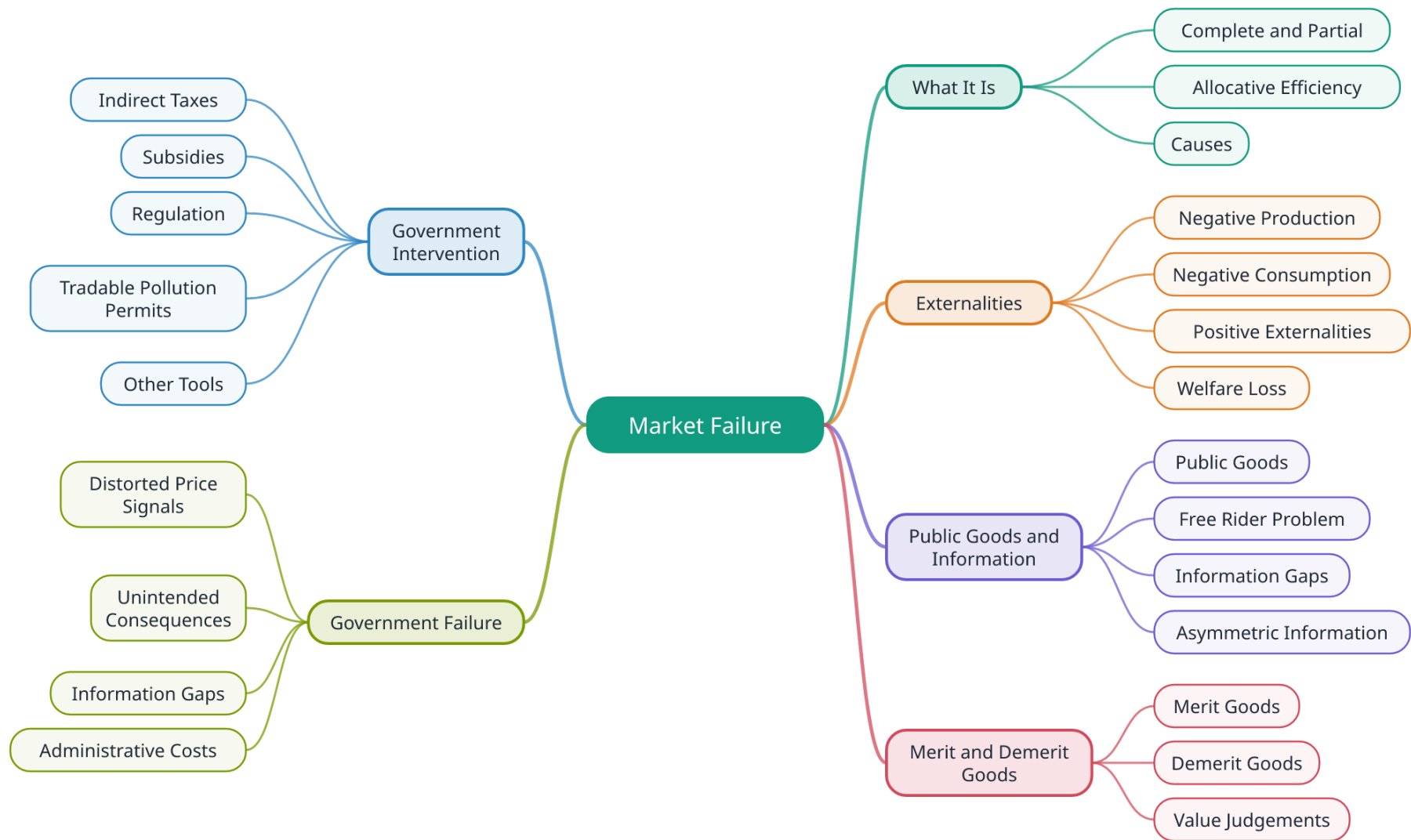


Market Failure Mind Map (A Level Economics)

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Market Failure mind map explained

What It Is

Market failure happens when the free market misallocates resources, so the outcome is not allocatively efficient.

Complete and Partial

Complete failure means a missing market, as with public goods. Partial failure means the market exists but produces the wrong quantity or price.

Allocative Efficiency

Resources go where society values them most: where marginal social benefit equals marginal social cost.

Causes

Externalities, public goods, information gaps, and, in the second year, monopoly power, immobility of factors and inequality.

Externalities

Costs or benefits to third parties, outside the market transaction.

Negative Production

For example, pollution from a factory. Marginal social cost is above marginal private cost, so the good is overproduced and priced too low.

Negative Consumption

For example, passive smoking. Marginal social benefit is below marginal private benefit, so the good is overconsumed.

Positive Externalities

For example, education or vaccination. Marginal social benefit is above marginal private benefit, so the good is underconsumed.

Welfare Loss

On the diagram, the triangle between the free market quantity and the social optimum. Shade it and label it in every externality answer.

Public Goods and Information

Two more reasons markets fail.

Public Goods

Non-rival (one person's use does not reduce another's) and non-excludable (you cannot stop people using it). Examples: street lighting, national defence.

Free Rider Problem

People can benefit without paying, so private firms will not supply public goods: a missing market.

Information Gaps

When buyers or sellers lack full information, they make choices that are not in their best interest.

Asymmetric Information

One side knows more than the other, for example a used car seller (Akerlof's market for lemons). Moral hazard is changing behaviour once insured.

Merit and Demerit Goods

Goods that are under or overconsumed, usually because of information gaps and externalities.

Merit Goods

Underconsumed if left to the market, such as education and healthcare. People underestimate their benefits.

Demerit Goods

Overconsumed, such as cigarettes and alcohol. People underestimate their costs.

Value Judgements

Deciding what counts as a merit or demerit good involves value judgements, which is a useful evaluation point.

Government Intervention

Ways of correcting market failure.

Indirect Taxes

Raise the cost of goods with negative externalities, such as the tax on cigarettes. They work best when the tax equals the external cost, which is hard to measure.

Subsidies

Lower the cost of goods with positive externalities, such as public transport.

Regulation

Laws and limits, such as bans on smoking in public places or limits on emissions.

Tradable Pollution Permits

A cap on total pollution, with permits firms can buy and sell, such as the UK Emissions Trading Scheme.

Other Tools

State provision of public goods, providing information, and price controls such as Scotland's minimum unit price for alcohol.

Government Failure

When intervention makes the allocation of resources worse, not better.

Distorted Price Signals

Taxes and subsidies set at the wrong level can cause overproduction or underproduction of their own.

Unintended Consequences

For example, high taxes can encourage smuggling or black markets.

Information Gaps

Governments rarely know the exact size of an externality, so the right tax or subsidy is hard to set.

Administrative Costs

Running and enforcing a policy can cost more than the benefit it brings.

How to revise with this mind map

1. Master the diagrams. Draw externality diagrams with marginal social and private cost or benefit, mark the free market and social optimum, and shade the welfare loss, until you can do it in a minute.
2. Use a real example for every point: a tax on sugary drinks, a congestion charge, a minimum unit price for alcohol. Examiners reward application.
3. Evaluate every policy. For each intervention, say why it might not work: information gaps, elasticity of demand, unintended consequences, or administrative cost.
4. Practise essays that end with a judgement. Weigh which policy is best in the context given, rather than listing them.
5. Make it yours. Build your own market failure map in Mindmapi from your notes, and ask the AI about anything you are unsure of. The answer is saved into that branch's notes for next time.