3.8 Limitations to Markets

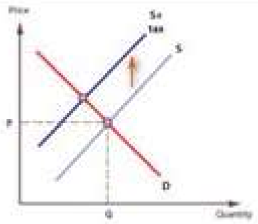
Key Words

Externality	An effect of an economic activity on a third party
Negative externalities	Harmful effect of an economic activity on third parties. Also known as an external cost.
Indirect tax	A tax on spending. An indirect tax is charged on producers of goods and services and is paid by the consumer indirectly. Eg VAT, sugar tax
Subsidy	An amount of money the government gives directly to firms to encourage production and consumption
Regulation	Rules, directives or government orders to control the way people and organisations behave
Information provision	The government provides information to encourage people and organisations to change their behaviour.
Positive externality	Beneficial effect of an economic activity on their parties. Also known as an external benefit.
State provision	Goods and services provided directly by the government

Negative Externalities

When a transaction takes place it is between a first and second party ie buyer and seller. Negative externalities occur when a third party ie someone not involved in that transaction is negatively affected by the transaction. One possible third party may be the NHS who are negatively affected by higher levels of obesity or it may be friends and family of someone who inhales the smoke from someone smoking a cigarette. These negative or harmful consequences are seen as a limitation of the free market economy as the price of the good or service does not reflect the harm that is caused to others. In these cases the government may choose to intervene to try to correct the market failure and reduce consumption of the good or services causing negative externalities.

Evaluation of tax as a government intervention

Policy	Examples	Impact	Benefits	Costs
Taxation	Excise duties on tobacco, alcohol and petrol Carbon tax Air passenger duty	 The tax will lead to a rise in the price and fall in quantity demanded The extent of the impact depends on the PED. If demand is price inelastic	Provides revenue to the government Makes the "polluter" pay	Indirect taxes are regressive and therefore lead to greater inequality Can lead to unofficial ie black markets which need policing Low PED so tax may not change behaviour

Positive Externalities

When a transaction takes place it is between a first and second party ie buyer and seller. Positive externalities occur when a third party ie someone not involved in that transaction is beneficially impacted by the transaction. One possible third party may be the community who gain from higher levels of immunity against disease through the vaccination programmes offered by the NHS. te. These positive consequences are seen as a limited by f the free market economy as the price of the good or service does not reflect the benefits gained by others. In these cases the government may choose to intervene to try to correct the market failure and increase consumption of the good with positive externalities.

Evaluation of state provision

Policy	Examples	Impact	Benefits	Costs
State provision	NHS Education	The government decides how much healthcare to provide and sets a budget which in the short term fixes the supply of healthcare. As the NHS is free for patients, demand is high. There is excess demand. This means there is a shortage. This explains the long waiting lists for hospital operations.	Everyone has access to healthcare/education Increases the productivity of the workforce	Demand will exceed supply for services where there is no cost to the consumer The UK's rising and aging population means that the demand for healthcare has shifted to the right and the excess demand is increasing Opportunity cost that the money could be spent on other priorities.

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