Intro to Market Failure

# Starter: Recap Questions

**Instructions:** Test yourself with the below quick questions

What is meant by a market?

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What diagram explains how a market allocates resources?

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How is the welfare of those in the market shown in this diagram?

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# Presentation 1 – Intro to Market Failure

Complete the activities below so as to have a complete set of Notes:

**Definition:** *Market Failure*

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**Recap:** Classical Economics believes that the markets maximise economic welfare as the sum of producer and consumer surplus is maximised at equilibrium

*However:*For a few reasons this allocation might not be socially optimal

**Brainstorm:** *Reasons why markets might fail in practice*

**Definition:** *Merit Good*

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**Definition:** *Demerit Good*

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# Discussion Task: Importance of Market Failure

**Instructions:**

* Individually consider the key discussion question below
* Discuss both sides of the debate with your partner/group
* Debate your overall viewpoint with the class

*‘Should Economists care about Market Failure?’*

Note Space:

# Presentation 2 – Types of Market Failure

Complete the activities below so as to have a complete set of Notes:

**Matching up:** Scope of Market Failure:

*Draw lines to link the scope of market failure to the correct definition, and then to the relevant types of failure*

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| --- | --- | --- | --- | --- |
| Partial Market Failure |  | when there is no market whatsoever, a missing market |  | Externalities |
| Complete Market Failure |  | A market exists but there is a misallocation of resources |  | Public Goods |
|  |  |  |  | Imperfect Market Information |

**Definitions:**

*Externalities*

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This can result in under or over consumption/production of the good

The spill-over can occur either when the good is made, or when the good is consumed.

*Imperfect market information*

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Demand and Supply would be different in a free market compared to if the two parties had perfect information. Welfare is not maximised.

*Public Goods*

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*Free-rider problem*:In a free market, no one would pay for public goods and so they wouldn’t be provided despite adding to society’s welfare,

# Task: Test Yourself

1. Define the term misallocation of resources.

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1. Distinguish between complete and partial market failure.

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*Extension:* Explain whether a toll road is a public or private good.

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# Presentation 3 – Marginal Analysis

Complete the activities below so as to have a complete set of Notes:

**Quick Question:** Explain what is meant by ‘marginal’?

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**Definitions:** Benefits

*Marginal Private Benefit (MPB)*

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MPB falls with output due to diminishing marginal utility. Each successive unit of consumption brings less and less satisfaction than the unit prior

In a free market, consumers’ MPB is shown by the market demand curve

Consumer’s willingness to pay for each unit is determined by the utility from consuming it.

*Marginal Social Benefit (MSB)*

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It can be considered as what the demand curve should be in order to maximise society’s total welfare

*Marginal External Benefit (MEB)*

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It is the difference between MPB and MSB (MEB = MSB-MPB)

**Key Notes:** *Total Benefits*

The total benefits of a given quantity can be found from summing up all the marginal benefits of the consumed units

 *E.g.* \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Diagram:** Draw a diagram to show MPB, MEB and MSB in price-quantity space

**Definitions:** Costs

*Marginal Private Costs (MPC)*

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MPC rises with output as higher wages are needed to attract more workers, greater profits are demanded by enterprise etc.

MPC is mostly in financial terms

In a free market, producers’ MPC is shown by the market supply curve

How much suppliers are willing to sell each unit for is determined by cost if making it

*Marginal Social Costs (MSC)*

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It can be considered as what the supply curve should be in order to maximise society’s total welfare

*Marginal External Costs (MEC)*

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MEC can be considered as the non-financial burden on members of the general public occurring from production

It is the difference between MPC and MSC (MEC = MSC-MPC)

**Key Notes:** *Total Costs*

The total costs of a given quantity can be found from summing up all the marginal costs of the consumed units

 *E.g.* \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Diagram:** Draw a diagram to show MPC, MEC and MSC in price-quantity space

# Task: Marginal Benefits

**Instructions:** Complete the below questions to test your understanding of marginal benefit curves



1. What is the marginal private benefit of the 4th unit?

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1. What is the marginal social benefit of the 4th unit?

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1. What is the marginal external benefit of the 4th unit?

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1. Annotate the diagram with to show these benefits
2. Calculate the total private benefit from making 3 units

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1. Calculate the total social benefit from making 3 units

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1. Calculate the total external benefit from making 3 units

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1. **Challenge:** Highlight the areas on the diagram that show the TPB, TSB and TEB of producing 3 units

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# Task: Marginal Costs

**Instructions:** Complete the below questions to test your understanding of marginal cost curves



1. What is the marginal private cost of the 5th unit?

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1. What is the marginal social cost of the 5th unit?

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1. What is the marginal external cost of the 5th unit?

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1. Annotate the diagram with to show these costs
2. Calculate the total private cost from making 4 units

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1. Calculate the total social cost from making 4 units

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1. Calculate the total external cost from making 4 units

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1. **Challenge:** Highlight the areas on the diagram that show the TPC, TSC and TEC of producing 4 units

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# Non-Exam Essay

**Title:**

*With reference to a market of your choice, explain why the free-market allocation might not be socially optimal AND explain how the government might intervene to improve the situation.*

**Things to consider**

* What is the type of market failure in your market?
* What does the market failure look like in reality?
* Can you incorporate a diagram into your explanation?
* Would society be better off if more or less of the good was consumed compared to the free-market result?
* How would the government intervention lead to a ‘better’ quantity?
* Can you evaluate your analysis of the market failure and government intervention?

**Rules:**

* Type your essay on computer and add any diagrams by hand (don’t just copy and paste images from the internet)
* Cite your sources in a Bibliography at the end of your essay (I don’t care if you use Wikipedia, it is normally very good)
* 1000-word approximate word count (A bit either side is fine within reason)