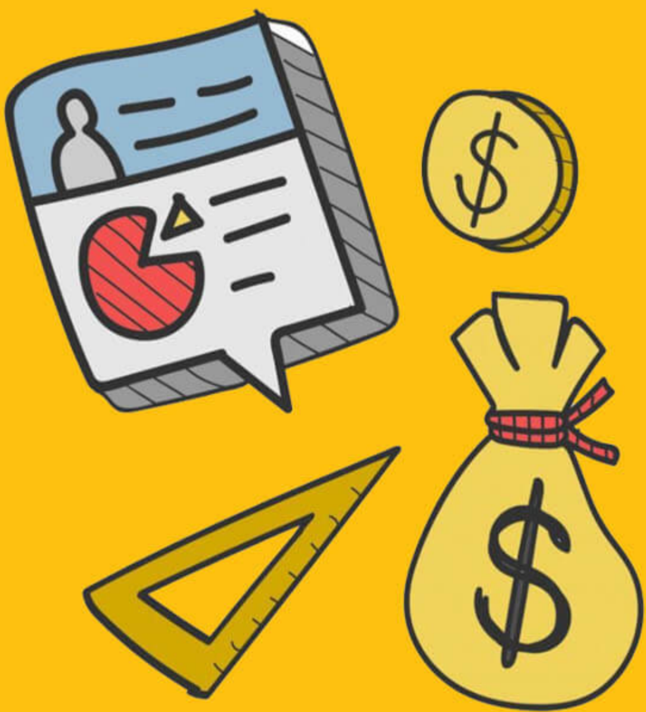
Exam Papers Practice

Merit and Demerit Goods



AQA A Level Economics Revision Notes

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- Negative externalities are caused by **demerit goods.** These are associated with information failure, since consumers are not aware of the long run implications of consuming the good, and they are usually overprovided. For example, cigarettes and alcohol are demerit goods. The negative externality to third parties of consuming cigarettes is second-hand smoke or passive smoking.

- Positive externalities are caused by **merit goods.** These are associated with information failure too, because consumers do not realise the long run benefits to consuming the good. They are underprovided in a free market. For example, education and healthcare are merit goods. The positive externality to third parties of education is a higher skilled workforce.

- The extent to which the market fails involves a value judgement, so it is hard to determine what the monetary value of an externality is. For example, it is hard to decide what the cost of pollution to society is. Different individuals will put a different value on it, depending on their own experiences with pollution, such as how polluted their home town is. This makes determining government policies difficult, too.

- The over-provision of demerit goods and the under-provision of merit goods may result from imperfect information about the long term implications of consuming the good. For example, education would be under-provided in a free market, because the long term benefits of it are not accounted for in society.

- Not all products that result in positive or negative externalities in consumption are either merit or demerit goods.