

Market Failure - **key information for answers**

- 1 non
excludable
- 2 non
rivalrous

1. Define the term "public good." (4 marks/4 minutes)

2. List any **4** types of market failure. (2 minutes/2 minutes)

- 1. Public/merit goods
- 2. monopoly
- 3. externalities
- 4. asymmetric information
- 5. (see PAJ clip on externalities)

3. Are gun incidents and flu shots both examples of externalities? Explain your answer. (5 marks / 5 minutes) (note: flu shot is an injection to prevent the outbreak of the flu virus)



Flu shots are an example of positive externality of consumption.
Gun accidents: possible to argue "yes" or "no" but guns are not a negative externality like a cigarette which causes a health risk to a 3rd party. Probably better to argue that guns are not an example of market failure!

Syllabus Ref: 1. 4
Syllabus Items: 34-41

Webnote 150

4. Draw a diagram to show how an indirect tax can be used to show how a demerit good can be regulated. Diagram must have a title and be fully labeled. Tip! Use 2 diagrams - one for the externality and the other for the market action by government. (2 marks/ 4 minutes)

Fig A: Supply and Demand to show indirect tax impact on demerit good e.g. cigarettes

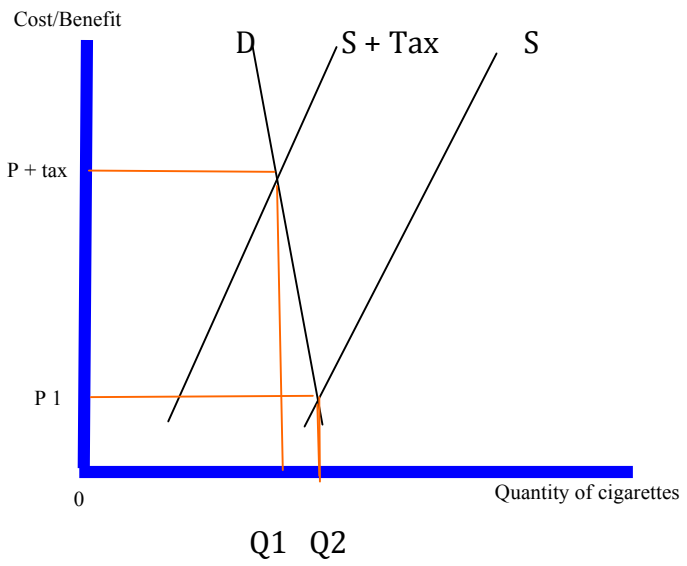
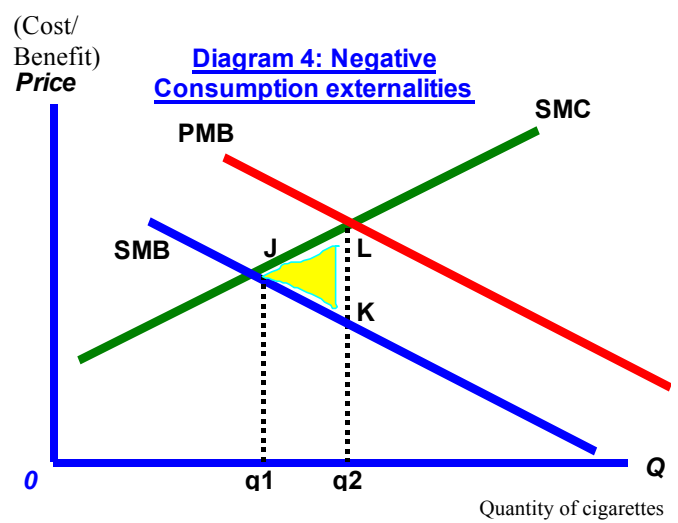


Fig B: Externalities diagram to show a demerit good (cigarettes) and overconsumption of q1-q2



Syllabus Ref: 1. 4
Syllabus Items: 34-42

Webnote 150

5. Using your knowledge of elasticity and the diagram that appears in figure B in question 4 above explain why the use of taxation might have a limited effect on consumption of cigarettes. (3 marks/ 6 minutes)

Cigarettes are inelastic and consumption can fall but not significantly as shown in Figure A in question 4

6. Is zero pollution possible? Use negative externalities theory to make your argument. (4 marks/ 8 minutes)

See Webnote 144 for a diagram to help you here!

7. Read this excerpt from Yahoo below. Can you use externality theory to decide if the ownership of guns should be regulated? Use negative externalities theory to make your argument. (4 marks/ 8 minutes)

Most people are either totally against guns or find a complete necessity for them. The Constitution of The United States of America ensures us the right to bear arms, so there should be no debate about it, right? Unfortunately the issue is not so simple. We have to take into consideration age, criminal record, and knowledge of firearms safety. If everybody with a trigger finger owned a firearm, America as we know it would cease to exist. A common everyday dispute would be resolved by a quick shootout; the loser going home in a body bag. There is a necessity for the ownership of firearms to be regulated, and laws are needed to protect those who genuinely use firearms as a last resort for self-defense.

Source: <http://voices.yahoo.com/social-issues-gun-control-2nd-ammendment-2216734.html>

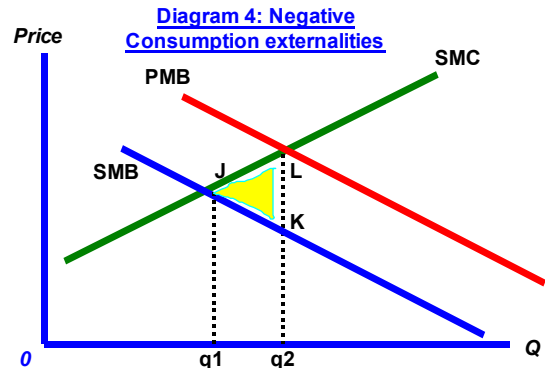
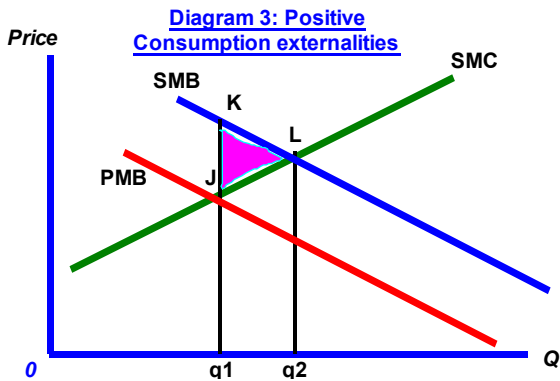
See answer to question 3. Probably better to argue that guns are not a negative externality.

Is fast food a negative externality of consumption? Is this the reason that governments 'sugar taxes' for example on soft drinks in McDonalds to help reduce obesity?

Overconsumption of common access resources may result in damage to the environment e.g. overfishing in a lake

8. What do 'common access resources' and 'sustainable development' have in common? (4 marks/8 minutes)

9. Draw a positive externality of consumption and a negative externality of consumption and list the differences between the two diagrams.



10. Draw a negative externality of production and a negative externality of consumption and list the differences between the two diagrams.

Diagram 2: Positive Production Externality

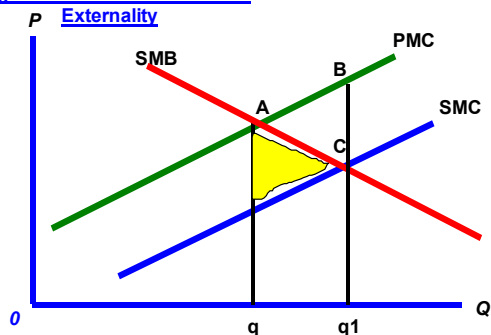
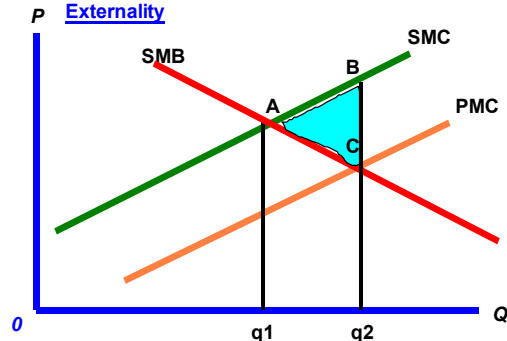


Diagram 1: Negative Production Externality



11. **Plan an answer to this question: 10 minutes**

Use a paragraph plan and put in diagrams you could use and key words. Be sure to make a plan that defines the key terms, uses the correct diagrams, provides an example and focuses exactly on answering the question (answerability)

Exam focus

MAY 2002 HL 2

2. Explain how the use of expenditure / indirect taxation might be an appropriate response to the problem of negative externalities.

P1

- Define expenditure/indirect taxation
- Define negative externalities

P2

- Show diagram (use the diagrams in question 4) to show exactly how an indirect tax will reduce quantity and therefore over consumption/production will be solved

P3

- Show how elasticity may reduce the impact of such a tax. Mention here that the indirect tax may not be fully appropriate in terms of a solution. This relates directly to the question.