

AS Micro: Government Failure

Intervention and (Possible) Government Failure

- Government failure occurs when an intervention leads to a **deeper market failure** or even worse a **new failure may arise**
- In other words – intervention creates further inefficiencies, a misallocation of resources + a loss of economic and social welfare
 1. Policies may have damaging **long-term consequences**
 2. Policies may be **ineffective in meeting their aims**
 3. Policies may create **increase inequalities of income and wealth**

Government failure can happen if a policy decision fails to create **enough of an incentive** to change people's behaviour

Cutting Emissions From Cars – EU Policies in Action

Regulations on Max CO2 Emissions per km Travelled

A command and control approach

2015: Max 130gms per km + penalties for exceeding

Effective in driving innovation

Cap on emissions higher than actual

Max limit might shift FDI outside the EU

Bringing vehicles into the Emissions Trading Scheme

Cap on emissions – “allowances” are traded

Incentives for investment in low carbon technologies

Most efficient emissions reducers can sell some allowances

Collapse in prices has eroded the incentives for investment

Higher road and fuel taxes

Inelastic demand – fuel taxes generate significant revenues

Easy to collect and adjust the rate

Tax depends on actual fuel consumption not theoretical level

But cannot guarantee target specific reductions in emissions

Some Causes of Government Failure

When discussing any government policy intervention, look to see if you can make **an evaluative comment on the risk of policy failure / ineffectiveness**



Political self interest / lobbying



Quick fixes not long-term solutions



Regulatory Failures



Lack of expertise in government



Disincentive effects and creation of shadow markets



Enforcement costs might outweigh any of the benefits



Intervention may conflict with other objectives



Damaging effects of red tape and other laws / rules

Political Self Interest

Government policy can be unduly influenced by influential **political lobbying**

Minimum alcohol price dropped



17 July 2013 Last updated at 14:51

The government has shelved plans to introduce a unit price on alcohol but there will be a clampdown on the cheapest alcohol sales, MPs have been told.

Home Office Minister Jeremy Browne said there was not enough evidence that minimum alcohol pricing would have its desired aim - to reduce binge drinking.

Multi-buy offers will not be banned due to a "lack of convincing evidence" that it would have a significant effect on consumption

But the government will bring in a ban on the sale of drinks priced below the level of duty and VAT.

2013 – plans for a minimum price for alcohol are dropped

The BBC reported that an investigation by the British Medical Journal found the government had met with representatives of the drinks industry 130 times between 2010 and 2014

Poor Value for Money from Government Spending

Low productivity / high waste may make government spending less effective

PFI will ultimately cost £300bn

Repayments on contracts will grow to £10bn a year by 2017-18, say Guardian figures, and government is still striking new deals [PFI contracts: read the full list here](#)



📷 PFI schemes for new hospitals could end up costing NHS trusts 12 times as much as the capital outlay.
Photograph: Christopher Furlong/Getty Images

The cost of Britain's controversial private finance initiative will continue to soar for another five years and end up costing taxpayers more than £300bn, according to a [Guardian analysis of contracts that were sanctioned by the Treasury](#).

The **Private Finance Initiative** is a controversial policy designed to get the private sector to fund and then run public projects – in many cases there has been a substantial cost over run.

Incentives to bypass official markets

Interventions such as tariffs and quotas often lead to smuggling / black markets

'Heavy smoker' is caught smuggling 33,000 cigarettes

🕒 17 April 2015 | Tayside and Central Scotland

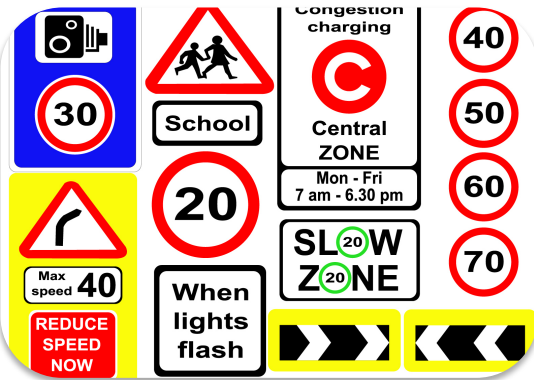


Kowal was caught with thousands of cigarettes at customs at Glasgow and Edinburgh airports

A "heavy smoker" caught smuggling 33,000 cigarettes into Scotland has been ordered to pay more than £9,000 in duties.

Britain has some of the highest cigarettes duties / taxes in the world

Dangers of the Search for a Quick Fix Solution



Congestion and Speeding



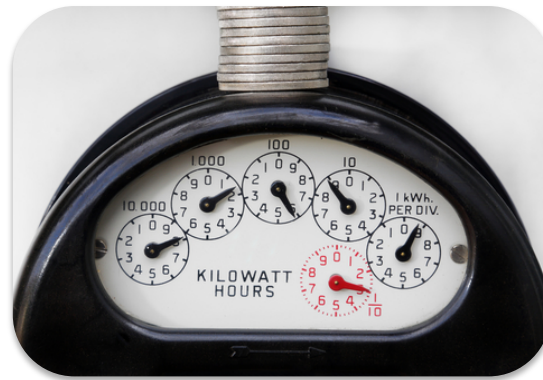
Rising Housing Rents



Binge Drinking / Anti Social Behaviour



Banking Instability / Crisis



Unaffordable Energy Prices



Tackling Obesity and Diabetes

Regulatory Failures (A Form of Government Failure)



Regulators may limit innovation in fast-growth markets



Capping prices might prevent new firms entering a market



Regulator becomes very bureaucratic & costly



May lack the powers to be effective in protecting consumers



Regulator might be "behind the curve" with new technologies



Frequent rule changes can stifle business investment

The Law of Unintended Consequences

Actions of consumers, producers and government—always have effects that are unanticipated or "unintended"

- Well-intentioned legislation often acts against the interests of those it is intended to serve
- People and businesses try to find ways to **circumvent new laws**
- **Shadow markets** develop to undermine an official policy
 - E.g. rent controls on housing or minimum prices for alcohol
 - Bootlegging of cigarettes as a result of high taxes
- Examples of unintended consequences:
 - **Bank bail-outs** – raises the problem of moral hazard
 - **Import tariffs on steel** – hits domestic car & construction firms
 - **Targets for treating patients in NHS hospitals** – leads to reduction in the quality of care e.g. the Mid-Staffordshire General scandal

The Law of Unintended Consequences

Beer drinkers join the fight against fracking with claims it poses a 'substantial threat to the quality of real ale'



Now the pint becomes political, as Camra warns the gas extraction technique could poison water

The Law of Unintended Consequences

Five unintended consequences of pensions freedom...and how to deal with them

Professional Adviser | 27 Apr 2015 | 15:22

Author: Carmen Reichman

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Summary of some Causes of Government Failure

Root cause of government failure	Brief explanation of the problem	Examples to consider
• Political self interest	Government is influenced by influential political lobbying	Farm support policies, the drinks industry, transport lobby
• Poor value for money	Low productivity / high waste makes spending less effective	Investment on IT projects in the NHS, poor record of PFI projects
• Policy short-termism	Governments often looking for a “quick fix” solution	Road widening to reduce congestion, ASBOs for offenders
• Regulatory failures	When Govt agency operates in favour of producers	Self-regulation on alcohol prices, powerful energy lobby
• Conflicting objectives	One policy objective might conflict with another	Minimum carbon price could damage UK competitiveness
• Bureaucracy & red tape	Costs of enforcement may hurt enterprise & incentives	Costs of meeting health and safety and environmental laws
• Unintended consequences	Policies have unanticipated or unintended side-effects	Smoking ban – increased use of outdoor patio heaters

Shoves and Nudges – Behavioural Economics in Action

Behavioural nudges are an alternative to using taxes and subsidies to influence choices

Eliminating or restricting choices

- Banning smoking in public places
- Banning takeaways close to schools / laws on using tanning salons

Financial disincentives to take a particular course of action

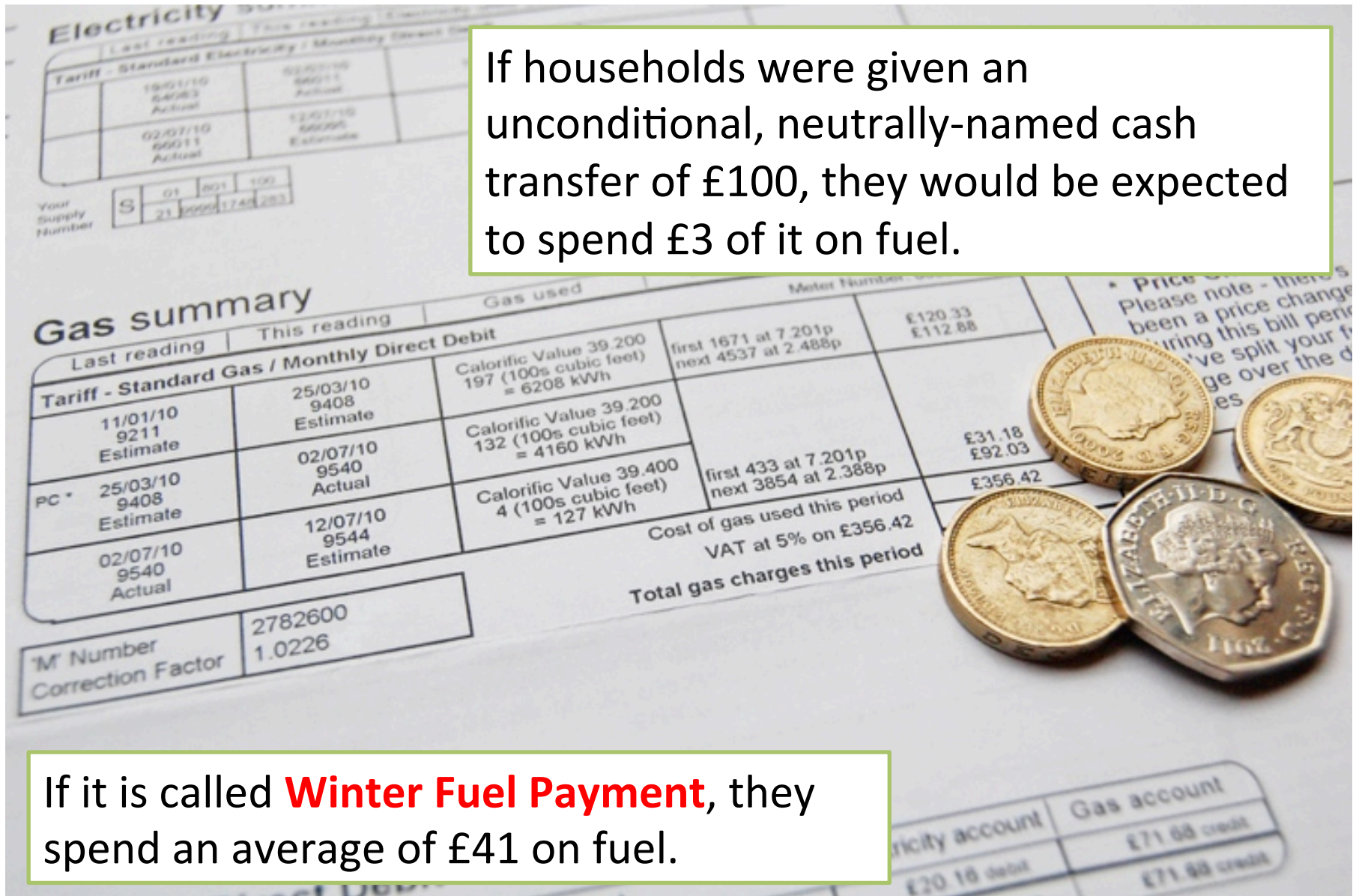
- Higher taxes on cigarettes / fuel / congestion charge
- Vouchers for healthy behaviour choices

Influencing Choice

- Provision of information – Providing calorie counts on menus
- Changes to environment – Designing buildings with fewer lifts
- Changes to default – Making salad the default side option instead of chips
- Use of norms – Providing information about what others are doing

Labelling can increase effectiveness!

If households were given an unconditional, neutrally-named cash transfer of £100, they would be expected to spend £3 of it on fuel.

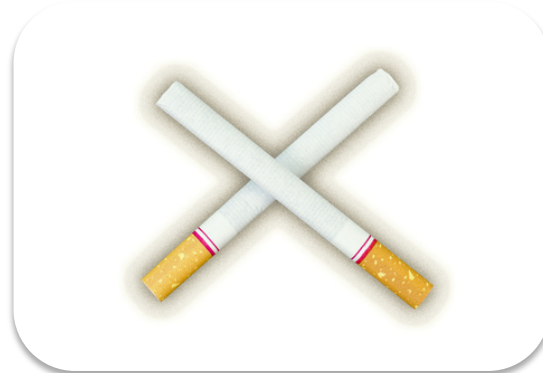


If it is called **Winter Fuel Payment**, they spend an average of £41 on fuel.

Some Behavioural Economics in Action!



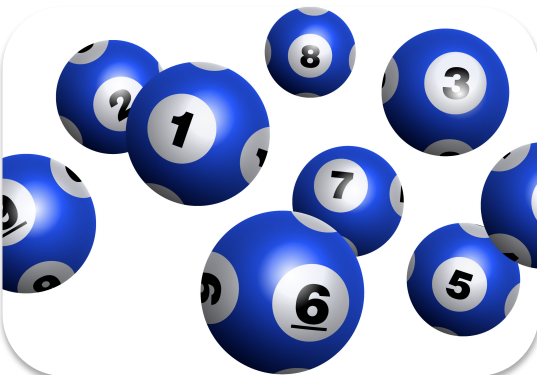
Organ Donation and importance of form design



Cash incentives to stop smoking



“Chunking” to increase drug treatment completion



Lotteries to encourage weight loss or cut speeding on roads



Using simple checklists in hospitals to reduce number of x-rays



Choice architecture to encourage healthy eating

Evaluation on Government Intervention

- 1. Value judgements:** Many people want a particular intervention because of their own political interests and views
- 2. Changing prices to change incentives and behaviour:** The value of price elasticity has a big effect on the effectiveness of policy
- 3. Social science:** The effects of intervention cannot be forecast – people's behaviour is subject to change
- 4. Combinations of policies:** One single intervention is unlikely to produce a solution to deep-rooted problems – build a variety of policy options into your discussion e.g. policies that work on both demand supply-sides of the market
- 5. The power of markets:** Market forces / innovation can be powerful in finding profitable solutions to problems
- 6. The 'law of unintended consequences':** Intervention does not always work in the way in which it was intended or the way in which standard economic theory predicts it should.

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