Government Intervention in Markets

Welcome to week 6. This presentation explores how and why governments intervene in markets, examining various policy tools, their effects on market equilibrium, and evaluating their effectiveness. We'll analyze specific interventions like price controls and taxation, while considering the economic rationale behind government action in different sectors.

Why Do Governments Intervene?

Economic Rationales

- Correct market failures and inefficiencies
- Address externalities (positive and negative)
- Provide public goods and services
- Promote competition and prevent monopolies
- Ensure equitable distribution of resources

Governments step in when markets fail to achieve socially optimal outcomes, balancing efficiency with equity considerations.

Types of Intervention: Tax, Subsidy, Regulation

Taxation

Governments impose taxes to raise revenue, discourage consumption of demerit goods, and correct negative externalities. Examples include carbon taxes, cigarette taxes, and alcohol duties.

Subsidies

Financial assistance to encourage production or consumption of merit goods. Examples include renewable energy subsidies, agricultural support, and education funding.

Regulation

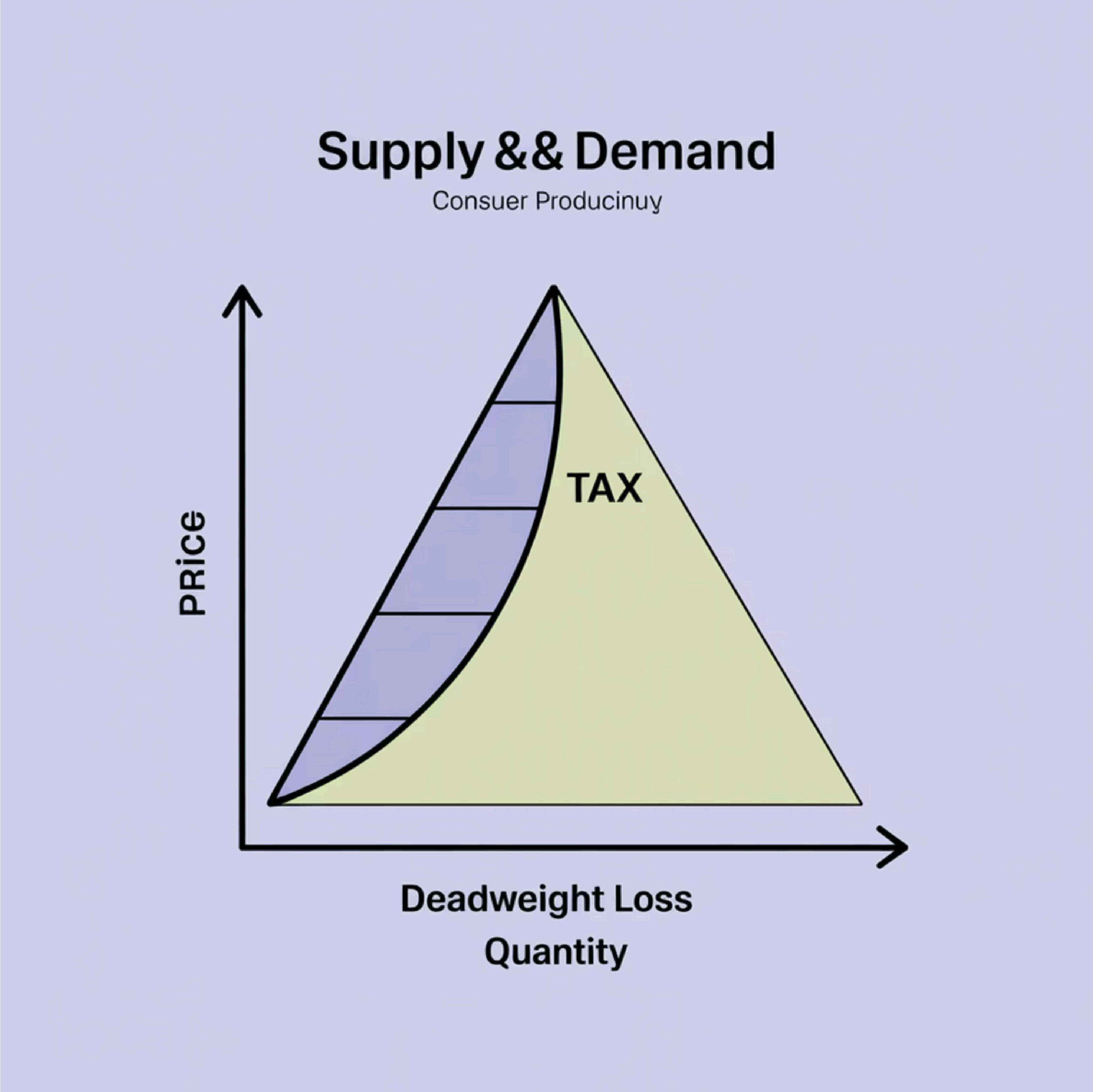
Rules and standards that control market behavior. Examples include environmental regulations, consumer protection laws, and financial oversight.

Effects of Indirect Taxes on Market Equilibrium

Indirect taxes shift the supply curve upward, resulting in:

- Higher equilibrium price
- Lower equilibrium quantity
- Tax incidence shared between consumers and producers
- Deadweight loss (reduction in economic efficiency)

The price elasticity of demand determines how much of the tax burden falls on consumers versus producers.



Price Ceilings and Floors: Rent Control, Minimum Wage

Price Ceilings

Maximum prices set below equilibrium (e.g., rent control)

- Creates shortage of supply
- May reduce quality of goods/services
- Can lead to black markets

Price Floors

Minimum prices set above equilibrium (e.g., minimum wage)

- Creates surplus of supply
- May cause unemployment
- Can increase production costs

Evaluating Policy Effectiveness

1. ## Efficiency Criteria

   Does the intervention correct market failure? Does it minimize deadweight loss? Are administrative costs reasonable compared to benefits?

2. ## Equity Considerations

   Does the policy improve income distribution? Who benefits and who bears the costs? Are vulnerable populations protected?

3. ## Unintended Consequences

   Does the intervention create new problems? Are there behavioral responses that undermine policy goals? Are there long-term structural impacts?

Externalities and Market Failure

Negative Externalities

Social costs exceed private costs

- Pollution and environmental damage
- Noise and congestion
- Public health impacts (e.g., smoking)

Solutions: Pigouvian taxes, regulation, cap-and-trade systems

Positive Externalities

Social benefits exceed private benefits

- Education and skills development
- Research and innovation
- Vaccination and public health measures

Solutions: Subsidies, public provision, patents/IP protection

Government Intervention in Strategic

Healthcare

Public provision, insurance mandates, and price controls to address information asymmetry and ensure universal access.

Defense

Direct government provision of national security as a public good that markets cannot efficiently provide.

Energy

Regulation of natural monopolies, strategic reserves, and environmental standards to ensure reliability and sustainability.