



AS Micro

Externalities and Market Failure

What is market failure?

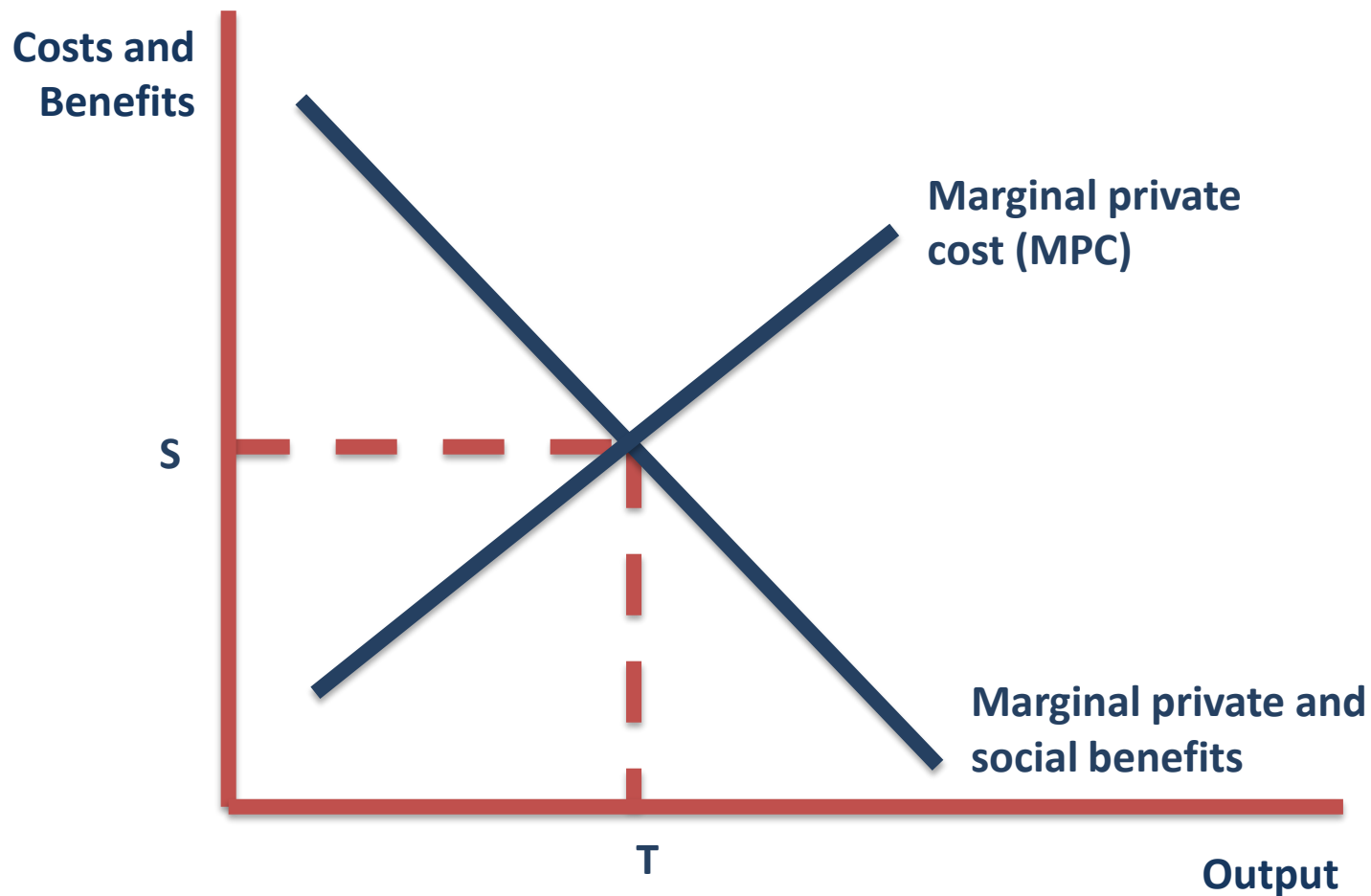
- Market failure - where resources are inefficiently allocated due to imperfections in the working of the market mechanism i.e.
 - Externalities
 - Merit goods / demerit goods
 - Information failures
 - Public goods
 - Monopolies
 - Factor immobility
 - Inequalities in the distribution of income and wealth.
- When there is a clear economic case for government intervention in markets where some form of market failure is taking place

Externalities

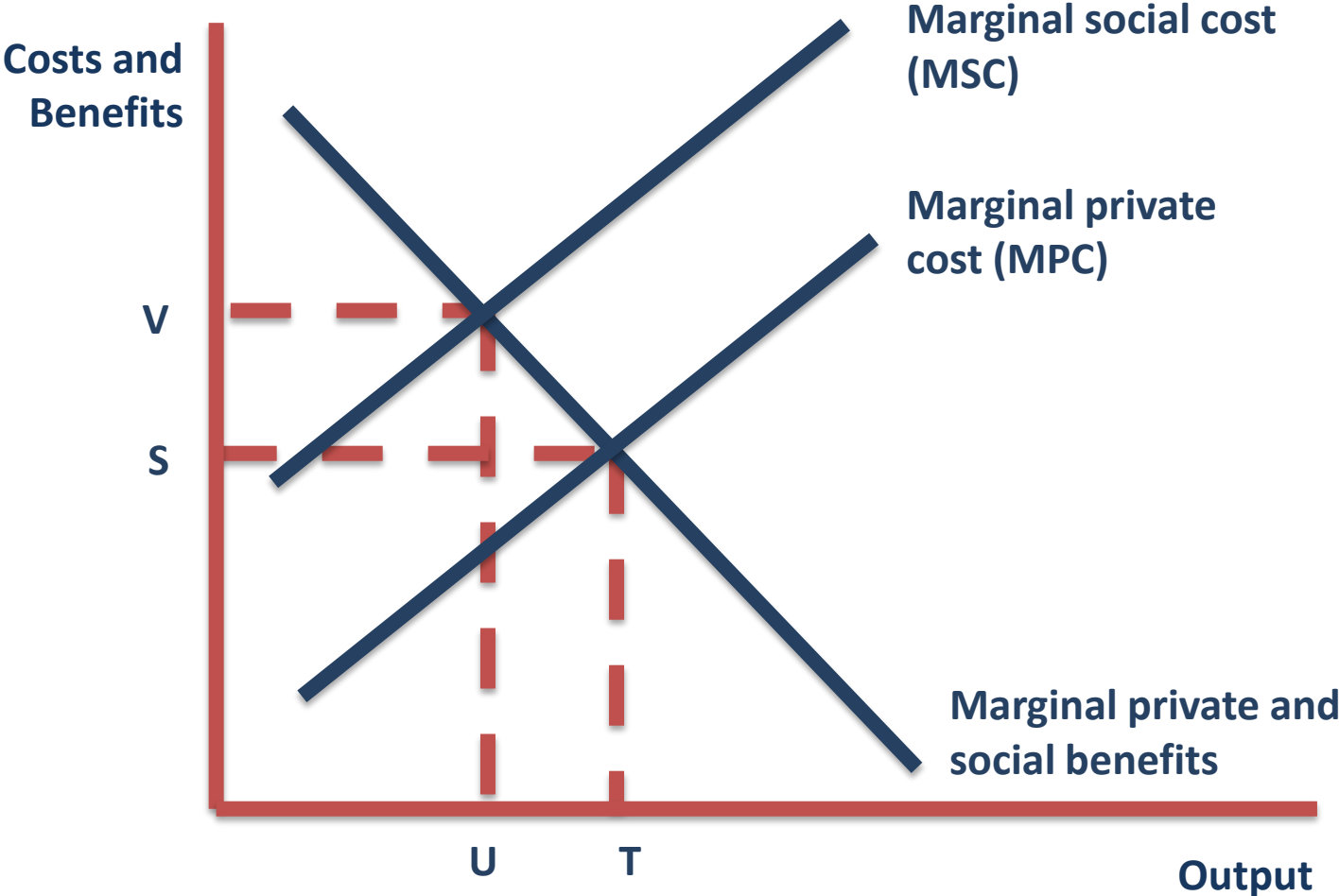
- Externalities are third party (spill-over) effects arising from production and consumption of goods and services for which no appropriate compensation is paid
- Externalities cause market failure if the price mechanism does not take account of the social costs and benefits of production and consumption
- Externalities can be positive or negative



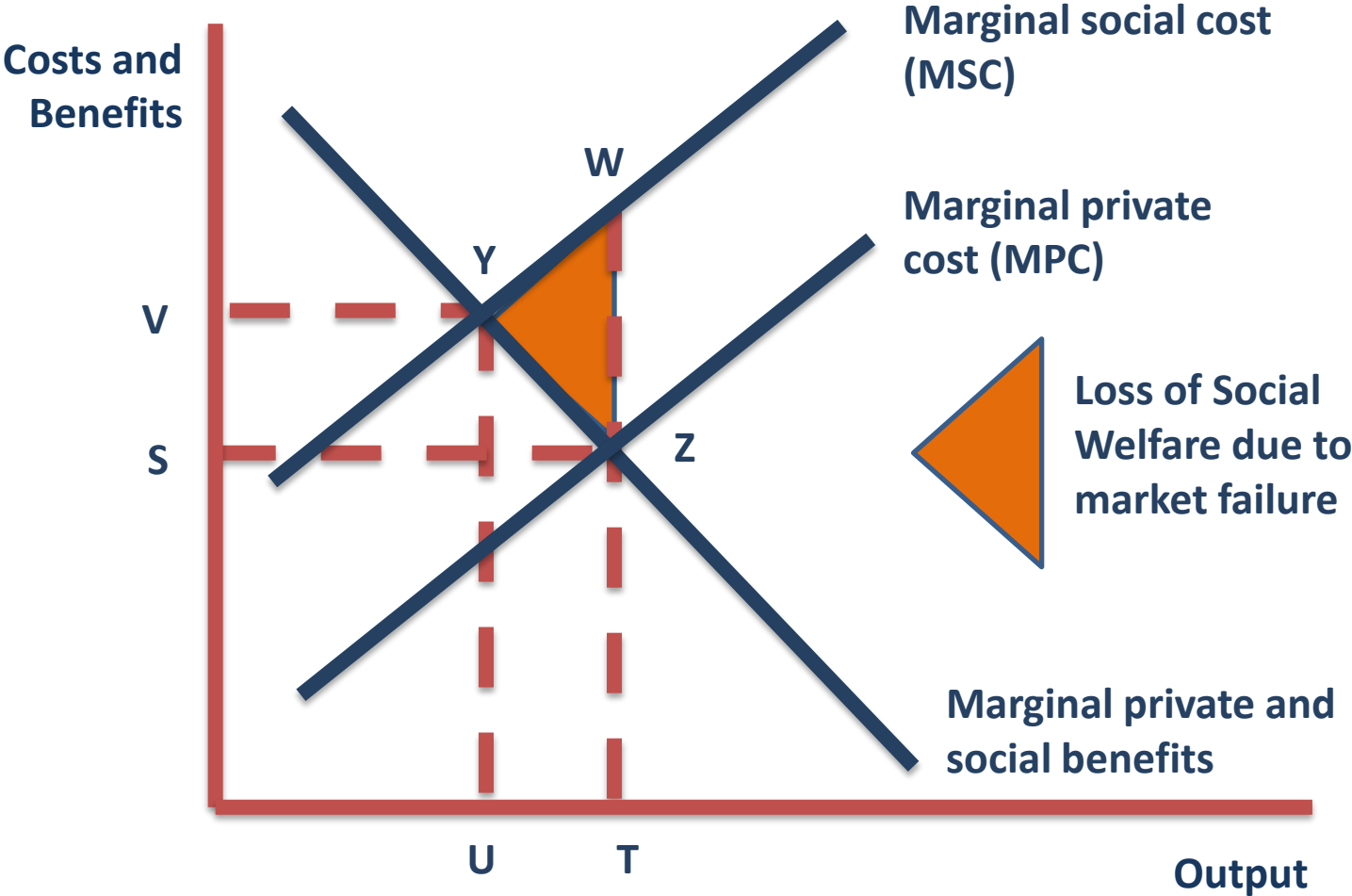
Negative production externalities and negative consumption activities



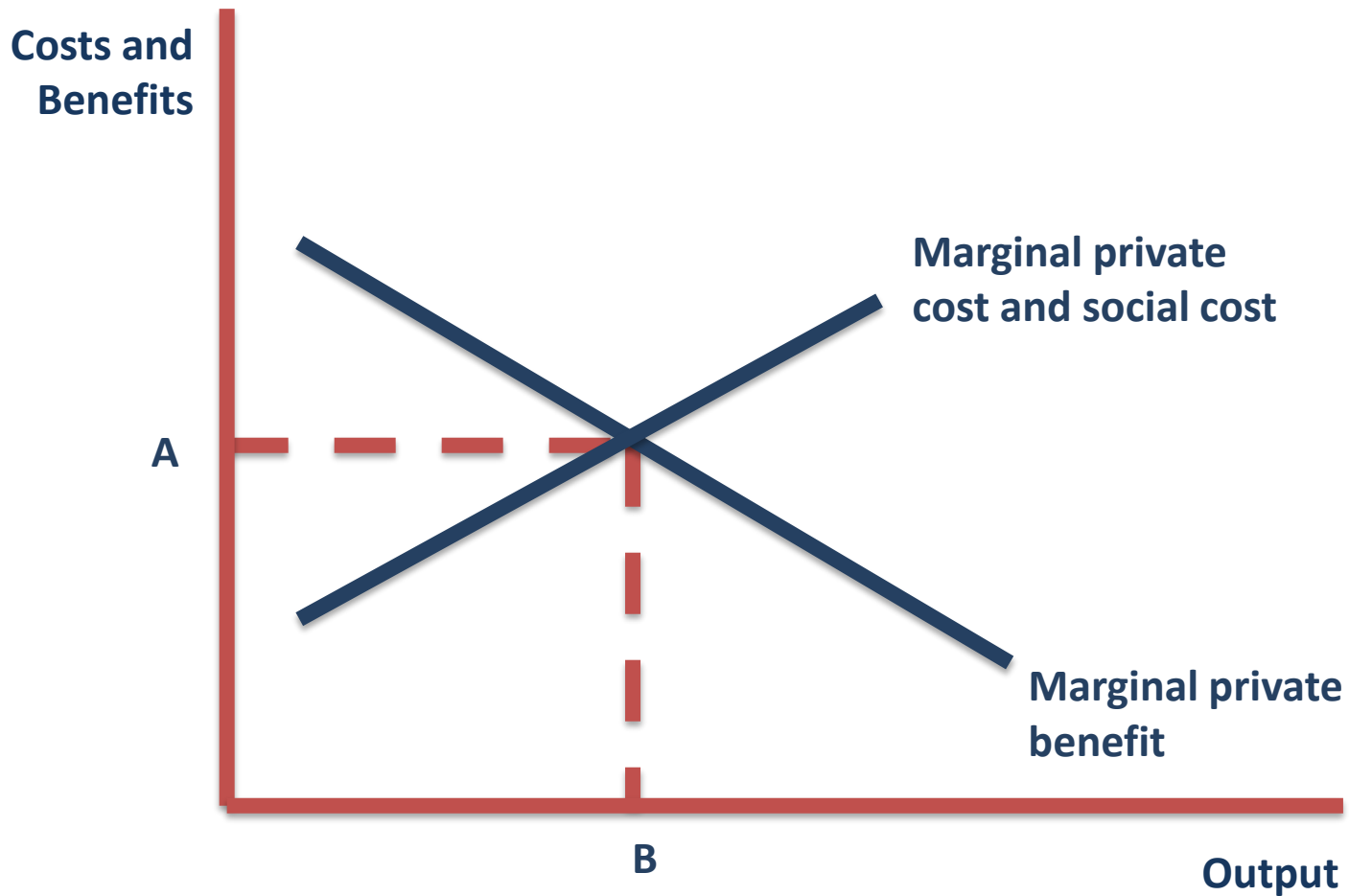
Negative production externalities and negative consumption activities



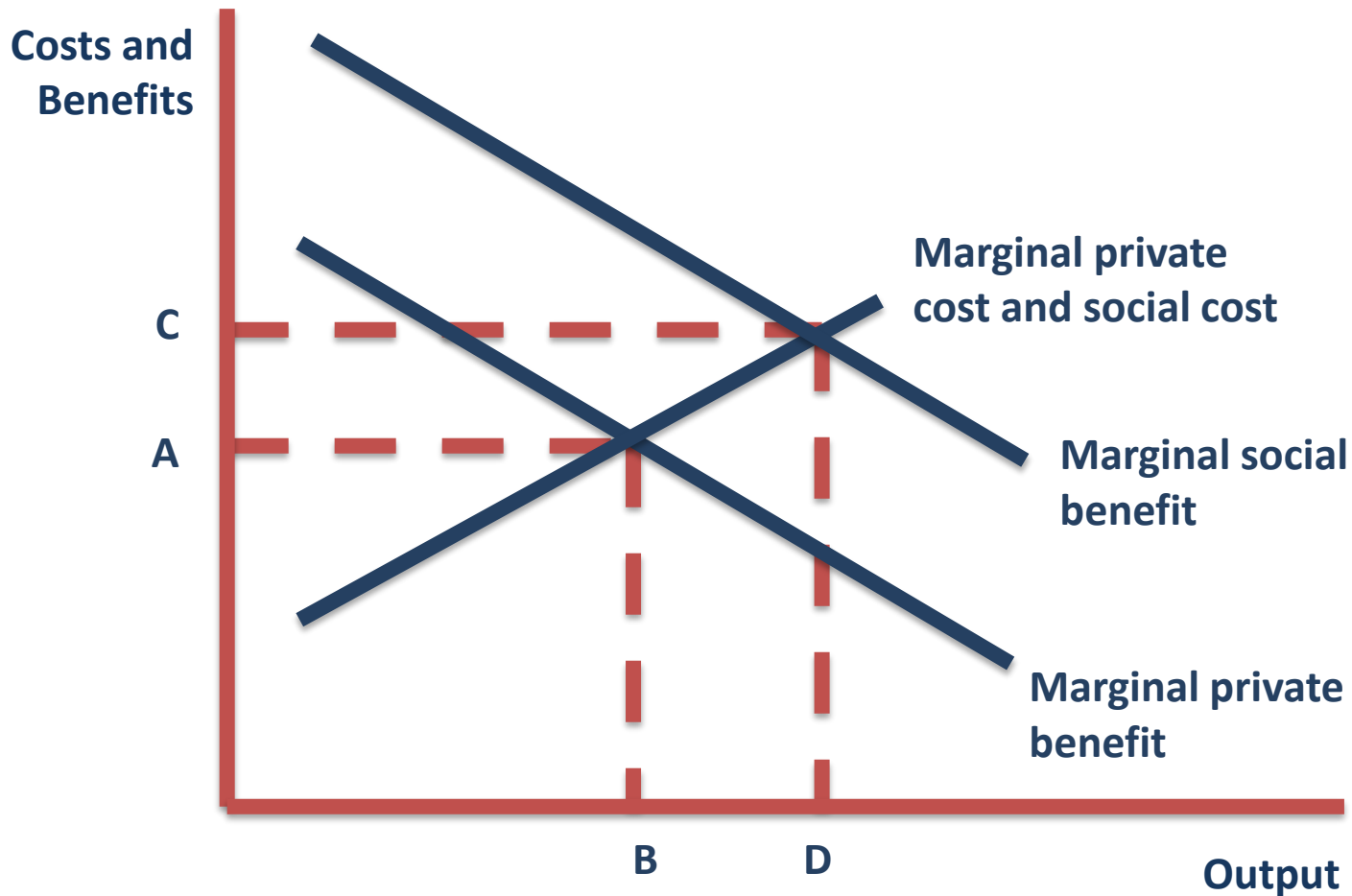
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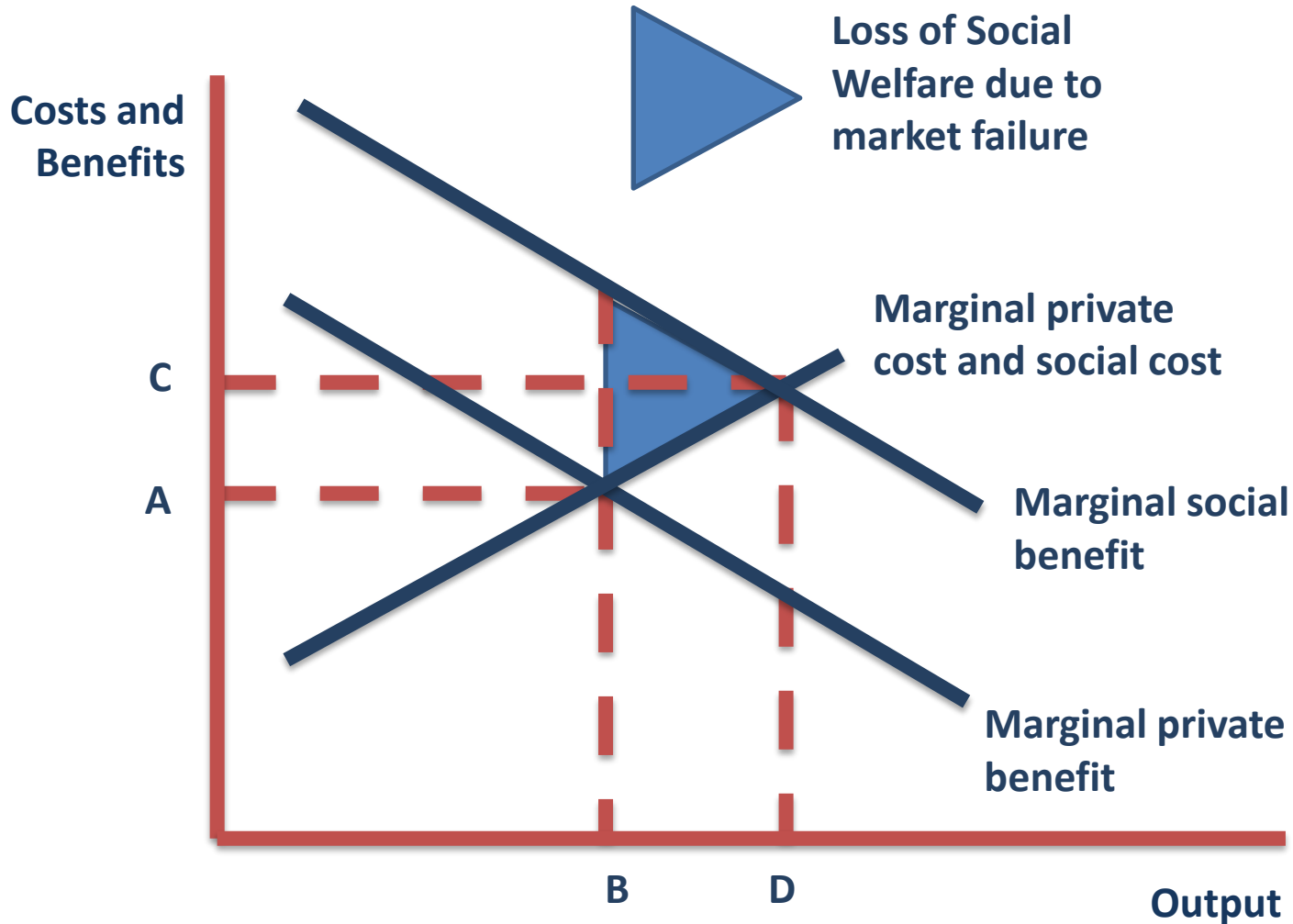
Positive consumption externalities



Positive consumption externalities



Positive consumption externalities



Renewable Energy & Solar Subsidies



Using cross-elasticity of demand, assess the likely relationship between the demand for solar panels and the price of household electricity from non-renewable sources





Rising electricity prices



Incentives to switch to renewable energy

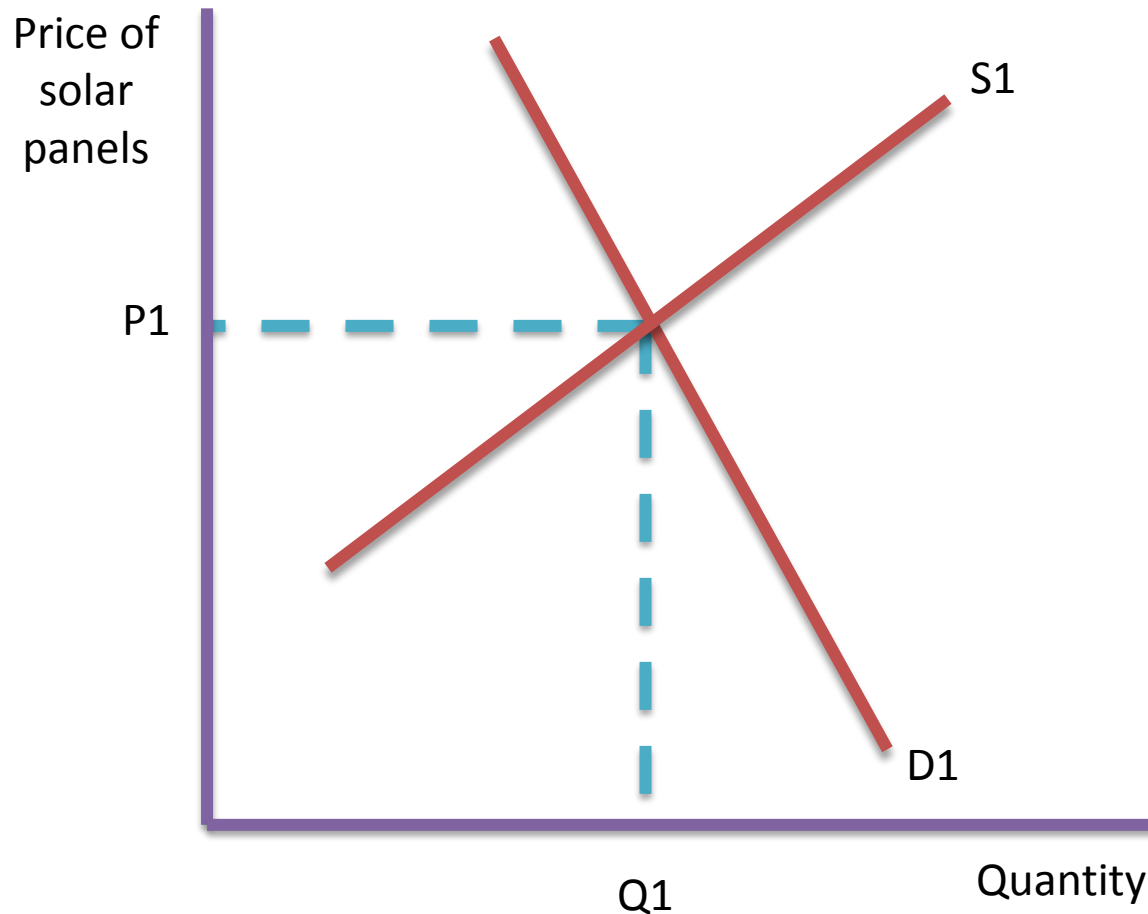


There is a cost to switching

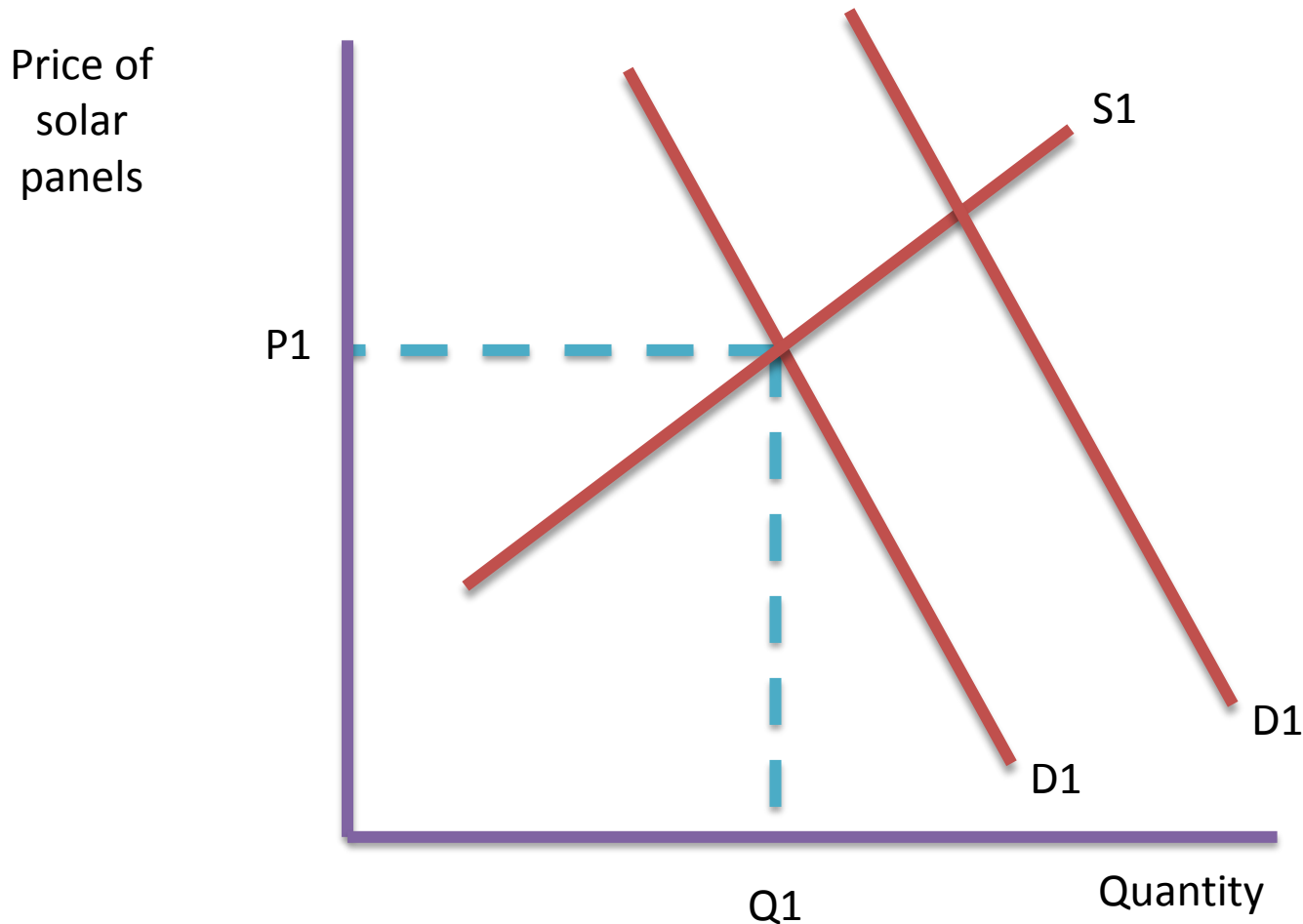


Rising market demand for solar panels

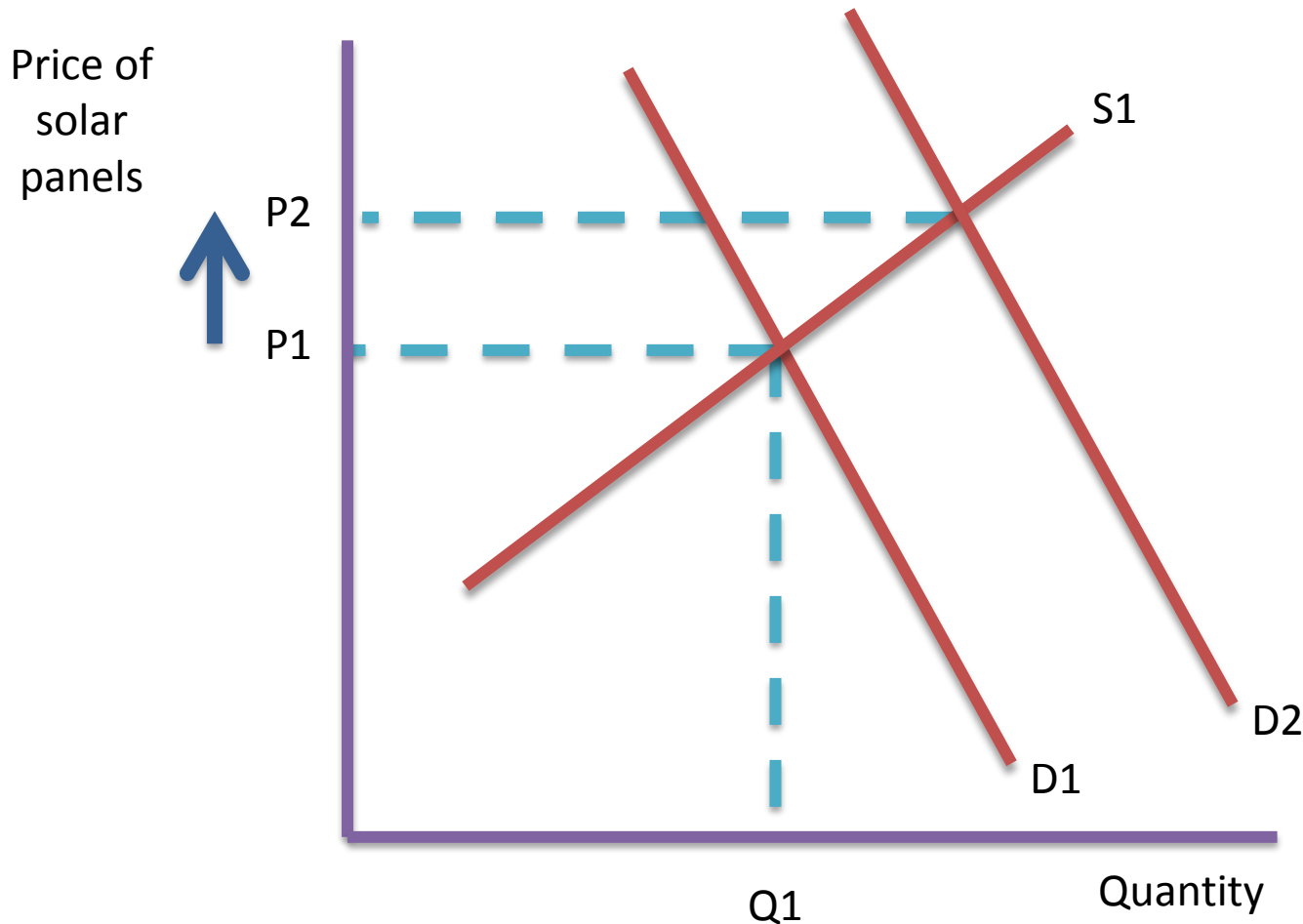
Despite a strong rise in demand, the market price of solar panels has fallen in recent years. With the help of a supply and demand diagram, explain why this can have happened



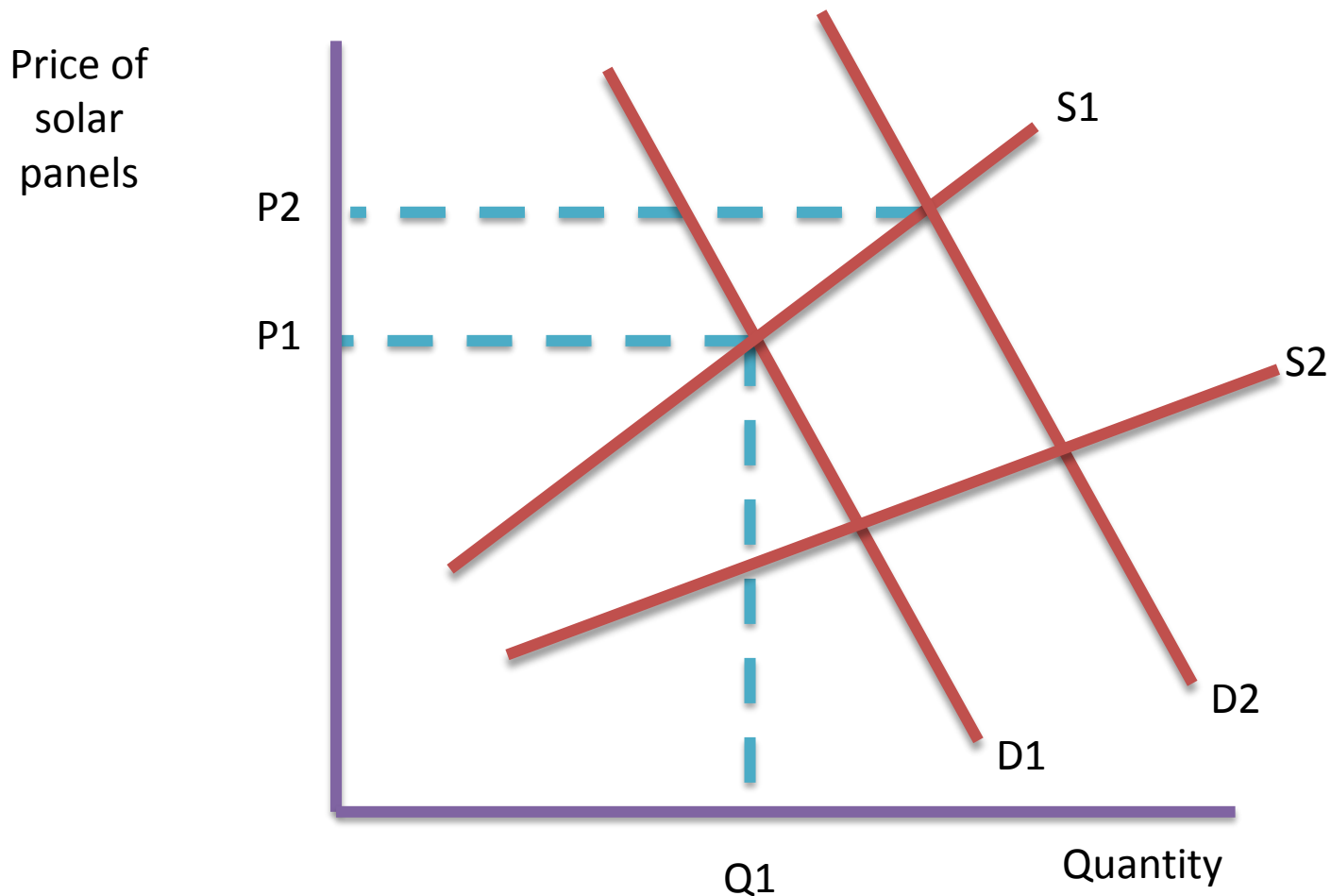
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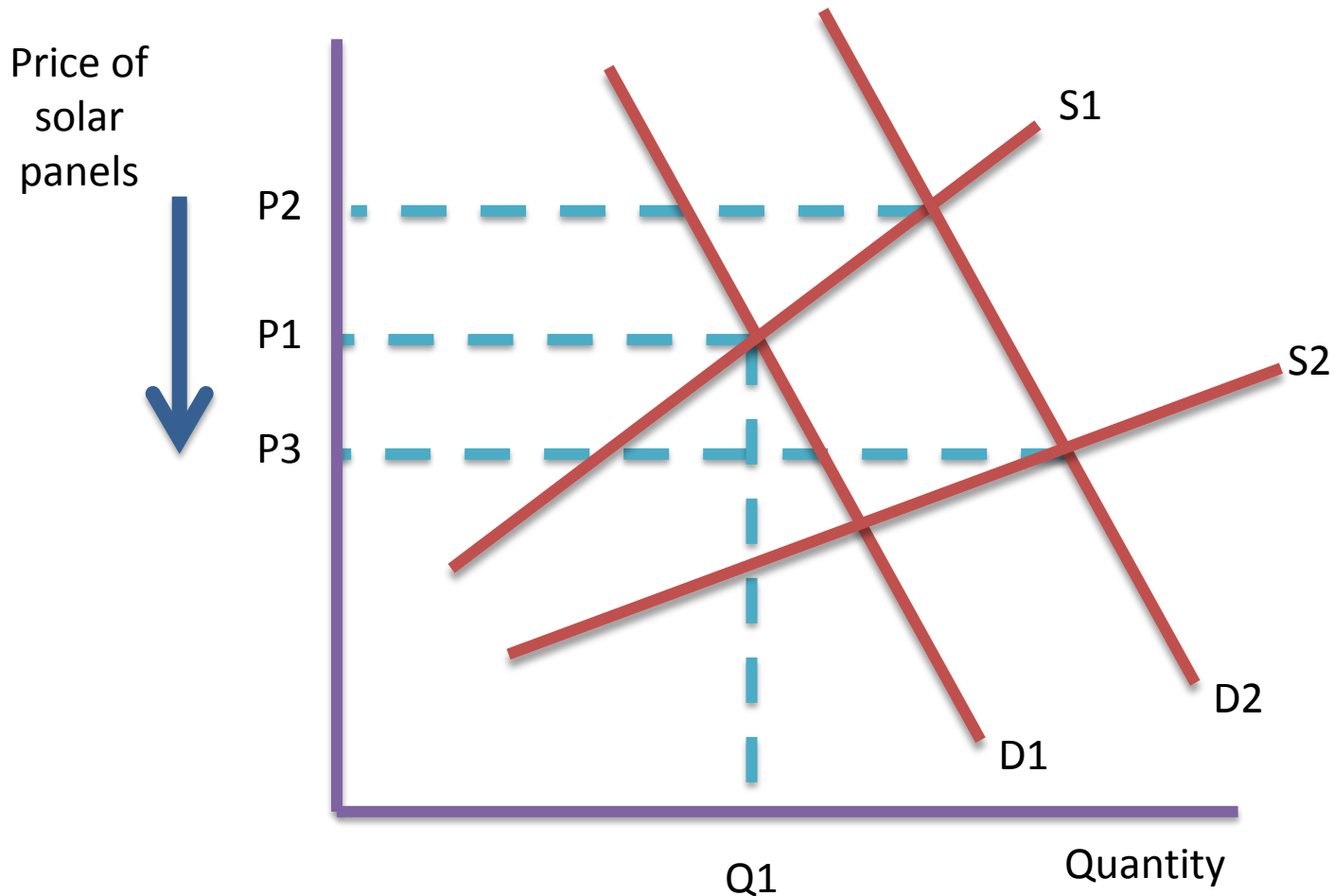
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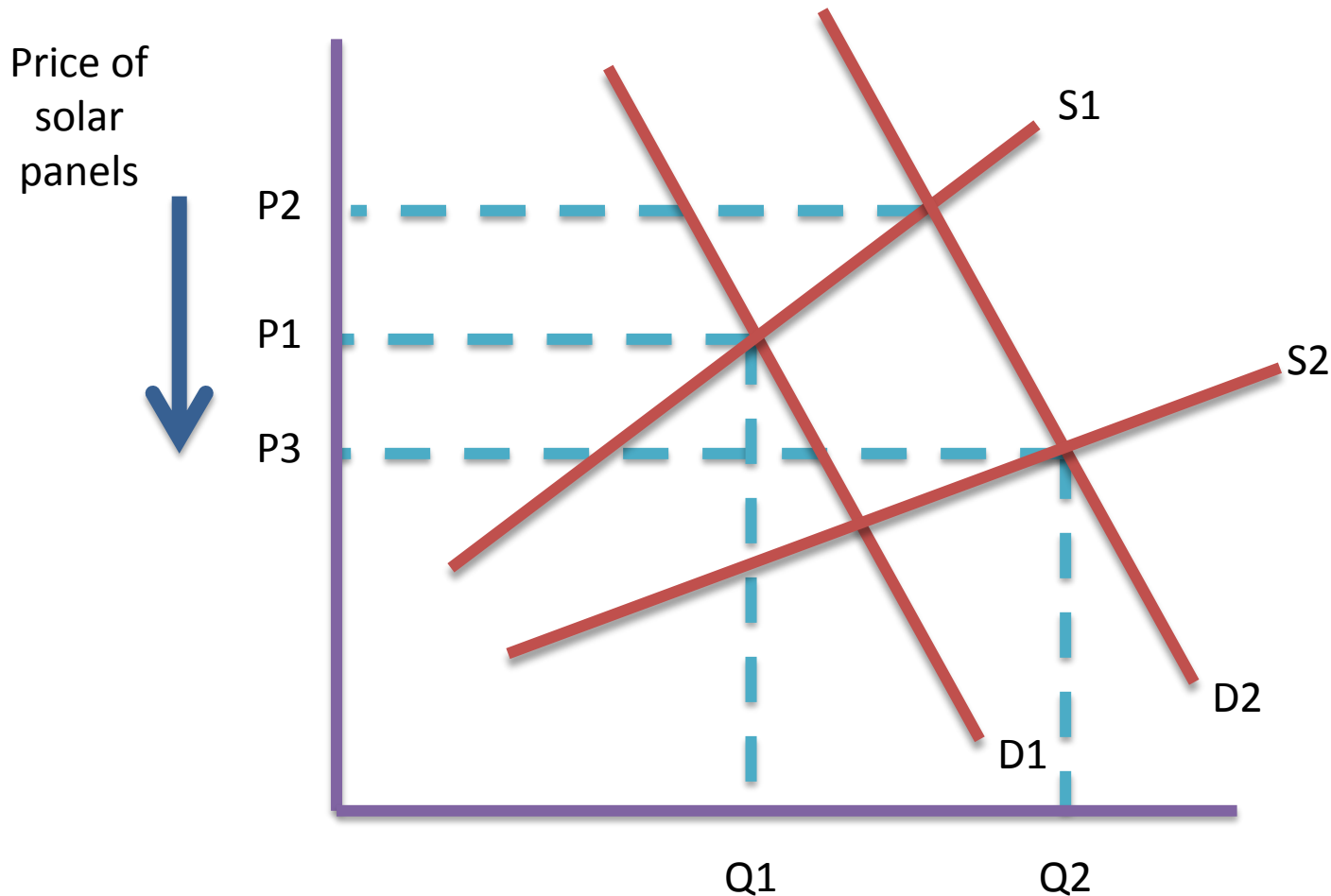
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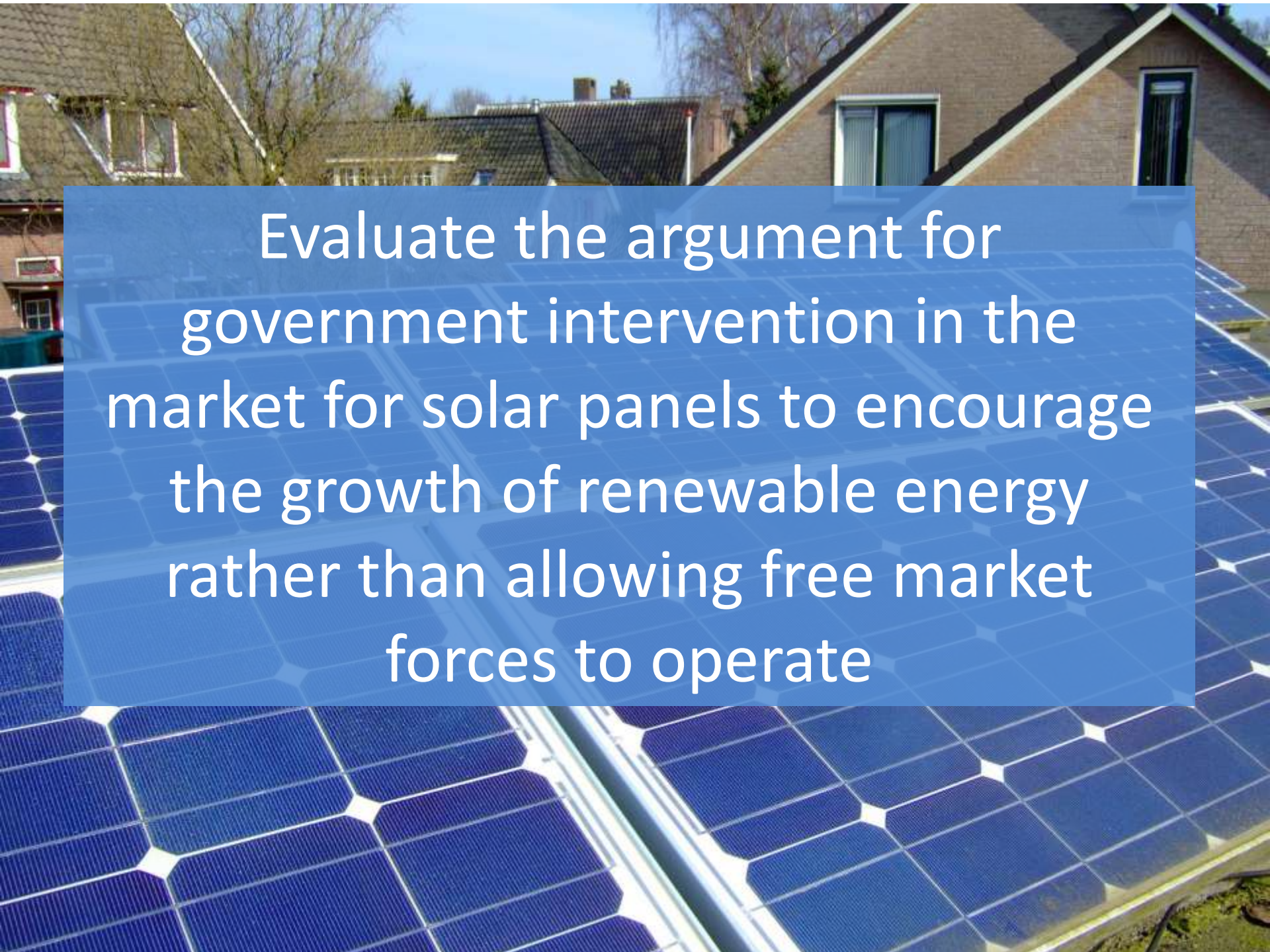


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Evaluate the argument for government intervention in the market for solar panels to encourage the growth of renewable energy rather than allowing free market forces to operate

The case for solar subsidies



Promotes renewable energy and lowers oil dependency



Creates thousands of new jobs – + a positive multiplier effect



Cuts bills for consumers & councils



Economies of scale if the take-up of panels increases

Solar subsidies – critical evaluation



Subsidies benefit richer households



Limited effectiveness for money spent – opportunity cost



Mis-selling of solar panels especially to vulnerable households



Most solar panels are imported