AQA - A Level Economics

Individuals, Firms, Markets & Market Failure

8.1 The market mechanism, market failure and government intervention in markets

Revision Notes

Contents

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Functions of the price mechanism

- **Price is simply the value at which goods or services are exchanged.**

But here's where it gets interesting: the **price mechanism** is like the invisible referee of the market. It decides how prices change based on supply and demand, helping the market settle at a new equilibrium. It's the key player in resource allocation in a market economy. Here's how it works:

Rationing Device:

- Resources are limited, and price decides who gets what.
- When something is scarce, the price rises. This limits access to those willing to pay the most, balancing supply and demand.
- **Example:** Imagine concert tickets for a popular artist. Prices soar, and only the biggest fans (or highest bidders) snag seats.

Incentive Device:

- Higher prices motivate producers to create more because they see bigger profits ahead.
- Similarly, rising prices can cover extra costs for increased production.
- **Example:** If electric car demand shoots up, car companies ramp up production because they can charge more and earn more.

8.1.1 How markets and prices allocate resources

Functions of the price mechanism

Signalling Device:

- Prices send signals to businesses about market conditions.
- **Example:** A sudden rise in coffee demand raises its price, signalling coffee producers to grow more beans. If demand drops, prices fall, telling producers to scale back.

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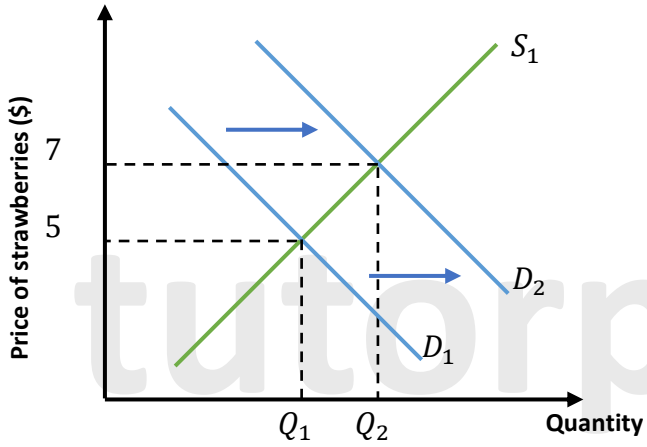
8.1.1 How markets and prices allocate resources

The price mechanism in the context of different types of markets

- **Local Market** 🍓

Imagine a bustling farmer's market in California where fresh strawberries are in high demand. Let's break down what happens when people start craving more strawberries:



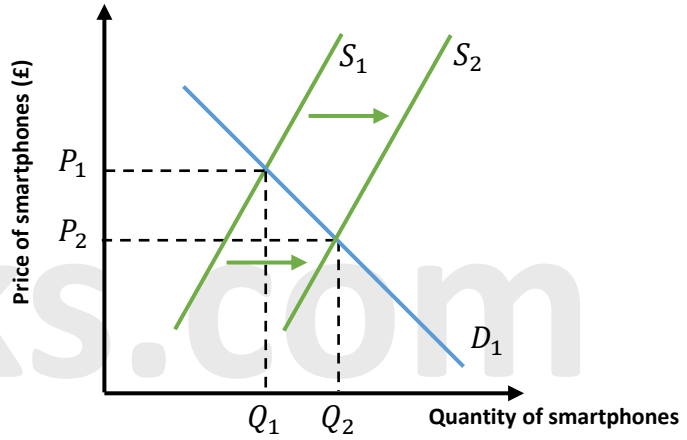
- **Demand Surge:** A health trend sparks an increase in strawberry demand, shifting the demand curve from D_1 to D_2. Prices jump from $5 to $7 per pound.
- **Rationing Effect:** The higher price ensures that only those willing to pay $7 can purchase the limited strawberries, helping allocate this valuable resource.
- **Incentive to Produce:** Farmers are motivated to grow more strawberries because they can earn more per pound. This leads to an increase in supply from Q_1 to Q_2.
- **Signals to Other Farmers:** The rising price and demand signal other farmers to start growing strawberries, boosting the overall market supply.

8.1.1 How markets and prices allocate resources

The price mechanism in the context of different types of markets

- **National Market** 📱

The US smartphone market is fiercely competitive. In 2021, advancements in production technology reduced manufacturing costs for smartphones:



- **What happened?** Producing smartphones became cheaper, leading to an increase in supply. The supply curve shifted from S_1 to S_2.
- **Impact on prices?** With more smartphones in the market, prices dropped from P_1 to P_2.
- **How did the market respond?** Lower prices attracted more buyers, increasing the quantity demanded from Q_1 to Q_2.

Result? More affordable smartphones for consumers and a thriving market where supply and demand found a new balance.

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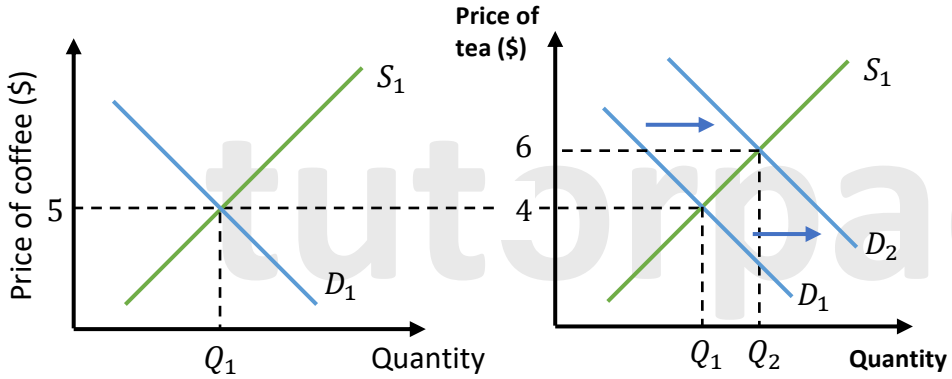
The price mechanism in the context of different types of markets

- **Global Market** ☕

Imagine the global market for coffee and tea. Coffee farmers in Brazil have been producing coffee steadily, selling it at $5 per kilogram. Meanwhile, tea, mostly grown in India, has been priced at $4 per kilogram for years. Suddenly, due to a rise in health trends favouring tea, global demand for tea skyrockets.



What happened?

- **Demand for tea increased** from D_1 to D_2, causing its price to jump from $4 to $6 per kilogram.
- The higher price **rationed** tea, meaning only those willing to pay $6 could buy it.

8.1.1 How markets and prices allocate resources

The price mechanism in the context of different types of markets

- **Global Market** ☕

How did producers respond?

- The higher price **incentivised tea producers** in India to plant more tea bushes and allocate more resources to tea farming. This resulted in an **extension of supply** from Q_1 to Q_2.
- The price hike **signalled to coffee farmers in Brazil** that tea was now more profitable. Many considered switching parts of their coffee plantations to tea to meet the growing demand and take advantage of higher profits.

This example shows how the price mechanism works across global markets, motivating farmers to adjust their production to changes in demand while ensuring resources are directed where they are most needed.

Tips and Tricks

Explaining the differences between the three functions of the price mechanism can feel tricky, but here's an easy way to think about it:

- **If demand or supply shifts**, the market is sending a **signal** to consumers or producers.
- **If there's movement along a curve**, that's the **incentive function** kicking in.

Whenever you're tackling questions about the price mechanism, just remember one golden rule: **it's all about self-interest.** This makes it much easier to explain each function.

For example:

- Lower prices **incentivize consumers** to buy more because they can stretch their income further.
- On the flip side, higher prices **incentivize producers** to switch their resources to more profitable products.

8.1.1 How markets and prices allocate resources

Advantages and disadvantages of price mechanism

✅ **Benefits of the Price Mechanism**

- **It's Impersonal**

The system doesn't play favourites. Prices are based on supply and demand, not personal needs or emotions.

If there's a pizza shortage, prices go up—simple.

- **It Sends Signals**

If something is expensive, it tells buyers to think twice and tells producers, "Hey, we need more of this!"

Example: If electric car prices rise, it signals high demand—so more companies start making them.

- **It Gives Power to Consumers**

Every time you spend money, you're voting. Buy a vegan burger? That's a vote for plant-based food.

This is called **consumer sovereignty;** the power of buyers to influence what gets made.

- **It Can Be Super Efficient**

Markets tend to allocate resources (like labour, materials, or money) to where they're needed most without needing a government plan.

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Advantages and disadvantages of price mechanism

⚠️ **But… It's Not Perfect**

- **It Ignores Inequality**

People with money have all the buying power. Those without? They're left out.

A luxury apartment might sit empty while someone else can't afford rent just down the road.

- **It Doesn't Care About Fairness**

The system doesn't ask, "Is this fair?" It only reacts to demand and supply.

In rich countries, inequality might be "tolerable," but in poorer ones, it can mean people go without basic needs.

- **It Can't Handle Public Goods Well**

Public goods (like street lighting or national defense) aren't sold in shops so the market doesn't provide them well.

The same goes for **merit goods** (like education or vaccines), which people may undervalue without help.

🧠 **Definitions:**

- **Public goods** = goods everyone uses but no one can be excluded from (e.g. parks, police).
- **Merit goods** = things that benefit both the individual and society, even if people wouldn't pay for them (e.g. school, free flu jabs).

8.1.1 How markets and prices allocate resources

Advantages and disadvantages of price mechanism

🎯 **So, Should We Use the Price Mechanism for Everything?**

Not really. While it works brilliantly in many areas (like deciding how many crisps to stock at Tesco), it struggles when fairness, human needs, or shared resources are involved.

That's why **government intervention** is often needed to make sure everyone has access to essentials, not just the people with the deepest pockets.

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8.1.2 The meaning of market failure

Understanding market failure

In a **free market**, prices decide how scarce resources (like land, labour, capital, and businesses) are shared out to meet everyone's wants and needs. This process is usually super efficient and works well most of the time. Think of it like a traffic light system for the economy, directing resources to where they're needed. 🚦

But sometimes things go wrong. This is called **market failure**. It's when resources aren't shared out in the best way for society. Imagine a pizza being cut unfairly, some people get too much (over-allocation), and others get too little (under-allocation). 🍕

Examples of market failure:

- When the market leads to **inequality** (some get a lot, others get none).
- When it causes **environmental damage** (like pollution).

Market failure happens when the price mechanism leads to resources being used inefficiently, causing demand and supply to result in a net loss of welfare for society.

Market failure can create:

1. **Too much** of some goods or services (like too many factories causing pollution).
2. **Too little** of others (like not enough healthcare or clean energy).

This means the economy isn't efficient or fair, and resources aren't being used in the best way for society. It's like having all the toppings on one slice of pizza while the others are plain.

8.1.2 The meaning of market failure

Complete and partial market failure

🛑 **Complete Market Failure**

📉 **Definition:**
A **complete market failure** is when the private sector doesn't supply a good at all, even though there's demand for it.

Why? Because nobody can make money from it, so businesses don't bother.

🔍 **Example:**
National defence — everyone needs it, but you can't sell it to individuals. Imagine trying to buy "your share" of the army. So, the government steps in to provide it.

These are often called **public goods,** things that are:

- Non-excludable (you can't stop people from using them)
- Non-rivalrous (one person using it doesn't reduce its availability for others)

Other examples: street lighting, flood barriers, clean air.

⚠️ **Partial Market Failure**

📉 **Definition:**
A **partial market failure** is when a market does exist, but the amount being produced or consumed isn't the *right* amount for society.

It might be:

- **Too much produced** (overproduction)
- **Too little produced** (underproduction)

🔍 **Example (Overproduction):**
Fast fashion – Cheap, trendy clothing is made in large amounts, but it harms the environment (waste, pollution, microplastics). Society gets more than it really needs.

🔍 **Example (Underproduction):**
Mental health services – People benefit from better mental well-being, but private healthcare often doesn't offer enough. So society ends up with less than what's ideal.

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8.1.2 The meaning of market failure

Causes of market failure

Market failure happens when resources aren't used in the best way from society's point of view. This means some people miss out, or too much or too little of something is made or consumed.

1. Public Goods

What are they?
Public goods are things that everyone benefits from, but private businesses won't supply because they can't easily charge people to use them.

Example:
Street lighting or free public parks; you can't stop someone from using them, and one person's use doesn't reduce others' use.

Why it fails:
Because no one wants to pay for them individually, the free market under-produces them, leaving a gap.

2. Externalities

Definition:
Externalities happen when a third party (someone not directly involved) is affected by an economic activity.

Types:

- **Negative** externalities: When others are harmed like loud construction noise near your house.
- **Positive** externalities: When others benefit like when your neighbour plants a beautiful garden that boosts the whole street's appeal.

Why it fails:
Markets don't consider these spillover effects, so too much "bad stuff" and not enough "good stuff" gets made.

8.1.2 The meaning of market failure

Causes of market failure

3. Merit & Demerit Goods

Merit Goods:
Goods that are good for people and society but are under-consumed like flu vaccines or healthy school lunches.

Demerit Goods:
Goods that are bad for people and society but over-consumed like sugary energy drinks or gambling.

Why it fails:
People might not have all the info to make the best choices (especially for long-term health), so governments may need to step in.

4. Market Imperfections

These are flaws in the market system that mess with how things are bought and sold.

- **Imperfect Information:**
  When buyers or sellers don't have all the info like someone buying a used car that turns out to be faulty.
- **Monopoly Power:**
  When one company controls the market (like your local internet provider) and charges too much because you've got no alternative.
- **Factor Immobility:**
  When resources (like workers or machines) can't move easily to where they're needed e.g. a skilled worker can't afford to move to a city with more jobs.

Why it fails:
These issues stop the market from reacting properly to demand, which wastes resources and limits supply.

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Causes of market failure

💰 **5. Unequal Distribution of Income and Wealth**

What's the problem?
When wealth is unevenly spread, some people can't afford basic goods or services.

Example:
In a society where top earners make 100x more than the poorest, many families may struggle to buy food, housing, or education.

Why it fails:
This causes under-consumption of important goods and can lead to social problems like crime or unrest; a form of **negative externality**.

8.1.2 The meaning of market failure

Continue to the next page…

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8.1.3 Public, private & quasi-public goods

Private Goods:

These are things businesses sell to make money. Why? Because they display characteristics of **rivalry** and **excludability**.

- **Excludable**: If you can't pay, you don't get it. Think about Netflix, it's locked unless you pay for a subscription.
- **Rivalrous**: If someone buys the last concert ticket, it's gone. You're out of luck.

Businesses love these goods because they can charge money, and people compete to buy them.

Public Goods:

Public goods are different because they're:

- **Non-excludable**: You can't stop people from using them. For example, streetlights. You can't stop someone from benefiting just because they didn't "pay their share."
- **Non-rivalrous**: One person using it doesn't take away from someone else. For instance, national defence protects everyone equally, no matter how many people there are.

Because businesses can't make a profit from public goods, governments usually step in to provide them.

8.1.3 Public, private & quasi-public goods

The "Free Rider" Issue 

Public goods often run into a big problem called the **free rider issue**, which is why they're under-provided. Here's the deal:

Once a public good is available to one person, it's available to *everyone*. You can't exclude people who didn't chip in from enjoying it. And that's where the market stumbles, businesses can't make money from people who refuse to pay.

For example:

- **Street cleaning:** Once the streets are clean, everyone benefits, even those who didn't contribute a penny.
- **Flood defences:** If your neighbourhood builds a flood wall, you're protected whether or not you helped fund it.

Now, imagine a rational consumer thinking, "Why should **I** pay if someone else will?" This leads to a classic stand-off: everyone waits for someone else to foot the bill. But if everyone waits, guess what? The public good never gets provided.

The key issue here is **non-excludability,** you can't keep people from using the good once it's available. And without a way to charge free riders, the **price mechanism** doesn't work.

So, governments often step in to make sure these essential goods (like flood defences or clean streets) are provided, even if no one's rushing to pay.

Tip: Don't call the National Health Service (NHS) or state education public goods, they involve rivalry in consumption. Instead, they're better described as merit goods that provide external benefits.

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8.1.3 Public, private & quasi-public goods

Quasi-public goods

Think of quasi-public goods as the hybrid cars of economics, they've got features of both **public goods** and **private goods**. They're not *completely* free for all, but they're not *entirely* restricted either.

- **Public goods** are things that are:
  - **Non-excludable**: you can't stop people from using them (like clean air).
  - **Non-rivalrous**: one person using it doesn't stop others from using it too (like a lighthouse).
- **Private goods** are the opposite, you can exclude people (like a cinema ticket), and if you consume it, others can't (like a sandwich).

So, what's a quasi-public good?

It's something that *kind of* fits the public category, but not always. In many cases:

- **They're free or cheap to use** — but not always.
- **You can use them without affecting others** — unless they get too busy.

Classic Example: A Road

- Roads are usually open to everyone (**non-excludable**).
- But when they get too crowded, more cars = more traffic (**rivalrous**).
- And if there's a toll booth? That's **excludability** kicking in.

These goods are often:

- **Funded by the government** (via taxes)

  Maintained with user fees (like tolls, entrance fees, etc.)

8.1.3 Public, private & quasi-public goods

Quasi-public goods

Examples	As a Public Good	As a Quasi-Public Good
Public Wi-Fi	Open city Wi-Fi is free for everyone (**non-excludable**) and doesn't slow down right away (**non-rivalrous**)	Gets slow when too many people join (that's **semi-non-rivalrous)**. Or add a login/paywall (**excludable).**
Public beaches	Free, open to all (**non-excludable**) and no one's enjoyment limits another's (**non-rivalrous**)	Crowded beaches reduce space (**rivalrous**) or charge a fee for entry or services (**excludable**)
Bike lanes	Everyone can use them freely (**non-excludable**)	If city charges for rental bikes or limits access in rush hours, they become **quasi-public**
Public libraries	Free entry and reading space (**non-excludable**, **non-rivalrous**)	If overcrowded or requires a membership card, it becomes more **exclusive** (hello, quasi)

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Technological change

Technology can totally change how we use public goods. It can turn something that used to be free for everyone into something that can be controlled, priced, or even limited.

1. 📡 Making things excludable and rivalrous

Tech makes it easier to **control access** to goods and services. That means we can now:

- **Charge people** to use them
- **Limit use** when demand is high

This can turn public goods into **quasi-public** or even **private goods**.

Example:
Streaming services like Netflix. TV used to be **non-excludable,** if you had a TV, you could watch it. Now, with subscriptions and passwords, only paying customers can access the content. That's **excludability** in action.

2. 📄 Tech and Excludability

Some goods are still **non-rival**, but they can be made **excludable** with tech.

Example:
Online newspapers.
They used to be free, but now many use **paywalls**. If you don't pay, you can't read. That turns them from public-ish to private goods.

3. 🚫 Tackling the Free-Rider Problem with Tech

The **free-rider problem** happens when people use something without paying for it, classic example: enjoying fireworks without contributing a penny.

Tech Solution Example:
🚲 **Bike-sharing programs**.
In many cities, shared bikes used to be unlocked and free, until people started damaging or hogging them. Now, **app-based systems** track bike usage, require payment, and even penalise users for misuse. That tech stops freeloaders and keeps the system fair.

8.1.3 Public, private & quasi-public goods

The tragedy of the commons

Ever heard the phrase "too much of a good thing"? That's what the **tragedy of the commons** is all about.

It happens when a resource is free for anyone to use and people, acting in their own self-interest, overuse it until it's damaged or gone.

💡 What are common-pool resources?

- These are **non-excludable**, meaning no one can be easily stopped from using them.
- BUT they are **rivalrous**, which means the more you use, the less is left for others.

Unlike true **public goods** (like streetlights or national defence), common-pool resources get used up.

🔁 So... what's the problem?

When everyone's allowed to take as much as they want from a shared resource:

- People tend to **overuse** it.
- Supply can't keep up with demand.
- Eventually the resource is depleted or even destroyed.

🚰 Example: Groundwater (like underground wells)
Farmers often rely on shared underground water sources to irrigate crops. But if **too many** farms draw too much water (without coordination or limits) the water runs dry.

- If no one manages the water use (aka **unregulated**), we get:
  - 🌵 **Dried-up wells**
  - 📉 **Crop failures**
  - 🏜️ **Desertification**.

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8.1.4 Positive & negative externalities

Introduction

Externalities are those costs or benefits which are external to an exchange. They are third party effects ignored by the price mechanism.

Externalities are like the ripple effects of an economic activity; they impact people who aren't directly involved in the transaction. These effects can be **positive (good)** or **negative (bad)** and are often called **spillover effects**. They can happen on the:

- **Consumption side** (what consumers do).
- **Production side** (what businesses make).

External Costs (The Bad Stuff)

External costs happen when the **social costs** (what society pays) are greater than the **private costs** (what the producer pays).

- **Private cost**: The cost a business actually pays to make something, e.g., wages for workers, rent for office space, machinery costs, raw material costs, etc…
- **External cost (negative externality)**: The hidden harm to others that isn't included in the price, like noise pollution from construction.
- **Social cost**: Private cost + external cost.

Example:
A delivery company might save money using cheap, old vans. But those vans create air pollution, which leads to health problems in the city. The company pays for fuel, but society pays for the dirty air.

8.1.4 Positive & negative externalities

Introduction

External Benefits (The Good Stuff)

External benefits happen when the **social benefits** (what everyone gains) are greater than the **private benefits** (what the individual gets).

- **Private benefit**: What the consumer personally gets from using a product or service.
- **External benefit (positive externality)**: The bonus benefit to others, like how public Wi-Fi helps tourists and businesses around it.
- **Social benefit**: Private benefit + external benefit.

Example:
A farmer plants a new apple orchard. They sell the apples (private benefit), but the trees also help clean the air and create habitats for birds (external benefit).

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8.1.4 Positive & negative externalities

External costs of production

Sometimes, producing goods or services creates **negative side effects** for people who aren't involved in the transaction. These are called **negative externalities** of production, and they often cause market failure.

In a free market, businesses only think about their **private costs** - what it costs them to make something. But they don't consider the **external costs**, like the pollution or noise their production causes. This leads to **over-production**, meaning too many goods are made, and society suffers.

If businesses considered the **true costs** (private + external), they'd produce fewer goods, charge higher prices, and reduce the negative impacts.

Key Concepts

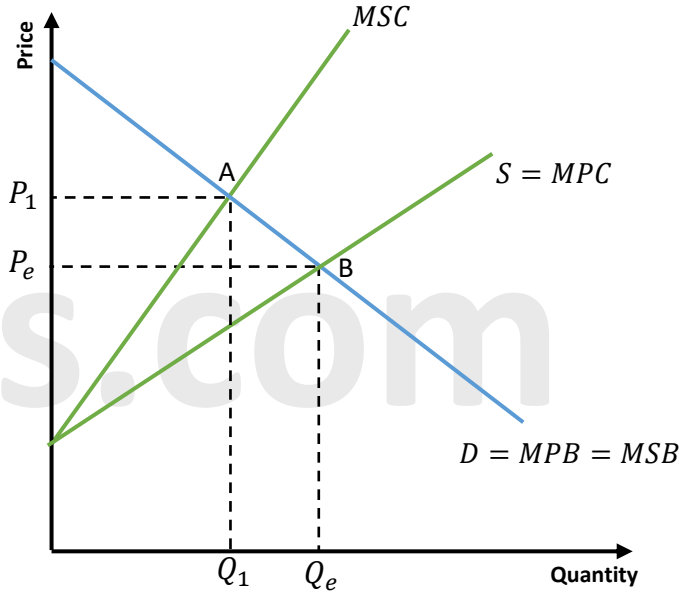
- **Marginal Private Cost (MPC)**: What the producer pays to make one extra unit.
- **Marginal Social Cost (MSC)**: The total cost to society (MPC + external cost).
- **Over-Production**: Happens when businesses only focus on MPC, leading to too many goods being made and a **welfare loss** for society.

Example:
A factory making cheap shoes might dump waste into a nearby river, polluting the water. The factory doesn't pay for the cleanup, the town does. If the factory included the cost of cleaning the river, they'd produce fewer shoes and charge more.

8.1.4 Positive & negative externalities

External costs of production

- **Marginal Private Benefit (MPB)**: The extra satisfaction an individual gets from consuming one more unit of a good.
- **Marginal Social Benefit (MSB)**: The extra benefit to society from that additional consumption.



The **free-market equilibrium** is at P_eQ_e, where businesses ignore external costs.

To fix this, we need to reach P_1Q_1, where **MSC = MSB** (Marginal Social Cost = Marginal Social Benefit). The social cost of making the last unit equals the social benefit of consuming it. At this point, the market reaches the social optimum, and welfare is maximised.

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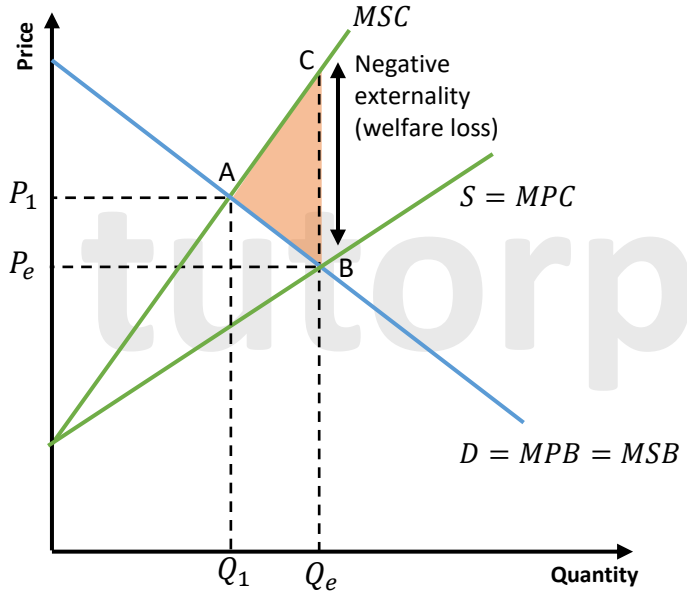
8.1.4 Positive & negative externalities

Negative externalities

Negative externalities of production (diagram analysis)

Negative externalities happen when producing something causes extra costs for society that aren't paid by the producer. In simple terms, the **social costs** (what society pays) are higher than the **private costs** (what the business pays).



When markets are left alone, they ignore these extra costs. Businesses produce where $\boldsymbol{MPB = MPC}$ (where private benefits equal private costs), which is at $\boldsymbol{Q_eP_e}$ in the diagram. But here's the issue: society ends up paying more than it benefits, creating a **welfare loss** (the shaded area in the diagram). The bigger the external costs, the larger the gap between MPC and MSC.

8.1.4 Positive & negative externalities

Negative externalities

Ideally, the economy should produce at the **social optimum** (Q_1P_1), where $\boldsymbol{MSB = MSC}$ (social benefits equal social costs). But that's not what happens in a free market.

Why Do External Costs Grow?

The more something is produced, the bigger the external costs. For example:

- If one person cuts down a tree, the environmental impact is small.
- If a logging company cuts down an entire forest, the loss of biodiversity and carbon absorption becomes a major issue.

Examples of negative production externalities:

- Chemical factories polluting nearby water sources.
- Large-scale farming using pesticides that harm bees and other wildlife.

How can we fix this?

Governments can step in with:

- **Taxes** (to make producers pay for external costs).
- **Regulations** (to limit harmful production).
- **Legislation** (to force businesses to reduce their impact).

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8.1.4 Positive & negative externalities

Negative externalities

Negative externalities of consumption (diagram analysis)

Sometimes, when we enjoy a good or service, others end up paying the price, literally or figuratively. That's called a **negative externality of consumption**.

What's a Negative Externality?

A **negative externality** happens when someone else is harmed by your actions even though they're not involved. For consumption, this usually means:

- The **consumer** only thinks about their own benefits and **private costs**.
- They ignore the **external costs** (like pollution or noise) that hurt others (**third parties**).

Why is this a problem?

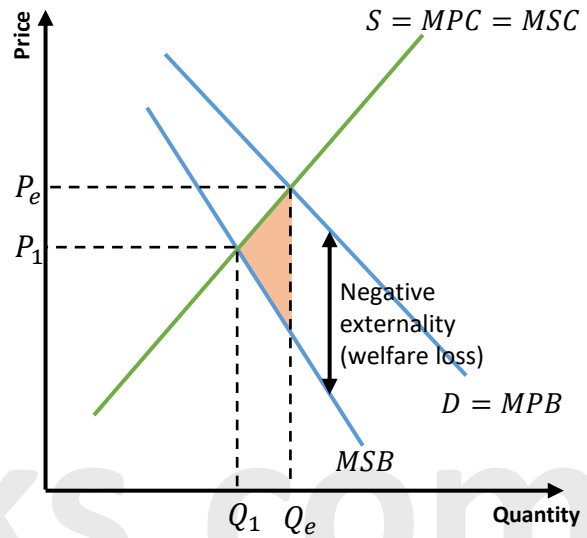
Because people **over-consume**. They don't see the full cost to society, just the cost to themselves. That means we end up using too much of something that actually causes harm overall.

Examples

- **Fast fashion** – Cheap clothes may look great but buying too many fuels pollution and exploitative labour. The environmental damage and social costs? Externalities.
- **Single-use party decorations** – Fun for one evening, but they add to landfill waste and plastic pollution.
- **Energy drinks** – Overconsumption might lead to increased public healthcare costs due to heart issues, anxiety, or addiction, which others have to pay for through taxes.

8.1.4 Positive & negative externalities

Negative externalities



The Diagram: What's Going On?

- **MPB** = Marginal Private Benefit (what the consumer gains)
- **MSB** = Marginal Social Benefit (what society gains overall)
- **MPC** = Marginal Private Cost (cost to the buyer)
- **MSC** = Marginal Social Cost (real cost including harm to others)

On the graph:

- The **free market** gives us quantity **Qe** and price **Pe** (where MPB = MPC).
- But the **socially optimal** quantity is **Q1** and price **P1** (where MSB = MSC).

The gap between **Qe and Q1** is overconsumption, and the shaded triangle is **welfare loss**.

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Negative externalities

Negative externalities of consumption (diagram analysis)

Why It Matters

- When **MPB > MSB**, we're consuming too much.
- Every unit beyond Q1 adds more harm than good.
- This leads to **deadweight loss,** a fancy term for wasted potential where nobody wins.

The Fix?

To make things fairer and more efficient, the government can:

- **Tax** harmful goods (e.g. sugary drinks tax)
- **Regulate** their use (e.g. bans or limits on fireworks in cities)
- **Educate** the public (e.g. campaigns on e-waste disposal)

By stepping in, we aim to reduce overconsumption and bring the market back to what's called **social efficiency** where society gets the most benefit without paying hidden costs.

8.1.4 Positive & negative externalities

Negative externalities

Continue to the next page…

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8.1.4 Positive & negative externalities

Positive externalities

Positive externalities of production (diagram analysis)

What's going on here?
Sometimes when producers make a product, they unintentionally create benefits for others who aren't involved in the transaction. These extra benefits are called **positive externalities of production**.

How It Works

In the real world, producers usually only focus on the **private benefits** like profits. They don't consider the **external benefits** their product gives to society.

So, what happens? The market **under-produces** these useful goods, which leads to a **market failure**.

If we included those external benefits in the decision-making process, we'd make **more** of these helpful goods and they'd probably be **cheaper** too.

Example: Urban tree planting

- When a landscaping company plants trees around a city, they do it because someone paid them.
- But those trees **cool the air**, **reduce pollution**, and make neighbourhoods **prettier and more liveable** for everyone not just the people who paid.
- These are all **positive externalities.**

Without government support or funding, not enough trees would be planted even though society benefits a lot. That's a market failure.

8.1.4 Positive & negative externalities

Positive externalities

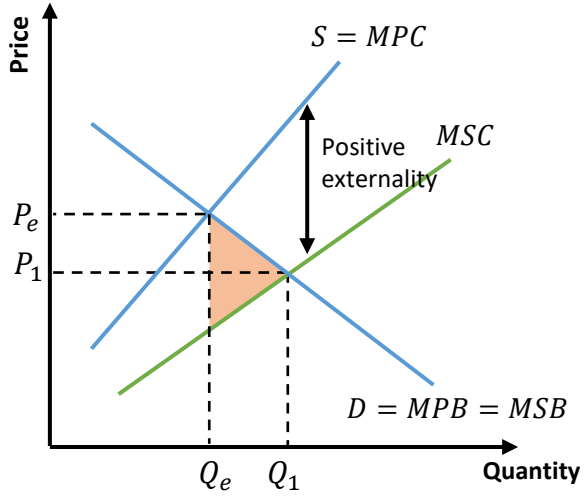

Diagram Explained

In the diagram, you'll see two quantities:

- **Q_e**: What the market actually produces (based on private benefit).
- **Q1**: What society would want produced if we included those external benefits.

The gap between them shows the **under-production**. The shaded triangle? That's the **deadweight loss,** basically the wasted opportunity to make life better.

What Can Be Done?

To fix this, the government might:

- Give **subsidies** to tree-planting businesses
- Offer **tax breaks** to solar panel manufacturers
- Provide **free training** to increase skills in high-demand industries

This pushes the quantity produced closer to **Q1**, reduces deadweight loss, and helps the market become **socially efficient**.

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8.1.4 Positive & negative externalities

Positive externalities

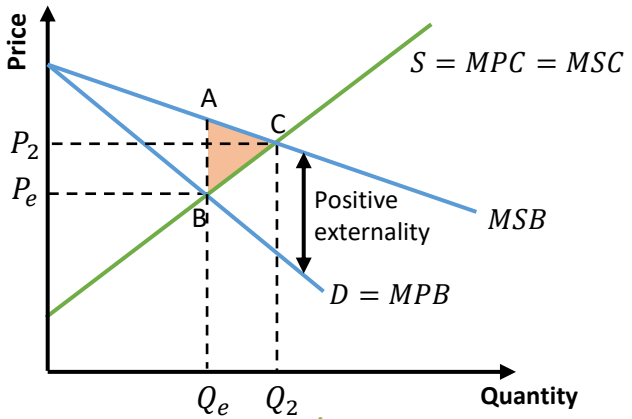
Positive externalities of consumption (diagram analysis)

Positive externalities happen when consuming something benefits not just the person who uses it but also society as a whole. Think of these as **merit goods,** things the market under-produces because people and businesses only focus on their own private benefits and ignore the wider societal benefits.

In a free market, people consume where $\boldsymbol{MPB = MSC}$ (private benefit equals cost), shown as Q_eP_e in the diagram. But here's the catch: this leads to **under-consumption** because the **external benefits** aren't being factored in.

If we accounted for these external benefits, more of these goods would be consumed, and they'd be sold at a slightly higher price, as seen at Q_2P_2.

The ideal outcome, from society's perspective, is at Q_2P_2, where $\boldsymbol{MSB = MSC}$ (social benefit equals cost). Here, everyone wins, and there's no market failure. But to get there, more resources need to be allocated to these goods to maximise **welfare gain** to society.



8.1.4 Positive & negative externalities

Positive externalities

Why Do Social Benefits Grow?

The more people do certain activities, the bigger the social benefits. For example:

- **Using public transport**: Individuals save money and time, while society benefits from reduced traffic congestion and cleaner air.
- **Recycling**: Helps individuals feel good about reducing waste while society benefits from less landfill and lower pollution levels.

The Challenge

- Figuring out the size of these external benefits is tough because they often involve **subjective value judgments** (like deciding how much cleaner streets or reduced traffic are worth). Plus, **information gaps** make it harder, people don't always realize how their actions impact society.

How can we fix this?

Governments can step in to help by:

- **Subsidising** goods with positive externalities.
- **Partially providing** these goods themselves.
- Encouraging consumption through **public awareness campaigns**.

8.1.4 Positive & negative externalities

Why no property rights = big problems for the environment and the economy

Property rights mean that someone legally owns a good or resource and can control how it's used. But when **nobody owns** a resource (like air or oceans), we often run into trouble. Let's break down why this causes **market failure**.

No Ownership = No Control

Markets don't work well when **property rights are missing**. Why? Because when nobody owns something, nobody takes responsibility for protecting it.

Example: The Ocean & The Air

You can't really "own" the sea or the air. Since no one controls access, **everyone can use them freely** and that leads to problems. For instance:

- People might dump waste into the ocean
- Or factories might pollute the air
- Because... who's going to stop them?

This leads to **overuse** and **damage**, a classic case of the **free-rider problem;** people benefit from using a resource without paying or caring for it.

Moral Hazard: "Someone Else Will Deal With It"

This is when people **take risks or act carelessly** because they expect others to bear the cost.

Example:
At a public festival, someone leaves their food wrappers on the grass thinking,
"Someone will clean this up later."
Multiply that by thousands of people, and you've got a **huge cleanup bill** and environmental mess.

8.1.4 Positive & negative externalities

Why no property rights = big problems for the environment and the economy

Overusing Scarce Resources

When resources are unowned or unmanaged, they get used up, fast.

Examples:

- **Groundwater wells** in farming regions being drained by overuse
- **Public Wi-Fi** slowing down because too many people are streaming movies
- **Wild berry patches** in forests being picked clean by foragers with no rules

Because there's no control, people grab what they can before it's gone.

End Result?

- Natural resources get ruined
- Pollution increases
- And society pays the price (literally and environmentally)

This is a big **market failure**, and it's why economists push for strong property rights and environmental regulation.

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8.1.5 Merit and demerit goods

Classification of merit and demerit goods

What are Merit Goods?

Merit goods are things that are *good for you* and for society, but people often don't use them enough on their own.
Think: veggies, education, or exercise.

Why?
People might not fully understand or appreciate the benefits, or they might ignore them altogether.

What are Demerit Goods?

Demerit goods are things that can be *bad for you* or others, yet people still use them too much.
Think: smoking, junk food, or gambling.

Why?
They might seem fun in the moment, but they come with harmful side effects and society often pays the price.

But Sometimes… It's Not So Clear!

Here's the twist: Not all goods are obviously "good" or "bad."
That's where **value judgements** come in; what one person or culture sees as helpful, another might see as harmful.

Example:

Good	Merit Good View	Demerit Good View
Coffee	Boosts alertness, improves focus, and has antioxidant properties	Excessive intake can cause anxiety, insomnia, or heart problems
Social media	Helps people stay connected, share ideas, and spread awareness	Can reduce attention spans, increase anxiety, and fuel misinformation

8.1.5 Merit and demerit goods

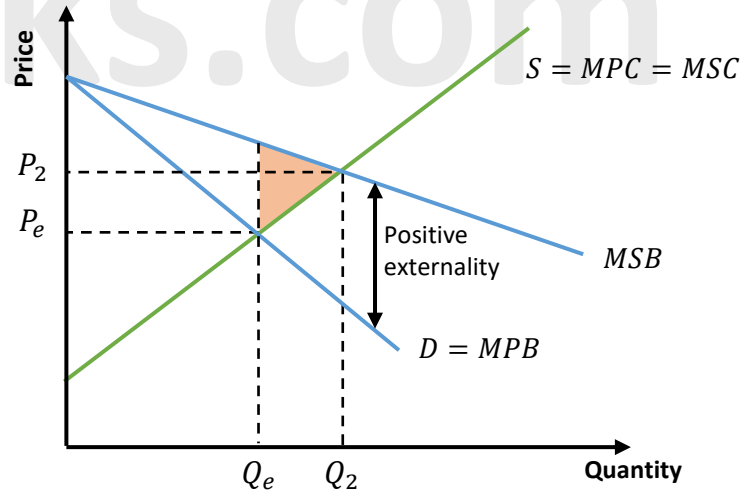
Merit goods

Merit goods are things that are **really good for us**, but we often don't realise it, or we just don't want to pay for them. So we **don't consume enough** of them when they're left to the free market.

These goods offer **private benefits** (like helping you directly) and **external benefits** (which help society too). But since most people only think about what's in it for them, we **under-consume** these goods. This leads to something called a **partial market failure**.

Examples include public libraries, cycle lanes and first aid training.

Governments often step in to **subsidise** these goods (basically help pay for them) to make them more affordable and encourage people to use them.



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8.1.5 Merit and demerit goods

Merit goods

The Diagram:

This shows a free market where **merit goods are under-consumed**.

- **MSC = MPC**: Marginal Social Cost equals Marginal Private Cost. This means from the cost side, things are normal, so producers and society are aligned.
- **MSB > MPB**: Marginal Social Benefit is higher than what consumers think they're getting (MPB = Marginal Private Benefit). This gap shows the **external benefit** that's being ignored.

In a perfect world (for economists), we'd consume at **Q2**—the point where MSB = MSC. But in reality, we stop at **Qe**, which is lower. That difference means:

✅ Not enough people are using the good
❌ We lose out on the extra benefits
⚠️ There's **deadweight loss** (a fancy way of saying "wasted potential")

How Do We Fix It?

To be **socially efficient**, we need to push people closer to Q2. That might mean:

- Offering discounts or subsidies
- Running awareness campaigns
- Making it easier to access these goods

In short, merit goods are like veggies, they might not seem appealing at first, but they're good for you and everyone else too. Sometimes you just need a little nudge (or government help) to get people to consume enough of them.

8.1.5 Merit and demerit goods

Demerit goods

Demerit goods are things people tend to use too much of, even though they're not great for us or society. Why? Because when buying them, people often only think about their own enjoyment, not the bigger picture.

🧠 **So, What's the Problem?**

- **Overconsumption:** People use demerit goods more than is ideal. Society says, "maybe not too much," but people go, "I'll take more!"
- This is because we often **ignore the full cost** of using them especially the **social costs** (the harm it causes others).
- The result? **Too much use**, which leads to **partial market failure** where the market fails to produce the best outcome for everyone.

Demerit goods examples:

Good	Why it's overused	Hidden Harm
Vapes	Tasty flavours + trendiness	Lung health risks & plastic waste
Fast fashion	Cheap, stylish clothes	Environmental damage + sweatshop labour
Energy drinks	Quick boost for tired folks	Sleep disruption & heart issues

🔍 **Why Are These Overprovided?**

- These goods are usually **addictive**, **heavily advertised**, or just feel good short-term.
- People don't think about the **external costs** like pollution, health care costs, or noise.
- And since they're sold freely in the **free market**, there's **too much of them available**.

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8.1.5 Merit and demerit goods

Demerit goods

🧯 Government to the Rescue

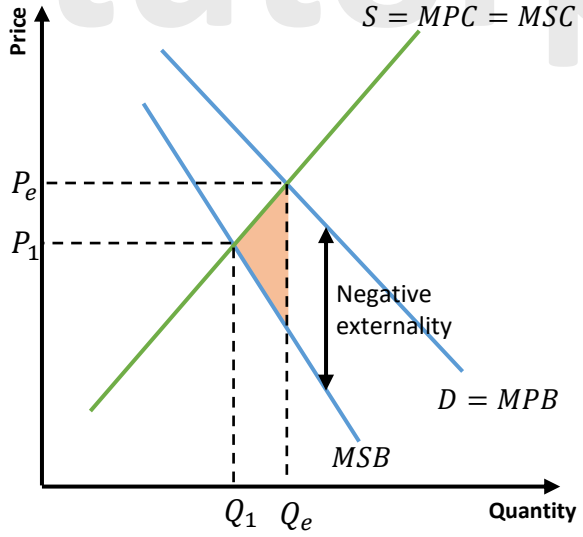
Governments often try to fix the problem by:

- **Taxing** these goods (like sugar or vape taxes),
- **Limiting availability** (e.g. banning energy drinks for minors),
- Or **educating the public** about the harm.

🏭 What About Producers?

Sometimes, it's not the product itself, but the **way it's made** that causes harm. For example:

- A fireworks factory brings joy with the end product 🎆
- But it also causes **noise pollution**, **waste**, and **air pollution** for the surrounding area.



8.1.5 Merit and demerit goods

Demerit goods

📈 Diagram Breakdown

The graph shows:

- People buy **more (Qe)** than what's socially ideal **(Q1)**.
- The **true cost** to society is higher than what consumers think.
- The **orange triangle**? That's called a **welfare loss,** it's a fancy way of saying "society loses out."

✅ What's the Fix?

To make things **socially efficient**:

- We need to **cut down production** of harmful goods.
- Focus resources elsewhere.
- Let governments **step in** when needed.

8.1.5 Merit and demerit goods

Imperfect information and merit and demerit goods

When people don't have the **right information**, they can make poor choices about what to buy or use. This is what economists call **imperfect information** when the info is incomplete, misleading, or just plain wrong.

💡 **What Happens with Imperfect Information?**

- **People don't know enough** to make smart choices.
- As a result, they may **avoid beneficial things** (like healthy food or education) or **overuse harmful things** (like sugary drinks).

✅ **Merit Goods (The Good Stuff People Ignore)**

Merit goods are things that are really good for you and society but people often **don't use them enough** because they don't realise their full value.

📌 **Example:**

- **Eye tests** – They're quick, cheap, and could catch serious issues early... but many skip them. Why? They don't know how important they are.
- **Mental health counselling** – Some avoid it due to stigma or because they think it won't help. In reality, it could greatly improve their life.

🚫 **Demerit Goods (The Not-So-Good Stuff People Overdo)**

Demerit goods are things that are more harmful than they seem. People **overuse them** because they **don't fully understand the risks**.

📌 **Example:**

- **Energy drinks** – They give you a boost now, but too many can mess with your heart or sleep.

8.1.5 Merit and demerit goods

Imperfect information and merit and demerit goods

🏛 **What Can Be Done?**

When people don't have the right info, **governments can step in** to help:

- Run **public awareness campaigns**.
- Educate people through schools or media.
- Add warnings to products (like labels on high-caffeine drinks).

🎯 **Bottom Line:**

Better information = better choices.
If we **know more**, we're more likely to use **merit goods** and avoid **demerit goods**, making us healthier, happier, and reducing harm to others too.

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8.1.6 Market imperfections

Information gaps

Markets don't always work perfectly because people don't have **all the info they need;** this is what we call an **information gap**.

In a perfect world, buyers and sellers would have the **same information** about products and services. We call this **symmetric information,** everyone's on the same page.

But in reality? It's usually **asymmetric (or imperfect) information**, meaning:

- One party (usually the seller) knows more than the other.
- Or the info available is **incomplete, wrong, or misleading**.
- As a result, people make **bad decisions** leading to **market failure**.

For example:

- In the **used car market**, sellers know the car's true condition, but buyers? They're guessing. This creates a trust issue, nobody wants to end up with a bad deal.

Why It Messes Things Up

When one side has more info, markets can go haywire. This leads to:

1. **Over-provision** (too much of something bad):
    - **Example:** Fast fashion brands might hide poor working conditions. If buyers knew, they'd buy less, and fewer resources would go into making those clothes.
2. **Under-provision** (too little of something good):
    - **Example:** Solar panels could help reduce energy bills, but not everyone knows about government rebates. If they did, more people would invest in solar, and society would benefit.

8.1.6 Market imperfections

Information gaps

Fixing information gaps can help markets work better. This means:

- Educating consumers about harmful products (like warning labels on cigarettes).
- Spreading the word about benefits (like government incentives for electric cars).

When people have the right info, markets get closer to **fair and efficient**.

8.1.6 Market imperfections

Monopoly power and market failure

💼 What is Market Power?

Market power is when a business has enough control over a market that it can influence things like:

- **Prices** (charge more)
- **Output** (produce less)
- **Choices** (limit options for consumers)

Basically, they have the power to do what's best for them and not necessarily what's best for everyone else.

👑 What's a Monopoly?

A **monopoly** happens when one company is the **only major player** in a market.
In the UK, if a firm controls more than **25%** of the market, it's considered to have **monopoly power**.

📜 Why Can Monopolies Cause Problems?

Monopolies often lead to **market failure**, and here's why:

- 🏗️ **High Barriers to Entry**
  It's tough for new businesses to enter the market because of crazy startup costs, exclusive patents, or brand dominance. This means **less competition**.
- 😴 **No Motivation to Be Efficient**
  With no real competition, monopolies don't have to lower prices or improve service. Why bother if customers have no other choice?

8.1.6 Market imperfections

Monopoly power and market failure

- 💸 **Higher Prices, Lower Output**
  Monopolies tend to charge more and produce less compared to competitive markets. Consumers pay more for less.
- 🧃 **Lower Consumer Welfare**
  "Consumer welfare" basically means how happy and satisfied we are as buyers. In a monopoly, that drops because we pay too much and don't have enough choice.

⚖️ What About Efficiency?

In economics, we love something called **allocative efficiency** which means resources are used in the best possible way for society.

But in monopoly markets:

- Resources are **not** used efficiently.
- We get a **misallocation** (producing too little of what people want, at too high a price).
- That's a classic case of **market failure**.

🧃 Real-World Example:

- Take your internet provider. If there's only one major company in your area, they might charge high prices, offer mediocre service, and you can't really go elsewhere. That's **monopoly power** in action and it can reduce overall satisfaction and progress in the market.

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8.1.6 Market imperfections

Immobility of factors of production

Factor mobility is all about how easily businesses can switch their resources (land, labour, capital, and enterprise) from one use to another. The more flexible they are, the better the market runs.

🚀 **When Resources Are Flexible: Mobility in Action**

If your business can quickly switch from making phone cases to making laptop sleeves with the same equipment, your **capital** is mobile. This helps your firm adjust when customer demand changes and that's great for profits and efficiency.

✅ More mobility = more **responsiveness** = less waste and more happy customers.

Example: A bakery that switches to gluten-free cupcakes because demand rises. It already has ovens and bakers, so it just tweaks the recipe and goes for it.

🚧 **When Things Get Stuck: What Is Factor Immobility?**

Now here's the problem, not all factors are easy to shift. **Factor immobility** happens when it's hard or slow to move resources to where they're most needed. This causes **market failure** because resources get stuck doing the wrong thing.

😱 **So What Happens When Things Aren't Mobile?**

Imagine a sudden spike in demand for solar panels.

But the machines and workers needed to make them aren't ready or trained yet.

So, supply can't catch up = **supply bottleneck** = unhappy customers = **market failure**.

8.1.6 Market imperfections

Immobility of factors of production

Factor	What It Means	Mobile or Not?	Example
Land	Natural resources from the earth	Usually **immobile**	You can't grow pineapples in Norway (climate says no)
Capital	Equipment & tools	Depends. Can be both	A VHS factory can't make Blu-rays; that tech's **obsolete**
Labour	Workers	Can be stuck due to geography or skills	A coal miner may not instantly become a web developer; needs training.
Enterprise	The risk-taker and decision-maker	Generally, **very mobile**	An entrepreneur who starts a coffee shop could also open a clothing brand

8.1.6 Market imperfections

Immobility of factors of production

Two Big Types of Labour Immobility

1. **Geographical Immobility** = Workers can't move
   - Can't afford to relocate
   - Tied to family in their hometown
   - Don't know where jobs are (info gap)

2. **Occupational Immobility** = Workers can't switch careers
   - Lack of education or skills
   - Don't have the right qualifications
   - E.g. A plumber can't become a nurse overnight even if nurses are in demand

This often leads to **structural unemployment** (people are willing to work, but their skills or location don't match the jobs available).

Why This All Matters

When resources get stuck, it causes a **misallocation;** we aren't making what people actually want or need. That's bad news for the economy and for society and it's a textbook case of **market failure**.

Solution?

- Job relocation support
- Retraining programmes
- Clear job market info
- Investing in modern tech

8.1.6 Market imperfections

Immobility of factors of production

Continue to the next page…

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8.1.7 Competition policy

Competition policy is all about making sure businesses compete fairly so that consumers get better prices, more choices, and good quality. It's kind of like being a referee in a football match, making sure no team (or business) plays dirty.

In the **UK**, competition policy includes a bunch of tools to keep the market fair and open:

- **Legislation**: Laws are made to stop unfair practices like price fixing (where companies secretly agree to keep prices high).
- **Privatisation**: When the government sells public companies (like Royal Mail) to private owners to increase competition.
- **Deregulation**: Removing unnecessary rules so more companies can enter the market. For example, letting more bus companies operate in one city.
- **Stopping harmful mergers**: Big mergers (when two companies combine) might reduce competition. So, the government checks if a merger would hurt customers by giving one firm too much power.
- **Controlling monopoly power**: A **monopoly** is when one firm dominates the market. Policies help stop them from charging super high prices or reducing quality just because they can.

👮 In the UK, all of this is overseen by the **Competition and Markets Authority (CMA).** They're like the watchdogs making sure the rules are followed.

8.1.7 Competition policy

Principles of UK competition policy

⚖️ **Key Ideas Behind the Policy:**

- **Efficiency is better with competition**: If we ignore the benefits of large-scale production (**economies of scale**), then **perfect competition** (many small firms) is seen as more efficient. This is because it pushes firms to use resources wisely (**productive efficiency**) and to produce what society actually wants (**allocative efficiency**).
- **Monopolies can be bad for consumers**: A monopoly might limit how much they produce so they can charge higher prices and earn **supernormal profits** (profits above the normal expected level). This means consumers lose out as they pay more and get less, which reduces **consumer surplus** (the extra value consumers get over what they pay) and leads to lower **welfare** in society.

😏 **But Wait — Monopolies Aren't Always Bad...**

- **Sometimes big firms are cheaper**: If a monopoly can produce at a lower cost per unit than smaller firms (thanks to **economies of scale**, like bulk buying or big machines), then it might actually be good for prices.
- **Innovation can thrive in big firms**: Some monopolies, like big tech companies, can reinvest their profits into new technologies, making them more **dynamically efficient** (better over time).
- **Each case is different**: The CMA looks at every situation on its own. Not all monopolies are punished; it depends on whether they harm consumers or not.

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8.1.7 Competition policy

Principles of UK competition policy

🔍 **What Does UK Competition Policy Focus On?**

- **Monopolies** – preventing abuse of power and high prices
- **Mergers** – making sure big companies joining forces won't reduce competition
- **Restrictive practices** – stopping sneaky behaviour like price-fixing or blocking rivals
- **Promoting competition** – encouraging new businesses to enter the market and shake things up

8.1.7 Competition policy

Monitoring Monopolies

In the real world, we don't see many true monopolies (where one firm completely controls a market). Most markets are **concentrated**, meaning just a few big firms dominate. These are often called **oligopolies**.

The UK's **Competition and Markets Authority (CMA)** looks at how firms behave (structure, conduct, and performance) to decide if they're being fair and what action to take if not.

🛠️ **How Can We Keep Monopolies in Check?**

1. Break Them Up
Some economists believe breaking up big monopolies is the way to go. The idea is that smaller companies = more competition = better prices and services for consumers.
📌 Example: Think of breaking up a huge tech company into separate businesses like messaging, shopping, and video each competing on its own.

2. Tax Their Huge Profits (Windfall Taxes)
When a monopoly makes **supernormal profit** (extra big profits above what's considered normal), the government might step in with a special tax to share the wealth.
📌 Example: An energy company making record profits during a fuel crisis could face a windfall tax.

3. Price Controls
The government might set a **maximum price** that the company can charge, to stop it from taking advantage of its power.
📌 Example: A cap on electricity prices to protect households.

4. Nationalise It (Public Ownership)
This means the government takes over the company, so it's run for the benefit of the public, not for profit.
📌 Example: Some people argue the train network or healthcare should be publicly owned and focused on service, not profits.

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Monitoring Monopolies

5. Sell It to Private Firms (Privatisation)
On the flip side, some think private companies do a better job because they're more focused on being efficient and satisfying customers.
📌 Example: A government-run service being sold to a private business that then competes to improve performance.

6. Remove Rules (Deregulation)
Sometimes, the government takes away rules that stop new businesses from entering the market. This makes the market more **contestable**, meaning even if there's one big player, the threat of new competitors keeps them in check.
📌 Example: Letting smaller delivery companies enter the parcel market to compete with the big names.

8.1.7 Competition policy

Controlling Mergers

Mergers (when two or more companies join together) can sometimes create super-powerful firms that dominate a market. This can lead to problems like:

- Higher prices for consumers
- Less choice
- Poorer quality products

That's where the **Competition & Markets Authority (CMA)** steps in. 🛑

The CMA works alongside other regulatory bodies too, like:

- **CAA (Civil Aviation Authority)** – keeps the skies fair
- **OFGEM** – keeps an eye on energy companies
  In the **EU**, the **European Commission** also helps crack down on businesses that try to reduce competition unfairly. So, if a UK company trades in the EU, it must follow **both UK and EU rules**.

🔍 **How Does the CMA Keep Mergers in Check?**

One of their superpowers is the ability to **monitor mergers**.

A **merger** is when two businesses combine into one. While sometimes that's good, it can be a problem if the new firm becomes too big especially if it ends up with more than **25% of the market share** (that's considered a lot of power in one firm).

Here's what the CMA can do:

- 🚫 Stop the merger if they think it would harm competition
- ✅ Let it go ahead, but with conditions (e.g. force the company to sell off parts of the business to keep things fair)

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8.1.7 Competition policy

The cost and benefits of competition policies

Competition policies are rules and actions put in place to keep markets fair. The goal? Stop firms from becoming too powerful and ensure consumers get good value.

But let's be real, to make these policies work, regulators (like the CMA in the UK) need to constantly check up on businesses. And that takes a lot of time and money.

Benefits of competition policies

What's Great About It	Why It Matters
Lower Prices	When firms compete, they often drop prices to attract customers. More competition = cheaper prices for us.,
Better Quality & Service	No business wants to lose customers. So, they work harder to give us better products and friendlier service.
Efficiency Boosts	We get: • **Productive efficiency** – making stuff using fewer resources • **Allocative efficiency** – producing what people actually want.
More Innovation	Companies invest more in R&D (research and development) to stay ahead. That means new tech, smarter processes, and better products.

8.1.7 Competition policy

The cost and benefits of competition policies

Costs of competition policies

Potential Downsides	Why It's a Problem
Risk of Government Failure	If the government messes up (like regulating too much or in the wrong way) it could make markets worse, not better. That's called **government failure**.
Hurts Natural Monopolies	Think of water or rail networks, these are **natural monopolies** (where it's more efficient for one company to operate). Interfering might stop them from growing efficiently.
Less "Creative Destruction"	Some monopolies (big dominant firms) pump tons of money into R&D. If you limit their power, you might limit future innovation too.

Example:

- **Innovation win**: In a competitive tech market like smartphones, we get new features every year. That's thanks to companies trying to outdo each other.
- **Government failure risk**: If regulators set price limits on energy that are too low, companies might stop investing and then everyone suffers from blackouts or poor service.

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8.1.8 Public ownership, privatisation, regulation & deregulation of markets

The arguments for and against the public ownership of firms and industries

Public ownership (also called **state ownership**) means the government owns businesses, industries, or important services instead of private companies running them for profit.

Nationalisation is the process where a government takes something from private ownership and brings it under public control. This is often done for:

- **Merit goods** (like healthcare and education), which benefit society but might not be provided enough by private firms.
- **Public goods** (like street lighting)

8.1.8 Public ownership, privatisation, regulation & deregulation of markets

The arguments for and against the public ownership of firms and industries

✅ **Benefits of Public Ownership**

💡 Advantage	📝 Why It's Helpful
1. Supplies stuff the market may ignore	The free market might not provide enough schools, buses, or public libraries. Government steps in so we're not left without.
2. Helps control natural monopolies	Some services are just better when there's only one provider. For example, we don't need five different companies digging up roads to lay **water pipes;** one public provider is more efficient.
3. Some services are too important to fail	Things like water or emergency services are essential. Leaving them to profit-driven firms can be risky.
4. Focuses on social good, not just money	Unlike private companies, public firms can make choices that help society like keeping bus fares low for everyone.
5. Can create positive externalities	These are benefits to society that go beyond the person using the service. For example, **public transport** reduces car use, which cuts down traffic jams and pollution
6. More efficient outcomes (sometimes)	Governments aim for **allocative efficiency** meaning they try to produce exactly what people need.

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8.1.8 Public ownership, privatisation, regulation & deregulation of markets

The arguments for and against the public ownership of firms and industries

⚠️ Downsides of Public Ownership

🚫 Disadvantage	💬 Why It's a Problem
1. May lack business know-how	Governments aren't always the best at running businesses; this could lead to poor decisions.
2. Can create **natural monopolies**	For example: You wouldn't want 10 companies digging roads to lay water pipes. One firm is more efficient but that also means no competition.
3. Higher cost to taxpayers	Running industries can be expensive, so more public ownership = higher taxes.
4. Risk of inefficiency	Publicly owned firms can lack competition, which might lead to inefficiency.

8.1.8 Public ownership, privatisation, regulation & deregulation of markets

The arguments for and against the privatisation of state-owned enterprises

Privatisation is when the government sells something it owns (like a company or service) to private businesses or individuals. Basically, it moves from the **public sector** (run by the government) to the **private sector** (run by private people or companies).

- After it's sold, it operates in the **free market**, where competition and profit take the lead.
- A common example is British Airways which was once owned by the government but was privatised and now competes like any other airline.

✅ Benefits of Public Ownership

💡 Advantages	💬 Why It's a Problem
1. More Efficiency	In the private sector, businesses are driven by profit, so they have a strong incentive to be **efficient**, cut waste, and find better ways to operate. That can mean faster services, fewer delays, and smarter use of resources.
2. Brings in money for the government	Selling government-owned companies brings **short-term revenue** that can be spent on things like healthcare or education.
3. Encourages competition and innovation	When firms are privatised, **new players** might enter the market. This can lead to better services and lower prices because everyone's trying to win over customers.

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8.1.8 Public ownership, privatisation, regulation & deregulation of markets

The arguments for and against the privatisation of state-owned enterprises

⚠️ Downsides of Privatisation

🚫 Disadvantage	💬 Why It's a Problem
1. Monopolies might stay monopolies	Even after privatisation, a company can still hold a **huge chunk of market power** meaning they dominate and face little competition. That's risky for consumers.
2. Profit before people	Private firms might **cut corners** or raise prices just to make more money. For example, they might reduce customer service quality or raise energy bills.
3. Might sell assets too cheaply	Sometimes government-owned businesses are sold **below their true value**, which means taxpayers lose out.
4. Supernormal profits	These are **extra-large profits** firms make when they have little competition. Some privatised firms may restrict supply to keep prices (and profits) high.

8.1.8 Public ownership, privatisation, regulation & deregulation of markets

The arguments for and against the regulation of markets

Regulation is when the government steps in to make sure markets don't go wild. It's all about **monitoring and enforcing rules** to protect people, the environment, and ensure fair competition.

Governments create rules to:

- **Limit harm** from **negative externalities** (when a product causes harm to people who aren't directly involved like air pollution from factories).
- Make sure markets are **competitive** so no business becomes too powerful and takes advantage of consumers.

Who enforces the rules?
That's the job of **regulatory agencies**. Think of them as referees in a football match. They blow the whistle if a business breaks the rules.

- Regulators include FCA (ensure fair play in financial services), Ofwat (watches over water providers) and Ofgem (keeps an eye on energy companies.
- Breaking the rules can lead to **fines or even prison**.

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8.1.8 Public ownership, privatisation, regulation & deregulation of markets

The arguments for and against the regulation of markets

✅ **Pros and** ❌ **Cons of Regulation**

Advantages	Disadvantages
Businesses that don't follow the rules may face **big fines**, which discourages them from breaking the law. And fines = extra money for the government.	Could result in **government failure** when the government's attempt to fix a problem makes things worse
Leads to **positive externalities** like requiring kids to stay in education longer, creating a smarter, more skilled workforce	Some rules can be **expensive to enforce** (like checking everyone is recycling properly) which **reduces profits** for firms, which might lead to less investment in innovation
Can reduce **external costs** of **demerit goods** (harmful goods like junk food or cigarettes)	Can create **barriers to entry** making it tough for small or new businesses to join the market
Can lead to **lower prices**, giving consumers more bang for their buck (increases **consumer surplus**)	People might still **break the rules** (e.g., banned goods may be sold on the black market).
	Risk of **regulatory capture** when regulators end up helping the very companies, they're supposed to be policing

8.1.8 Public ownership, privatisation, regulation & deregulation of markets

The arguments for and against the deregulation of markets

Deregulation means reducing or removing government rules, giving firms more freedom. It's like **cutting the red tape** that slows businesses down.

Why Deregulate?

- It encourages **competition** – more firms can enter the market, keeping prices down and quality up.
- It can improve **economic efficiency** – businesses can produce more, innovate faster, and react to consumer needs.

Advantages	Disadvantages
💸 **Lower Prices** – Deregulation can increase competition, which often leads to lower prices for consumers. For example, in the airline market, budget airlines have popped up.	💼 **Hard for Small Firms to Compete** – Big private firms might dominate the market, making it hard for smaller ones to survive.
⚡ **Better Efficiency** – Firms are motivated to cut waste, improve services, and reduce costs.	💰 **Higher Prices Possible** – If one big firm takes over, it might charge more without regulation keeping it in check.
🏢 **Less Red Tape** – Fewer government rules can mean lower administrative costs for businesses.	📉 **Worsened Service Quality** – Companies might cut corners to save money. For instance, deregulated bus routes sometimes led to congestion and duplicated services.
🧑💼 **More Choice** – With fewer barriers, new firms can enter the market, giving consumers more options.	⚠️ **Safety Risks** – In essential industries (like construction), cutting rules might put safety at risk.

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The problem of regulatory capture

Regulatory capture happens when the people who are supposed to keep an eye on businesses (regulators) start looking out for those businesses instead of the public. It's like asking a referee to coach the team they're supposed to be judging.

This often happens because **regulators rely on the company's information**, which can be **biased or incomplete**. The company knows a lot more about its business than the regulator does; this is called **asymmetric information**. And when the regulator doesn't have the full picture, they might accidentally make rules that help the company more than the consumers.

💡 **Example:** Suppose a water company tells the regulator their costs are super high (even if they're not). The regulator might allow them to raise prices to cover these "costs." Meanwhile, customers end up overpaying.

If the government doesn't get accurate info, they might:

- Set **price caps** (maximum prices) that are too high or too low
- Approve decisions that **waste resources** (e.g. building unnecessary infrastructure)
- Miss the chance to protect consumers properly

8.1.8 Public ownership, privatisation, regulation & deregulation of markets

Continue to the next page…

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8.1.9 Government intervention in markets

Most economies around the world are a **mix** of free markets and government intervention. But why do governments get involved in the first place? Here's the scoop:

Fixing Market Mess-Ups (a.k.a. Market Failure)

- Markets don't always work perfectly. Sometimes, resources aren't used in the best way for society. Firms and people are busy chasing their own goals, so the government steps in to balance things out like controlling how much stuff is made or used.

Collecting Cash for Important Stuff

- Governments need money to fund schools, hospitals, and public services. They earn this cash through taxes or privatising industries. This keeps the system running smoothly.

Making Life Fairer (Promoting Equity)

- Life isn't fair, but governments try to make it a bit better by narrowing the gap between the rich and poor. They use tools like taxes to redistribute wealth, helping those in need while ensuring society stays stable.

Supporting Businesses

- In a global economy, some industries need a little push to stay competitive. Governments back these key players so they don't fall behind, helping the whole economy in the process.

Helping Struggling Households

- Poverty doesn't just hurt individuals; it drags down the economy too. Governments aim to reduce poverty by redistributing income and offering safety nets, like benefits, to keep things moving forward.

8.1.9 Government intervention in markets

Common Tools Governments Use

To step in, governments often rely on methods like:

- **Taxes** to influence prices
- **Subsidies** to encourage production or consumption
- **Maximum prices** to make goods affordable
- **Minimum prices** to ensure fair wages or incomes

🎯 **Government Objectives & Resource Allocation**

Governments step in to improve how resources (like money, labour, and land) are used; this is called **resource allocation**. The goal? To make the economy work better and fairer for everyone.

How much should the government intervene?

It depends on its **macroeconomic goals** (e.g. low inflation, full employment, growth, fairness).

There are two main views:

🧵 **Free-market economists**

- Want **limited** government role
- Say the market works best on its own
- Government should only provide essentials (like defence or law enforcement)

🛠️ **Interventionist economists**

- Support **more government involvement**
- Believe it ensures **fairness**, access to key services, and prevents market failure
- Helps reduce inequality and improve public welfare

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8.1.9 Government intervention in markets

Indirect Taxation

A tax is a mandatory charge by the government to raise revenue to fund public services and programs. There are two main types: direct and indirect taxes.

Direct taxes are taken directly from individuals or organizations, usually on income. Examples include personal income tax and corporation tax (on company profits).

Indirect taxes are applied to goods and services when purchased, essentially taxing spending. These come in two forms:

- **Specific tax**: A fixed amount per unit, like £0.50 sugar tax on a bottle of fizzy drink or £1 on every litre of petrol.
- **Ad valorem tax**: A percentage of a good's price, like a 20% VAT on clothes.

When an indirect tax is introduced, it increases the price of goods or services. This tax creates a gap between what producers earn and what consumers pay. This shifts the supply curve upward and left (decreasing supply).

8.1.9 Government intervention in markets

Indirect Taxation

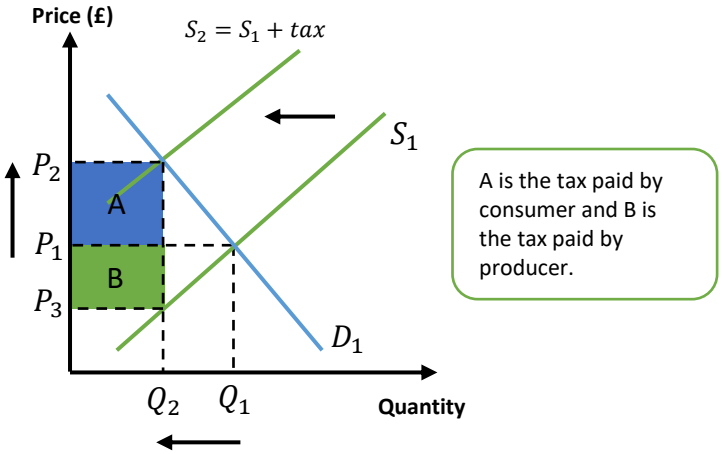


Diagram Breakdown:

1. **Before the Tax:**
   The market starts at equilibrium (P_1, Q_1). No stress, just balance.
2. **After the Tax Hits:**
   - The supply curve shifts up from S_1 to $S_1 + tax$.
   - Prices rise (P_1 to P_2), and fewer goods are bought (Q_1 to Q_2).
3. **Who Pays What?**
   1. **Consumers** pay the chunk marked "A" (higher prices).
   2. **Producers** lose part of their revenue, marked "B".

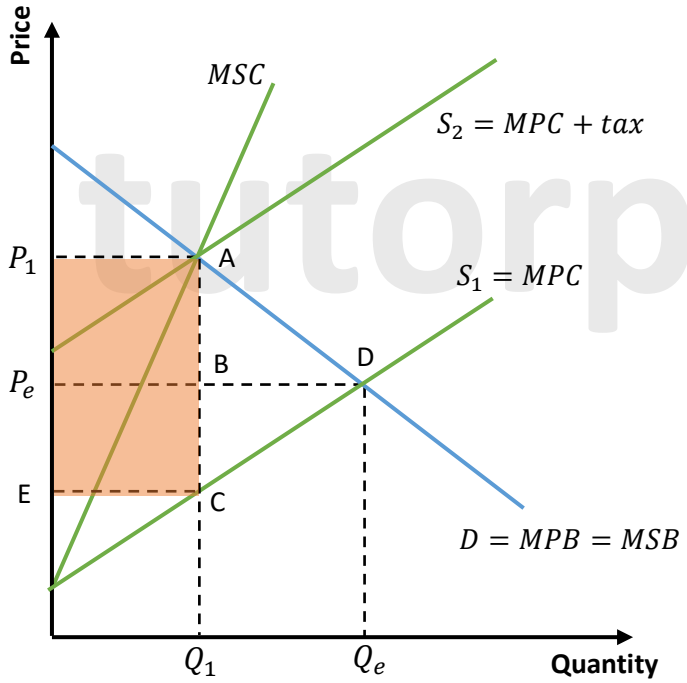
The government, meanwhile, happily pockets the sum of A and B as tax revenue.

8.1.9 Government intervention in markets

Indirect Taxation

How Taxes Fix Negative Externalities

- When a product or activity causes harm to others (a negative externality), the government can step in with an indirect tax to fix the problem. This tax makes production more expensive for businesses, shifting the supply curve (or the Marginal Private Cost, MPC curve) from **S1** to **S2**.



8.1.9 Government intervention in markets

Indirect Taxation

What's the Issue?

- Without intervention, the free market produces at **PeQe**, where **MPC = MPB** (Marginal Private Benefit). But here's the problem: at this point, the harm caused to society (**Marginal Social Cost, MSC**) is greater than the benefit. The **socially optimal level** is actually at **P1Q1**, where **MSB = MSC** (Marginal Social Benefit = Marginal Social Cost).

How Does the Tax Work?

- By introducing a tax, the government forces businesses to "internalise" the external cost (like pollution or noise). This shifts the market to **P1Q1**, which is better for everyone. It reduces overproduction and cuts down on the harm caused to society.

Bonus: Government Revenue

- The orange rectangle in the diagram shows the revenue raised by the government from this tax. This money could be used to fix the damage caused by the externality (like funding clean-up projects or public health campaigns).

- The tax is shared between producers and consumers based on demand and supply elasticities. Consumers pay the red area; producers pay the blue area.

Specific vs Ad Valorem Taxes

- This example uses a **specific tax**, which adds a fixed cost per unit. An **ad valorem tax** (a percentage-based tax) would also work, but the curve would shift slightly differently.

8.1.9 Government intervention in markets

Indirect Taxation

Advantages

- **Solves Problems:** Taxes fix externalities by making markets operate at the socially optimal level, reducing harm like pollution.
- **Generates Revenue:** Taxes fund public services like healthcare, education, and recycling programmes.
- **Adaptable:** Governments can adjust taxes based on the level of harm (e.g. higher taxes on coal than bread).

Disadvantages

- **Hard to Measure:** It's tricky to calculate the exact harm and set the right tax.
- **Black Markets:** High taxes can lead to illegal trade, like untaxed alcohol or fuel.
- **Limited Effect on Necessities:** Inelastic goods like fuel won't see much demand reduction despite high taxes.
- **Hits the Poor Harder:** Lower-income groups spend more of their income on taxed basics like energy or fuel.
- **Conflicting Goals:** Governments may focus on revenue over fixing the externality.
- **Costly to Enforce:** Collecting and monitoring taxes can be expensive, especially for small or informal markets.

8.1.9 Government intervention in markets

Indirect Taxation

Examples:

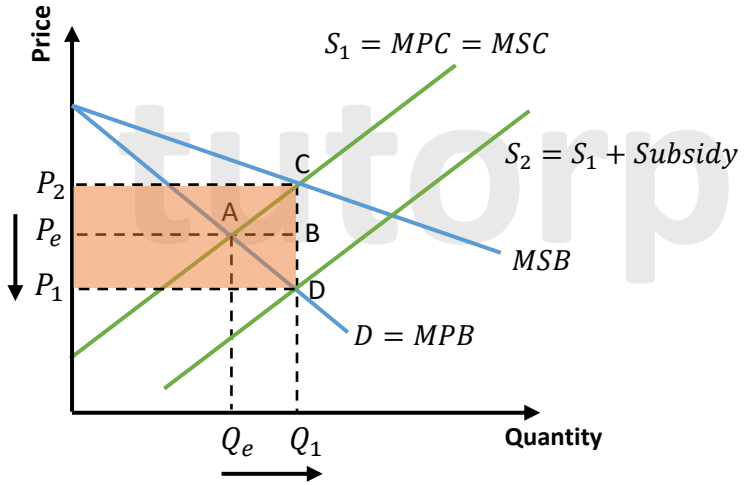
- **Plastic Tax:** Reduces waste by encouraging reusable bags and biodegradable materials.
- **Congestion Charges:** Cuts traffic and funds public transport.
- **Water Taxes:** Discourages wasteful water use and funds conservation efforts.

8.1.9 Government intervention in markets

Subsidies

A subsidy is financial support, often from the government, to help businesses produce more. For example, farmers may get subsidies to grow more crops, which increases supply and lowers food prices. This benefits both producers and consumers, making goods cheaper and more accessible.

When the government gives a subsidy, it shifts the supply curve. This helps increase the quantity and lowers the price for consumers.



Without help, the market produces at QePe, where private costs and benefits (MPC = MPB) balance out. But society's ideal spot is at Q1P2, where social costs and benefits (MSC = MSB) align. A subsidy shifts the supply curve to the right (from S1 to S2), making it cheaper for producers to create more and reach that socially optimal output.

8.1.9 Government intervention in markets

Subsidies

The result? Social welfare is maximised. The market now produces at a level that benefits everyone, with government spending (the orange box in the diagram [P2CBP1]). Think of it as the government stepping in to make sure resources are used where they do the most good.

Part of the subsidy is passed on to consumers equal to the area PeBDP1 and the other portion of the subsidy (P2CBPe) remains with the producer.

Advantages of subsidies:

- **Boosts society's benefits**: Subsidies help reach the ideal output, where everyone benefits and welfare is at its best.
- **Promotes fairness**: Subsidies can level the playing field, helping smaller farms or struggling renewable energy projects.

Disadvantages of subsidies:

- **Expensive for governments**: Subsidies cost a lot and can divert money from other crucial areas like healthcare or education.
- **Hard to target perfectly**: Governments may not always know the right amount of subsidy needed to fix the problem (e.g., how much support clean water projects need).
- **Difficult to stop**: Once subsidies are in place, removing them can lead to backlash, like protests or companies struggling to survive without support.

Subsidies can support public transport to cut traffic and pollution, boost AI tech startups for better healthcare, and fund affordable housing projects.

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8.1.9 Government intervention in markets

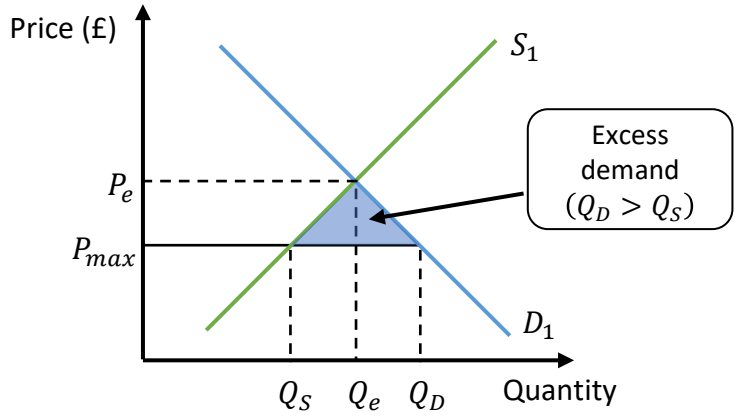
Maximum Prices

A **maximum price**, also known as a **price cap**, is like a rulebook move from the government to make certain essential goods or services more affordable for everyone. This price cap is set **below** the free market price (Pmax < Pe), ensuring that suppliers can't overcharge. But it creates a bit of chaos in the form of **excess demand** (or a shortage). Why? Because at this lower price, more people want the good (QD), but fewer suppliers are willing to provide it (QS).

For example: the government can cap rents to make housing affordable. By capping rents, more people can afford homes. However, some landlords might pull out of the market, leading to a **housing shortage**. Another example could be **fuel caps during a crisis** to ensure people can still fill their cars without going broke.

In the graph:

- The free-market equilibrium is at Pe and Qe.
- The **maximum price (Pmax)** reduces the price but creates a gap between QS (what's supplied) and QD (what's demanded).
- That shaded triangle? It's the **excess demand** showing more people wanting the product than what's available.



8.1.9 Government intervention in markets

Minimum Prices

A **minimum price** is like a safety net set by the government to stop prices from falling too low. It's usually done to either help producers or reduce the consumption of harmful goods (like alcohol). For it to work, the minimum price has to be **above** the current market price, so sellers can't legally charge anything less.

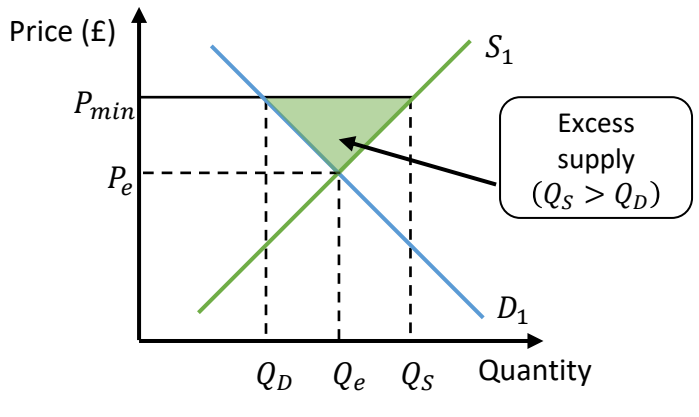
Imagine this: the government sets a **minimum price on milk** to support farmers. The new price is higher than the market price, so farmers make more money. However, now there's **excess supply,** the farmers are producing more (QS), but shoppers only want less (QD). This creates a surplus, shown in the diagrams as the **orange triangle** (QS - QD).

Another example could be **minimum wages**. It ensures workers earn a fair amount, but if the wage is set too high, businesses might not hire as many people, leading to unemployment (excess supply of workers).

Government response to **minimum prices:**

Agriculture: Farmers benefit as they earn more. The government buys the extra supply and may **export it** or store it for later.

Demerit goods (e.g., alcohol): Producers face lower demand and excess supply. The government **doesn't buy the surplus**, so producers cut back on production.



Pros and Cons of Maximum and Minimum Prices

Advantages:

1. **Helps society and fairness:** Prices can be set where the social benefit equals the social cost (MSB = MSC). This means everyone benefits, and society's well-being improves.
    - **Example:** Minimum wages can reduce poverty by ensuring workers earn a fair income.
2. **Improves access and equity:** Maximum prices make essential goods like food or housing affordable, while minimum prices ensure farmers or producers get paid fairly.
    - **Example:** Rent controls can help people afford housing in expensive cities.

Disadvantages:

1. **Messes up supply and demand:** Maximum prices can cause shortages (too many people want it, but there's not enough to go around). Minimum prices can cause surpluses (too much is produced, but not enough buyers).
    - **Example:** With rent caps, more people want homes, but fewer landlords want to rent them out, creating a housing shortage.
2. **Hard for governments to get it right:** It's tricky to decide where to set these prices. If they're set too high or too low, they can miss the mark and create unintended problems.
    - **Example:** Misjudging a minimum price for crops could leave tons of unsold food.

8.1.9 Government intervention in markets

Buffer Stock Scheme: Keeping Prices Steady

A **buffer stock scheme** is like a safety net for prices, used for goods like agricultural products where prices can swing wildly. Here the government implements both a maximum and minimum price at the same time. Imagine wheat farmers: some years they grow too much, and prices crash; other years, there's barely any, and prices skyrocket. A buffer stock scheme helps keep things balanced.

Here's how it works:

- **When prices drop below a set minimum**, the government steps in to buy the extra supply. This stops prices from falling too low.
- **When prices shoot above a set maximum**, the government sells from its stored stock to bring prices back down.

This keeps prices stable and ensures farmers earn a steady income, but it comes with challenges:

- **High costs for the government:** Buying and storing all that extra produce isn't cheap.
- **Encourages overproduction:** Farmers might grow too much, knowing the government will always buy it.

8.1.9 Government intervention in markets

Other methods of government intervention

1. Pollution Permits: Pay to Pollute Less

Governments give out “pollution tickets” to factories, letting them release a set amount of pollution. Want to pollute more? Buy extra tickets from cleaner companies. This helps reduce **negative externalities** of production and also makes pollution expensive, so firms invest in cleaner technology. Bonus: Cleaner companies can sell their extra tickets and earn money.

Advantages of pollution permits

- **Revenue for the government**: Selling permits and fining companies brings in money, which can be spent on projects like renewable energy or tree planting.
- **Pollution is guaranteed to drop**: By limiting the number of permits, the government makes sure pollution stays under control.
- **Tech gets greener**: Companies are motivated to upgrade to cleaner technologies. Because it's often cheaper than buying more permits.

Disadvantages of pollution permits

- **Prices might go up**: Businesses often pass on the extra costs of permits to customers.
- **Costs a fortune to monitor**: Keeping an eye on who’s polluting and enforcing rules takes a lot of effort (and cash).
- **Tricky to set the right number**: Deciding how many permits to allow isn’t easy. Too many, and pollution won’t drop. Too few, and businesses struggle.

8.1.9 Government intervention in markets

Other methods of government intervention

2. Public Goods/State Provision: Stuff Everyone Uses

Think parks, streetlights, and lighthouses, things we all enjoy but no business wants to provide because they can’t stop people from using them for free (free rider problem). That’s where the government comes in, using taxes to make sure we get these essentials.

Advantages of public goods

- **Promotes equality**: By ensuring everyone has access to basic needs like education or clean water, the government helps bridge the gap between the rich and poor.
- **Fixes market failure**: The government steps in to provide essential goods (like fire services or vaccines) that the market would otherwise ignore. This boosts social welfare and keeps things running smoothly.
- **Benefits the public**: For example, funding public libraries gives people free access to knowledge, helping students, jobseekers, and lifelong learners thrive.

Disadvantages of public goods

- **Could mess up priorities**: Without market signals, governments might overspend on unnecessary things. Imagine too many sports stadiums but no public toilets.
- **It’s expensive**: Running big public projects costs loads of money, which could’ve been spent elsewhere (this is what economists call "high opportunity cost"). Plus, admin costs can pile up.
- **Corruption risk**: Politicians and officials might prioritise their own interests or conflicting goals, leading to misuse of funds or poor decisions.

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8.1.9 Government intervention in markets

Other methods of government intervention

3. Provision of information

Sometimes, markets fail because not everyone has the same information, this is called an **information gap**. To fix this, governments step in with easy-to-access resources (like job centres) or force companies to provide the information e.g., nutritional labels.

Advantages

- It helps people make **smarter choices.** With better information, consumers can act **rationally**, making the market run smoother.
- It works even better when paired with other policies. For example, combining it with taxes can help reduce demand for harmful products like sugary drinks in the long run.

Disadvantages

- Even the **government might not know everything;** if they don't have the right facts, how can they inform others?
- It's **not cheap**. Running campaigns, creating websites, or printing labels costs the government time and money (which could've been used elsewhere).
- People can be stubborn. Even with all the information, some might just **ignore it** or stick to old habits.

8.1.9 Government intervention in markets

Other methods of government intervention

4. Regulation

Governments set up rules to protect us all from the harm caused by **negative externalities** (like noise pollution or unsafe products). Here's how they make sure these rules are followed:

They create **regulatory agencies** to enforce the rules and keep everything in order. If someone breaks the rules? They might face **fines** or even **jail time**.

Examples of regulators:

- **Food Standards Agency**: Ensuring the food you eat is safe and up to standard.
- **Ofsted**: Ensuring schools and nurseries are up to standard.
- **The Financial Conduct Authority (FCA)**: Watching over banks, investments, and insurance to protect consumers.

Advantages

- **Protects Consumers**: Clear rules keep consumers informed and safe from shady practices. Think food safety standards or workplace regulations.
- **Tackles Market Failures**: Regulations make sure businesses consider externalities (like pollution) and stop consumers from being taken advantage of.

Disadvantages

- **It's Costly**: Monitoring and enforcing laws can drain government funds, leaving less for other priorities (opportunity cost alert!).
- **One Size Doesn't Fit All**: Different companies have different needs, and blanket rules don't always work.
- **Higher Prices**: Businesses might pass their added costs (from following regulations) onto you, the consumer.
- **Stifles Innovation**: Too many rules can create red tape, discouraging new ideas or competition in industries.

8.1.9 Government intervention in markets

Other methods of government intervention

5. The extension of property rights

What are property rights?
They're legal rights that say who owns what and how a resource can be used.

What's the issue?

Some resources, like oceans, air, or public parks, are called **common pool resources,** they're free for everyone to use and no one really owns them.

But here's the problem:

- If everyone can use them freely, people tend to overuse or damage them. This is known as the **tragedy of the commons** where something good for one person can end up being bad for everyone (like overfishing in a public lake).

How do property rights help?

Giving private ownership to these resources (like assigning a lake to a community group) means someone now has the **incentive** to take care of it.

Why? Because if it's yours, you'll want to protect it for future use. This helps reduce overuse and environmental harm.

8.1.9 Government intervention in markets

Other methods of government intervention

5. The extension of property rights

Advantages of Property Rights

- Reduces **negative externalities** like pollution and overuse
- Makes people consider the **external costs** of using public resources (e.g. forest loss, clean air damage)
- Helps use resources **efficiently** (no more "first come, first exploit")

Disadvantages of Property Rights

- Tricky to assign rights **fairly** – who should get what?
- Some resources (like **air or oceans**) are hard to divide up or "own"
- It can be **expensive** to set up and enforce ownership rights (courts, monitoring, etc.)

Example:
If a forest is public, people might chop down trees freely. But if it's privately owned, the owner might plant more trees and control logging, keeping it sustainable.

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8.1.10 Government failure

Government failure happens when the government tries to fix a problem in the market (like market failure) but ends up making things worse. Instead of helping, their intervention causes **more harm** by wasting resources and creating a **net welfare loss**.

- **Bigger Welfare Loss**: The "fix" backfires, leaving society worse off.
- **Poor Value for Money**: Taxpayer money goes down the drain without achieving much.
- **Lasting Consequences**: The damage could take years to undo, affecting the economy and people's lives.

Causes of government failure

Governments step in to fix markets, but sometimes their "solutions" make things worse. Let's explore how:

1. Distorting Price Signals

Governments sometimes send the wrong message with their price controls:

- **Example 1: Agricultural Markets**
  A minimum price on crops? Sounds great – except farmers grow too much, and the extra goes to waste.
- **Example 2: Housing Markets**
  A **minimum price** for rent to protect landlords might sound nice. But it could lead to landlords holding onto empty properties, leaving fewer homes available for renters.

💡 **Takeaway**: Interventions can accidentally create waste, shortages, or overproduction.

8.1.10 Government failure

Causes of government failure

2. Unintended Consequences

People are clever and always aim to maximise their self interest. When governments step in, producers and consumers find ways around the system. Instead of solving issues, interventions can fuel unintended chaos. For example, **loopholes** or even create **illegal markets** (think black markets for banned goods).

3. Excessive Administrative Costs: It's Expensive.

Running these schemes isn't cheap:

- Managing all the rules and regulations costs **a lot of money.**
- Sometimes, the expense of running these programmes outweighs the benefits they bring. Imagine spending £10 to save £5.

4. Information Gaps: Nobody's Perfect

Governments aren't perfect. They:

- Lack **perfect information** (just like the rest of us).
- Face **political pressure** to please everyone.
- Make decisions based on **flawed data**, which leads to bad calls.

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8.1.10 Government failure

Government failure in various markets

Clean Air Zones – Great Idea, Poor Execution

- To reduce air pollution, clean air zones were introduced in cities, charging high-polluting vehicles to enter. While it improved air quality, small businesses relying on older vans faced skyrocketing costs. Many had to close down or relocate, defeating the purpose of supporting local economies.

Rail Privatisation – Derailing Expectations

- The UK privatised its rail network to improve efficiency, but ticket prices soared, and delays became more common. Commuters faced **record-high fares**, while service quality declined. Instead of competition improving things, it left the public paying more for less.

Sugar Tax – A Bittersweet Solution

- The sugar tax was introduced to combat obesity by increasing prices of sugary drinks. While consumption fell slightly, people shifted to **cheaper high-calorie snacks**, which didn't solve the health issue. Worse, some lower-income families found themselves paying more for their usual groceries.

Housing Crisis – The Rent Control Dilemma

- Rent caps were introduced in some cities to make housing affordable. Sounds great, right? But landlords withdrew properties from the rental market, creating a **shortage of homes**. Tenants ended up competing for fewer properties, leaving many struggling to find a place to live.

8.1.10 Government failure

Government failure in various markets

Failed Tech Projects – Money Down the Drain

1. **Track and Trace App**: The UK government spent millions on a COVID-19 contact tracing app that barely worked and wasn't even compatible with all smartphones.
2. **Universal Credit System**: A welfare reform programme aimed at simplifying benefits turned into a nightmare. Delays in payments caused hardship for vulnerable families, and the costs of rolling it out spiralled out of control.

Please see the '8.2 The market mechanism, market failure and government intervention in markets Worked Examples' pack for exam style questions.

For more revision notes, tutorials, worked examples and more help visit www.tutorpacks.com