MICROECONOMICS UNIT 6

Market Failure & Government

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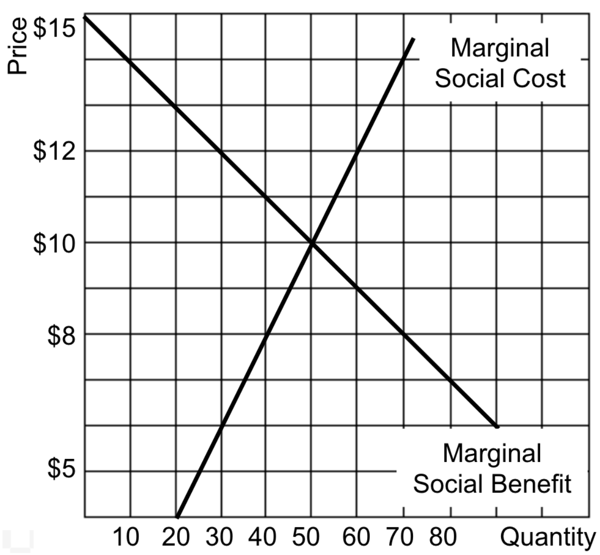
BIG PICTURE IDEAS

#1. Markets are socially optimal, with no deadweight loss, when the marginal ________ benefit equals the marginal ________ cost.
#2. A ________ externality occurs when the production or consumption of a product results in a cost to a third party.
#3. A ________ externality occurs when the production or consumption of a product results in a benefit to a third party.
#4. Due to the free rider problem, private individuals usually lack the incentive to produce ________ goods.
#5. The ________ enacts policies to address market failures and the problems that arise from externalities, public goods, monopolies, and income ________ .

Topic 6.1- Socially Efficient and Inefficient Market Outcomes



Use the graph to complete the following:

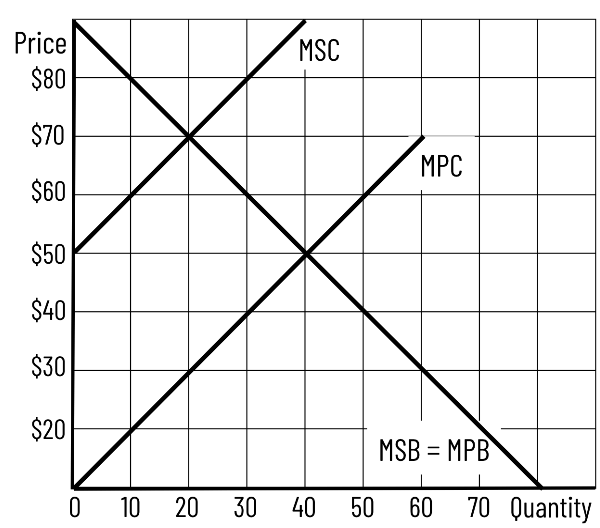
1. Identify the socially optimal price and quantity.
2. Calculate the deadweight loss at output 20. Show work.
3. Calculate the deadweight loss at output 60. Show work.
4. Calculate the deadweight loss at output 50. Show work.
5. Calculate the deadweight loss at output 70. Show work.
6. Assume a market produced 40 units. Identify a government policy that could eliminate deadweight loss.
7. Assume a market produced 70 units. Identify a government policy that could eliminate deadweight loss.

Topic 6.2- Externalities

8. Externalities occur because rational decision makers often respond to ________ benefits and costs rather than ________ benefits and costs.

Use the graph of an externality to complete the following.

9. Identify the price and quantity produced by the free market.
10. Identify the socially optimal price and quantity.
11. Is this a positive externality or a negative externality? Explain.
12. Is this a consumption externality or production externality? Explain.
13. Using numbers on the graph, identify the marginal external benefit or external cost.
14. Calculate the deadweight loss.



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Topic 6.2- Externalities (continued)

For each of the following, label the free market price and quantity P_{FM} and Q_{FM}, the socially optimal price and quantity P_{SO} and Q_{SO} and deadweight loss.

15. Positive consumption externality.

16. Positive production externality.

17. Negative consumption externality.

18. Negative production externality.

19. Explain the difference between a production externality and a consumption externality.

20. Positive externalities generate a quantity that is ________ than the socially optimal quantity.
21. Negative externalities generate a quantity that is ________ than the socially optimal quantity.
22. Identify two policies that can mitigate the effects of a positive externality.

23. Identify two policies that can mitigate the effects of a negative externality.

Topic 6.3- Public and Private Goods

24. Why are public goods considered a market failure?

25. Define nonexclusion.

26. Define non-rivalry (shared consumption).

Topic 6.4- Government Intervention

27. ________ laws are designed to prevent monopolies and make markets more competitive.
28. What is the difference between a per-unit tax and a lump-sum tax?

29. For each scenario, identify how each will change (↑, ↓, or no change).

	Variable Costs	Fixed Costs	MC	ATC	Output
Lump-sum tax					
Per-unit subsidy					
Lump-sum subsidy					
Per-unit tax					

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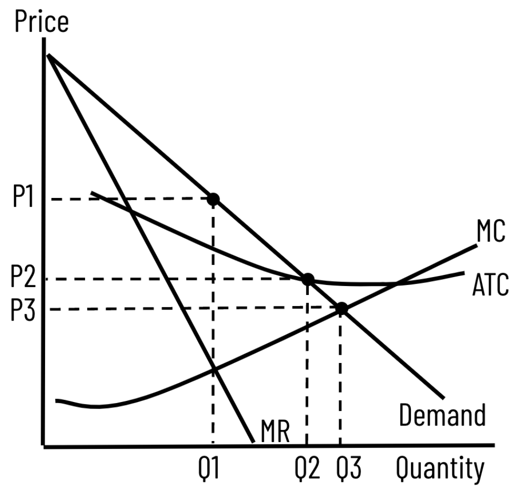
Topic 6.4- Government Intervention (continued)



Use the graph of a natural monopoly to complete the following.

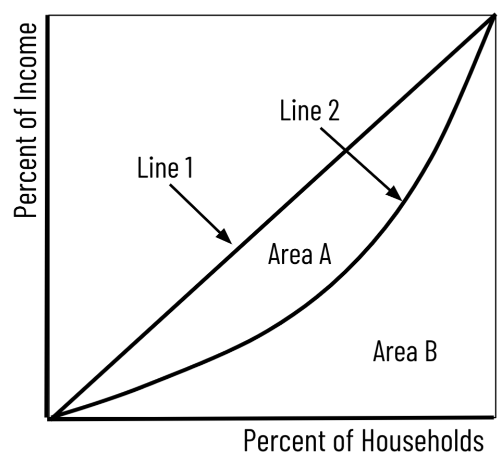
30. Identify the unregulated price and quantity.
31. Identify the fair-return price and quantity.
32. Identify the allocatively efficient price and quantity.
33. Would a lump-sum tax cause the deadweight loss to increase, decrease, or stay the same. Explain.
34. If the government sets a price ceiling at the socially optimal price will the monopoly need a per-unit tax, a lump-sum tax, a per-unit subsidy, or a lump-sum subsidy? Explain.

Topic 6.5- Inequality

35. What is the difference between income inequality and wealth inequality?
36. Identify three sources of income inequality.
37. What are progressive taxes?
38. What are proportional taxes?
39. What are regressive taxes?

Use the Lorenz Curve to the right to complete the following.

40. What does Line 1 represent?
41. What does Line 2 represent?
42. Define Gini Coefficient.
43. Would the Gini Coefficient increase, decrease or stay the same if the government made income taxes more progressive and increased payments to those in poverty?
44. How would an increase in job training for low-skilled workers affect income inequality and the Gini coefficient?



Thank you!

Wow, you did it! You reviewed everything in microeconomics. Now it's time to practice. Be sure to check out my practice sheets, free response questions, and practice exams. Thank you for watching my videos and getting my Ultimate Review Packet. You rock! -Jacob Clifford