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Junior College 2

The Ultimate Exam Revision Notes

H2 Economics

- Market Failure
- Diagram Summary Sheet
- Factors of Globalisation

Use these notes to assess your comprehension of JC H2 Economics, identify weak spots, and evaluate if additional support could benefit you.

Start now and take the first step toward mastering JC Economics with insight and confidence.

Market Failure

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Market fails when free market, operating without any government intervention, fails to deliver a socially efficient allocation of resources for goods and services. As a result, society's welfare is not maximised.

Public Goods

Traits:

- Non-rivalrous
- Non-excludable
- Example: Street lighting

Policies:

- Direct provision with full subsidy

Externalities

Positive

Explanation:

- In a free market, producers and consumers only weigh private costs (MPC) and benefits (MPB) and do not consider benefits enjoyed by third parties (MEB)
- MEB causes divergence between MPB and MSB
- Market currently consumes at MPC=MPB, but socially optimal is where MSB=MPC/MSC
- Hence there is underconsumption = deadweight loss = market failure

Policies:

Subsidies, Moral suasion/Education, Direct Provision

Negative

Explanation:

- In a free market, producers and consumers only weigh private costs (MPC) and benefits (MPB) and do not consider cost imposed on third parties (MEC)
- MEC causes divergence between MPC and MSC
- Market currently consumes at MPC=MPB, but socially optimal is where MSC=MPB/MSB
- Hence there is overconsumption = deadweight loss = market failure

Policies:

Taxes, Moral suasion/ education, Quota, Ban

Information Failure

Asymmertic Information

Moral Hazard:

One party has more information than the other. Once transaction is made, the more informed party changes his behaviour to benefit himself as the cost is borne by the other party

Policies:

- Law & Regulation
- Moral suasion/ education

Adverse Selection

When products of different qualities are sold at a single price because buyers/sellers are not sufficiently informed to determine the true quality at time of purchase

Policies:

- Universal coverage/full provision
- Laws & Regulation
- Screening & Signalling

Imperfect Information

Causes:

- Incorrect information
- Ignorance

Types of market where it may occur:

- Market for merit goods
- Market for demerit goods

Policies:

- Law & Regulation
- Moral suasion/ education

Diagram Summary Sheet

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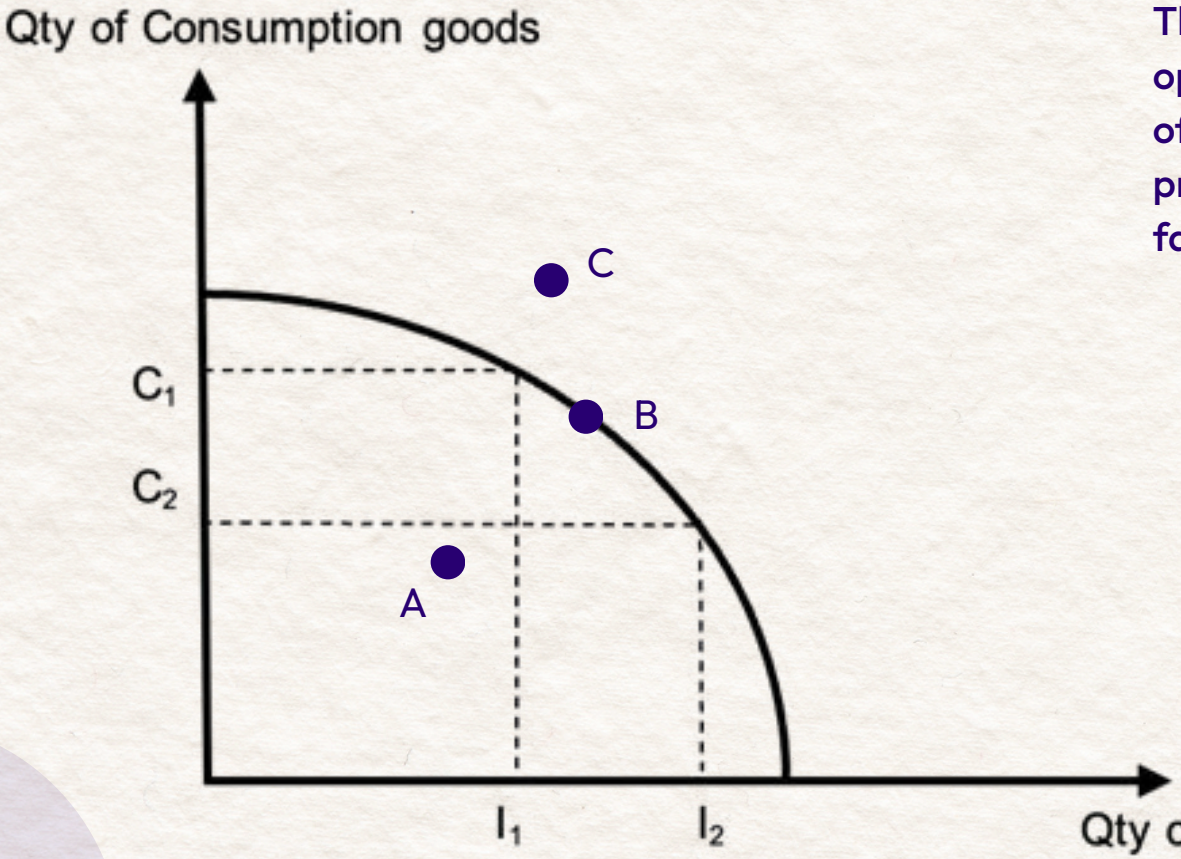
Production Possibility Curve

The PPC shows all the different combinations of goods and services that can be produced in an economy, given the level of resources available.



The downward sloping curve will reflect the opportunity costs, where given the amount of resources available, an increase in the production of consumer goods will cause a fall in the production of capital goods.

A At A, resources are not fully employed.

B At B, allocative efficiency occurs and societal welfare is maximised.

C At C, there is scarcity as the combination of goods cannot be produced.

Diagram Summary Sheet

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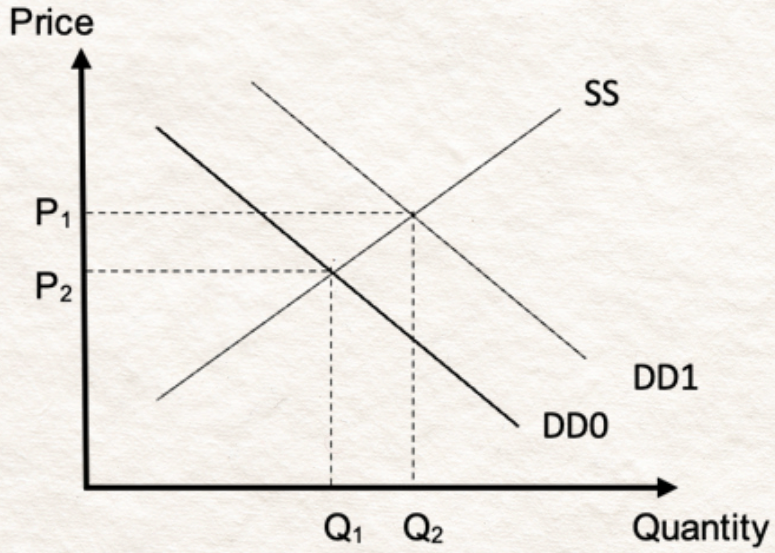
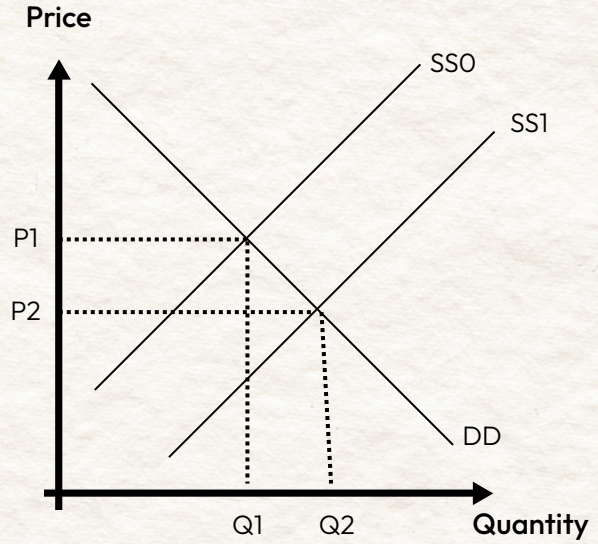
Demand and Supply

Increase in Demand



Demand curve shifts right from DD0 to DD1. P increases from P0 to P1 and Q increases from Q0 to Q1.

Increase in Supply



Supply curve shifts right from SS0 to SS1. P decreases from P1 to P2 and Q increases from Q0 to Q1.

Diagram Summary Sheet

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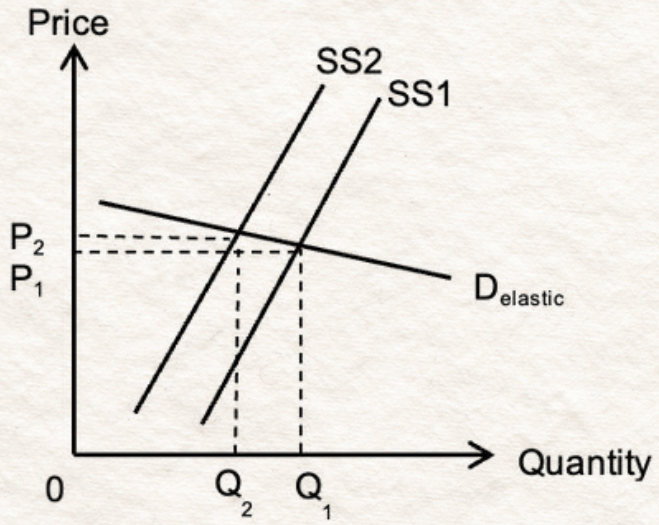
PED Analysis

(Fall in Supply)

Vice versa for PES!
(Shift in Supply)

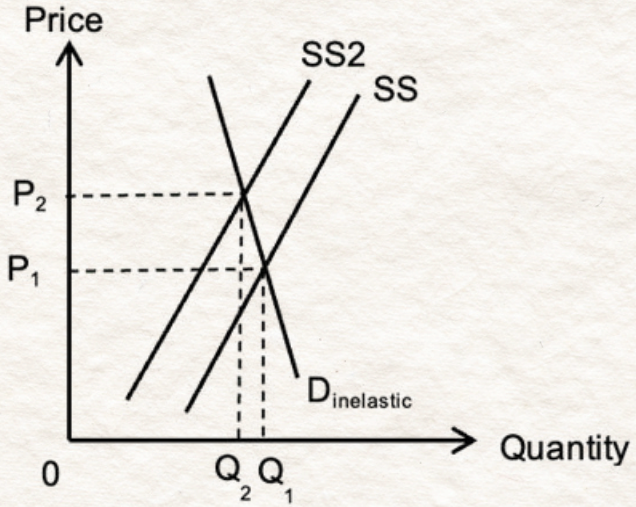
At market equilibrium, price is P0 and quantity is Q0. The consumer expenditure / producer revenue is given by P0 x Q0

Elastic Demand



When demand is price elastic, price increases to P2 which leads to a more than proportionate decrease in quantity demanded to Q2. The consumer expenditure / producer revenue decreases to P2 x Q2

Inelastic Demand



When demand is price inelastic, price increases to P2 which leads to a less than proportionate decrease in quantity demanded to Qi. The consumer expenditure / producer revenue increases to P2 x Q2

Diagram Summary Sheet

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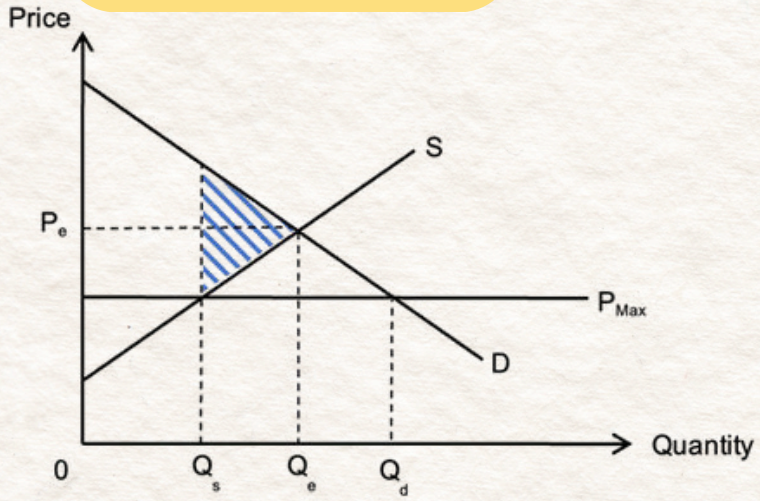
Price Control

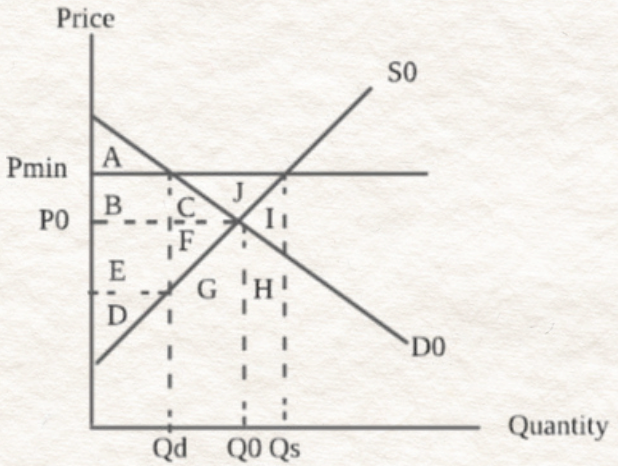
Maximum Price



At market equilibrium, price is P0 and quantity is Q0. When price ceiling Pe is imposed:

- At Pc, producers are willing and able to produce at Qs, while consumers are willing and able to consume at Qd.
- Since Qd < Qs, there is a shortage.
- Policies such as US Rent Control are price ceilings which cause deadweight loss (blue)

Minimum Price



At market equilibrium, price is P0 and quantity is Q0. When price ceiling Pmin is imposed:

- At Pmin, producers are willing and able to produce at Qs, while consumers are willing and able to produce at Qd.
- Since Qs > Qd, there is a surplus.
- Policies such as Minimum Wages are price floors which can cause deadweight loss (area CF)

Diagram Summary Sheet

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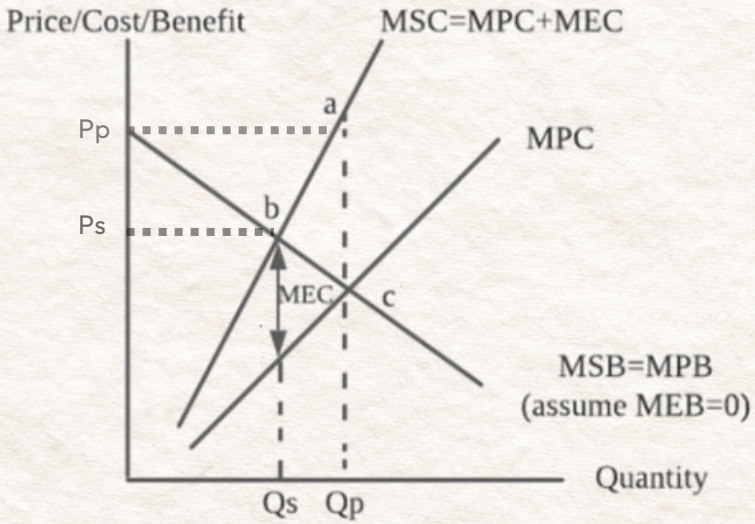
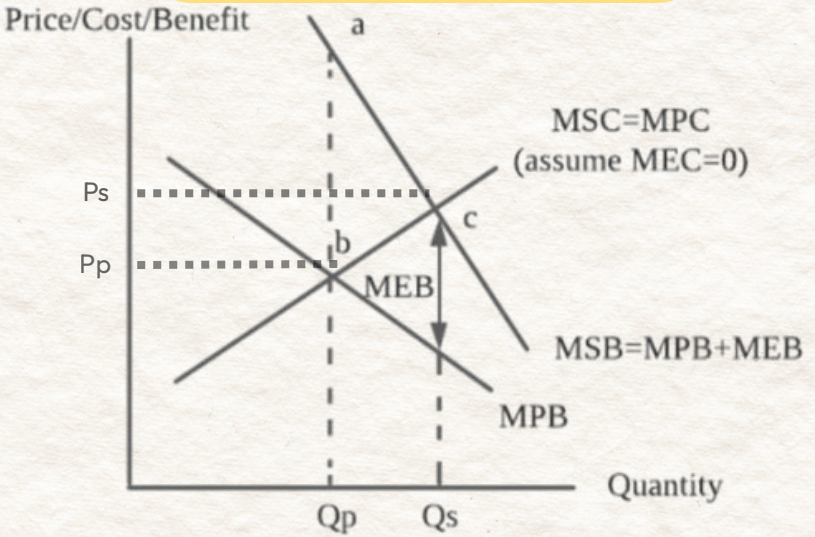
Market Failure

Negative Externality



- MSC = MPC + MEC
- The free market equilibrium is given where demand is equal to supply and were quantity demanded is Qp while price is Pp
- However, the socially optimal level of output is given by MSB = MSC where quantity demanded is Qs while price is Ps
- Since Qs < Qp, there is an overconsumption/production of the good and market failure occurs with deadweight loss (area ABC)

Positive Externality



- MSB = MPB + MEB
- The free market equilibrium is given where demand is equal to supply and where quantity demanded is Qp while price is Pp
- However, the socially optimal level of output is given by MSB = MSC, where quantity demanded is Qs while price is Ps
- Since Qs > Qp, there is an underconsumption/production of the good and market failure occurs with deadweight loss (area ABC)

Diagram Summary Sheet

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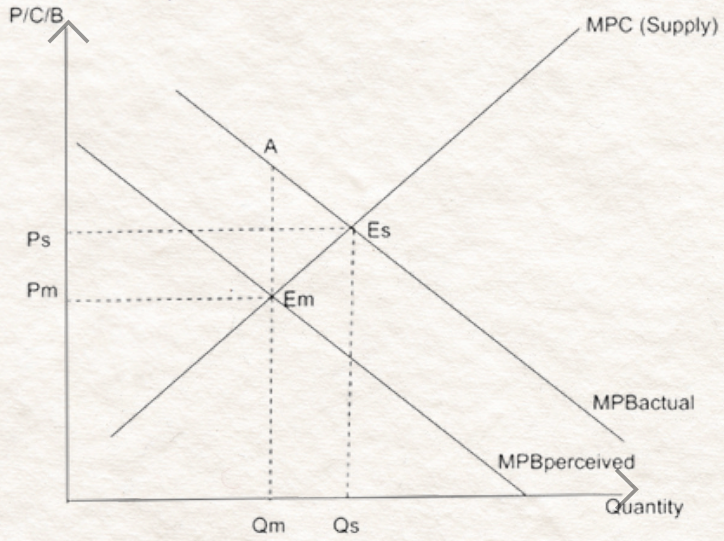
Imperfect Information

Merit Goods

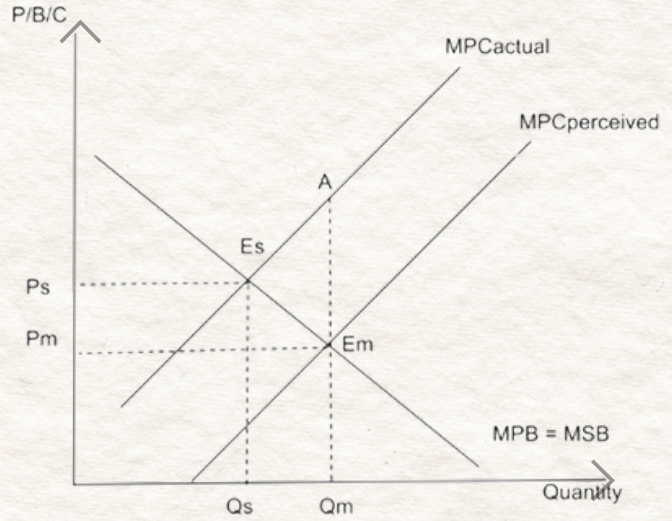
E.g. education and healthcare



- MPBperceived is lower than MPBactual due to underestimation of the benefits.
- Consumption occurs at Qm based on MPBperceived instead of basing on MPBactual at Qs.
- Since Qs > Qm, there is an underconsumption of the good and market failure occurs.

Demerit Goods

E.g. smoking and gambling

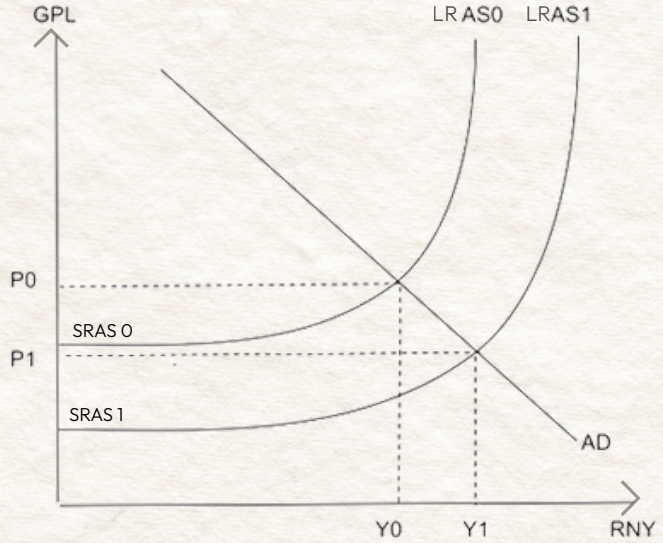


- MPCperceived is lower than MPCactual due to the underestimation of the costs.
- Consumption occurs at Qm based on MPCperceived instead of basing on MPCactual at Qs.
- Since Qs < Qm, there is an overconsumption of the good and market failure occurs.

Diagram Summary Sheet

Macroeconomics

Shift in AS



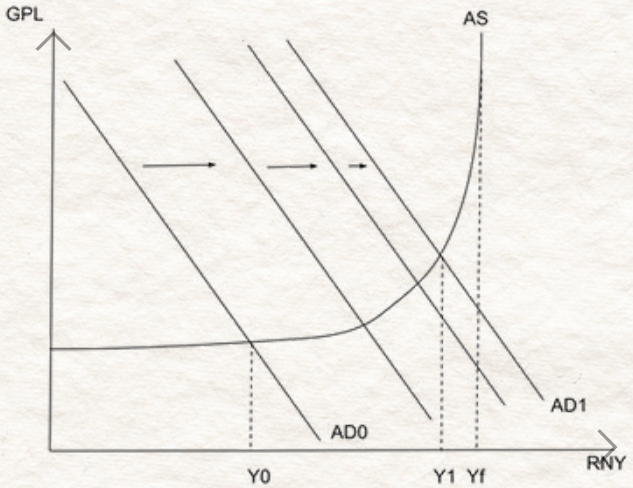
Increase in LRAS (LRAS0 → LRAS1):

- More training programmes that increase productivity, hence productive capacity

Rise in SRAS (SRAS0 → SRAS1):

- Decrease in the price of factors of production such as oil

Shift in AD



Rise in AD:

- Increase in government expenditure such as increased spending on public works

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