Your notes

GCSE Economics: revision notes

Market failure

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What market failure is

- **Market failure** happens when the free market leads to a misallocation of resources: too much or too little of something is produced.

Externalities

- Negative externalities are costs to third parties, such as pollution from a factory or noise from an airport.
- Positive externalities are benefits to third parties, such as education benefiting society or vaccinations protecting others.
- The free market overproduces goods with negative externalities and underproduces those with positive externalities.

Public, merit and demerit goods

- **Public goods** are non-rival (one person using it doesn't reduce it for others) and non-excludable (people can't be stopped from using it), such as street lighting and national defence. The free market won't provide them because people can use them without paying (the **free rider problem**).
- **Merit goods**, such as education and healthcare, are underconsumed because people don't realise their full benefits.
- **Demerit goods**, such as cigarettes and alcohol, are overconsumed because people underestimate their harm.

Government intervention

- Taxes (such as the soft drinks levy on sugary drinks) and regulation (such as emissions limits) reduce harmful activities.
- Subsidies and state provision (such as free schools and the NHS) increase beneficial ones.

- Information campaigns correct information failure. But intervention can fail, for example if taxes are set at the wrong level.

Key terms

Market failure	When the free market misallocates resources.
Externality	A cost or benefit to a third party.
Negative externality	A cost to a third party, such as pollution.
Public good	A good that is non-rival and non-excludable.
Free rider problem	People using a good without paying for it.
Merit good	A good that is underconsumed, such as education.
Demerit good	A good that is overconsumed, such as cigarettes.

Quick questions

Cover the answers and test yourself: remembering is what makes it stick.

1. What is market failure?
2. What is a negative externality?
3. Which is a positive externality?
4. What is a public good?
5. What is the free rider problem?
6. Which is a merit good?
7. Which is a demerit good?
8. Which policy is used to reduce consumption of sugary drinks?

Answers

1. When the free market misallocates resources
2. A cost to a third party, such as pollution
3. Vaccinations protecting others from disease
4. A good that is non-rival and non-excludable
5. People using a good without paying for it
6. Education
7. Cigarettes
8. A tax (the soft drinks levy)

What to do next

Practise 10 questions on this topic

Try 3 exam questions, with mark schemes

Read the lesson, one step at a time

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