

Government Microeconomic Intervention

A-Level Economics ■ Topic 3

A-Level Economics



What we will cover

- 1 Why markets fail
- 2 Externalities
- 3 Taxes & subsidies
- 4 Price controls & buffer stocks
- 5 Regulation & government failure
- 6 Inequality



pollution spills onto others

Why markets fail

externalities – costs/benefits on others

public goods – free-rider problem

merit & demerit goods – misjudged

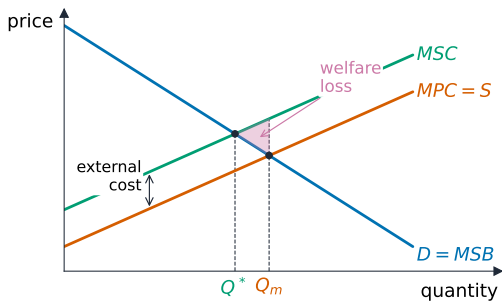
monopoly power – cuts output, raises price

inequality & asymmetric information



demerit goods are over-consumed

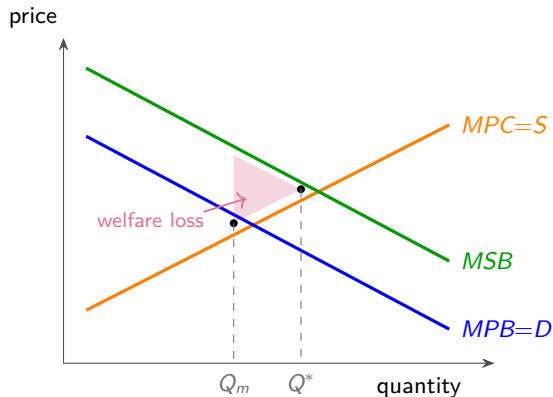
Negative externality



A **negative externality** 负外部性:
social cost 社会成本 (MSC)
exceeds **private cost** 私人成本
(MPC).

Ignoring the external cost,
the market **over-produces**
at Q_m ; the triangle is the
welfare loss.

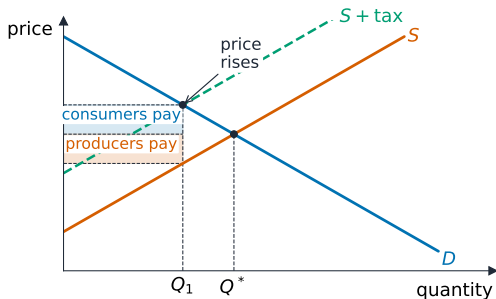
Positive externality



A **positive externality** 正外部性: **social benefit** 社会收益 (MSB) exceeds private benefit (MPB).

Buyers ignore the benefit to others, so the market **under-produces** at Q_m (e.g. vaccination).

Indirect taxes and incidence

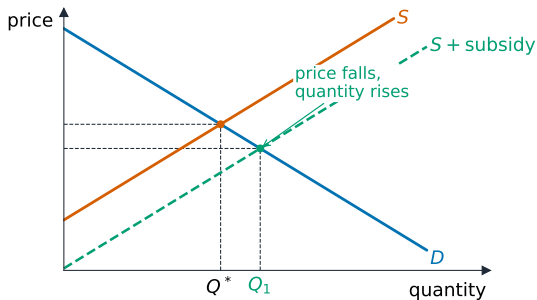


An **indirect tax** 间接税 shifts supply left, raising price, cutting quantity.

- demand **inelastic** 缺乏弹性 → consumer pays most
- demand **elastic** 富有弹性 → producer pays most

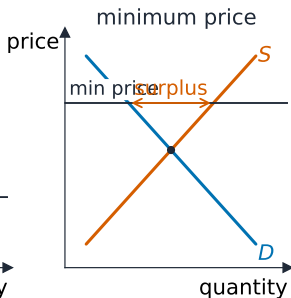
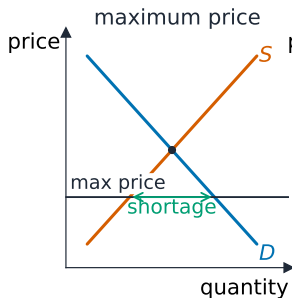
The **incidence** 税收归宿 is who really pays.

Subsidies



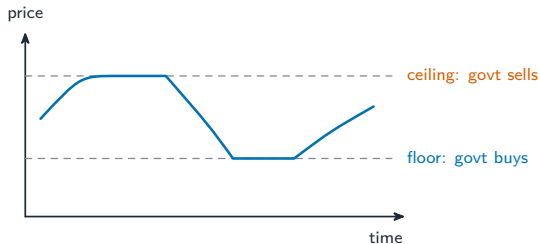
A **subsidy** 补贴 is a payment to producers – it lowers costs, shifts supply right, lowers the price and raises the quantity. Used for **merit goods** 优值品 and goods with positive externalities.

Maximum and minimum prices



- **maximum price** 最高限价
(below equilibrium) → **shortage** 短缺 (e.g. rent control)
- **minimum price** 最低限价
(above equilibrium) → **excess supply** 超额供给 (e.g. minimum wage)

Buffer stocks



A **buffer stock** 缓冲库存 steadies a farm price inside a band:

- price hits the **floor** → government **buys** & stores
- price hits the **ceiling** → government **sells** from store

Other tools and government failure

regulation

bans, limits, standards

state provision

free at point of use

permits 可交易许可证

cap pollution, trade

Government failure 政府失灵: intervention makes things worse – poor information, high cost, a **black market 黑市**, or political motives.

Income and wealth inequality

income 收入 – a flow

money over a period

wealth 财富

assets owned

Redistribution 再分配 via a **progressive tax** 累进税, **benefits** 福利金 & state provision – but a **trade-off** 取舍: too much may weaken the incentive to work.



Markets can leave income highly unequal

Worked example – taxing an externality

A factory pollutes. Explain how an indirect tax can correct the market failure.

- Pollution is a **negative externality** 负外部性: MSC lies **above** MPC.
- The market sets $MPC = MPB \Rightarrow$ **over-production** above the social optimum.
- A tax **equal to the external cost** shifts supply left, raising private cost to the social cost.
- The firm now **internalises** the externality $\Rightarrow$ **output falls to the social optimum**.

Set the tax **equal to the marginal external cost at the optimum**, not at the free-market output. The problem is over-production; the fix is to **make the polluter pay**.

Topic 3 – key takeaways

1 Market failure

externalities, public/merit goods,
monopoly

2 Externalities

negative over-produces; positive
under-produces

3 Tools

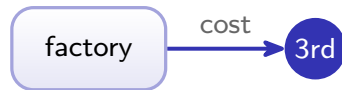
tax, subsidy, price controls, buffer
stock

4 Government failure

intervention can make things
worse

Check yourself

- 1 Does a negative externality over- or under-produce?
- 2 Who pays most of a tax if demand is inelastic?
- 3 A maximum price below equilibrium causes what?
- 4 Income is a flow – what is wealth?



Answers 1. over-produces 2. consumers 3. a shortage 4. a stock of assets owned