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

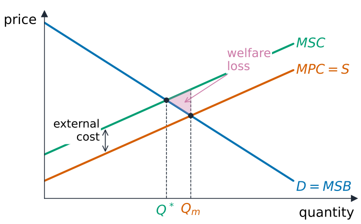
1 Market failure

Why markets fail

- **externalities** – costs/**benefits** 福利金 on othe
- **public goods** – **free-rider problem** 搭便车问
- **merit & demerit goods** – misjudged
- **monopoly power** – cuts **output** 产出, raises p
- **inequality** & **asymmetric information**

demerit goods are over-consumed

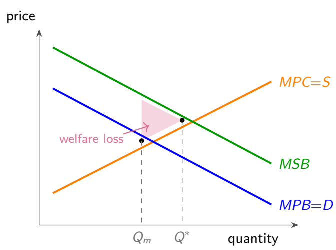
Negative externality



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

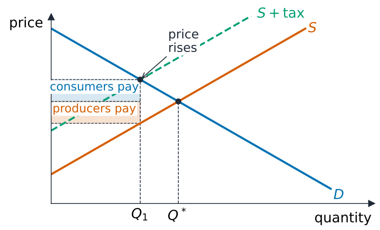


A **positive externality** 正外部性: **social benefit** 社会收益 (MSB) exceeds private benefit (MPB).

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

2 Intervention

Indirect taxes and incidence

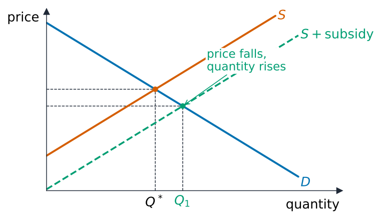


An **indirect tax** 间接税 shifts supply left, raising price, cutting quantity.

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

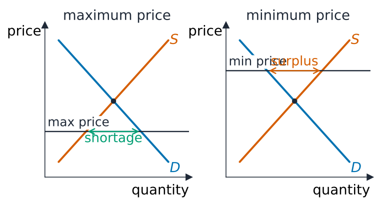
The **incidence** 税收归宿 is who really pays.

Subsidies



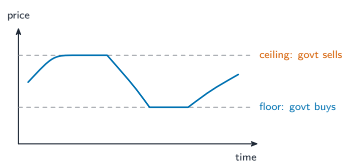
A **subsidy** 补贴 is a payment to producers – it lowers costs, shifts supply right, lowers the price and raises the quantity. Used for **merit goods** 优值品 and goods with positive externalities.

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	**state provision**	**permits 可交易许可证**
bans, limits, standards	free at point of use	cap pollution, trade

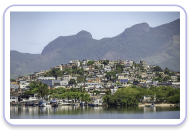
Government failure 政府失灵: intervention makes things worse – poor information, high cost, a **black market** 黑市, or political motives.

Income and wealth inequality

income 收入 – a flow
money over a period

wealth 财富 – a stock
assets owned at a point

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

3 Recap

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 ⇒ 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 ⇒ output falls to the social optimum.

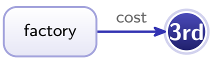
Set the tax equal to the marginal external cost at the optimum, not at the free-market output. The problem is over-production; the fix is to make the polluter pay.

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