

3. Government Microeconomic Intervention

3.1 Government Intervention Reasons

Syllabus 3.1 ✓

1. addressing the **non-provision of public goods**
2. addressing the **overconsumption of demerit goods** and the **underconsumption of merit goods**, due to information failure
3. **controlling prices** in markets

3.2 Government Intervention Methods

Syllabus 3.2

- impact and incidence of specific indirect taxes, subsidies
- direct provision of goods and services
- maximum and minimum prices
- buffer stock scheme
- provision of information

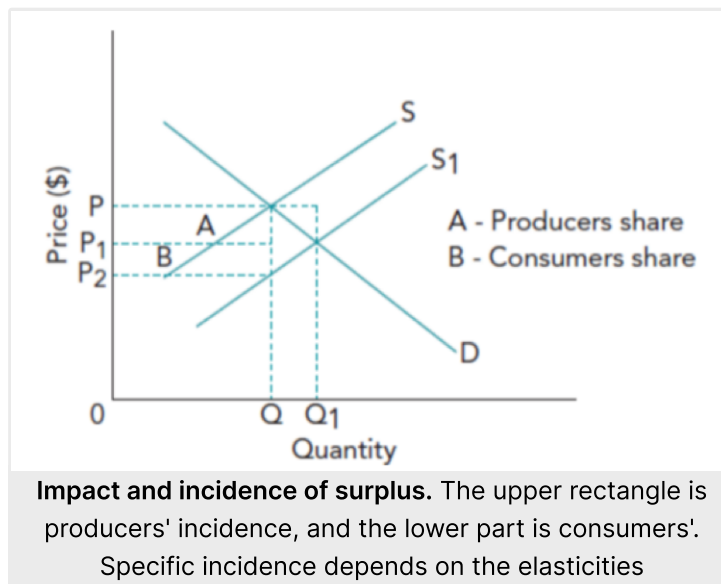
Specific Indirect Taxes

- **Indirect Tax**: a tax levied on expenditure on G&S, e.g., sales tax
- **Ad Valorem Tax**: a tax of a fixed **percentage** of the price on each unit purchased
- **Specific Tax**: a tax of a fixed **amount** on each unit purchased
- **Tax Incidence** depends on **PED & PES**
 - **Elastic Supply + Inelastic Demand** → **consumers** pay more
 - **Inelastic Supply + Elastic Demand** → **suppliers** pay more

Advantages	Disadvantages
Control consumption	Regressive tax → poor pays more
Less evasion → sale-based	Inelastic demand → might not change QD but more cost of living
Government revenue	Cost of collection → opportunity cost
Does not influence incentive to work	Setting the "right tax rate"
Broad revenue-base	Increased cost of production → inflation

Subsidies

- **money** given by the government to producers to encourage production of a good or service
- subsidies distort market dynamics → **causing deadweight losses**



Reasons for subsidies

1. To correct market failures

- To keep down price for **essential goods**
- To encourage greater consumption of **merit goods**
- To provide **public goods**

2. For equality

- For **equitable distribution of income** → poor pays less when inferior goods are subsidized
- For **rising producer's income**, especially for **farmers**

3. For competitive trade

- For **exporters** → they have more competitive advantages
- For **reducing dependency on imports**

Limitation of subsidies

1. **Inelastic demand** → may not be effective
2. **Financial cost** → opportunity cost
3. **Encouraging inefficiency** → reduce incentive to work
4. **Risk of corruption**

Direct Provision

- The government provides goods and services **itself**
- **Reasons: public & merit goods, redistribution of income** (as tax is used to supply goods and services to the poor)
- **Alternative:** government might pay the private sector to provide G&S → increasing efficiency as private firms compete

Advantages	Disadvantages
Reduce market failure	Opportunity cost, tax burden
All social benefits considered	Public sector inefficiency
Good for equality	Hard to determine the right amount to produce

Maximum Price

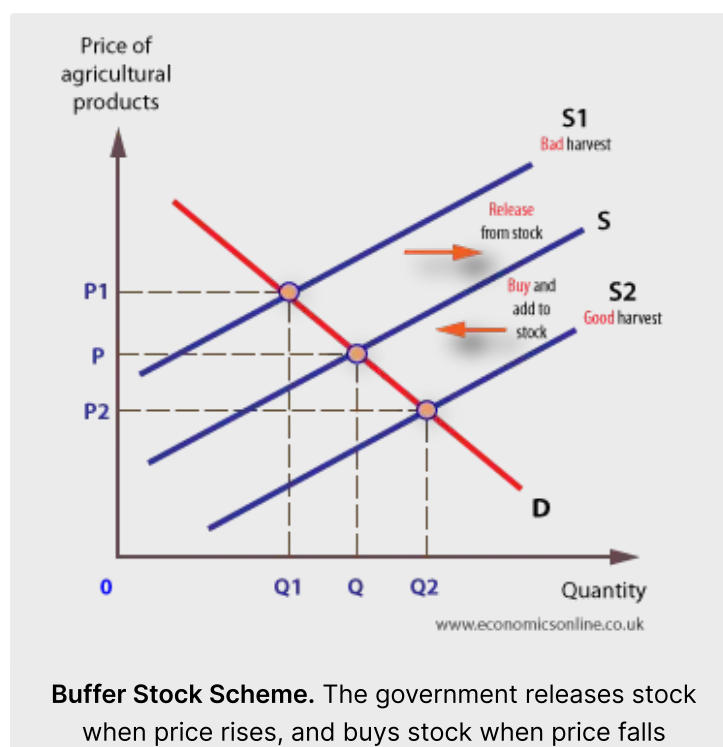
Advantages	Disadvantages
Increased affordability → Low-income	Shortages, wants & needs not fulfilled
Control inflation	Reduced quality & investment
Preventing price gauging & monopoly	Black markets
Equity & Access	Resource misallocation → underproduction & overproduction

Minimum Price

Advantages	Disadvantages
Support suppliers → helps stable supply	Surplus
Stabilising market → people may buy knowing price wouldn't fall	Black markets
Quality improvement	Increased cost → less competitiveness
Encouraging production of merit goods	Does not take into account regional differences

Buffer Stock

- a scheme by the government to **stabilize the price of a commodity** by **buying excess supply in periods when supply is high**, and **selling when supply is low**



Advantages	Disadvantages
Stabilize price to prevent structural unemployment → also encourages investment	Cost of buying
Stabilize production as farmers know the govt. would buy	Encourage oversupply as farmers know any surplus would be bought
Stabilize price to maintain price of essential goods, e.g., farming	Cost of storage, Difficulty of storage
Farming can have positive externalities	Difficult to know when the surplus happens & when the shortage happens

Provision of Information

- **government-funded** information provision, advertising, and education to encourage or discourage consumption

Advantages	Disadvantages
Demand for demerit goods fall and vice versa	Cost of advertising
More market friendly	Might take a long time
Healthier labour force → higher productivity	Depends on PED, Ease of understanding, Audience Targeting

3.3 Income and Wealth Inequality

Syllabus 3.3

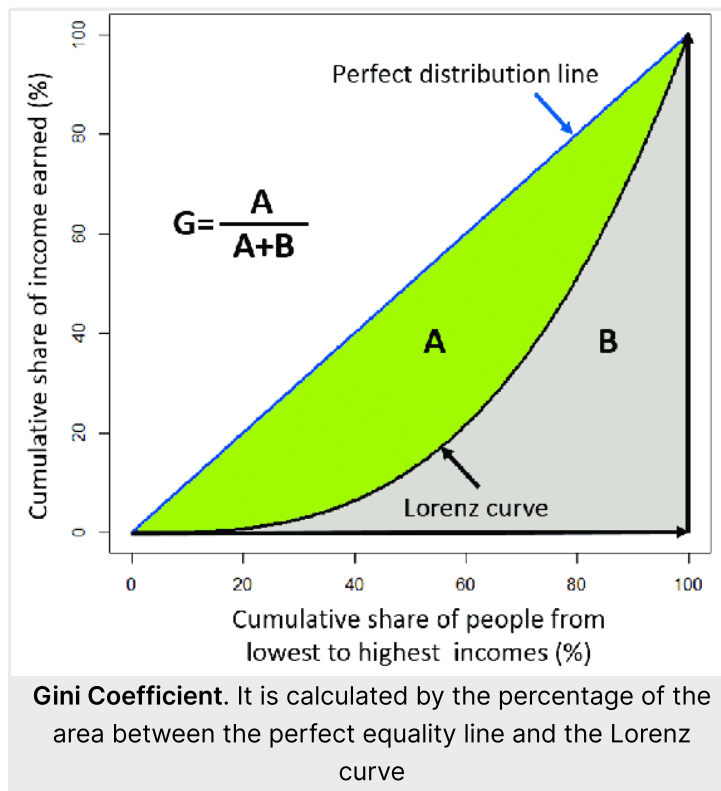
- difference between income as a flow concept and wealth as a stock concept
- measuring income and wealth inequality: Gini coefficient
- economic reasons for inequality of income and wealth
- policies to redistribute income and wealth: minimum wage, transfer payments, progressive income taxes, inheritance and capital taxes, state provision of essential goods and services

Wealth and Income

- **Wealth: stock of assets** that have been built up often over a long time period
 - e.g., pension scheme, shares, property, gold and antiques
- **Income: flow of payments** related to factors of production over a given time period
 - e.g., wages, salaries, and bonuses
 - **flow:** income is variable over any given period of time

Reasons for Inequality

1. Lack of formal employment opportunities
 2. Poor vocational training
 3. Lack of investment in education and health sector
 4. Poor infrastructure
 5. Inability to obtain credit (poor gets poorer)
- **measuring inequality** → **Gini Coefficient**: a numerical measure of the extent of income inequality in an economy, referring to the **Lorenz Curve**



Minimum Wage

Advantages	Disadvantages
Equity	Unemployment → firms need to cut cost
Poverty Reduction	Increased cost for smaller businesses
Incentive to work	Inflation → international competitiveness

- It also does not include **black market labor** and **geographical disparities**

Transfer Payments

- payments from tax revenue for the government to the people in monetary terms

Advantages	Disadvantages
Less poverty, more equality → better health conditions	Opportunity cost, tax revenue
Increase consumption → rich might save	Reduced incentive to work (Dependency)
Economic stabilization, less social security problems from poverty	Fraud or corruption