1.4.2 Government failure

a) Understanding of government failure as intervention that results in a net welfare loss
b) Causes of government failure:
  - *distortion of price signals*
  - *unintended consequences*
  - *excessive administrative costs*
  - *information gaps*

c) Government failure in various markets

- Government failure: When government intervention results in net welfare loss
- The distortion of price signals causes government failure as intervention often involves manipulation of prices which can undermine some parts of the price mechanism such as signalling, rationing and incentives which means resources are not allocated efficiently
- Unintended consequences cause government failure because some government intervention may have an impact which was not predicted by policy makers. E.g. cigarette tax causes smuggling
- Excessive administrative costs cause government failure because large amounts of resources can be used to enforce intervention and some may require policing
- Information gaps cause government failure because governments are unlikely to have all the relevant information so the intervention could move output further away from the socially optimum level for example they don't know how consumers will react or what they want
- Bureaucracy: The enforcement of laws by government officials which can interfere with the market forces
- Other reasons for government failure:
  - Time - problem may change
  - External shocks
  - Regulatory capture - regulatory bodies influence decisions to favour companies not people
  - Political acceptability
  - Governments favour short-term impacts
- Examples of unintended consequences:
  - People and businesses find ways to circumvent laws
  - Shadow markets develop
  - Moral hazards occurs when banks are bailed out
  - Tariffs on raw materials hurt domestic producers
- Regulatory failure:
  - They may limit innovation
  - Price capping reduces competition
  - Regulation is costly
  - May lack enough power
  - Frequent rule changes stifle investment
- Indirect taxes can be an example of government failure as high taxes can encourage smuggling or tax avoidance

- Agricultural stability schemes are an example of government failure as they can result in massive surpluses which involve massive storage costs so resources aren't allocated efficiently
- Housing policies can be an example of government failure as housing subsidies prevent the market working efficiently as there is little incentives for people to move even with rising incomes limiting the geographical mobility of labour
- Governments can increase competition by promoting small businesses by providing tax breaks or subsidies for small firms and reducing 'red tape' so there are greater choice and lower prices for consumers