

AP Microeconomics

Unit 6: Market Failures and the Role of Government

6.1 Market Failures

- Occurs when resources are not allocated efficiently ($P = MC$)
 - Imperfect competition
 - Externalities
 - Public goods
 - Imperfect information
 - Buyers and sellers don't have full knowledge about available markets, prices, products, customers, suppliers, and so forth
 - Ex. Consumers pay too much for a product because they aren't aware of a cheaper alternative

6.2 Externalities

- Costs and benefits felt beyond those causing the effects → **spillover effects**
- Lead to inefficient allocation of resources as those making decisions fail to consider all of the repercussions of their behavior
- Negative externalities
 - Lead to overconsumption of a good
 - Restricting output to the socially optimal quantity
 - Imposing a price floor at the socially optimal price
- Positive externalities
 - Lead to underconsumption of a good
 - Solution
 - Can be subsidized by the amount of the MEB

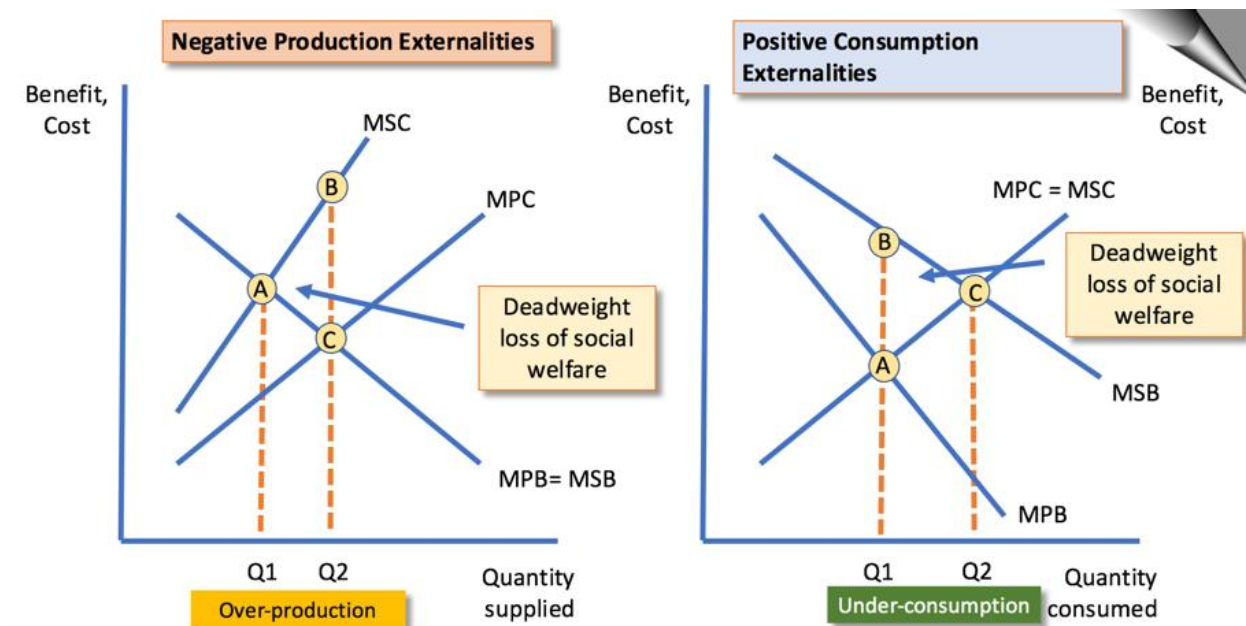


Image source: <https://www.tutor2u.net/economics/reference/4-key-diagrams-on-externalities>

6.3 Public Goods

- Those that many individuals benefit from at the same time
- Key characteristics
 - Nonrival in consumption
 - One person's consumption doesn't affect its consumption by others
- Nonexcludable
 - Goods cannot be held back from those who desire access
 - Ex. the police cannot choose who they protect
- **Free rider problem**
 - Consumer attempts to benefit from a public good without paying for it
 - Consumers know they can enjoy the provision of these goods without paying for them
 - Thus, the gov. oftentimes provides these goods and pays for them through taxes

6.4 Poverty and Taxes

- **Poverty line:** Official benchmark of poverty
- **Progressive tax:** Gov. receives a larger percentage of revenue from families with larger incomes

- **Regressive tax:** Government receives a larger percentage of revenue from families with smaller incomes
- **Proportional tax:** Government receives the same percentage of income from all families
- **Social Security:** Provides cash benefits and health insurance to retired and disabled workers and their families

