Why government intervenes in business activities economics essay

Economics

The government plays a variety of roles in business primarily to ensure that the public's interests are preserved and to control any and all market failure. Apart from that the Government has 4 distinctive role: REGULATORY ROLE: The rules that are established to make the market system work efficiently. Any market economy necessitates some collective authority in order to enforce property rights and to make sure that people execute contractual responsibility. ALLOCATIVE ROLE: The government must determine how some resources are allocated. The allocative function refers to how much of the government's budget will be allocated to particular projects. For example, the government may decide that, as part of their economic policy, it needs to spend more money on developing collective goods such as roads, education and health care. Allocating funds gleaned from taxes also allows the government to create jobs or public venues. DISTRIBUTIVE ROLE: The free market outcome results in an unfair distribution of income, so the government will intervene to assure everyone has a sufficient income. This basic statement assumes that it is possible to arrive at a collective judgment as to the desirable income distribution. In the absence of such an agreement, government intervention may aim at several different targets including providing a floor to income, increasing equality of opportunity, equalizing incomes and increasing incentives of individuals. STABILISATION ROLE: The government intervenes in the market to ensure there is steady growth. It concerns the use of budget deficits or surpluses to add to or subtract from aggregate demand in the economy, with the intention of influencing the level of output and unemployment and the rate of inflation in the economy. They do this through monetary and fiscal policy.

Why government intervenes in business activities?

Businesses are usually profit motivated. Many times in order to get more profit the business might neglect issues like environmental issues and production of harmful and dangerous products. Large business might take the advantage of their size and exploit consumers, employees and even use unfair tactics to overcome competition from small businesses. Business might use media to portray a wrong image of their product or may even mislead customers to buy products.

Market Failure

Market failure occurs when freely-functioning markets, fail to deliver an efficient allocation of resources. The result is a loss of economic and social welfare. Market failure exists when the competitive outcome of markets is not efficient from the point of view of society as a whole. This is usually because the benefits that the free-market confers on individuals or businesses carrying out a particular activity diverge from the benefits to society as a whole.

Types of Market Failure

Monopoly Power: Markets may fail to control the abuses of monopoly power. Few modern markets meet the stringent conditions required for a perfectly competitive market. The existence of monopoly power is often thought to create the potential for market failure and a need for intervention to correct for some of the welfare consequences of monopoly power. The classical economic case against monopoly is thatPrice is higher and output is lower under monopoly than in a competitive marketThis causes a net economic welfare loss of both consumer and producer surplusRent seeking behaviour by the monopolist might add to the standard costs of monopoly. This includes high (possibly excessive) amounts of spending on persuasive advertising and marketing. Public goods: Markets may fail to form, resulting in a failure to meet a need or want, such as the need for public goods (defense, street lighting, and roads). When people refuse to contribute to the cost of providing a public good on the grounds that once it is provided no one can be barred from using it. In this situation private producers will have no incentive to produce the goods as they have no way of charging for the product so they can't make a profit. Merit goods: Markets may fail to produce enough merit goods, such as education and healthcare. A merit good is a good that society or the government deems that people ought to have because it is considered to be good, consumption is encouraged. De-merit goods: A demerit good is a good that government or society considers being harmful or bad for people. Markets may also fail to control the manufacture and sale of goods like harmful products such as cigarettes and alcohol, which have less merit than consumers see. Negative Externalities: Consumers and producers may fail to take into account the effects of their actions on third-parties. Third-parties are individuals, organisations, or communities indirectly benefiting or suffering as a result of the actions of consumers and producers attempting to pursue their own self interest. Information Failure: Markets may not provide sufficient information because, during a market transaction, it may not be in the interests of one party to provide full information to the other party. Often market failure results from consumers suffering from a lack of information about the costs and benefits of the products available in the market place. Labour Market Failure: occurs when supply and demand don't result in an efficient allocation of labour resources. This can be seen in occasions where there is either a surplus or a shortage of labour, as well as cases where workers are in the wrong jobs, workers are poorly or not trained at all, and where wage rates are low. The causes of labour market failure are: Abuse of labour market powerImperfect informationSkill shortagesEconomic inactivityUnemploymentDiscriminationOccupational immobility of labour

Government intervention to correct market failure

Taxation (for Public goods, De-merit goods, Negative externalities and Monopoly)

Indirect tax: to discourage production of demerit goods and others services that produce negative externalities. Some of the tax revenue are use to finance merit goods and public goods, such as education and health. The government can also bring down monopoly price to competitive level by price regulation and taxation. In either case, the plan is to bring monopoly price to the competitive level.

Subsidies

Subsidies are used to encourage production and consumption which is particularly relevant in the case of merit goods and products that generate positive externalities

Legislation and Force

Demerit goods: restrictions on the sales of tobacco products and alcohol.

Information Failure: Government action can have a role in improving information to help consumers and producers value the ‘ true’ cost and/or benefit of a good or service and this is done by: Compulsory labeling on cigarette packages with health warnings to reduce smokingImproved nutritional information on foods to counter the risks of growing obesityadvertising campaigns to raise awareness of the risks of drink-drivingAdvertising health screening programmesConsumer Protection legislations, under which we have: Trade Description Act: deliberately giving false impression about a product is illegal. Consumer Credit Act: According to this act, consumers should be handed a copy of the credit agreement and should be aware of the interest rates, length of loan while taking a loan. Sale of Goods Act: It is illegal to sell products with serious defects or problems and goods sold should match to the description given.

Employees Protection legislations

Government may pass laws to protect the interest of employees such as: Laws against unfair discrimination at work and when applying for jobs. There is no unfair discrimination on the basis of Race, religion, sex, age, or color.

Legislations for health and Safety at work:

To protect workers from dangerous equipment. Workers should be provided with proper safety equipments and clothing. A reasonable workforce temperature is maintained for workers. Proper hygienic conditions and washing facilities are provided. Workers get adequate breaks between shifts.

Protect employees against unfair dismissal

Business cannot fire the workers because they have joined a trade union or for being pregnant. There should be proper notice before dismissing a worker or else it will be treated as unfair dismissal.

Ensure fair wages for the employees

In many countries, government makes it obligatory to have a written contract of employment. It encloses the details of the wage rate; working hours, deductions and other necessary details concerning working conditions. The government also determines the minimum wages paid to different types of workers.