

2.9 Market failure

Name: _____ Class: _____ Date: _____ **Total: 17 marks**

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

Objective

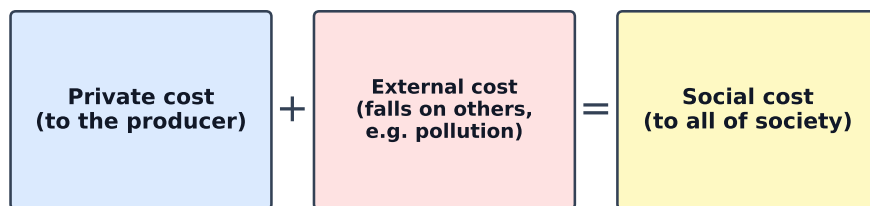
Build the skills to answer exam questions on **market failure** – external costs and benefits, merit, demerit and public goods, and the abuse of monopoly power.

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]
