit and supplies none → the **government** must provide public goods (An)