NAME ______________________________________ PERIOD _______

Types of M rket Fai ure

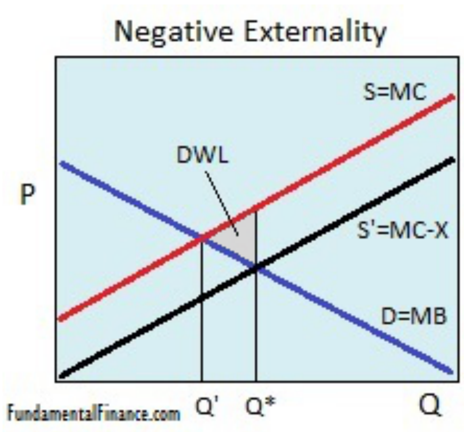
DEFINITION OF <u>M RKET FAI URE</u>: A situation in which the mark t fails to allocate resources efficiently or fairly.

	WHAT IT IS	GOV'T INTERVENTION?
NEGATI E EXTERNALI IES	Consumers and producers may fail to take into account the effects of their actions on **third parties** who are uninvolved in the transaction (example: car drivers generate traffic & pollution that affect others). **Third parties** *are:* individuals, organizations, or communities indirectly benefitting or suffering as a result of consumers and producers attempting to pursue their own self-interest.	
MONOP LY POW R	Markets may fail to control the abuses of monopoly power. When a company has a **monopoly** on a good or service, it can be a "price maker" and set a price well above equilibrium, since no competitive market actually exists.	
MISSI G MARKE S	Markets may fail to form, resulting in a failure to meet a need or desire, such as the need for **public goods** like street lighting, highways, ports, police, or defense.	
INCO PLETE MA KETS	Markets may fail to produce enough **merit goods**, such as education or health care, to meet the needs of everyone in society, at a price they can afford.	
DE-M RIT GOO S	Markets may also fail to control the manufacture and sale of **de-merit goods** or services (such as cigarettes, alcohol or gambling) that may have less merit than consumers perceive (and that may increase costs for society, overall).	
UNSTAB E MAR ETS	Sometimes markets become highly unstable, and no reliable equilibrium may be established (such as with agricultural markets, foreign currency exchange or credit).	
INEQ ALITY	Market may also fail to limit the size of the gap between income earners (the so-called **income gap**). Market transactions reward consumers and producers with incomes and profits, but these rewards may be concentrated in the hands of a few people.	
INFORM TION FAILU E	Markets may not provide enough information because, during a market transaction, it may not be in the interests of one party to provide full information to the other party.	
PRO ERTY RIG TS	Markets work most effectively when consumers and producers are granted the right to own property, but in many cases property rights cannot be easily allocated to certain resources. Failure to assign property rights may limit the ability of markets to form, or result in a **"Tragedy of the Commons."**	

Source: <u>Economics Online</u>. 2016. <<u>http://economicsonline.co.uk/Market_failures/Types_of_market_failure.html</u>>

Examples of **Negative Externalities**

"A negative externality occurs when an individual or firm making a decision **does not have to pay the full cost of the decision**. If a good has a negative externality, then *the cost to society is greater than the cost consumer is paying for it.* Since consumers make a decision based on where their marginal cost equals their marginal benefit, and *since they don't take into account the cost of the negative externality*, negative externalities result in market inefficiencies [or failures] unless proper action is taken." - economics.fundamentalfinance.com definition



A few examples:

❑ If you produce chemicals and dump them into local water supplies, the pollution may mean local fishermen have fewer fish to catch. Their loss of income is a negative externality.

❑ If people smoke in public places, it may cause higher rates of cancer due to second hand smoke.

When the consumption or production of a good causes harmful effects to a third party, it is a negative externality.

In your group, come up with 3 additional examples of a negative externality situation:

1.

2.

3.