

(d) Evaluate the argument that market failure can be solved by government intervention.

(20)

Market failure occurs when resources are inefficiently allocated and this often causes external costs. Governments ~~or~~ can intervene to try to correct market failure. For example, ~~the~~ the UK government has identified that obesity is caused by market failure\* and may want to employ means to reduce the negative externalities caused by unhealthy food and drink. \* as it costs £51 billion a year (3% of GDP spending.)

The government often attempts to reduce asymmetric information provision of merit or demerit goods. Merit goods are underproduced, underconsumed and their benefits are underestimated and demerit goods are the opposite. Governments can launch campaigns to make consumers more aware of the negative externalities (or positives) of goods and services. This could influence the demand of the good or service. For example, the government may campaign about the health risks of smoking. It may cause a reduction in demand for cigarettes and reduce the amount of negative externalities they produce thus reducing the market failure extent.



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Governments can also introduce regulation and legislation to reduce market failure. For example, it is against the law to smoke in a public building as well as in a car with a young person (under 18s). This could also reduce quantity demanded and consumption of demerit goods which allows market failure to reduce. However, government intervention can sometimes make situations worse, which is known as government failure. For example, the government put a ban on drug use such as cannabis. This encourages criminal activity due to and black markets. Only criminals benefit from this which then requires enforcement which then puts wastage on other services such as policing and healthcare. Alternative intervention may be more successful. - For example, the government could tax drug use. This could reduce demand and consumption as well as raise revenue for government spending that could reduce police strainage on the policing system for example. Furthermore, government intervention requires heavy administration costs as well as enforcement. Government resources may be wasted or used inefficiently on intervention of market failure than on other services that require



spending.

It all depends on the levels to which the government are intervening. Too much intervention could make situations worse, government failure, due to government's scarce resources being allocated inefficiently to correct market failure. On the other hand, governments can't let there be too much market failure because of the negative externalities that are caused on society. (social costs)

(Total for Question 1 = 50 marks)

**TOTAL FOR SECTION A = 50 MARKS**



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