IGCSE ECONOMICS • EXERCISE SHEET

2.9 Market failure

Name: ____________ Class: ________ Date: __________ **Total: 17 marks**

KEY WORDS external cost 外部成本 • external benefit 外部效益 • private benefit 私人效益 • private cost 私人成本 • public goods 公共物品

Objective

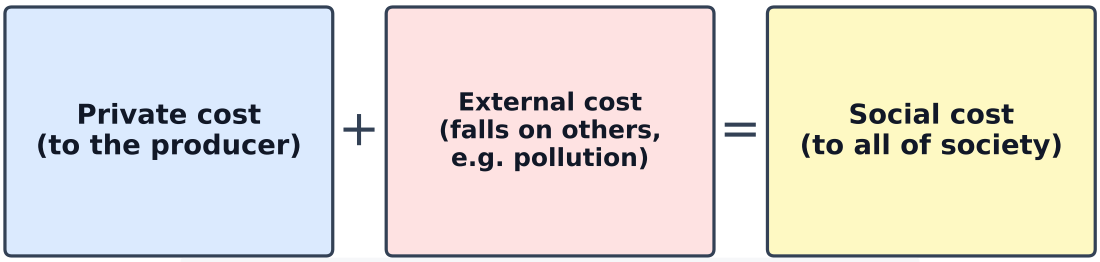
Build the skills to answer exam questions on **market failure** 市场失灵 — **external costs and benefits** 外部成本与外部效益, **merit, demerit and public goods** 有益、有害、公共物品, and the **abuse of monopoly power** 垄断势力的滥用.

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 Worked examples

■ Why markets fail



MSC = MPC + external cost (negative production externality)

Firms ignore external costs, so the market over-produces

- **Private cost** 私人成本: to the person acting. **External cost** 外部成本: paid by others (pollution). **Social cost** 社会成本 = private + external.
- **Merit goods** 有益物品 (education): under-produced. **Demerit goods** 有害物品 (cigarettes): over-produced. **Public goods** 公共物品 (street lights): the market makes none.
- **Monopoly** 垄断: 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]

Solutions

IGCSE Economics answers are marked by **level of response**: award **K** knowledge, **App** application, **An** analysis and **Ev** a justified judgement.

2.1 a cost of an activity that falls on a third party (others), not the person doing it (2 for a clear definition; 1 for a partial idea).

2.2 a merit good is under-consumed because people undervalue its benefit (education); a demerit good is over-consumed because people underestimate its harm (cigarettes) (2 for a clear difference; 1 for a partial idea).

2.3 a good that everyone can use and no one can be stopped from using, so the market provides none (e.g. street lighting) (2 for a clear definition; 1 for a partial idea).

3.1 **B**. Pollution from a factory is an external cost.

3.2 *[4]* K 1 + An up to 3 — buyers of a demerit good think only of their private benefit, not the harm to themselves or others → they value it too highly → so they consume too much → the market over-produces it.

3.3 *[6]* K/App/An — a public good is non-excludable (no one can be stopped from using it) and non-rival (one person's use does not reduce another's) → because non-payers cannot be shut out, people can use it without paying (free riders) → a firm cannot make buyers pay, so earns no revenue → it makes no profit and supplies none → the government must provide public goods instead.