GCE Economics Knowledge Organiser – Year 12 Lent Term

Business Growth, Competitive Advantage, and Productivity

Market Failure and Government Intervention

Market Failure and Government Intervention		
Concept	Definition and Examples	Your Turn
Market Failure	Market Failure occurs when market forces fail to lead to the best **allocation of resources.**	What is the name of the system should lead to the best allocation of resources?
Causes/Types of Market Failure	**Public goods –** Goods are non-excludable and non-rivalrous – e.g. street lights. This leads to a **missing market.** Some goods are seen as quasi-public goods - NHS **Merit/Demerit goods/services** - the market over provides or under provides certain goods that produce **positive or negative externalities** (impact on a third party) – e.g. alcohol **Information gaps – asymmetric information** means the one party in a transaction has more information than the other **Monopoly/Monopsony Power** – when there is not enough sellers/buyers in the market **Unstable Markets –** certain markets, like agriculture, can be very unstable because of changing tastes, seasons, and other factors. **Volatility** creates **uncertainty** for firms and consumers, affecting their ability to make decisions.	For each example, identify the type of market failure: • **The regulatory body** Ofgem (Office of Gas and Electricity Markets) say that the **Big 6** electricity companies are colluding to charge households more than they should • **Bad harvests** lead to fluctuating cocoa prices • No one wants to pay for an army, but lots of people think we need one! • If only people knew the long-term effects of smoking, they might not do it so much… • An antiques dealer might buy something from someone at a very low price because they don't know how much it's really worth.

Are we covering this this year?

SUBSIDIES AND INDIRECT TAXES	MARKET FAILURE
A <u>subsidy</u> is money paid by the government to the producer of a good or service to make it cheaper than it would otherwise be **An <u>indirect tax</u> is an amount charged to a producer for providing a good or a service and so makes it more expensive – a *specific tax* is a specific amount (e.g. 10p) and *ad valorem* is a percentage (e.g. 5%)** Consumers and producers gain from a subsidy but lose out from a tax. The amount they gain or lose will be dependent on the **elasticity** of demand in each case	**Market failure is when the market does not allocate resources effectively**. **Public goods –** *Goods are non-excludable and non-rivalrous – e.g. street lights. Some goods are seen as quasi-public goods - NHS* **Merit/Demerit goods/services** - *the market over provides or under provides certain goods that produce <u>positive or negative externalities</u> (impact on a third party) – e.g. alcohol* **Information gaps** – *<u>asymmetric information</u> means the one party in a transaction has more information than the other*
	GOVERNMENT INTERVENTION Government intervenes in the market in the following ways: taxation, subsidies & the use of minimum and maximum prices. **Minimum price** – where the price can't go below a certain point, e.g. NMW or CAP **Maximum price** – where the price can't go above a certain point, e.g. Rent control Also they can use: Trade **pollution permits**, state provision of **public goods**, **regulation** and provision of information **Government failure is when government intervention causes a misallocation of resources and creates a net welfare loss** The main causes of government failure are distortion of price signals, unintended consequences (e.g. job losses), excessive admin costs and information gaps

Might be useful elsewhere

Comparative Advantage	Comparative advantage exists when • the relative opportunity cost of production for a good or service is lower than in another country • **or** when a country is relatively more productively efficient than another Countries take advantage of this by specialising in goods and services that they are relatively best at **Remember** that this is a simplified model because in the modern world **most exports contain inputs from many different countries.**	