3 Market failure – Part 2 — Answers

Answers

3.1 (a) supply shifts to the left (falls); (b) the price rises.

3.2 A merit good (e.g. education) or a good with a positive externality, to encourage more of it to be made and used.

3.3 A shortage — the quantity demanded is greater than the quantity supplied.

3.4 Excess supply (a surplus) — the quantity supplied is greater than the quantity demanded.

3.5 Any one: a maximum price creating a black market; a tax or subsidy set at the wrong level because of poor information; high cost of running the policy. (Any clear example.)

3.6 The tax raises firms' costs, shifting supply left and pushing the price up — so the quantity demanded falls. But cigarettes are addictive, so demand is very *inelastic*: the higher price cuts the quantity only a little, so the tax may not reduce smoking much (it mainly raises tax revenue).