

# UNIT - 2: MARKET FAILURE/ GOVERNMENT INTERVENTION TO CORRECT MARKET FAILURE



## Introduction

- The **market** is an environment where buyers and sellers transact or exchange goods and services.
- The general belief is that since rational individuals act to maximise self interest, a perfectly working market system is, by default, efficient and will effectively allocate scarce economic resources in the best possible manner.
- In other words, in a well functioning market, **prices** provide the accurate signals to producers and consumers and the right quantity of whatever consumers choose to consume will be produced and supplied at the right price.
- However, this is not always true. Under certain circumstances, 'market failure' occurs, i.e. the market fails to allocate resources efficiently and therefore, market outcomes become inefficient.

## Market Failure

- The inefficient allocation of resources in an economy is described as **market failure**.
- The term "market failure" does not mean the market is not working at all, it only means that the market does not function in the way that it should.
- Market failure is a situation in which the free market leads to misallocation of society's scarce resources in the sense that there is either overproduction or underproduction of particular goods and services leading to a less than optimal outcome.



## Types of Market Failure

### Complete Market Failure

This is a case of "missing markets" and occurs when the market does not supply products at all despite the fact that such products and services are wanted by people. E.g. Pure public goods.

### Partial Market Failure

Market does actually function, but it produces either the wrong quantity of a product or at the wrong price. This results in loss of economic welfare.

## Why do Markets Fail?

- **Perfectly competitive markets** will generate outcomes in which the economy's resources are allocated to their 'highest valued uses' and no one person can be made better off without making at least another person worse off.
- But we know that conditions such as large number of small firms, perfect knowledge, homogenous products etc. are not generally present in most markets.

There are four major reasons for market failure. They are:

- Market power,
- Externalities,
- Public goods, and
- Incomplete information



$$P = MC, \text{ Normal profit}$$

$$P > MC$$

→ Monopoly

## Market Power

■ Market power or **monopoly power** is the ability of a firm to profitably raise the market price of a good or service **over its marginal cost**. Firms that have market power are **price makers** and therefore, can charge a price that gives them **positive economic profits**.

■ Excessive market power causes the single producer or a small number of producers to **restrict output** (i.e. produce and sell less output than would be produced in a competitive market) and **charge price higher** than what would prevail under perfect competition.  $D > S$

■ **These profits are not achieved due to operating efficiency, but due to market power and dominance.**

Thus, market fails to produce the right quantity of goods and services at the right price

## Externalities

■ When a **consumption or production activity** has an **indirect effect** (either positive or negative) on consumption or production activities of others and such effects are not reflected directly in market prices, we call it an externality.

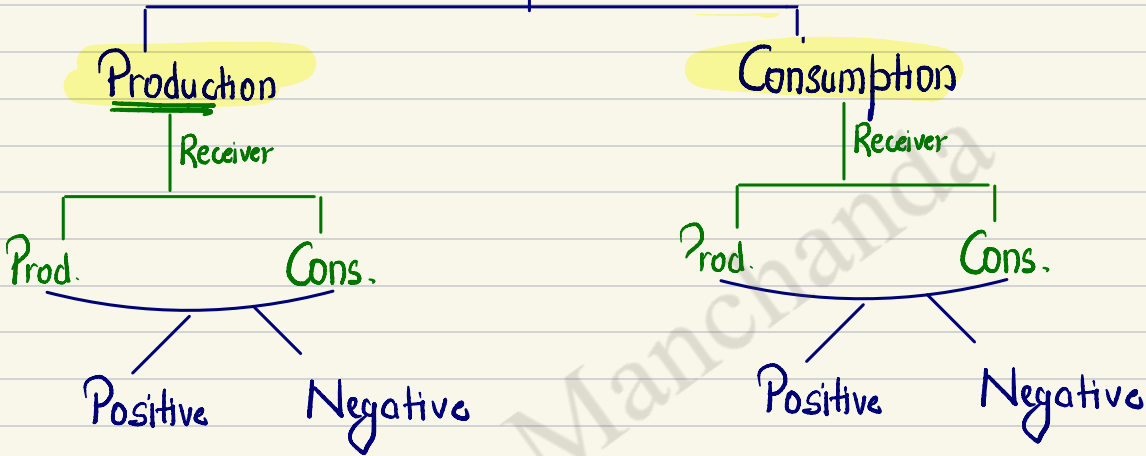
■ Externalities are **costs (negative externalities)** or **benefits (positive externalities)**, which are not reflected in free market prices. They are called externalities because they are “external” to the market.

■ Externalities are also referred to as '**spillover effects**', '**neighbourhood effects**' '**third-party effects**' or '**side-effects**', as the **originator** of the externality **imposes costs or benefits on others who are not responsible for initiating the effect**.

■ Since it occurs outside the price mechanism, it has not been compensated for, or in other words it is **uninternalized** or the cost (benefit) of it is not borne (paid) by the parties.



# Externalities



Cost ↑  
Price ↑ — Demand ↓ → Overprod.



## Production Externalities

### Negative Production Externality

A negative production externality initiated in production which imposes an external cost on others may be received by another in consumption or in production.

- **Received in consumption:** when a factory which produces aluminium discharges untreated waste water into a nearby river and pollutes the water causing health hazards for people who use the water for drinking and bathing.
- **Received in production:** when pollution of river affects fish output as there will be less catch for fishermen due to loss of fish resources.

The firm, however, has no incentive to account for the external costs that it imposes on consumers of river water or on fishermen when making its production decision. Additionally, these external costs are never reflected in the price of the product.

### Positive Production Externality

A positive production externality initiated in production that confers external benefits on others may be received in production or in consumption.

- **Received in Production:** A firm which offers training to its employees for increasing their skills generates positive benefits on other firms when they hire such workers as they change their jobs.
- **Received in consumption :** A positive production externality is received in consumption when an individual raises an attractive garden and the persons walking by enjoy the garden.

These external effects were not in fact taken into account when the production decisions were made.



## Consumption Externalities

### Negative Consumption Externality

Negative consumption externalities initiated in consumption which produce external costs on others may be received in consumption or in production.

■ **Received in Consumption:** Smoking cigarettes in public place causing passive smoking by others, creating litter and diminishing the aesthetic value of the room and playing the radio loudly obstructing one from enjoying a concert.

■ **Received in Production:** The act of undisciplined students talking and creating disturbance in a class preventing teachers from making effective instruction and the case of excessive consumption of alcohol causing impairment in efficiency for work and production.

### Positive Consumption Externality

A positive consumption externality initiated in consumption that confers external benefits on others may be received in consumption or in production.

■ **Received in Consumption:** if people get immunized against contagious diseases, they would confer a social benefit to others as well by preventing others from getting infected.

■ **Received in Production :** Consumption of the services of a health club by the employees of a firm would result in an external benefit to the firm in the form of increased efficiency and productivity.



## Private costs and Social costs

**Private cost:** The money cost of production incurred by the firm i.e. costs such as wages, raw materials, heating and lighting which must be paid to carry out production, and these which would appear in the firm's accounts.

**Social costs:** It refers to the total costs to the society on account of a production or consumption activity.

Social costs are private costs borne by individuals directly involved in a transaction together with the external costs borne by third parties not directly involved in the transaction.

In other words, social costs are the total costs incurred by the society when a good is consumed or produced. It is thus private costs plus costs to third parties (i.e. private costs + total negative externalities).

☞ Social Cost = Private Cost + External Cost

## How externalities cause inefficiency and market failure?

- As discussed before, each firm's cost which is considered for determining output would be only private cost or direct cost of production which does not incorporate externalities.
- The market prices determined without incorporating externalities are not ideal as they do not reflect all social costs and benefits.
- Such prices send incorrect signals to producers and consumers and cause either overproduction or underproduction.

Thus, we conclude that when there is externality, a competitive market will produce a level of output which is not socially optimal. This is a clear case of market failure.



# Public Goods

- **Paul A. Samuelson** who introduced the concept of 'collective consumption good' in his path-breaking 1954 paper 'The Pure Theory of Public Expenditure' is usually recognized as the first economist to develop the theory of public goods.

- A public good (also referred to as collective consumption good or social good) is defined as one which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtraction from any other individuals' consumption of that good.

## Private Goods v/s Public Goods

### Private Goods

- They are **scarce**, anyone who wants to consume them must purchase them at a price.
  - Private goods **do not face any free-rider problem.**
  - Private goods are '**excludable**' i.e. it is possible to exclude or prevent consumers who have not paid for them from consuming them or having access to them.
  - Consumption of private goods is '**rivalrous**' that is the purchase and consumption of a private good by one individual prevents another individual from consuming it.
- Normally, the market will efficiently allocate resources for the production of **private goods**. A few examples are: food items, clothing, movie ticket, television, cars, houses etc.



### Public Goods

- Public good is **non-rival** in consumption. It means that consumption of a public good by one individual does not reduce the quality or quantity available for all other individuals.

For example, if, you eat your apple, (a private good) another person too cannot eat it. But, if you walk in street light, other persons too can walk without any reduced benefit from the street light.





- Public goods are **non-excludable**. Consumers cannot be excluded from consumption benefits. If the good is provided, one individual cannot deny another individual's consumption.

For example, national defence once provided, it is impossible to exclude anyone within the country from consuming and benefiting from it.

- Public goods are characterized by **indivisibility** i.e. the total amount consumed is the same for each individual.

- Once a public good is provided, **the additional resource cost of another person consuming the goods is 'zero'**. No direct payment by the consumer is involved in the case of pure **public goods**.

A few examples of public goods are: national defence, highways, public education, scientific research which benefits everyone, law enforcement, lighthouses, fire protection, disease prevention and public sanitation.

- Public goods are generally **more vulnerable to issues such as externalities, inadequate property rights, and free rider problems**.

The absence of excludability in the case of public goods and the tendency of people to act in their own self-interest will lead to the problem of free-riding. There is no incentive for people to pay for the good because they can consume it without paying for it. Since private goods are excludable, free-riding mostly occurs in the case of public goods.

### Reason for Market Failure:

- If individuals make no offer to pay for public goods, there is market failure in the case of these goods and the profit-maximizing firms will not produce them.

- Producers are **not motivated to produce a socially-optimal amount of products** if they cannot charge a positive price for them or make profits from them.

As such, though public goods are extremely valuable for the well-being of the society, left to the market, they will not be produced at all or will be grossly under-produced.

Thus, there is market failure in the case of public goods.



## Incomplete Information

**Complete information** is an important element of a competitive market. Perfect information implies that both buyers and sellers have complete information about anything that may influence their decision making. However, this assumption is not fully satisfied in real markets because of:

- Complexity of products and services (e.g. cardiac surgery, financial products like mutual funds),
- Difficulty of getting correct information, and
- Deliberate misinformation by interested parties (e.g. highly persuasive advertisements).

Information failure results in market failure.

## Asymmetric Information

Asymmetric information occurs when there is an imbalance in information between the buyer and the seller i.e. when the buyer knows more than the seller or the seller knows more than the buyer. This can distort choices. For example,

- the landlords know more about their properties than the tenants,
- a borrower knows more about their ability to repay a loan than the lender,
- a used-car seller knows more about the vehicle quality than the buyer,
- health insurance buyers know more about their state of health than the insurance companies and
- some traders may possess insider information in financial markets.

These are situations in which one party to a transaction knows a material fact that the other party does not. This phenomenon is an important source of market failure.

**Adverse selection** and **moral hazard** are two central concepts related to the problem of information gaps in many markets.



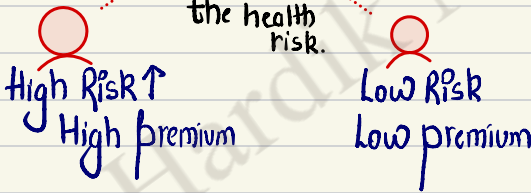
## Adverse Selection

Asymmetric information generates adverse selection and affects a transaction before it occurs.

When one party to a contract or negotiation, say X, possesses information relevant to the contract or negotiation that the other party Y does not have, the expected value of the transaction is known more accurately to X due to asymmetry of information. Then, the party which has more information i.e. X may take advantage Y's ignorance and this could potentially put the ignorant party Y at a loss.

eg.

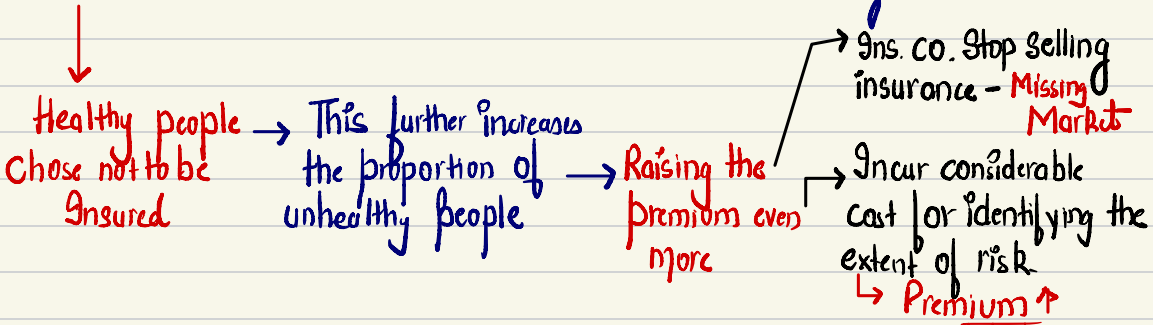
Insurance company



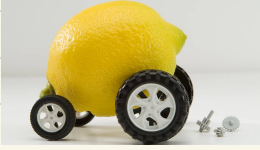
But Insurance co. knows less about health conditions of buyers.

Unhealthy people do not reveal their actual state of health, so that ins. prem. remains low.

Insurance ↑  
Premium ← Heavy Ins. claims



## 2nd Case



# Lemon problem - George Akerlof

↳ Second hand car Market

Good Quality

Poor Quality cars  
↳ defined as lemons

↳ May not disclose all the Mechanical defects.  
⊙ Seller of Second hand car

⊙ Buyer ↳ Since there is quality uncertainty, the price offered is likely to be less.

⊙ Seller of good quality car will not place their car for sale in the Market

The good quality car disappears from the Market &

Market becomes flooded with 'lemons'

**Market failure** - Market has only lower price & low quality cars.

→ Asymmetric info. leads to elimination of high-quality goods from the Market.



## Moral Hazard

- Moral hazard arises whenever there is an **externality** (i.e., whenever an economic agent can shift some of its costs to others).
  - It is about actions made after making a market exchange which may have adverse impact on the less-informed person.
  - In other words, **it is about the opportunism** characterized by an informed person's taking advantage of a less-informed person through an unobserved action.
  - It arises from **lack of information about someone's future behaviour**.
  - It occurs when one party to an agreement knows that he need not bear the consequences of **his bad behaviour** or poor decision making and that the consequence, if any, would be borne by the other party.
- Therefore, he engages in risky behaviour or fails to act in good faith or acts in a different way than if he had to bear those consequences by himself.

eg - Insurance Market

1]

Driver with car insurance Policy → tends to be less careful, act irresponsibly  
 ↓  
 Probability of Insurance Claims ↑

2] Patient with Medical Insurance → Does not care whether doctor charges excessive fees or uses costly procedures → Insurance claim ↑  
 ↓  
 Insurance premiums ↑



## Government Intervention

Government can ensure economic efficiency by providing the necessary legal and regulatory system that facilitates efficiency and /or it can intervene to correct specific market failures. The role of the government is discussed below:

Government plays a vital role in ensure a well functioning market by:

- Creating the necessary physical infrastructure such as roads, bridges, airports and waterways
- Provision of institutional infrastructure such as legal and regulatory framework, establishment of the 'rule of law', protection of property rights, ensuring performance of contracts
- Ensuring an appropriately framed competition and consumer law framework that regulates the activities of firms and individuals in their market exchanges

### Government Intervention to Minimize Market Power

- Governments intervene by establishing rules and regulations designed to promote competition and prohibit actions that are likely to restrain competition.
- These legislations differ from country to country. For example, in India, we have the Competition Act, 2002 (as amended by the Competition (Amendment) Act, 2007) to promote and sustain competition in markets. The Antitrust laws in the US and the Competition Act, 1998 of UK etc are designed to promote competitive economy by prohibiting actions that are likely to restrain competition. Such legislations generally aim at prohibiting contracts, combinations and collusions among producers or traders which are in restraint of trade and other anticompetitive actions such as predatory pricing.



Other measures include:

- **Market liberalisation** by introducing competition in previously monopolistic sectors such as energy, telecommunication etc.
- **Controls on mergers and acquisitions** if there is possible market domination
- **Price capping and price regulation**
- **Profit or rate of return regulation**
- **Patronage to consumer associations**
- **Tough investigations into cartelisation and unfair practices** such as collusion and predatory pricing
- **Restrictions on monopsony power of firms** *Single buyer*
- **Reduction in import controls** and
- **Nationalisation**

However, sometimes we find that **governments protect monopoly positions of firms** that have developed **unique innovations**.

■ For example, **patent and copyright laws** grant exclusive rights of products or processes to **provide incentives for invention and innovation**.

■ Another example is that of permitted **natural monopoly**. Natural monopolies can produce the entire output of the market at a **cost that is lower than what it would be if there were several firms**.

Examples of such natural monopoly are electricity, gas and water supplies. In order to control the market power of such natural monopolies, **governments usually regulate the price of the goods and services provided by them**.



## Government Intervention to Correct Externalities

☞ Freely functioning markets produce externalities because producers and consumers need to consider **only their private costs** and benefits and **not the full social costs**.

🚩 To promote the overall welfare of all members of society, social returns should be maximized and social costs minimized. This implies that **all costs and benefits (both private and external) need to be internalized** by consumers and producers while making buying and production decisions.

The key to internalizing an externality (both external costs and benefits) is to ensure that **those who create the externalities include them while making decisions**.

Government initiatives towards **negative externalities** may be classified as:

### Direct Control

openly regulate the actions of those involved in generating **negative externalities**.

### Market Based


**policies that would provide economic incentives.**





## Direct controls


■ Also known as **command solutions**, prohibit specific activities that explicitly create negative externalities or require that the negative externality be limited to a certain level.


■ A few examples are:


 The government may, through legislation, fix emissions standard which is the legal limit on how much pollutant a firm can emit. If the firm exceeds the limit, it can invite monetary penalties or/and criminal liabilities.

 Licensing, production quotas and mandates regarding acceptable production processes are other examples of direct intervention by governments.


 Production, use and sale of many commodities and services are prohibited in our country.


 Smoking is completely banned in many public places.


 Stringent rules are in place in respect of tobacco advertising, packaging and labeling etc.

 Governments may pass laws to reduce the effects of negative externalities.

Government established environmental standards are rules that protect the environment by specifying actions by producers and consumers. For example, India has enacted the Environment (Protection) Act, 1986.

 Government may limit the amounts of certain pollutants released into water and air by individual firms or make it mandatory to use pollution control devices.

 Government may insist that the polluting firms install pollution-abatement mechanisms to ensure adherence to the emission standards. This means additional expenditure to the firm leading to rise in the firm's average cost. New firms will find it profitable to enter the industry only if the price of the product is greater than the average cost of production plus abatement expenditure.

 Governments may also form special bodies/ boards to specifically address the problem, for instance the Ministry of Environment & Forest, the Pollution Control Board of India and the State Pollution Control Boards.



The market-based approaches → environmental taxes and cap-and-trade, operate through price mechanism to create an incentive for change. In other words, the government tries to alter the prices of goods through taxes and subsidies and thus change the behaviour of market participants. This is achieved by:

1. Setting the price directly through a pollution tax
2. Setting the price indirectly through the establishment of the cap-and-trade system.

### Pollution Taxes

- These taxes are named Pigouvian taxes after A.C. Pigou. The size of the tax depends on the amount of pollution a firm produces. These taxes have the effect of 'making the polluter pay'.
- Tax increases the private cost of production or consumption as the case may be, and would decrease the quantity demanded and therefore the output of the good which creates negative externality.

However, there are problems in administering an efficient pollution tax:

- Pollution taxes are difficult to determine and administer because it involves the use of complex and costly administrative procedures for monitoring the polluters.
- If the demand for the good is inelastic, the tax may have only an insignificant effect in reducing demand. In such cases, the producers will be able to easily shift the tax burden in the form of higher product prices.
- Pollution taxes also have potential negative consequences on employment and investments because high pollution taxes in one country may encourage producers to shift their production facilities to those countries with lower taxes.



## Tradable Emissions Permits - Cap & Trade systems

■ A **tradable permit** is a license that allows a company to release a unit of pollution into the environment over some period of time.

■ By issuing a fixed number of permits, the government determines the total level of pollution that can be legally emitted during each period (the 'cap'). Each firm has permits specifying the number of units of emissions that the firm is allowed to generate.

■ A firm that generates emissions above what is allowed by the permit is **penalized with substantial fines**.

■ Since the permits are tradable (the firm can sell for a price), a polluting firm faces an opportunity cost i.e. for each unit of pollution that it creates, it must either buy a permit, or it must forgo the revenue it could earn by selling the permit to some other firm. A firm which produces less pollution can sell their permits and earn money.

■ A firm whose technology would make it very costly to reduce pollution generally buys permits in the market. At the same time, a firm whose technology enables it to discharge less pollution or can reduce pollution rather cheaply will sell its permits.

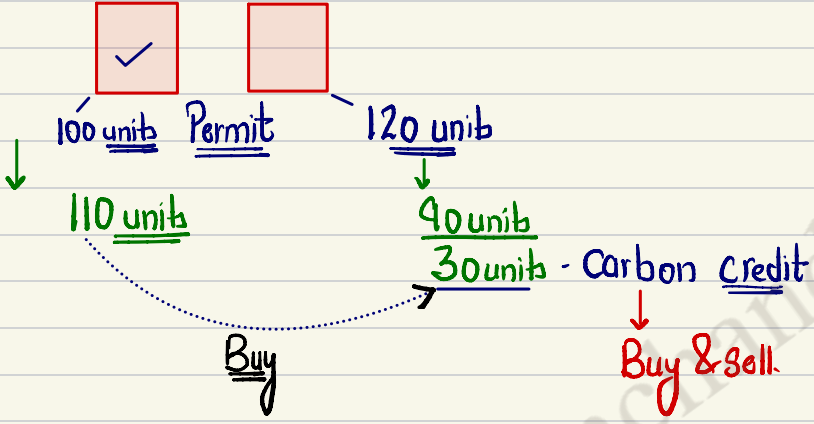
■ The high polluters have to buy more permits, which increases their costs, and makes them less competitive and less profitable. The low polluters receive extra revenue from selling their surplus permits, which makes them more competitive and more profitable. Therefore, firms will have an incentive not to pollute.

■ Usage of tradable permits:

👉 **USA** - usage since early 1980s to reduce several types of pollution. In 1994 the United States began a cap and trade system for sulphur dioxide emissions.

👉 **INDIA** - India does not have an explicit carbon price or a market-based mechanism such as cap-and-trade; but India has many schemes and mechanisms. For example, the Perform, Achieve & Trade (PAT) scheme, carbon tax in the form of a cess on coal, lignite and peat, Renewable Purchase Obligations (RPO) and Renewable Energy Certificates (REC), Internal Carbon Pricing (ICP) etc. In 2017, the coal cess was abolished and replaced by the GST compensation cess since it failed to achieve the desired outcomes.

■ The **Energy Conservation (Amendment) Bill, 2022** empowers the central government to specify a carbon credit trading scheme and to stipulate energy consumption standards.



CA Hardik Manchanda



However, firms with a relatively inelastic demand for its product can easily shift the extra cost incurred for procuring additional permits in the form of higher price.

## Government Initiatives towards Positive Externalities

When positive externalities are present, government may attempt to solve the problem through -

- corrective subsidies to the producers aimed at increasing the supply of the good
- corrective subsidies to consumers aimed at increasing the demand for the good.

As we are aware, a corrective production subsidy involves government paying part of the cost to the firms in order to promote the production of goods having positive externalities. This is in fact a market-based policy as subsidies to producers would lower their cost of production.

E.g. fertilizer subsidy is a production subsidy & subsidy on fee for education is an example of consumption subsidy.

- In the case of products and services whose externalities are vastly positive, the government enters the market directly as an entrepreneur to produce and provide them. Public education, health care and fundamental research are the obvious examples.
- Governments also engage in direct production of environmental quality. Examples are: afforestation, reforestation, protection of water bodies, treatment of sewage and cleaning of toxic waste sites.



## GOVERNMENT INTERVENTION IN THE CASE OF MERIT GOODS

- **Merit goods** are goods that have **substantial positive externalities** and hence they are **socially desirable**.
- Merit goods can be provided through the market, but are likely to be **under-produced** and under-consumed through the market mechanism so that social welfare will not be maximised.
- Examples of merit goods include **education, health care, welfare services**, housing, fire protection, **waste management, public libraries, museum, public parks** etc.
- The possible government responses to under-provision of merit goods are **regulation, subsidies, direct government provision and a combination of government provision and market provision**.

👉 **Regulation determines how a private activity may be conducted.**

CBSE

For example, the way in which education is to be imparted is government regulated. Governments can **prohibit** some type of **goods and activities**, set standards and issue **mandates making others oblige**. For example, government may make it compulsory to avail **insurance protection**. **Compulsory immunization** may be insisted upon as it helps not only the individual but also the society at large. Government could also use legislation to enforce the consumption of a good which generates positive externalities. E.g. **use of helmets, seat belts** etc.

👉 **An additional option is to compel individuals to consume the good or service that generates the external benefit.**

The Right of Children to Free and Compulsory Education Act, 2009 which mandates free and compulsory education for every child of the age of six to fourteen years is another example. If suspected of having a contagious disease such as COVID, an individual may be forced to get medical treatment.

👉 **The ultimate encouragement to consume is to make the good completely free at the point of consumption:** for example freely available hospital treatment for various diseases.



## GOVERNMENT INTERVENTION IN THE CASE OF DEMERIT GOODS

Demerit goods are goods which are believed to be **socially undesirable**.

Examples of demerit goods are **cigarettes, alcohol, intoxicating drugs** etc.

The consumption of demerit goods imposes **significant negative externalities** on the society as a whole.

👉 However, **it should be kept in mind that all goods with negative externalities are not essentially demerit goods**; e.g. Production of steel causes pollution, but steel is not a socially undesirable good.

👉 The production and consumption of demerit goods are **likely to be more than optimal under free markets**.

How do governments correct market failure resulting from demerit goods?

■ At the extreme, the government may enforce **complete ban on a demerit good**. e.g. the possession, trading or consumption of **intoxicating drugs is made illegal**.

■ **Through persuasion** which is mainly intended to be achieved by **negative advertising campaigns** which emphasize the dangers associated with consumption of demerit goods.

■ **Through legislations** that prohibit the advertising or promotion of demerit goods in whatsoever manner.

■ **Strict regulations** of the market for the good may be put in place so as to limit access to the good, especially by vulnerable groups such as **children and adolescents**.

■ **Regulatory controls in the form of spatial restrictions** e.g. smoking in public places, sale of tobacco to be away from schools, and time restrictions under which sale at particular times during the day is banned.

■ **Imposing unusually high taxes** on producing or purchasing the good making them very costly and unaffordable to many is perhaps the most commonly used method for reducing the consumption of a demerit good. Refer the GST rates in India for demerit goods, you will find how high they are.

■ The government can fix a **minimum price** below which the demerit good should not be exchanged.



The demand for demerit goods such as, cigarettes and alcohol is often highly inelastic, so that any increase in their price resulting from additional taxation causes a less than proportionate decrease in demand. Also, sellers can always shift the taxes to consumers without losing customers.

The effect of stringent regulation such as total ban is seldom realized in the form of complete elimination of the demerit good; conversely such goods are secretly driven underground and traded in a hidden market.

## GOVERNMENT INTERVENTION IN THE CASE OF PUBLIC GOODS

### Production

- Direct provision of a public good by government can help overcome the free-rider problem which leads to market failure.
- The most important public goods like defence, establishment and maintenance of legal system, fire protection, disease prevention etc are invariably provided by the government. *everytime*
- Excludable public goods such as parks, universities, museums etc can be provided by government and the same can be financed through entry fees.
- Government may grant licenses to private firms to build a public good facility and charge fee from the user. In such cases, the government regulates the level of entry fee chargeable from the public and keeps strict watch on the functioning of the licensee to guarantee equitable distribution of welfare.
- Some public goods are provided by voluntary contributions and private donations by corporate entities and nongovernmental organisations.
- Some goods are produced and consumed as public goods and services despite the fact that they can be produced or consumed as private goods. This is because, left to the markets and profit motives, these may prove dangerous to the society. Examples are scientific approval of drugs, production of strategic products such as atomic energy, provision of security at airports etc.





## GOVERNMENT INTERVENTION FOR CORRECTING INFORMATION FAILURE

Governments actively intervene in the market for combating the problem of market failure due to information problems and considering the importance of information in making rational choices. A few examples are:

- Government makes it mandatory to have **accurate labeling and content disclosures** by producers. E.g. Labeling on **cigarette packets**, display of **nutritional information** on **food packages**.
- **Mandatory disclosure of information**, for example: SEBI requires that accurate information be provided to prospective buyers of new stocks.
- **Public dissemination of information to improve knowledge** <sup>spread</sup>
- **Regulation of advertising** and **setting of advertising standards** to make advertising more responsible, informative and less persuasive.

## GOVERNMENT INTERVENTION FOR EQUITABLE DISTRIBUTION

- One of the most important activities of the government is to redistribute incomes so that there is equity and fairness in the society.
- Some common policy interventions include: **progressive income tax**, **targeted budgetary allocations**, **unemployment compensation**, **transfer payments**, **subsidies**, **social security schemes**, **job reservations**, **land reforms**, **gender sensitive budgeting** etc.
- Government also intervenes to **combat black economy** and market distortions associated with a black economy.
- **Government intervention in a market that reduces efficiency while increasing equity is often justified because equity is greatly appreciated by society.**



## Government Failure

■ Government failures where government intervention in the economy to correct a market failure creates inefficiency and leads to a misallocation of scarce resources occur very often.

■ Government failure occurs when:

☞ intervention is ineffective causing wastage of resources expended for the intervention

☞ intervention produces fresh and more serious problems

There are costs and benefits associated with any government intervention in the market, and it is important that policy makers consider all the costs and benefits of a policy intervention.

Unit over :)

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