AQA Economics AS-level

Microeconomics

Topic 5: Market Mechanism, Market Failure and Government Intervention in Markets

5.9 Government failure

Notes

- Governments can fail when they intervene in markets. They could worsen the market failure already present or a new failure might occur.
- This results in a **net welfare loss** to society.
- The loss could be from having ineffective intervention or when harm is caused.

Causes of government failure:

Distortion of price signals

- Government subsidies could distort price signals by distorting the free market mechanism. A free market economist would argue that this could lead to government failure. There could be an inefficient allocation of resources because the market mechanism is not able to act freely.
- For example, the government might end up subsidising an industry which is failing or has few prospects.

Unintended consequences

- This is when the actions of producers and consumers have unexpected, or unintended, consequences.
- With government policies, consumers react in unexpected ways. A policy could be undermined, which could make government policies expensive to implement, since it is harder to achieve their original goals.

Excessive administrative costs

- The social benefits of a policy might not be worth the financial cost of administering the policy. It might cost more than the government anticipated. The government has to consider whether the policy is good value for money.

Information gaps

- Some policies might be decided without perfect information. This might require a full cost-benefit analysis, and it could be time-consuming and expensive.

- For example, government housing policies are long term, and have failed several times in the past.
- However, it is impractical for governments to gain every bit of information they need, so assumptions are made.