Unit 3 **Government Interventions to minimize Market Failure**

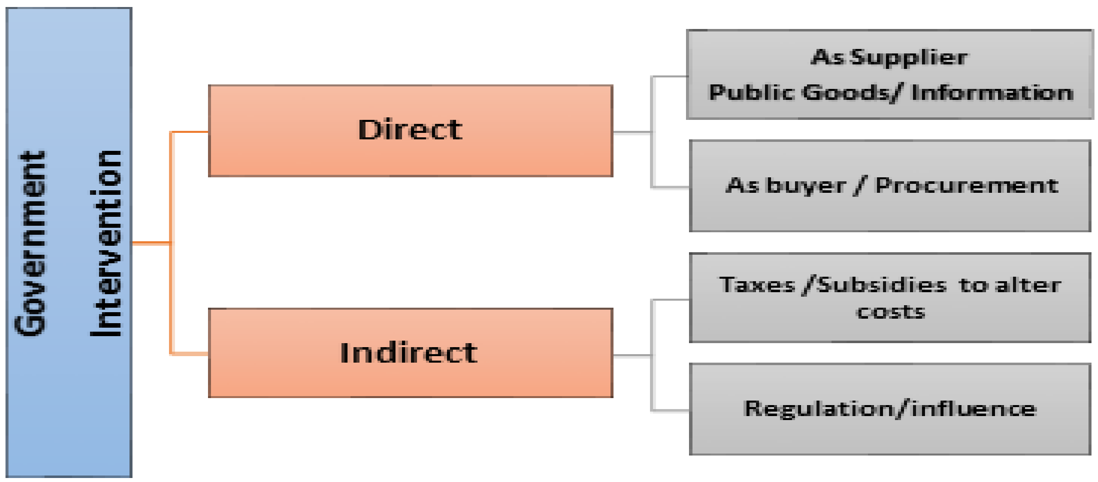
- Governments intervene in various ways to correct the distortions in the market which occur when there are deviations from the ideal perfectly competitive state.
- Government initiatives towards combating market failures due to negative externalities are either direct controls or market-based policies that would provide economic incentives.
- Direct controls prohibit specific activities that explicitly create negative externalities or require that the negative externality be limited to a certain level, for instance limiting emissions.

Government Intervension to Correct Market Failure

- **Minimise Market Power**
- **Correct Externalities**
- **Equitable Distribution**
- **Correcting Information Failure**
- **Merit and Demerit Goods**

Government interventions to Minimize Market Power

- Because of the social costs imposed by monopoly, governments intervene by establishing rules and regulations designed to promote competition and prohibit actions that are likely to restrain competition.
- E.g. Competition Act, 2002 (as amended by the Competition (Amendment) Act , 2007).
- Natural Monopolies such as electricity, gas and water supply are subject to price control.



Government Intervention in case of Merit Goods

- Merit goods such as education, health care etc. are socially desirable and have substantial positive externalities. They are rival, excludable, limited in supply, rejectable by those unwilling to pay, and involve positive marginal cost for supplying to extra users.
- Left to the market, merit goods are likely to be under- produced and under-consumed so that social welfare will not be maximized.
- The possible government responses to under-provision of merit goods are regulation, legislation, subsidies, direct government provision and a combination of government provision and market provision.
- When governments provide merit goods, it may give rise to large economies of scale and productive efficiency and there will be substantial demand for the same.

Government Intervention in case of Demerit Goods

- Demerit goods are goods which impose significant negative externalities on the society as a whole and are believed to be socially undesirable.
- The production and consumption of demerit goods are likely to be more than optimal under free markets. The government should therefore intervene in the marketplace to discourage their production and consumption.

Government Intervention in Case of Public Goods

- *In the case of pure public goods where entry fees cannot be charged, direct provision by governments through the use of general government tax revenues is the only option. Excludable public goods can be provided by government and the same can be financed through entry fees.*

Price Intervention : Non - Market Pricing

- Price controls may take the form of either a price floor (a minimum price buyers are required to pay) or a price ceiling (a maximum price sellers are allowed to charge for a good or service).
- When prices of certain essential commodities rise excessively government may resort to controls in the form of price ceilings (also called maximum price) for making a resource or commodity available to all at reasonable prices.
- With the objective of ensuring stability in prices and distribution, governments often intervene in grain markets through building and maintenance of buffer stocks.

Government Intervention for Correction Information Failure

- Government makes it mandatory to have accurate labeling and content disclosures by producers. For example: SEBI requires that accurate information be provided to prospective buyers of new stocks.
- Public dissemination of information to improve knowledge and subsidizing of initiatives in that direction.
- Regulation of advertising and setting of advertising standards to make advertising more responsible, informative and less persuasive

Equitable Distribution

- One of the most important activities of govt is to redistribute incomes so that there is equity & fairness in the society
- Some common policy interventions include :
    1. Progressive income tax,
    2. targeted budgetary allocation,
    3. Unemployment Compensation,
    4. Transfer Payments, Subsidies,
    5. Social Security Schemes,
    6. job Reservation,
    7. land reforms,
    8. gender sensitive budgeting etc.