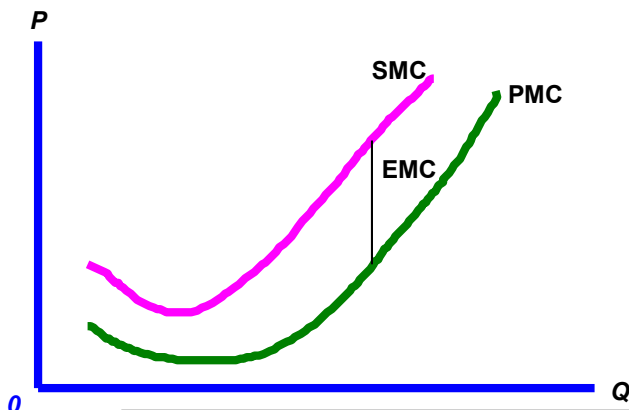


**SYLLABUS REFERENCE 1.3<sup>1</sup>: addressing market failure**  
**Resource Allocation applying the concept of welfare economics: A solution to Market Failure using**

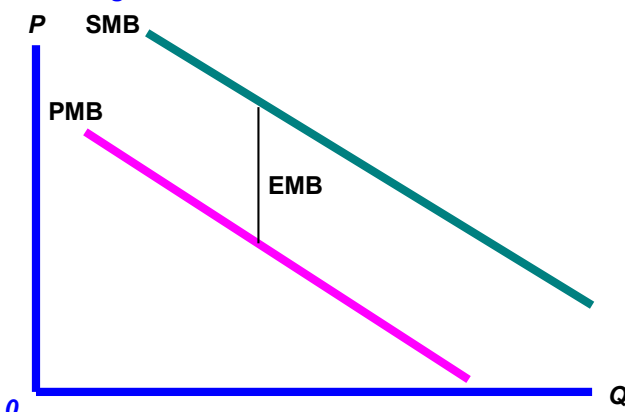
**Social Costs + Benefits**

**Social Marginal Cost**



- **Where  $smc > pmc = emc$**   
**Where e is external mc**

**Social Marginal Benefit**



- **Where  $smb > pmb = emb$**   
**where emb is external mb**

- Government may intervene to reduce consumption of the **negative externalities** and attempt through advertising to shift demand or use taxation to force the firm to internalise the cost and eventually to improve production methods
- Government may attempt to encourage consumption of **positive externalities**
- Optimal resource allocation? No winners and no losers following a reorganisation of production or distribution = Pareto efficiency criteria
- Use social cost benefit analysis whereby
  1. Social benefit = private benefit + positive externalities
  2. Social cost = private cost + negative externalities

- **Externalities = costs and benefits not included in GNP but they affect human welfare**
- **Pollution**
- **Firms training workers that become available for work elsewhere**

**Dictionary:**

- **EMC = external marginal cost**
- **EMB = external marginal benefit**
- **Demerit goods = those which consumers ought not have**

<sup>1</sup> TKB/NOTES/IB S+H/ source: grant + young