What are the main reasons for government intervention?

1. To correct for perceived ‘market failure’
2. To achieve a more equitable distribution of income and wealth
3. To improve the short and long-term performance of the economy

Laissez faire economics

In a free market economic system, governments take the view that markets are best suited to allocating scarce resources and allow the forces of supply and demand to set prices. The role of the government in a laissez faire system is to protect property rights, uphold the rule of law and maintain the value of the currency. Competitive markets often do deliver improvements in allocative, productive and dynamic efficiency – but there are occasions when they fail – providing a rationale for intervention of different forms.

Causes of market failure:

Each of these is a revision topic in its own right – make sure you have covered each thoroughly!

1. **Externalities** causing a divergence between private and social costs and benefits
2. **Imperfect information** means merit goods are under produced while demerit goods over produced
3. Failure of the market to supply pure public goods and quasi-public goods at a profit
4. Under-provision of merit goods and over-consumption of de-merit goods
5. **Market dominance** by monopolies leads to under-production and over-charging, loss of efficiency
6. **Factor immobility** causes unemployment and limits economic growth
7. **Equity (fairness) issues**: free markets may generate an intolerably high degree of relative poverty
8. **Excessive price and income volatility** in markets

Options for government intervention

Legislation and regulation:
- Laws on minimum ages for buying cigarettes and alcohol
- Competition Act which penalises businesses found guilty of price fixing cartels
- Statutory minimum wage
- Equal Pay Act and acts preventing other forms of discrimination
- Maximum CO2 emissions for new vehicles, laws which restrict flight times at night
- Government appointed utility regulators who may impose price controls on privatised monopolists e.g. telecommunications, the water industry

Improved information
- Compulsory labelling of demerit goods or advertising to promote merit goods
- Home information packs
- Increased awareness of carbon footprint from consuming different products

State provision
- Nationalised industries such as Royal Mail or Northern Rock
- National Health Service
- Outsourcing of NHS services to the private sector
- Private Finance Initiative for building and operating new prisons and motorways etc
Use of fiscal policy

Changes to direct taxation & welfare benefit system to alter market prices or affect incomes:
- Indirect taxes to raise the price of demerit goods and products with negative externalities
- Tariffs on imports and other forms of import controls e.g. export subsidies
- Environmental taxes or subsides to lower the price of merit goods
- Progressive taxes on the rich / welfare system to reduce inequality in distribution of income

Other interventions

- Minimum prices
- Maximum prices
- Buffer stock schemes

Key evaluation points:

a) **Value judgements**: Be aware of the frequent use of ‘value judgements’ in discussions about government intervention

b) **Changing prices to change incentives and behaviour**: Many interventions work though the price mechanism by changing the relative prices / relative costs of day-to-day decisions
   - E.g. raising the price of fuel to curb consumption
   - Offering a subsidy to bio-fuel producers
   - Using tariffs to change the relative prices of imports in a domestic economy

c) **Social science**: Economics is a social science and the effects of intervention cannot be calibrated / forecast with great accuracy – people’s behaviour is subject to change – remember the ‘law of unintended consequences’!

d) **Combinations of policies**: One single intervention is unlikely to produce a solution to deep-rooted economic and social problems – try to build a variety of policy options into your discussion e.g. policies that work on market demand and market supply

e) **The power of markets**: Is government intervention always necessary? Market forces can be really powerful in finding profitable solutions to problems – don’t underestimate the importance of innovation and invention – government’s rarely have all of the answers and the new economics of mass collaboration offers powerful insights into the impact that collusive behaviour can have e.g. in fast-tracking ideas linked to reducing carbon emissions

f) **Costs and benefits**: You cannot go far wrong in an evaluation question by trying to identify and then discuss the costs and benefits of government intervention – some of which only become apparent over long time periods

*Make sure you have revised the main causes of market failure and the diagrams that go with each of them*

*Make sure that you have revised thoroughly the topic of government failure*