Government failure

a) 'Government failure' as intervention that results in a net welfare loss.

Government failure : occurs when it intervenes in the market but this intervention leads to the loss of economic welfare rather than again.

b) Causes of government failure:

1. **Information gaps**

- The information available is positively misleading, in some cases, then you may make the wrong policy respond to a problem.
- E.g. government does not know how much-public goods should be provided
- E.g. government does not know the true value of external cost and external benefit in terms of money - It difficult to identify the value of tax and subsidy.

2. **Lack of incentives**

- Goods and services provided by government may be inefficient as the gov lacks of profit motive. Government does not have incentive to improve quality of product & production

3. **Unintended consequences**

- Income tax may discourage people to work.
- Providing unemployed benefits may reduce incentive to find jobs.
- Indirect tax is regressive tax which mainly falls on poor people resulting in higher income inequality or larger income gap between rich and poors.

4. **Excessive administrative costs**

- Sometimes, the administrative cost of correcting market failure is so large that it outweighs the welfare benefit from the correction of market failure.
- E.g. cost of intervention > benefit which could be ganned.

5. **Moral hazard**

- People may take higher risk, if they know negative consequences lie to the third party.
- E.g. when commercial banks realized that the risk of business bankruptcy will be backed up by central bank they may take higher risk by issue loan to low credit borrowers.