Lesson plan

Course Name: Economics II

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Topic: General equilibrium and microeconomic policy of the state, part III.

Course Objectives:

The aim of the third lecture is to explain the active role of te stady focused on the economic policy and the possibility of its influencing.

Microeconomic policy of the state - actions of the State, or Government, is part of economic policy. Economic policy is summary of objectives, tools and decision-making processes in the various areas of economic reality.

Economic policy has the micro-economic and macro-economic aspect.

MICROECONOMIC POLICY OF THE STATE

25. CAUSES AND INSTRUMENTS

There are four ***basic causes*** *or* group initiatives with state regulation:

1) inefficient allocation of production factors and the final production due to the ***imperfect competition, externalities, public goods and imperfect information;***
2) ***Social unacceptable of income distribution,*** the effort to change distribution of income;
3) ***The conflict between efficiency and value system of the society.***

Micro-economic policy tools:

1) ***individual market subjects behavior rules establishing:***
   a) Defining property rights in the society.
   b) Anti-trust legislation or state price regulation, quality of goods, etc.
2) **State fiscal policy**: the revenue and ***expenditure of the state budget (in connection with taxes).***
3) ***State as a market subject*** can influence situation in the markets of the final production as well as in the markets of production factors.

26. RULES OF MARKET SUBJECTS BEHAVIOR

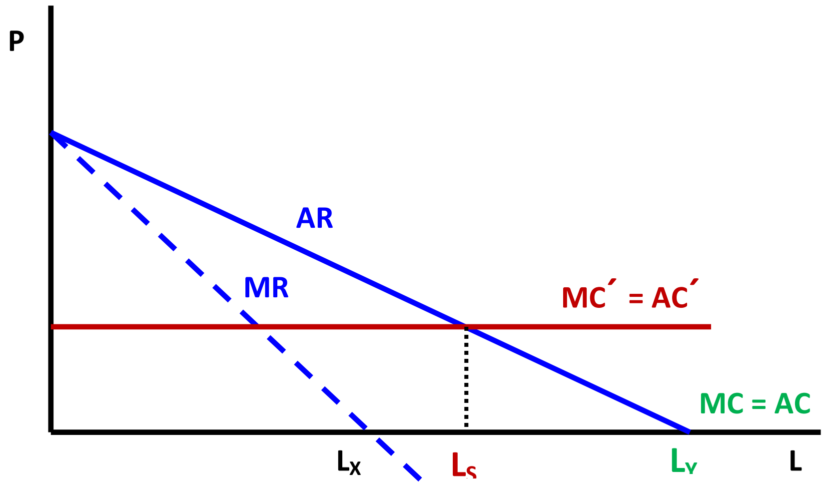
26.1 Defining property rights

There are two core cases = the factors of production (F) are ***free and available to everyone*** or ***are in the private ownership.***

26.1.1 Production factor is free (a factor can use each subject)

Starting point **=** perfectly competitive market, ***decreasing MR and decreasing AR*** (causes are not on the demand side, but on the supply side) → MP and AP of the free production factor are ***decreasing***.

Because the production factor is the free good, than ***TC = 0 (AC = 0, MC = 0).*** Because, there are zero operating costs, ***the number of producers* will *increase*** until **AR = *0 (because AR = AC,*** so also as long as ***AC = 0).***



26.1.2 Production factor is owned privately

If the production factor is in private ownership, then ***TC > 0*** and provided constant returns of scale will be graphically represented as **MC = *AC*** line parallel to the axis X. The number of producers will increase until ***AR = AC.***

The task of government is to distribute production resources to the various ***owners and reduce resources waste = well defined property rights prevents the waste of resources.***

26.2 State regulation

State regulation is normally used against firms in a situation approaching situation of monopoly.

- ***Price control*** is motivated by government by the attempt to eliminate monopoly profits from the price.
  - ✓ Price control ***at the level MC (P = MC) -*** *may lead to* **AC > *AR* = *loss*** → ***leavind the industry*** or ***the pressure on the state*** → State must compensate the loss (by increasing prices or subsidies).
  - ✓ Price adjustment ***at the level AC (P = AC) -*** then ***AC = AR*** → company reaches ***only*** normal profits.

26.3 Anti-trust legislation

Anti-trust legislation is intended to control the growth of monopolies and to protect competitors from undesirable monopolistic firms practices. These can allow reduction in number of competitors.

27 FISCAL POLICY

Fiscal policy affects the market situation in the first place through ***sales tax, subsidies and penalties.***

27.1 Sales (turnover) tax

The sales tax is included in price of the goods. To the state budget is payed by sellers. The turnover tax has an impact on the behavior of the economic entities that:

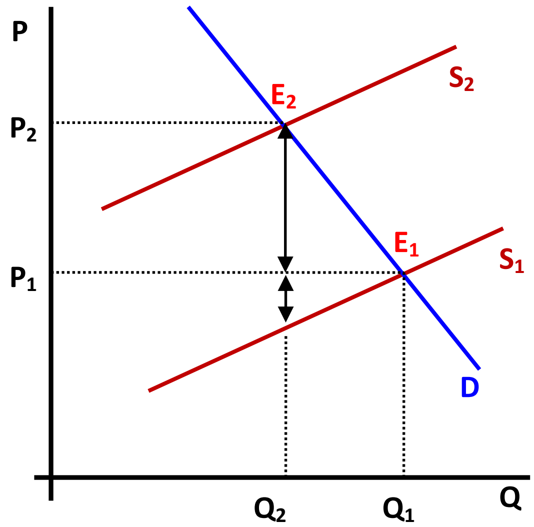
- Affects the balance of the market
- Falls unevenly on different subjects
- Reduces allocation effectiveness of the market.

27.1.1 The turnover tax and market equilibrium

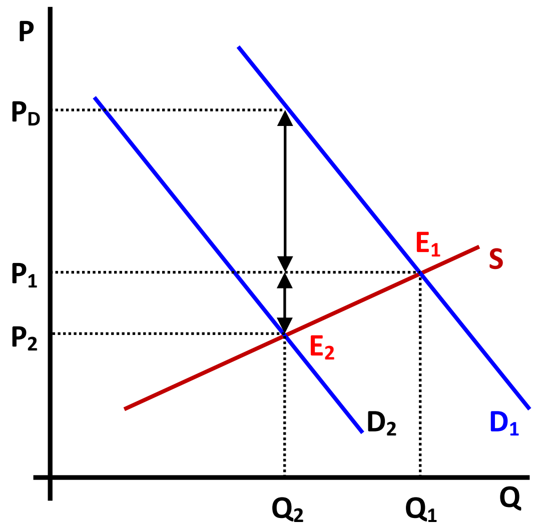
Sales tax usually reduces equilibrium quantity ($Q_{(e)}$ and increases price (P).

Exception: If the supply or demand are ***completely inelastic*** (demand or supply curve is vertical), then only price is changed (not the quantity).

a) payed by producers



b) payed by consumers



27.1.2 Unequal impact of sales tax

Problem of sales tax is the fact that its effect does not remain limited only to the subject that is imposed. Subject paying tax trying to move the tax burden to other market players. Movement may be directed:

- Forward or
- Backward

Ramsey tax rule: the highest tax should be imposed on the factors of production and goods, whose supply or demand are at least cost-elastic.

27.1.3 *The turnover tax and allocation inefficiency*

Tax usually reduce production factors and final production allocation effectiveness. Tax burden is in most cases larger than the amount paid in tax → ***additional tax burden.***

28 PUBLIC GOOD AND ASYMMETRIC INFORMATION REGULATION

28.1 Public goods provision

With the existence and provision of public goods are connected three problems:

i) optimal volume determination

ii) Obtaining sufficient funding for their production

iii) The choice of efficient providing

28.2 Asymmetric information regulation

Information (or at least in some part) is in its features very similar to ***public goods.***

State regulation of the market with the information:

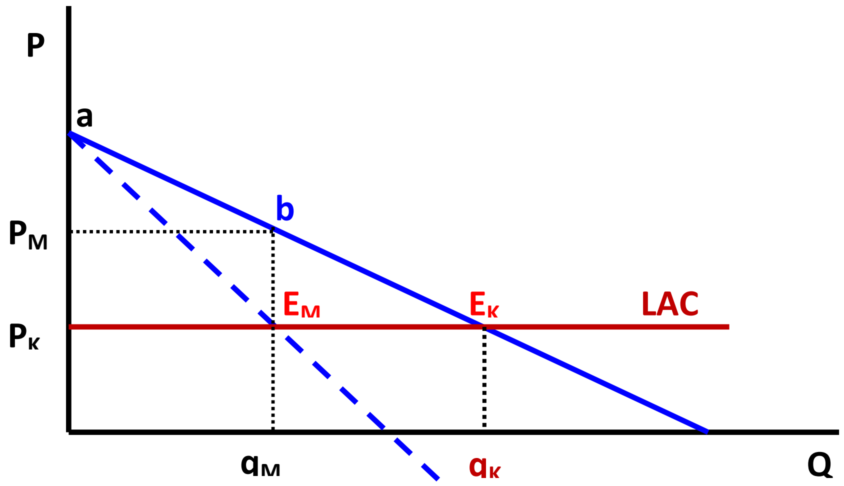
- Requesting the production of goods in accordance with the health or security regulations
- Requiring the disclosure ofthe key information about offered products from sellers
- Provide a public availability of the necessary information (state agencies)
- Subsidize private subjests dealing with providing information to the public.

29 STATE FAILURE

The failure State is one of the causes of market failure. It can be generated from:

1) imperfect decision-making government institutions;
2) actions of public authorities, etc.

Rent seeking:



List of tasks for students:

Part „Microeconomic policy of the state „

1. **Explain the causes and instrumets of micro-economic state policy.**
2. **Why are accurately defined property rights important for the efficient functioning of the market?**
3. **Explain goals of the government regulation, their options, and negatives.**
4. **Explain the content of fiscal policy.**
5. **Explain the state failure and give some examples.**