Government intervention in markets

RIDLEY COLLEGE
SINCE 1889

Assessment Objectives

Specific Expectations	
AO2	Outline the key reasons why governments intervene in markets

Why governments intervene in markets

- There are several main reasons for government intervention at the microeconomic level.
  1. **Earn government revenue** – governments can earn revenue from indirect taxes, which are taxes on goods and services.
     - The lower the price elasticity of demand for a good, the greater the amount of tax revenue earned.
     - Indirect tax are often imposed on goods that have a price inelastic demand (PED<1), such as cigarettes, alcohol, and gasoline.
  2. **Provide support to firms** – governments provide support to firms for many reasons.
     - Small firms that have just been set up may require financial assistance to become well established so they can compete with larger firms.
     - Support may also be offered to firms in an industry whose growth the government would like to encourage.
     - Government may want to protect domestic firms from foreign competition arising from imports.

Why governments intervene in markets

3. **Provide support to households on low income** – households often do not earn enough income to be able to provide all necessities to meet their basic needs (food shelter, clothing).

4. **Influence the levels of production of firms** – government supports increase the firms' level of production.

5. **Influence levels of consumption of households/consumers** – the government may intervene to influence consumers to consume greater quantities of goods and services that are held to be beneficial to them (merit goods) or reduce consumption of goods and services held to be harmful (demerit goods).

6. **Correct market failure** – market failure refers to the failure of the market to achieve allocative efficiency.

    - When market failure occurs, it means that the market produces quantities of a good or service that are too large or too small in relation to what society most prefers.

Why governments intervene in markets

- It may mean that certain goods that are socially desirable are not produced at all by the market.

7. **Promote equity (equality)** – the market system as a rule does not achieve an equitable (or fair) distribution of income and wealth.

    - The market system results in income and wealth distributions that are too unequal.
    - A relatively small proportion of the population receives only a relatively small share of income.
    - Governments undertake to redistribute income.

Forms of government intervention

- There are several forms of government intervention at the microeconomic level.
  - These policies work to influence demand or supply of a good or service, thus affecting market outcomes.
  - The main forms of these interventions include the following:
    1. **Price controls**
    2. **Indirect taxes**
    3. **Subsidies**
    4. **Direct provision of services**
    5. **Command and control regulation and legislation**
    6. **Consumer nudges**