

Chapter 7

Business case questions

- 1. Why might governments want to intervene in the tobacco market?**
Because tobacco consumption creates a negative externality; this leads to over-consumption.
- 2. How do governments intervene in the tobacco market?**
Intervention may through helping educate people of the dangers of smoking; limiting and regulating the promotion of tobacco; taxing tobacco consumption
- 3. What are the potential advantages and disadvantages of this intervention by government?**
The advantage is that it leads to a more socially optimal outcome; the disadvantages may be it affects low income groups more than high income groups if these are heavier smokers- this could be regressive. It also affects jobs in the tobacco industry

Questions

- 1. Do you think the government needs to intervene to make sure living standards are high enough for everyone?**
The free market may encourage innovation, business and growth but rewards will not be equally shared; some have higher incomes and wealth than others. The government is needed to intervene if a country wants to influence income distribution.

If so, how should it do this?

May intervene through the tax system, the benefits system, through the provision of some goods and services, through regulation

Price

8	Excess demand 140	Government sell
9	Excess demand 80	Government sell
10	Equilibrium	
11	Excess supply 40	Government buy
12	Excess supply 100	Government buy

Free market equilibrium 30 units

Socially optimal output 20 units

7.1 DOING THE BUSINESS MATHS

Imagine the government is operating a buffer stock system to keep the price of a product at £10.

Market price (£)	Quantity demanded (units)	Quantity supplied (units)	Excess demand or supply (units)	Government action: buy or sell?
8	200	40	Excess demand 160	Sell
9	150	70	Excess demand 80	Sell
10	100	100	Equilibrium	Do nothing
11	80	120	Excess supply 40	Buy
12	50	150	Excess supply 100	Buy

7.2 DOING THE BUSINESS MATHS

1. What would be the equilibrium output in a free market? 30 units
2. What about if businesses took full account of the external costs of their actions? 20 units

Output	Marginal benefit (£)	Private marginal costs (£)	Social marginal costs (£)
10	50	5	15
20	40	25	40
30	30	30	50
40	20	40	70
50	10	50	85

Question

How might the concept of the circular economy affect car producers?

May mean that from design to manufacture companies have to consider how materials will be recycled and reused. Will have to develop distribution system that recalls items. Could increase costs although reusing may eventually save money.

Questions

- 1. What do you think are the benefits of the free market?**
Encourages efficiency and innovation.
- 2. What issues that are in the news currently do you think highlight some of the problems of free markets?**
May be linked to false information to customers, unsafe conditions or products, corruption.

7.1 Quick check

For each of the following statements, say whether it is true or false.

- A negative production externality occurs when the social cost are greater than the private costs. TRUE
- A public good is both diminishable and excludable. FALSE
- A positive production externality means that a product is over-provided in the free market. FALSE
- Asymmetric information occurs when one party in a market knows more than the other. TRUE

Questions

- 1. Would you prefer to be a manager in a private-sector business or a public-sector one? Why?**
Depends! May earn more in private sector- you output is sold and generates revenues which may provide more funds for you. Rewards may be directly linked to profits. However may have more social objectives in public sector; may feel you are doing more for society as a whole.
- 2. What services does the government provide in the UK?**
Education, health, police, armed forces., Regulates areas such as communications and transport
Do you think there are more services it should provide? Why?
Depends on your view of the role of government. Free marketers want less information; others think it would be better to have the government more involved as decisions would be made more on social basis. Conservatives generally want less intervention and Labour generally want more.

Question

Why might hotel booking sites need to be regulated?

They may mislead customer by favouring certain hotels for a fee; customers may think they are getting directed to the most popular or best hotels but they may be getting those who have paid the most.

Question

Do you think the government should limit price increases by energy companies?

May ensure more people have access to energy e.g. less people suffering from cold in the winter may be fairer

What might be the consequences of this?

Business may claim this affects profits and therefore investment. They may argue this will reduce the quality of service, lead to higher costs and eventually even higher prices.

7.2 Quick check

For each of the following statements, say whether it is true or false.

- a. A government will want to tax products that have positive externalities. FALSE
- b. A government is likely to directly provide some public goods. TRUE
- c. A government may use a buffer stock scheme to stabilize the output produced in a market. FALSE
- d. Nationalization occurs when a government transfers a business from government control to private control. FALSE

Quick questions

1. **What is meant by a public good?**
Non diminishable and non-excludable
2. **How does a negative production externality affect a market?**
Means social costs are greater than private; leads to over production
3. **How does information asymmetry distort a market?**
Means buyers may be wary because they know less than the sellers; this could reduce the price in the market and distort the amount supplied
4. **How might monopoly power distort a market?**
May lead to high prices, less output and lower quality output
5. **How does a government use buffer stocks to stabilize price?**
Buys in good years so supply on the market does not increase; releases stock in poor years so there is no shortage
6. **What is the difference between nationalization and privatization?**
Nationalisation occurs when the government takes control of a business; privatization occurs when it gives up ownership of a business.
7. **How do markets lead to income inequality?**
Because those people in demand and short supply will earn more than those with little demand and high supply.
8. **Why might prices in a market be unstable?**
Due to shifts in demand and supply
9. **How might governments intervene in markets?**
Through taxes and subsidies, through laws, through direct provisions, through regulation
10. **What might happen if managers think their business is too big to fail?**
Make take risks they would not otherwise do; affects decision making