

Guided Reading Activity

What is Economics?

Lesson 2 *Market Failures*

Review Questions

Directions: Read each main idea. Use your textbook to supply the details that support or explain each main idea.

A. Types of Market Failure

Main Idea: Several factors contribute to market failure, including lack of competition, lack of information or knowledge, lack of public goods, static resources, and negative externalities and spillovers.

- Detail:** Lack of _____ lowers a business's incentive to use _____ more efficiently.
- Detail:** All participants in the economy must have adequate _____ in order for the market to function _____.
- Detail:** Resource _____ is a situation in which necessary inputs do not move to markets where they would earn _____ returns.
- Detail:** Government must produce sufficient and viable _____ goods because private business cannot _____ by providing them.
- Detail:** When businesses do not account for negative _____ effects, these unintended consequences may result in huge losses and even market _____.
- Detail:** The pollution of underground drinking water is one type of negative _____ that harms an _____ third party—in this case, anyone who uses the drinking water.

B. Dealing with Spillovers

Main Idea: There are ways that government can help ease the effects of negative spillovers and externalities. These may involve laws, tax policies, and subsidies.

- Detail:** In a free market economy, if the government _____ firms with _____ spillovers, such as pollution, that adds to the cost of that firm's products and makes it less profitable.

Guided Reading Activity *cont.*

Market Structures

- 2. **Detail:** Free primary education is a form of _____ spillover, which is why it gets _____ support.

- 3. **Detail:** Both governments and businesses use _____ - _____ analysis to compare and evaluate _____ projects that have positive spillovers.

- 4. **Detail:** A project whose positive _____ exceed its _____ is more likely to be enacted than one that is the opposite.

- 5. **Detail:** Most spillovers and externalities can be dealt with via _____ action, such as _____, taxes, and subsidies.

Summary and Reflection

Directions: Summarize the main ideas of the lesson by answering the questions below.

Most companies that contribute to pollution do not do it because they are run by bad people. They do it because emitting pollution into the air or water is cheaper than treating and cleaning the materials they use in production. When production is cheaper, the price of goods is cheaper and the company is more competitive relative to other companies. To limit or eliminate this pollution, government has enacted laws, such as the Clean Air Act and the Clean Water Act, to make polluting illegal. Do you think it is government's job to use laws to control these negative externalities? Why or why not? What, if any, private sector, nongovernmental measures might work just as well? Use examples in your answer.
