8.1 Government policies to achieve efficient resource allocation and correct market failure

Name: ____________ Class: ________ Date: __________ **Total: 22 marks**

Objective

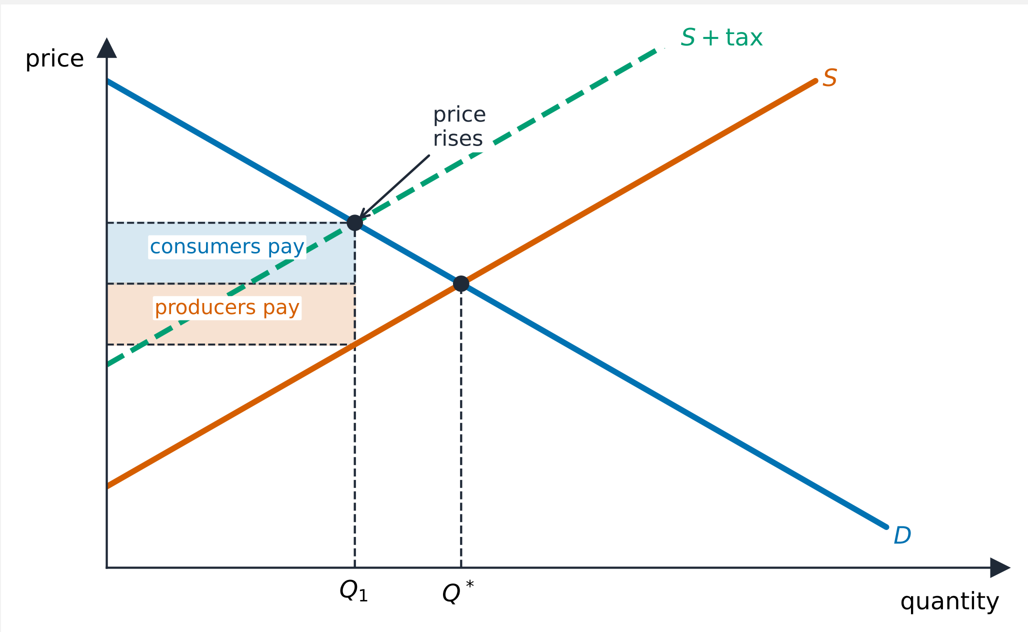
Build the skills to answer exam questions on **government policies to correct market failure** 政府纠正市场失灵的政策—taxes, subsidies, **tradable permits** 可交易许可证, regulation, state provision, **nationalisation/privatisation** 国有化/私有化, **competition policy** 竞争政策, and **government failure** 政府失灵.

You must be able to:

- describe the policy tools used to correct market failure
- explain competition policy and tradable permits
- analyse government failure

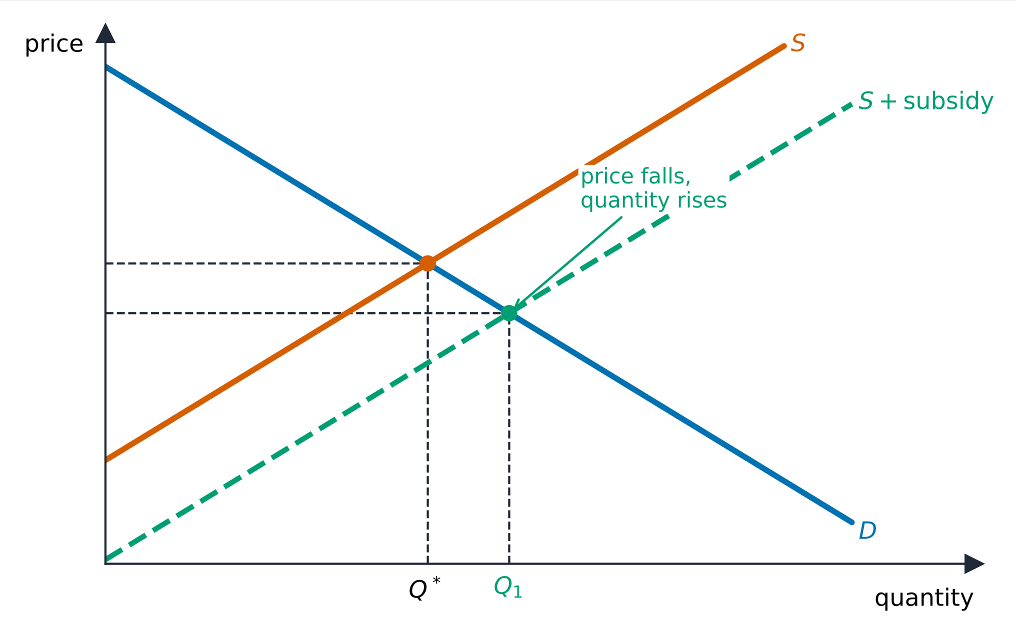
1 Worked examples

■ Policy tools



Used on goods with a negative externality (e.g. fuel)

- **Tax** on a negative externality; **subsidy** on a positive externality.



The other tool: a subsidy on a good with a positive externality raises output to the social optimum

- **Tradable permits** 可交易许可证: cap total pollution, firms trade the right to pollute.
- **Competition policy** 竞争政策: block harmful mergers, ban price-fixing, fine abuse of **monopoly power** 垄断势力.
- **Government failure** 政府失灵: intervention worsens resource use (poor information, lags, a black market).

Answer shapes: an **Explain** [**up to 8**] answer may use a diagram (AO3); **Discuss** [**12**] adds a judgement (AO4).

2 Practice

2.1 Define the term *tradable permit.* [2]

2.2 State one aim of competition policy. [1]

2.3 Define the term *government failure.* [2]

3 Exam-style questions

3.1 Tradable pollution permits reduce total pollution by: [1]

- **A** banning all pollution
- **B** capping total pollution and letting firms trade the right to pollute
- **C** subsidising polluting firms
- **D** taxing every unit of output equally

3.2 Explain how a system of tradable permits can reduce pollution at the lowest cost. [6]

3.3 Discuss whether government intervention always improves the allocation of resources. [12]

4 Go further

You are now ready for the real exam questions on this subtopic. Open the **8.1 Government policies to achieve efficient resource allocation and correct market failure** past-paper sheet in the Library, or try these in **Practice mode**:

- 9708/31 N25 —Q9 (correcting market failure)
- 9708/31 N25 —Q11 (competition policy)
- 9708/31 N25 —Q13 (government intervention)

Solutions

Economics answers are marked by **level of response** against the assessment objectives: award **AO1** knowledge, **AO2** application, **AO3** analysis and **AO4** evaluation.

2.1 a permit allowing a firm to emit a set amount of pollution, which can be bought from or sold to other firms (2 for a clear definition; 1 for a partial idea).

2.2 any one of: protect competition; block harmful mergers; ban price-fixing; stop the abuse of monopoly power (1).

2.3 when government action leads to a worse allocation of resources than the market outcome it replaced (2 for a clear definition; 1 for a partial idea).

3.1 B. Permits cap total pollution and let firms trade the right to pollute.

3.2 *[6]* AO1 1 + AO3 up to 5 —the government caps total pollution and issues permits → firms that can cut pollution cheaply do so and sell their spare permits → firms for whom cutting is expensive buy permits instead → the cap is met, but the cuts happen where they cost least → pollution falls at the lowest total cost.

3.3 *[12]* AO1/AO2/AO3 up to 8 + AO4 up to 4. **For:** taxes, subsidies, regulation and permits can correct externalities, provide public goods and curb monopoly power. **Against:** government failure —poor information leads to the wrong tax/subsidy, policies are costly and slow, and price controls can create black markets. Judgement: well-designed intervention usually improves allocation, but it can fail —so the gain depends on the quality of information and design.