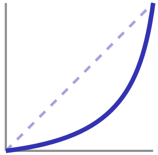
Government Microeconomic Intervention

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

1 Market failure

Correcting market failure

indirect tax

subsidy

price control

tradable permits

regulation

Also **nationalisation** 国有化 ↔ **privatisation** 私有化, and **competition policy** 竞争政策 (block mergers, ban price-fixing). Beware **government failure** 政府失灵 – intervention can backfire.

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 间接税	on a good with a negative externality (fuel): raises price, cuts quantity
subsidy 补贴	for a good with a positive externality (solar panels): lowers price, raises quantity
regulation 管制	rules and laws – bans, safety standards, pollution limits
state provision 政府提供	the government supplies it directly, often free: schools, hospitals, defence
nationalisation 国有化	taking an industry into public ownership; **privatisation** 私有化 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** 垄断势力 can raise prices and cut output, so **competition policy** 竞争政策 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.

2 Equity and inequality

Equity vs equality

It is important to separate two words that sound alike:

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

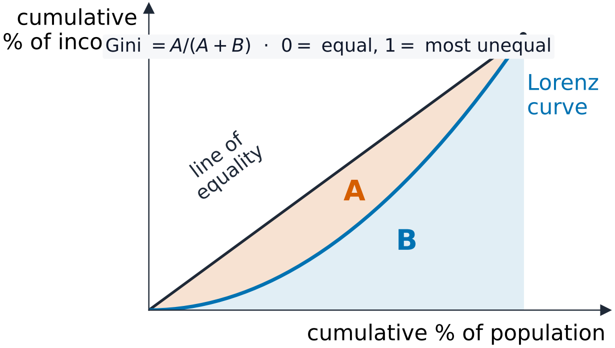
A fair outcome is not always an equal one. And keep the two things being shared apart: **income** 收入 is a flow received over time – wages, rent, interest – while **wealth** 财富 is a stock of assets owned: houses, shares, savings.

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** 洛伦兹曲线 plots income share against population share.

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

Redistribution

progressive tax 累进税

a higher rate on higher incomes

benefits 福利金

transfers 转移支付 to those in need

state services

free education & health

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

3 Labour markets

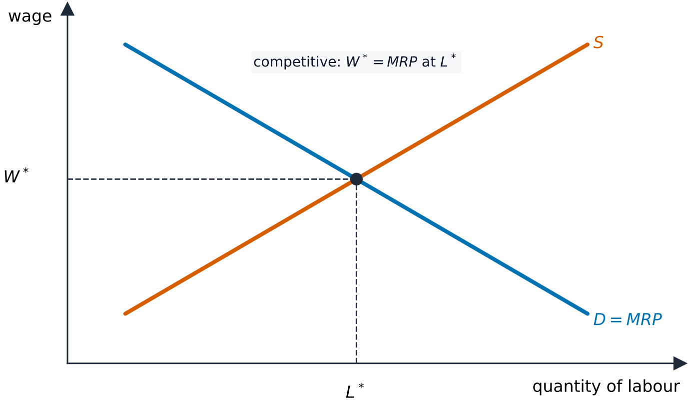
The labour market

A wage is the price of labour.

- demand is a **derived demand** 派生需求 – from the **MRP** 边际收益产品 (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** 买方垄断 (single buyer of labour) pays below the competitive wage
- a **trade union** 工会 bargains the wage up, but may cut jobs

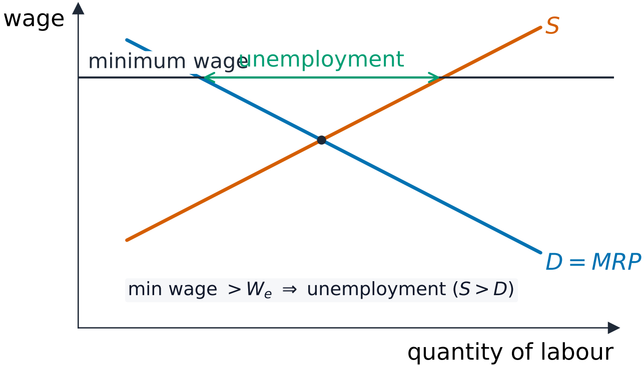
Wages also differ by **wage differential** 工资差异 & sometimes **discrimination** 歧视.

The minimum wage

A **minimum wage** 全国最低工资 above the market wage raises low pay but can cause some unemployment.

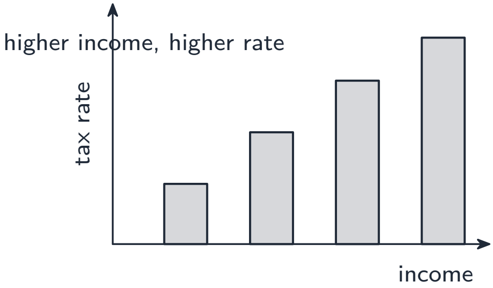
> In a monopsony, a minimum wage can raise *both* the wage and employment.

The minimum wage, in detail



A **minimum wage** 全国最低工资 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** 福利金 – also called **transfer payments** 转移支付 – 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 再分配	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 工资差异	wages differ between jobs, mainly through differences in **marginal revenue product** 边际收益产品 and in the supply of that labour
discrimination 歧视	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 工资差异	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 歧视	pay differences not explained by productivity
a national minimum wage 全国最低工资	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.

4 Recap

Worked example – a minimum wage

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

- Above equilibrium ⇒ 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 ⇒ 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 ⇒ 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**

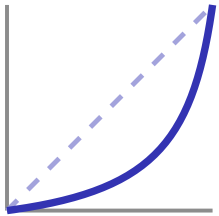
Lorenz curve & Gini; redistribution

4 **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