

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

Insurance
Relationship between defining framework and other interventions
Relationship between efficiency and distribution

Examples

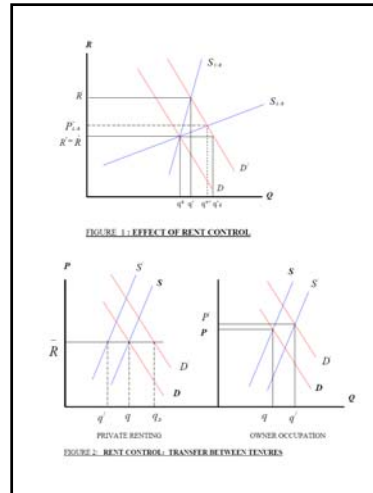
- Contract specification
 - Clarify legal framework
 - Provide methods of enforcement
 - Provide information good practice
 - Demonstration
- Risk and insurance
 - Mortgage Protection insurance
 - Contaminated land

(ii) Regulation

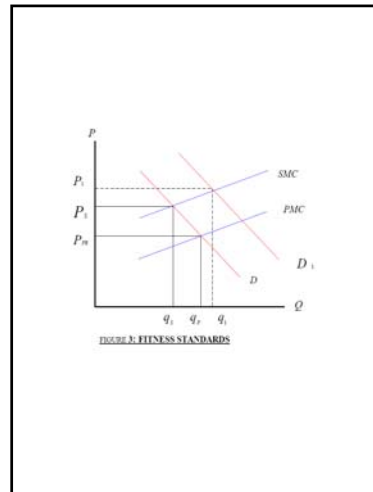
- Land-use planning
 - Organising public goods externalities "certainty"
 - Distribution
- Rent controls/security of tenure
 - property rights distribution
 - Slow adjustment
 - Relative power
- Standards –
 - health building etc
 - Information relative power merit good
- Financial probity
 - Liquidity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

Examples

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

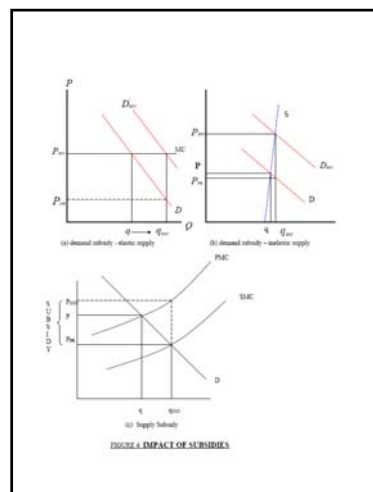


- Standards
 - Standards impact on costs
 - Individuals not prepared to pay
 - ↓
 - Avoidance/Evasion/Reduced Supply
 - ↓
 - Distributional problems
 - ↓
 - Subsidy?



(iii) Taxation/Subsidy

- Council tax } Revenue raising? but
- VAT } Impact on
- Stamp duty } Decisions
- Improvement grants
Prisoners' dilemma
- Income related benefits
merit goods
distribution



- Income v Price Subsidy

- Supply subsidies → lower rents?

- Subsidies to social landlords/ financial constraints

↓

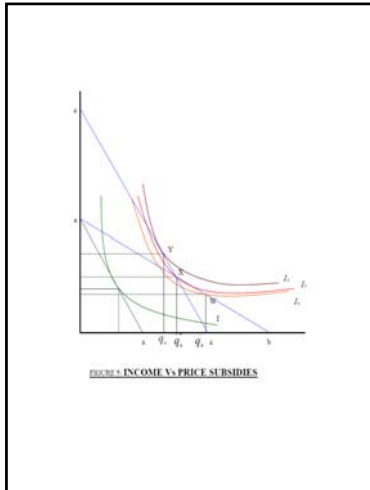
- Lower rents: shortages @ these rents

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

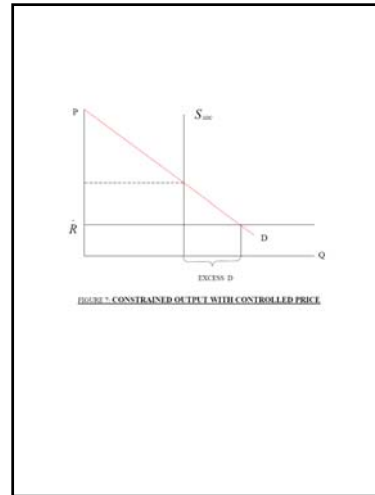
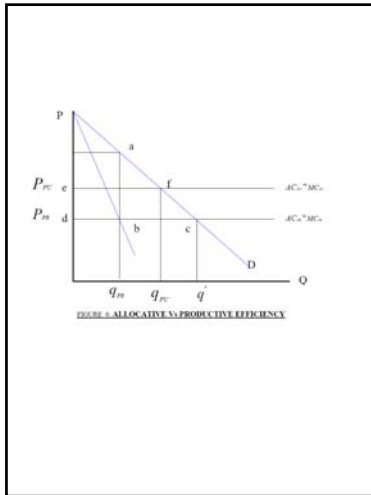
- Local Authorities/RSLs
- Administrative allocation investment allocation of dwellings pricing
- Contractual failures
- Economies of scale
- Relative power
- Merit good
- Distribution

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