



# Edexcel A - A Level Economics

## Theme 3 – Business behaviour and the labour market

### 3.6 Government intervention Revision Notes

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### 3.6.1 Government intervention

#### Government intervention to control mergers

The **Competition and Markets Authority (CMA)** is basically the UK's competition watchdog. Their job is to make sure businesses play fair, especially when it comes to **mergers** (when two companies join together) and **competition rules**. They also enforce consumer protection laws, fine companies who break the rules, and can even take people to court if they get involved in illegal cartels (groups that fix prices or cheat customers). They can even force companies to undo things they've already done if it harms competition.

#### Controlling Mergers

When two companies want to merge in the UK, the CMA steps in to check if this could **substantially lessen competition (SLC)**.

- In simple terms, they ask: "**Will customers be worse off?**" If the benefits (like cheaper prices or better services) outweigh the risks, the merger is allowed. If not, they can block it.

A merger will definitely get a closer look if:

- It would create a company with more than **25% market share**
- Or the combined business makes more than **£70 million a year**

The CMA's main worry is that if two big firms merge, they could **exploit customers** by:

- Charging higher prices
- Offering fewer choices
- Producing worse quality goods and services

This would give firms **monopoly power** (where one or two companies dominate the whole market, and customers have very few options).



### 3.6.1 Government intervention

#### Government intervention to control mergers

#### Real Example

In **2019**, the CMA stopped **Sainsbury's** and **Asda** (two of the UK's biggest supermarkets) from merging.

Why? Because together they would have controlled nearly **60% of the grocery market**, and the CMA believed this would **lead to higher food prices**, fewer stores, and less choice for shoppers.

The CMA decided it was better for consumers if the two companies stayed separate.

### 3.6.1 Government intervention

#### Government intervention to control monopolies

When businesses become too powerful, governments step in to make sure they do not take advantage of consumers. The **Competition and Markets Authority (CMA)** is the team in the UK that helps make sure markets stay fair and open for everyone. Let's break down how they keep monopolies under control:

#### Price regulation

Monopolies like to produce less and charge more because they want **maximum profit** (where marginal cost = marginal revenue, or  $MC = MR$ ).


#### The Problem:

- Prices become too high.
- There is not enough choice for customers.
- People get stuck paying more for less.

#### The Solution:

The CMA sets a **maximum price**, meaning businesses cannot charge whatever they want. They usually pick a price where **allocative efficiency** happens (where average revenue = marginal cost,  $AR = MC$ ), meaning resources are used in the best way for society.

This is especially used for **natural monopolies**, like water or electricity companies, where it would be silly to have lots of different providers.

 **Example:** Ofwat (the water regulator) controls how much water companies can charge households in the UK.




### 3.6.1 Government intervention


#### Government intervention to control monopolies

#### Price regulation

Another way governments determine how much monopolies can charge is using the **RPI-X** formula.

- **RPI** stands for **Retail Price Index** (a measure of inflation, basically how prices in general are rising).
- **X** is the expected amount of **efficiency improvements** the firm should make.


 **Simple idea:** Prices can only go up with inflation, but firms also have to become more efficient by X%. If they work smarter and cut costs, they can still make good profits. But if not, they cannot just charge customers more to cover it!

 **Example:** The **rail industry** uses RPI-X to stop train companies from endlessly hiking ticket prices while making no improvements.

#### An Upgraded System: RPI-X+K

Sometimes, regulators add a little extra letter: **K**.

- **K** stands for **investment needs** (like building new pipes, railways, or upgrading equipment).
- So now, firms can also raise prices slightly if they are spending money to improve services for the future.

 **Example:** The **broadband industry** has used RPI-X+K to encourage internet companies to invest billions in faster fibre networks for rural areas.

### 3.6.1 Government intervention

#### Government intervention to control monopolies

##### Profit regulation

Another method is to limit how much profit monopolies can make.

##### How?

The CMA calculates how much it costs a company to operate, adds a fair percentage for profit, and says, "That's enough!"

💡 **Example:** In **Canada**, the energy industry (especially electricity providers) has used this method to stop power companies from overcharging people while still allowing enough profits to fund upgrades like greener energy grids.

##### The Problems:

- It is **hard to calculate** real costs accurately. Regulators depend on information from the firms themselves, and companies can easily hide or exaggerate things to make sure the rules work in their favour.
- Companies might **inflate their costs** on purpose to sneak more profit.
- Since the firm's allowed profit is based on costs, there is no real motivation to be efficient. Why bother saving money if it won't boost profits?



### 3.6.1 Government intervention

#### Government intervention to control monopolies

##### Quality standards

Sometimes businesses try to boost profits by cutting corners and using cheaper materials, leading to **lower quality products**.

##### The Problem:

- If there are no alternatives (**no substitutes**), consumers have no choice but to accept lower quality.

##### The Solution:

Regulators set **quality standards** to protect customers, making sure businesses do not lower the bar just to save a few pennies.

💡 **Example:** In the UK, water companies are legally required to supply safe drinking water to every household, no matter how remote. They cannot just ignore rural areas to save money.

##### But... It's Not Always Easy ▶

Introducing quality rules sounds simple, but it's not. It needs a lot of **political will** (basically, politicians actually caring enough to make it happen) and a **proper understanding** of the industry they are regulating.

Without this, powerful monopolies can easily resist or dodge the rules, leaving customers stuck with poor service.

##### Fun Fact:

Businesses hate these rules because they eat into their profits.

### 3.6.1 Government intervention

#### Government intervention to control monopolies

##### Performance targets

Sometimes, businesses (especially big monopolies) get a little too relaxed offering bad service because they know customers have no choice. This is where **performance targets** come in.

**Performance targets** are official goals set by regulators to make firms step up their game.

✔ Targets might be about price, quality, customer service, or how fast they deliver their services.

##### The Goal:

- **Raise standards**
- **Improve customer satisfaction**
- **Keep companies on their toes**

##### How It Works: 🚚

One smart method is called **yardstick competition**.

Here, companies are compared against the best performers, almost like a leaderboard for businesses.

For example, **postal services** in different regions might be compared to see which one delivers parcels the fastest after ordering online.

Another example:

In the **healthcare sector**, hospitals could be compared on how quickly they treat patients in A&E (Accident & Emergency departments).



### 3.6.1 Government intervention

#### Government intervention to control monopolies

##### Quality standards

##### But... Companies Don't Always Make It Easy 😞

- Firms often **push back** when targets are introduced because it means more work and sometimes lower profits.
- Even when targets exist, some companies try to "**game the system**". For example, an internet provider might claim it meets speed targets by measuring internet speeds *only at quiet times* (like 3 AM) rather than when most people are actually online!
- Some firms might **completely miss their targets**, meaning customers are still stuck with poor service.  
A real-world case:  
In 2016, **Southern Water** faced huge fines because they missed their sewage treatment performance targets, causing environmental damage.

##### In a Nutshell:

- **Performance targets** are rules that force businesses to improve.
- **But** businesses often resist, bend the rules, or just fail.
- Governments must back up targets with **strong fines and penalties**, otherwise, firms won't take them seriously.

### 3.6.1 Government intervention

#### Government intervention to promote competition and contestability

Governments do not just sit back and watch big companies' squash everyone else. They step in with a few clever methods to make markets more competitive and **contestable** (which basically means making it easier for new firms to join the market and challenge the big guys).

Here's how they do it:

#### Enhancing competition between firms through promotion of small business

The government can offer **tax breaks, grants, or cheap loans** to small startups.

More small businesses mean more **competition**, which pushes everyone to **innovate** and **work more efficiently**. No more lazy big firms getting away with poor service.

#### Example:

- In the U.S., small tech startups like **Zoom** got early tax incentives that helped them grow and eventually challenge huge players like Microsoft Teams.
- In the UK, schemes like the **Start Up Loans Scheme** provide loans and mentoring to help small businesses grow.



### 3.6.1 Government intervention

#### Government intervention to promote competition and contestability


#### Deregulation

**Deregulation** is when the government removes rules that make it hard for new businesses to enter a market.

Less red tape = easier for firms to jump in and start competing = more **choice** and **better prices** for customers.

#### Example:

When the UK deregulated the **bus industry** in the 1980s, lots of new bus companies popped up, giving customers more routes and cheaper fares.

 But...if the government deregulates too much, it can lead to **bad business behaviour**, like poor safety standards. (Remember the **2008 financial crisis**? Yeah, part of that was because of poor regulation of banks.)


#### Competitive tendering for government contracts

Instead of the government making everything itself (which can kill competition), it can **open up contracts** for private businesses to bid for. Whoever offers the best service for the best price usually wins, and this keeps everyone on their toes.

This **saves money** and **boosts efficiency** because companies have to work hard to win contracts.

#### Example:

The NHS in England often uses **competitive tendering** when outsourcing cleaning services, meaning private companies compete to get the contract.

 Downside: Private firms might **cut corners** to win contracts, leading to lower quality work. Plus, organising tenders can be **slow and expensive** for the government.

### 3.6.1 Government intervention

#### Government intervention to promote competition and contestability

##### Privatisation

When the government owns a company (like a railway or a broadcaster), it might scare off private competitors because the government firm has deep pockets and advantages.

**Privatisation** means selling these companies to private owners, making the market more open and competitive.

##### Example:

In the 1980s, the UK government **privatised British Telecom (BT)**, before that, telecoms were a government monopoly. After privatisation, lots of new companies entered the market (like Vodafone), giving customers more choice and better prices.

##### ★ Advantages of privatisation:

- **More competition:**  
Firms now have to fight for customers! This cuts **X-inefficiency** (when businesses get lazy and wasteful) and usually means **lower prices** and **better quality** for everyone.
- **Managers are more accountable:**  
If managers slack off, shareholders get mad and can push them out. This keeps bosses on their toes!
- **Boosts government cash:**  
Selling companies brings in money straight away, helping reduce the **Public Sector Net Cash Requirement (PSNCR)**. Basically, the government's need to borrow money.
- **Less political interference:**  
Firms don't have to stress about changing their plans every time a new government gets elected. They can **invest with more confidence** in the long term.



### 3.6.1 Government intervention

#### Government intervention to promote competition and contestability

##### ⚡ Disadvantages of privatisation:

- **Natural monopolies become risky:**  
In industries like water and electricity, where it's impractical to have loads of competitors, a private monopoly could exploit customers. Some say the government should stay in charge here.
- **Some industries are too important:**  
Services like **hospitals, electricity, and public transport** are vital to society. Leaving them purely to private profit-seeking companies could be risky.
- **Externalities and inequality:**  
Private companies might not think about the broader impacts (like pollution), and poorer people might end up worse off.

##### Summary

##### In a nutshell:

- **More small businesses = more competition.**
- **Less red tape = easier for new firms to join.**
- **Tendering = businesses fight to win government jobs.**
- **Privatisation = no more 'untouchable' government giants.**

### 3.6.1 Government intervention

#### Government intervention to protect suppliers and employees

##### Restrictions on monopsony power of firms

Sometimes, big companies throw their weight around and treat suppliers unfairly. This is known as **monopsony power**, when there's basically only one major buyer in the market, so suppliers have very little choice but to accept bad deals.

(Imagine you bake cakes, but there's only one supermarket willing to buy them... you'd have to take whatever price they offer!)

Over time, this can **damage whole industries**. To stop that from happening, governments can step in with a few tricks up their sleeve:

- **Anti-monopsony laws:**  
Governments can pass special laws that ban unfair buying practices and fine companies that break the rules.
- **Encouraging self-regulation:**  
They can nudge firms to behave nicely on their own, setting up fair trade standards without needing loads of rules.
- **Bring in independent regulators:**  
A regulator acts like a referee, keeping a close eye on big buyers and making sure they play fair.
- **Subsidies for struggling suppliers:**  
If suppliers are being squeezed too hard, the government can give them financial help (basically, a cash boost) to keep them afloat.
- **Setting minimum prices:**  
The government can say, "Hey, you can't pay suppliers less than this minimum price!"  
(Kind of like a minimum wage, but for businesses selling goods.)



### 3.6.1 Government intervention

#### Government intervention to protect suppliers and employees

##### Protecting workers' rights

Governments don't just look out for suppliers, they also **have workers' backs** by setting up rights and protections at work. Here's how:

- **Health and safety laws:**  
Making sure workplaces are safe (no one wants a broken ladder or faulty machine). This also includes maternity leave (time off work when you have a baby) to protect workers' wellbeing.
- **National minimum wage:**  
The government can set a **minimum wage** (the lowest amount a worker can legally be paid per hour.) This helps to make sure that even people in the lowest-paid jobs get a fair deal.
- **Redundancy rules:**  
Making sure that if workers are laid off, it's done fairly, and often with financial support.
- **Employment contracts:**  
Written agreements to protect workers from unfair treatment.
- **Right to join a trade union:**  
Workers have the right to team up and stand up for their rights together.
- **Maximum working hours:**  
No one should have to work crazy long shifts with no rest.
- **Codes of conduct:**  
Governments can encourage firms to write up good behaviour rules for how they treat employees.

##### But there's a downside...

If workers' rights are **too strong or expensive**, some firms might think twice about **hiring new staff**. Why? Because offering generous rights (like paid sick leave, shorter hours, etc.) can **increase the cost** of employing someone, and businesses always keep an eye on costs.

### 3.6.1 Government intervention

#### Government intervention to protect suppliers and employees

##### Nationalisation

**Nationalisation** is when the government takes control of an industry or service instead of leaving it to private businesses.

In 2020, the UK government temporarily nationalised Northern Rail, after years of terrible service and passenger complaints. Private companies running the service had failed to deliver improvements, so the government stepped in to take control. While passengers initially saw some improvements (more reliable services, better investment in infrastructure 🚆), critics warned that long-term political management might still face the same old funding and efficiency problems if not handled carefully.

##### 🌟 Advantages of Nationalisation:

- **Perfect for natural monopolies:**  
A **natural monopoly** happens when it's cheapest to have only one provider like a water supply network (you don't want five companies all digging up the road for separate pipes). It's better if the government runs it to make sure people are treated fairly.
- **Long-term investment focus:**  
Governments think about future generations, not just next year's profits. Private companies often cut back on investment if it doesn't boost share prices fast enough.
- **Thinking about externalities:**  
Governments consider the bigger picture, like pollution or public health. Businesses often don't unless they're forced to.



### 3.6.1 Government intervention

#### Government intervention to protect suppliers and employees

##### Nationalisation

- **Keeping control of key industries:**  
It can be **risky** if strategic industries like healthcare, energy, or railways are owned by foreign investors. Nationalisation keeps control closer to home.
- **Guaranteeing essential services:**  
Some areas are expensive to serve like tiny villages for postal services or rural broadband. Governments can promise a **minimum level of service** to make sure nobody is left out.
- **⚠️ Disadvantages of Nationalisation:**
  - **Principal-agent problem and moral hazard:**  
Managers might get lazy when they know the government will bail them out if they make bad decisions (a bit like being reckless because someone else will pay the fine).
  - **Political meddling:**  
Politicians might make decisions to win votes instead of doing what's best for the service, like cutting train fares right before an election without thinking about the long-term costs.
  - **X-inefficiency:**  
With no competitors pushing them to do better, nationalised firms can get bloated, slow, and inefficient.

## 3.6.2 The impact of government intervention

### Impacts

When governments get involved in how the economy works, they're usually trying to make things better for everyone, not just businesses, but everyday people too. Here's how they do that:

#### Keeping Prices Fair and Predictable

Imagine if the price of milk jumped from \$2 to \$10 overnight, that would be chaos. Governments step in to keep **prices affordable and stable** so people can still buy the things they need without breaking the bank. They might control the price of essentials like energy, transport, or basic food to stop prices from going wild.

**Example:** A government might put a cap on rent prices to stop landlords from overcharging tenants, especially in big cities.

#### Allowing Profit – But Not Letting Greed Take Over

Businesses need to make money, that's called **profit**. But when profits get too high, especially in industries where there's not much competition (like electricity or medicine), companies might take advantage. The government allows **normal profit**, enough to keep businesses running, but puts limits in place to protect the public.

**Example:** A company selling insulin might be limited in how much it can charge so that people with diabetes can actually afford it. That way, **household income** isn't swallowed up by one single need.

## 3.6.2 The impact of government intervention

### Impacts

#### Reducing Waste and Improving Efficiency

Sometimes companies don't have much motivation to work smarter, especially if they're the only game in town. Governments help boost **efficiency**, which means using resources like money, energy, and time wisely. One way they do this is by encouraging **competition**, so businesses have to innovate and improve to stay ahead.

**Example:** If two internet providers are competing for customers, they'll work harder to offer faster speeds and better prices, which benefits everyone.

#### Making Sure Products Are Good Quality

No one wants to buy a toaster that sets fire to the kitchen. Governments make sure products are **fit for purpose**, meaning they do what they're supposed to and are safe to use. This also improves the overall **standard of living** because people aren't wasting money on dodgy or unsafe stuff.

**Example:** Food inspectors make sure the chicken you buy at the supermarket won't make you sick. That's the government looking out for your quality of life.

#### Giving You More Choice

More options = happier customers. The government encourages **consumer choice** by stopping monopolies and making sure new businesses can enter the market. This leads to better quality, more variety, and often lower prices.

**Example:** Instead of just one mobile phone provider, you get to choose between five, and they all try to win your business with better deals. This boosts **economic activity**, which means more spending, more jobs, and a healthier **GDP** (Gross Domestic Product: the total value of everything a country produces).

## 3.6.2 The impact of government intervention

### Limits

Governments try to step in and fix problems in the economy, things like unfair prices, poor service, or lack of competition. But here's the truth: **government intervention doesn't always work perfectly**. There are two big reasons for this:

1. **Regulatory capture**
2. **Asymmetric information**

#### 1. What Is Regulatory Capture?

**Regulatory capture** happens when big companies **influence the people who are supposed to be watching over them** (the regulators) and get them to make decisions that benefit the company instead of the public.

In simple terms, the watchdog ends up working for the people it's meant to be watching.

This can happen for a few reasons:

- Regulators often meet with company employees and **start seeing things from their point of view**. That might make them **more understanding**, but it also means they can lose their objectivity, like a referee rooting for one team.
- Big corporations **spend tons of money** learning how to "play the system" and win over the regulators. Sometimes, regulators used to work in that same industry, so they have **friends and contacts** there. That makes it even harder for them to stay neutral.

#### **Why it's a problem:**

If the regulator is too friendly with the company they're supposed to be monitoring, they might go easy on them, even if they're breaking rules or acting unfairly. This leads to **government failure**, where intervention causes more harm than good.

## 3.6.2 The impact of government intervention

### Limits

#### **Real-life example: Volkswagen emissions scandal (Dieselgate)**

VW was able to cheat emissions tests using special software for years. Regulators in Germany and even the U.S. were **slow to catch on**, partly because of the **automotive industry's political influence** and strong relationships with regulators. It was only when independent researchers tested emissions in the real world that the fraud was discovered.

#### 2. Asymmetric Information – When the Government Doesn't Know Enough

**Asymmetric information** is when one side has way more information than the other and that messes things up.

In the case of governments, they often **don't have all the information** they need to make smart, informed decisions, especially in complex markets like finance or tech.

Therefore, businesses know way more about their own costs, strategies, and market than the government ever could. So, when regulators try to set fair rules or price limits, they **depend on the info the companies give them**. And let's be honest, companies are going to share whatever helps them the most.

#### **Why it's a problem:**

If businesses give incomplete or misleading information, the government might set the wrong rules. Prices could be too high or too low, or quality standards might be off. This can lead to **government failure**.

#### **Real-life example: The 2008 Financial Crisis**

Many banks sold mortgage-backed securities that were **packed with risky home loans**, but they didn't fully disclose how bad the underlying loans were. Investors, and even the government, **didn't understand the risk** because the banks had all the inside info. This is a textbook case of asymmetric information causing disaster.

Please see the '3.6 Government Intervention Worked Examples' pack for exam style questions.

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