

2.9 Market failure

Name: _____ Class: _____ Date: _____

Total: 17 marks

KEY WORDS external cost • external benefit • private benefit
 • private cost • public goods

Objective

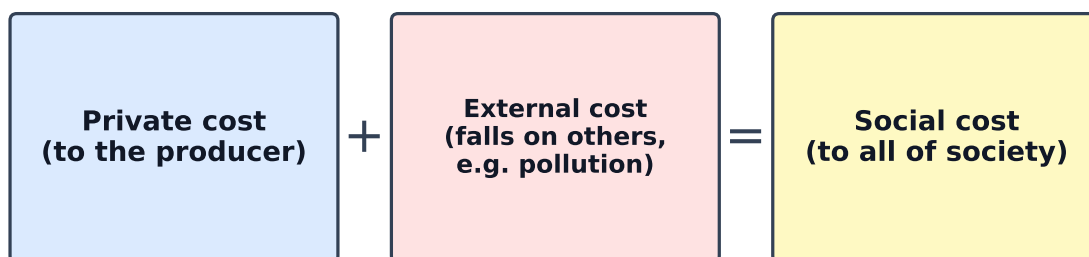
Build the skills to answer exam questions on **market failure** – **external costs and benefits**, **merit, demerit and public goods**, and the **abuse of monopoly power**.

You must be able to:

- define private, external and social costs and benefits
- distinguish merit, demerit and public goods
- analyse the causes of market failure

1 Key knowledge and worked examples

■ Why markets fail



$$MSC = MPC + \text{external cost (negative production externality)}$$

Firms ignore external costs, so the market over-produces

- **Private cost** : to the person acting. **External cost** : paid by others (pollution). **Social cost** = private + external.
- **Merit goods** (education): under-produced. **Demerit goods** (cigarettes): over-produced. **Public goods** (street lights): the market makes none.
- **Monopoly** : one firm → high prices, poor quality.

Private good

rival + excludable
firms supply it for profit
(e.g. an apple, a phone)

Public good

non-rival + non-excludable
free-rider problem, so the
government must supply
(e.g. street lighting)

Exam: public goods fail the free-rider test — non-rival and non-excludable → government supply

Public goods are a clear market failure – non-excludable, so no firm can charge for them

Answer shapes: K + App + An + Ev (a justified judgement, for discuss questions).

2 Practice

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]

3 Exam-style questions

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]

3.3 Analyse why public goods are not provided by a free market. [6]
