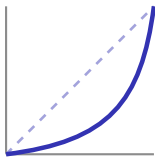


Government Microeconomic Intervention

A-Level Economics ■ Topic 8

A-Level Economics



What we will cover

- 1 Correcting market failure
- 2 Equity vs equality
- 3 Measuring inequality
- 4 Redistribution
- 5 The labour market
- 6 Minimum wage & wages



inequality side by side



Correcting market failure

indirect tax

subsidy

price control

tradable permits

regulation

state provision

Also **nationalisation** ↔ **privatisation**, and **competition policy** (block mergers, ban price-fixing). Beware **government failure** – intervention can back-fire.



Market failure cigarettes

What each policy tool actually does

A government has many tools to push a market towards a better use of resources:

Tool	What it does
indirect tax	on a good with a negative externality (fuel): raises price, cuts quantity
subsidy	for a good with a positive externality (solar panels): lowers price, raises quantity
regulation	rules and laws – bans, safety standards, pollution limits
state provision	the government supplies it directly, often free: schools, hospitals, defence
nationalisation	taking an industry into public ownership; privatisation is the reverse

A tax and a subsidy work on **price**; regulation works on **quantity** directly. Which suits depends on how responsive demand is.

Competition policy

A firm with **monopoly power** can raise prices and cut output, so **competition policy** is the set of laws that protects competition:

- block a merger that would concentrate a market too far
- outlaw price-fixing and other cartel behaviour
- regulate a natural monopoly's prices where competition is impossible

The aim is not to punish being big. It is to keep the **threat** of a rival alive, because that is what holds prices down.



Equity vs equality

It is important to separate two words that sound alike:

- **equality** – everyone gets the *same*
- **equity** – everyone gets what is *fair*

A fair outcome is not always an equal one. And keep the two things being shared apart:

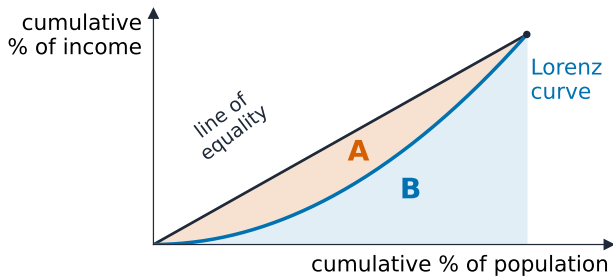
income is a *flow* received over time – wages, rent, interest – while **wealth** is a *stock* of assets owned: houses, shares, savings.

a fair outcome is not always an equal one

equality
everyone gets
the *same* share

equity
everyone gets a
fair share (not
always the same)

Measuring inequality



The **Lorenz curve** plots income share against population share.

The more it sags below the line of equality, the higher the **Gini coefficient** (0 = equal, 1 = all to one).

$$\text{Gini} = A/(A + B) \cdot 0 = \text{equal}, 1 = \text{most unequal}$$

Redistribution

progressive tax

a higher rate on
higher incomes

benefits

transfers to those in need

state services

free education & health

Redistribution moves income to the poor – but **wealth** is harder to redistribute (it can be hidden or moved abroad).



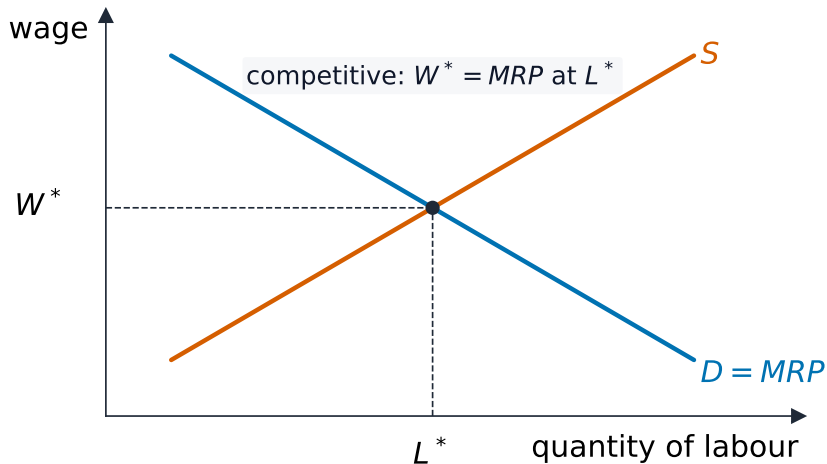
The labour market

A wage is the price of labour.

- demand is a **derived demand** – from the **MRP** (extra revenue per worker)
- supply rises with the wage, skills & conditions

The wage settles where they meet.

The labour market, in detail



A wage is the price of labour.

Imperfect labour markets



- a **monopsony** (single buyer of labour) pays **below** the competitive wage
- a **trade union** bargains the wage **up**, but may cut jobs

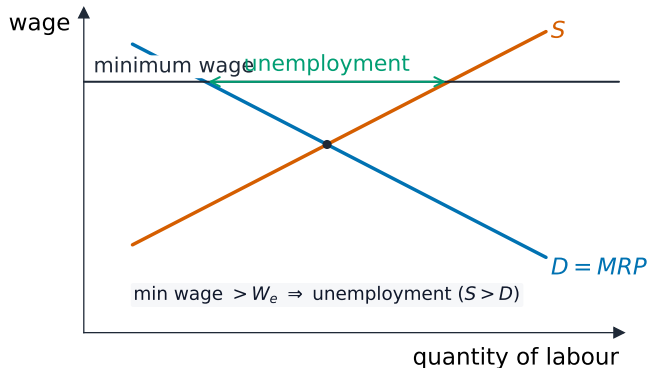
Wages also differ by **wage differential** & sometimes **discrimination** .

The minimum wage

A **minimum wage** above the market wage raises low pay but can cause some unemployment.

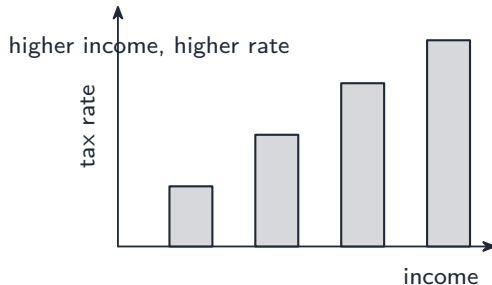
In a **monopsony**, a minimum wage can raise *both* the wage and employment.

The minimum wage, in detail



A **minimum wage** above the market wage raises low pay but can cause some unemployment.

Policies to redistribute



A progressive tax takes a higher *rate* from higher incomes. **Benefits** – also called **transfer payments** – move money the other way, to the poor, the old and the unemployed. Together they are how a government narrows the gap without touching the market itself.

Worked example – reading a Gini coefficient

Country X has a Gini coefficient of 0.25 and country Y one of 0.48. What does that mean, and what does each Lorenz curve look like?

- The Gini runs from **0** (perfect equality) to **1** (one person has everything), so a **higher** number is **more** unequal: Y far more than X.
- On the graph, Y's **Lorenz curve sags further below** the 45° line of equality; X's hugs it.
- The Gini *is* that sag: the area between the line of equality and the curve, as a fraction of the triangle beneath it.

One caution worth stating in an answer: the Gini measures **relative** inequality only. It says nothing about absolute living standards – a poor country and a rich one can share the same Gini.

Equity, equality, and how wages are set

equality

everyone receives the *same*

equity

everyone receives what is *fair* – which may not be the same

redistribution

moving income from richer to poorer through progressive tax and transfers

why wealth is harder

it is a stock, easier to hold abroad or in untaxed forms than a flow of income

a wage differential

wages differ between jobs, mainly through differences in **marginal revenue product** and in the supply of that labour

discrimination

some gaps come from paying people differently by gender, race or age – **not** explained by productivity

A Gini of 0.25 is a far more equal distribution than one of 0.48. Zero is perfect equality and one is perfect inequality – state the direction, not just the number.

Wage differentials, and the minimum wage

a wage differential

wages differ between jobs

the main reasons

differences in **marginal revenue product**, and in the **supply** of that kind of labour

what limits supply

the training needed, the danger or unpleasantness of the work, and geographic immobility

discrimination

pay differences **not** explained by productivity

a national minimum wage

a legal floor – it raises the pay of the lowest earners

its risk

set above the market wage it creates **excess supply of labour**: unemployment among exactly the group it was meant to help

How much unemployment depends on the **elasticity of demand for labour**. In a monopsony, a minimum wage can raise both the wage *and* employment.

Exam tips

- Evaluate ways to **correct market failure**, and warn of **government failure** (unintended effects, poor information).
- Distinguish **equity from equality**; discuss redistribution (progressive tax, benefits) and its trade-off with incentives.
- Analyse a **labour market** with the demand for and supply of labour, and explain wage differentials and the effect of a minimum wage.



Worked example – a minimum wage

A minimum wage is set above the equilibrium in a competitive labour market. Analyse the effect.

- Above equilibrium $\Rightarrow$ firms **demand less** labour, more workers **supply** it.
- The gap is **excess supply of labour** = **unemployment**.
- Those who **keep** their jobs gain; those who lose them are worse off $\Rightarrow$ a real trade-off.
- But in a **monopsony** the outcome flips: a minimum wage can raise **both** wages and employment.

The answer depends on the **market structure** and on **elasticity**: inelastic demand for labour $\Rightarrow$ little job loss. Always say “it depends, because...”.

Topic 8 – key takeaways

1

Tools

tax, subsidy, regulation,
competition policy

2

Equity

fair $\neq$ equal; income flow vs
wealth stock

3

Inequality

Lorenz curve & Gini;
redistribution

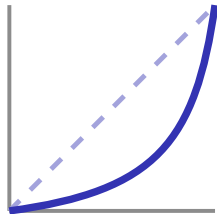
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Labour

derived demand (MRP);
monopsony; minimum wage

Check yourself

- 1 Equity means fair – what does equality mean?
- 2 A Gini of 0 means what?
- 3 The demand for labour is what kind of demand?
- 4 A single buyer of labour is called what?



Answers 1. everyone gets the same 2. perfect equality 3. derived demand 4. a monopsony