SA422 and SA4C7
2008/2009
Government Intervention

- Rationale –
  - Improve efficiency of use of resources
  - Pareto optimality
  - Market failure
  - Improve distributional outcomes
  - Incomes
  - Wealth
  - Welfare
  - Other objectives: political/social

Methods of Intervention

- Improve market
  - Legal framework
  - Information
- Regulate market
  - Set standards
  - Control prices, quantities, inputs
- Taxation and subsidy
  - Modifying price and incentives
  - Improving distribution
- Direct provision
  - Substitute administrative for market decisions to improve allocation of resources and distribution

Principles

- Can achieve same efficiency effect using each method
- But distributional outcomes different
- In practice methods depend on history/political feasibility/operationalising problems etc. etc.

(i) Improve Markets
Legal Framework

Definition of property rights
Contracts
Information
Development of markets
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Insurance
Relationship between defining framework and other interventions
Relationship between efficiency and distribution

(ii) Regulation

- Contract specification
  - Clarify legal framework
  - Provide methods of enforcement
  - Provide information
  - good practice
  - Demonstration
- Risk and insurance
  - Mortgage Protection insurance
  - Contaminated land

Examples

- Land-use planning
  - Organising public goods externalities
  - Distribution
- Rent controls/security of tenure
  - Property rights
  - Distribution
  - Slow adjustment
  - Relative power
- Standards
  - health
  - building etc
  - Information
  - relative power
  - merit good
- Financial probity
  - Liquidity and security
  - Transparency
  - Information
Examples

• Rent control
  - Sudden change in demand ↓
  - $P_{short} > L/R$ marginal cost ↓
  - Control for distributional reasons ↓
  - Efficiency/distributional problems

• Standards
  - Standards impact on costs
  - Individuals not prepared to pay ↓
  - Avoidance/Evasion/Reduced Supply ↓
  - Distributional problems ↓
  - Subsidy?

(iii) Taxation/Subsidy

• Council tax
• VAT
• Stamp duty
• Improvement grants
  - Prisoners’ dilemma
• Income related benefits
  - merit goods
distribution

Revenue raising? but
Impact on Decisions
• Income v Price Subsidy
  - Supply subsidies → lower rents?
  - Subsidies to social landlords/ financial constraints ↓
    - Lower rents: shortages @ these rents

Efficiency Case for Income v Price Subsidies
• Price subsidy distorts resource allocation [or externality merit good etc]
• Admin allocation limits choice
• Income subsidy allows freedom of choice
  BUT
• Issues with respect to incentives; second best

(iv) Direct Provision
• Local Authorities/RSLs
• Administrative allocation
  - investment
  - allocation of dwellings
  - pricing
• Contractual failures
• Economies of scale
• Relative power
• Merit good
• Distribution

Examples
• Investment
  - Optimal level of investment based on social costs and benefits and social discount rate
  - Problems where financial constraints
• Allocation given constraints
  - Housing allocation rules in relation to social objectives
• Pricing issues

Productive v Allocative Efficiency
• Concerns that administrative allocation will be productively inefficient –
  - multiple objectives
  - agency problems
  - oriented towards suppliers
  - information issues
  - target environment
• Trade-off between production and allocative efficiency
Pricing

• to cover costs? Rate of return
• to relate to value?
• to relate to market?
• to meet other goals?

Rent restructuring example