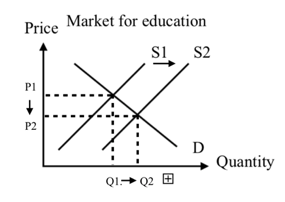
**To what extent are subsidies the most effective way of encouraging the consumption of merit goods?**

Subsidy is the money provided by government to firms to encourage production;

Merit goods are good that are not consumed enough because of consumers’ lack of knowledge, like education, health care, vaccination, etc;

Opportunity cost is the value for the next best alternative that must be given up in order to obtain something else.



First, the provision of subsidy by government can make merit goods more affordable to low-income consumers. In the free market for education, for example, the market equilibrium is achieved when MPC = MPB, thus P1 is the equilibrium price and Q1 is the equilibrium quantity. However, at Q1, there is the presence of external cost because the marginal social benefit of education is much larger than marginal private benefit. thus, there is market failure for education. In order to correct the market failure, a subsidy is provided by the government to encourage the supply of education. Thus, the cost of production decreases, and the willingness and ability to produce increases, which means that the supply of education increase from S1 to S2, the equilibrium quantity increases form Q1 to Q2, and the equilibrium price of education decreases from P1 to P2. Thus, as the price of education decreases because of the subsidy, according to the law of demand, which states that there is a negative relationship between demand and price, the consumption for education increase.

However, even though the price of the merit goods that is subsidized decreases and more people can afford them, tax increases for everyone. Because when government subsidize one good, they have fewer budget. In order to ensure they have enough budget, the government has to raise tax, which means people will have lower income (direct tax, tax on income) and higher price for other goods (indirect tax, tax on goods and services), which means that using the same money, people cannot buy as much as they used to, leading to less living standards, especially for those who do not enjoy the benefit from the merit good that is subsidized.

Second, subsidy can create more job opportunities and thus make people better off to consume more merit goods. As I showed in the diagram and according to my former explanation, when a merit good is subsidized, the supply increases and the quantity supplies also increase. The increase in quantity produced means there have to be more employment. Thus, when the unemployment rate decrease, more people will be able to earn more money and become better off. When people have more money, they will be more likely to afford more merit goods like education and health care.

However, subsidy also means opportunity cost. When government gives subsidy to one merit good, they will not be able to give that amount of subsidy to other merit goods, and will not be able to encourage consumption on those merit goods that the government do not choose to subsidize. For example, when government choose to subsidize education, even though the price of education goes down and the consumption increase, the government gives up the opportunity to subside health care, and many people still cannot afford it and the consumption is still very low.

Thirdly, compared to other measures like regulations or advertisement, the method of subsidy still maintains price mechanism, which means that it is still market that determines the price, and both the consumers and producers have the incentive to either produce or consume the merit good. In comparison, as regulations and advertisement cannot create the price mechanism, the government has to spend tax revenues for monitoring or advertising.

However, advertisement sometimes is better than subsidy in that they are more easy to implement while subsidy is hard to quantify the external cost. Advertisement are more easily to be implemented because the effect on arousing consumers’ awareness is immediate and the change in the amount of consumption can be changed more rapidly; but when subsidies are introduced, it may take longer time for the market to adjust to the equilibrium state.

In conclusion, subsidy is an efficient and effective way to encourage consumption of merit goods. However, many alternatives exist, and each has their own advantages and disadvantages when comparing with each other. In reality, in order to encourage the consumption of merit goods, the government should take practical situations into account and use a combination of different measures.