CHAPTER 19 : Government intervention in product markets

Key terms

1. Competitive tendering : introducing competition among private sector firms which put in bids for work that has been contracted out by the public sector
2. Contracting out : getting private sector firms to produce goods and services which are then provided by the state for its citizens
3. Deadweight welfare loss : the overall loss in welfare which arises after a tariff is imposed
4. Deregulation : the process of removing government controls from markets
5. Nationalisation : the transfer of firms or assets from private sector ownership to state ownership: it is the opposite of privatisation
6. Privatisation : the transfer of organisations or assets from state ownership to private sector ownership; it is the opposite of nationalisation
7. Regulatory capture : an example of government failure, it occurs when firms in industry are able to influence to their advantage a regulatory body which is supposed to be regulating their behaviour

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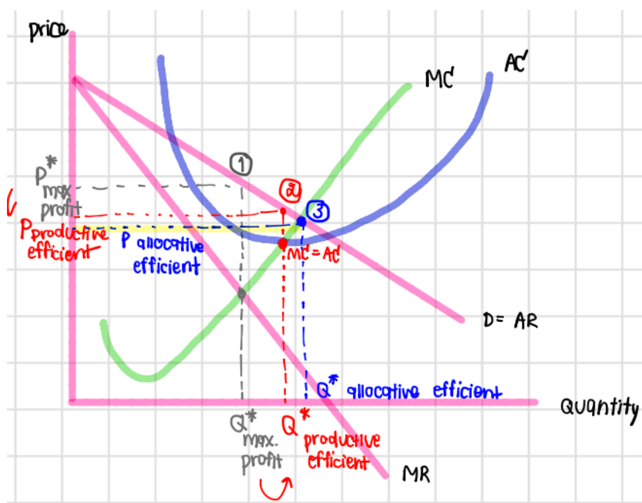
1. Measures to control monopolies and mergers

1.1 Price regulation

: Government will introduce price control, maximum price that a monopolist could charge

: Government can charge price at productive efficiency
(Point2) or allocative efficiency (Point 3)

Diagram



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1.2 Profit control or profit regulation

: Controlling monopolist is to fix a maximum level of profit that they can earn.

However, there are many problems to implement

- It require regulator to understand cost and rate of return in industry
- Monopolists have little incentive to minimise cost

1.3 Quality standards

: Quality is an issue, governments can intervene by setting quality standards

1.4 Performance targets

: Performance targets are similar to quality standards. The government sets target for a variety of different outputs from a firm. This could be about price changed, the quality of Product, degrees of customer choice or cost of production.

1.5 Referral to regulatory authorities

: It allows a monopoly to be investigated by the government or state authorities if it is

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thought to be exploding its consumers or being anticompetitive in is actions.

1.6 Legislation to control mergers and takeovers

: Competition authorities will investigate large mergers which will significantly reduce competition int he market and they have power to prevent the merger form going ahead.

2. Measures to promote competition and contestability

2.1 Tax incentive and grants to promote small business and FDI

2.2 Deregulation

2.3 Privatisation

2.4 Competitive tendering for public sector contracts

2.5 Trade liberalisation

3. Measures to protect suppliers and employees

3.1 Local sourcing of raw materials and components

: Government can force firms to use minimum amount raw material and components that are sourced locally from domestic manufacturers

3.2 Employment registration to protect workers from exploitation

3.3 Barriers to entry of foreign firms

3.4 Restriction on the monopsony power of firms

3.5 Nationalisation

: taking private assets into state ownership

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4. Advantages and disadvantages of government intervention

Advantages	Disadvantages
1. Lower price to consumers since it reduce power of monopoly 2. Reduce abnormal profit for firms especially for monopoly or oligopoly 3. Increase productive, allocative efficiency 4. Increase quality of product where quality standard is an issue 5. Increase consumer choice since it reduce merger and acquisition and encourage high competition in the market	1. Asymmetric information : regulator has less information than firm : Then regulator make decision which are more favourable to firms 2. Inadequate resources : Government does not has enough budget to control firms eg. High cost to monitor 3. Lack of regulatory power : Sometimes regulators do not have full responsibility / power to make decision etc

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