Business Economics (TCS2112)

Assignment 01 - Report

Should the government intervene in the market?

Jayaweera W.M.P.N.
TG/2018/392
Department of ICT
Faculty of Technology
University of Ruhuna

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Introduction

When considering human society, Humans are willing to get developed. Their desire to get a better life never stops. That's why we call it humans have unlimited needs, wands and desires. When we consider the world, the world is divided into many countries. Those countries are controlled by governments which are appointed by the public or in another way. As countries, every country in the world is in a race to development. Getting developed means they are in a race to easily fulfill their needs, wants and desires. There are two types of countries in the world. They are developed countries and developing countries. Developing countries are trying to grow their economy and be a developed country and developed countries are also trying to be more developed than the others. The government, which is controlling the country, is mainly responsible for the development of the country.

This development of a country mainly depends on the market economy. The market in the sense is the place which is for exchanging goods and services within two or more parties. As a country, the market plays a great role in the development of a country and the running of a country. We are going to study the conflict of markets and the government.

Free-market before government intervention.

What is a free-market

Let's understand what a free market is. In introduction, we have discussed what is a market. The free market is a special type of economic system which is only based on supply and demand. The specialty of the free market is, it has only a very little or no government involvement. The process of the free market goes automatically based on supply and demand. Suppliers decide what will be the prices of the goods or services and the people who have money and necessity will buy it. This free market gets a decentralized approach, individuals make economic decisions.

In the Free market, the resources are owned by private parties, not the government. Financial market which includes institutes like banks are thriving in the Free Market. Anyone can participate in the free market without any interruption.

Free market makes way for innovations. Developing new products and services includes those innovations. Free market based on customers. If customers are willing to buy a specific product, it will get sold among customers and if they are not, they will not get sold. The customers who have the ability or wealth to buy goods and services will buy them at any cost but if any customer does not have the ability to buy that product, he will not.

Government intervention to the market

In most countries, the government intervenes in the market. There are various reasons for the government to intervene in the market. Let's discuss them now.

Why does the government intervene in the market?

In a Free Market, there will be automatic monopolies around private companies. They will gain a great power to control the market including prices of goods and services. It will affect customers who are also citizens of the country badly. So, for the protection of the citizens, the government is intervening in the market.

Another case is, the government intervenes in the market to promote and enhance public goods. Public goods served and offered to the general public. They are not private properties. From the public goods, all citizens in the country are benefited without difference.

Governments intervene in the market because of the effects caused to the market because of natural reasons. Some cases which cannot be stopped. For example, when there is flood in Sri Lanka, paddy fields get destroyed and there will be a shortage in rice production. When that kind of scenario happens, the government will intervene in the market to reduce the problems that will occur in future.

Sometimes, there are other reasons such as when the government needs people's attention etc. When an election is soon to be held, the current government will try to reduce prices of goods and services to get the attention of the citizens.

Methods of Government Intervention

There are several ways or methods of intervening in the market by the government.

Buffer Stocks

Keeping a buffer of stocks is a common method of the government. If that specific good can be kept in a store, then the government stores that good to release them to the market when there is a shortage of supplies on that specific good.

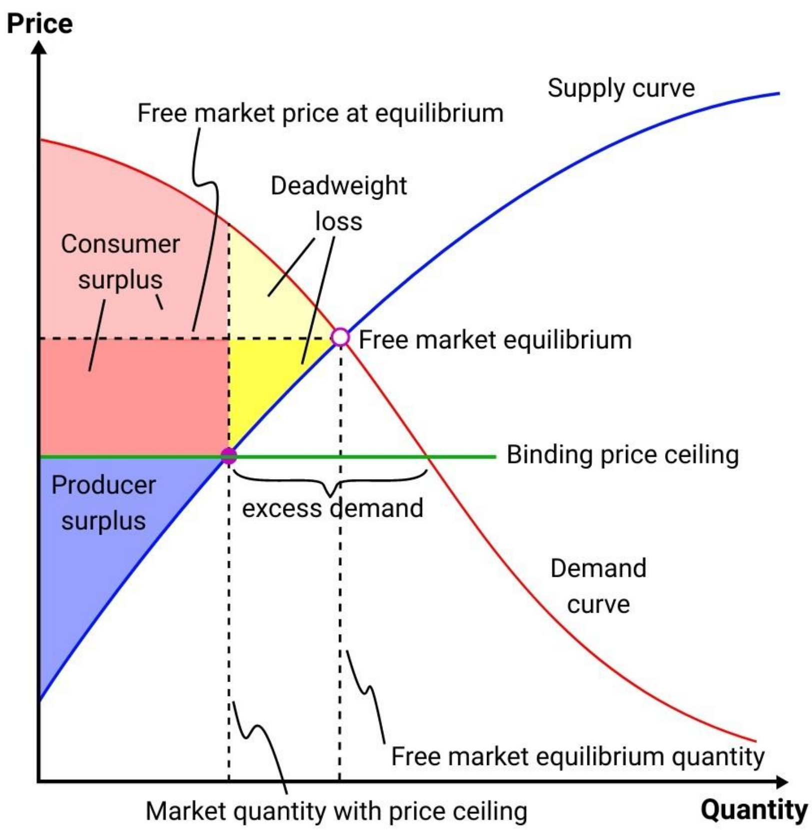
One of the well known examples is, the government of Sri Lanka is keeping a buffer of rice to release to the market when there is a grom damage or related issue.

Price Ceilings (Maximum price and Minimum Price)

Assigning a maximum or minimum price to selected goods or services is one of the famous ways to intervene in the free market. It's very common in Sri Lanka.

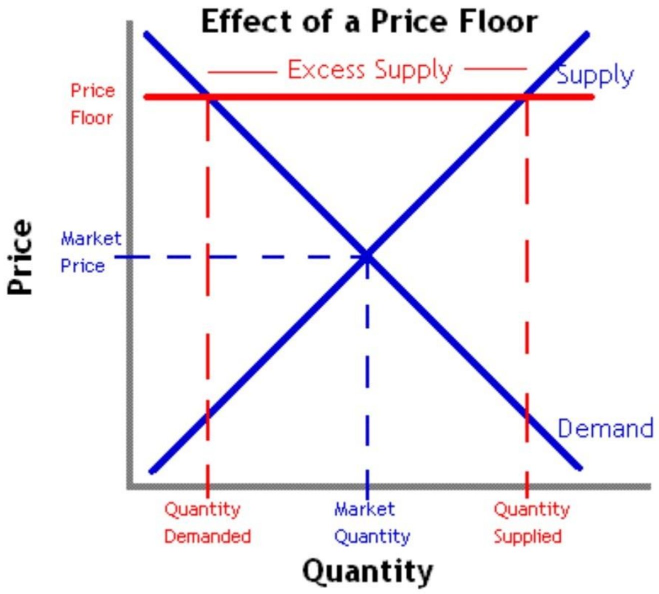
These price ceilings can protect both customers and suppliers on different occasions.

Price ceiling affects the market when the set price is below the free market equilibrium price. It will result in a supply shortage. The quantity demand will increase.

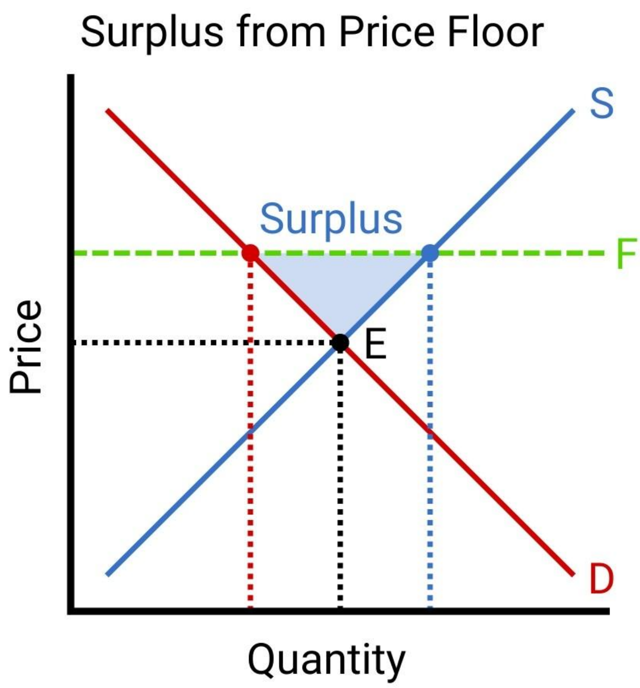


The deadweight loss represents yellow. If that specific goot is unable to buy which it needs and values most, it will increase deadweight loss.

If a price floor is set above the equilibrium price, consumers will demand less and producers will supply more.



Surplus from a price floor: If a price floor is set above the free-market equilibrium price (as shown where the supply and demand curves intersect), the result will be a surplus of the good in the market.



Taxations

Taxation is another way to intervene. As an example, in some seasons, there is excess potato supplies in the Sri Lankan market. In that kind of scenario, the Sri Lankan government is deciding to intervene in the market by assigning high tax rates on imported potatoes.

Subsidies

Giving subsidies to required persons is done by the Sri Lankan government also. The Sri Lankan government assigned subsidies plans called Samurdhi and helps families who are having low income. Those are for protecting Sri Lankan citizens.

State provision

Government can intervene in the market by state provisioning. It means, government can issue direct orders to enforce or limit activities in the market.

Most of these state provisions are used to control public goods by the government. Government can intervene to the free market by also use state provisioning for private goods.

Regulation

In some cases, the government is trying to regulate some actions on the market. The most famous example in Sri Lanka is TRCSL which is the Telecommunications Regulatory Commission of Sri Lanka. It regulates almost all stuff related to telecommunication. If there is no such intervention, it will not be able to control the call rates, internet fees etc.

Pros and cons of government intervention to the market

Pros of government intervention to the market

- Education

Government can intervene in the education field to give proper education for children without a big difference in their family backgrounds. If there is only a free market, the education will only go to the wealthier persons.

Sri Lanka has a free education system which has equally benefits all citizens in Sri Lanka. It is a good aspect of government intervention to the free market which will benefit in future.

- Control consumer behavior

Controlling consumer behavior is needed when consumers who are the citizens of the country are behaving unethically or badly for their own. As an example, Tobacco and alcohol usage is limited by assigning tax heavily on such goods in Sri Lanka. It can be considered a pro.

It's also good for the citizens in a circuitous way. Which is, those tax payments are collecting for the government and they are profitable to citizens through public goods.

Cons of government intervention to the market

- Government will make mew problems

When the government intervenes in the market, there can be long term consequences of that intervention. Governments will make their own problems in the market.

For example, when the government decides to set a fixed price on a product to a maximum size, it will cause a bad effect on the market. Sellers will hide the stocks and avoid selling them to customers. It can cause a fake shortage.

- Bad influence

When considering the free market, there is a potential to have new innovations and cost cuts because there is a good influence and incentive. But in the government sector, we can see that the influence is bad and state owned industries have inefficient workflow, demand for the productions is low, the staff is high and less supportive to the public.

- Using political power badly

While the government can intervene in the free market, they can appoint their political alleys for their public goods production and maintenance.

As an example, when there is a project ongoing to do a construction, the government will give that construction to one of their political allies instead of giving it to the most suitable contractor. It will affect negatively.

- Less freedom

Governments try to control customer behavior in many ways by intervening in the market. As an example, the Government tries to minimize tobacco and alcohol usage of customers by assigning heavy taxes on those products.

Some customers may feel this is an unwanted behavior of the government to control their freedom of life.

Conclusion

When considering all aspects we have discussed above, I suggest that the government intervene to the market is good when the country is a developing country which has the different wealth levels among citizens.

If almost all people are rich and can be involved with the free market without any issue, the free market can leave alone without much intervention by the government. Then the market will flow according to the supply and demand.

For a country like Sri Lanka, I suggest that the government should intervene in the free market.

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