
Markets and Government Influence

Vollkommener Markt / Perfect Competition

Homogenität: gleichartige Güter, keine Präferenzen

Homogeneity: fully **comparable** goods, no preferences



Transparenz: alle Informationen für alle vorhanden

Full transparency: all information can be obtained at any time

Freier Marktein- und austritt

No barriers to entry or exit

Schnelle Reaktionen der Marktteilnehmer auf Veränderungen

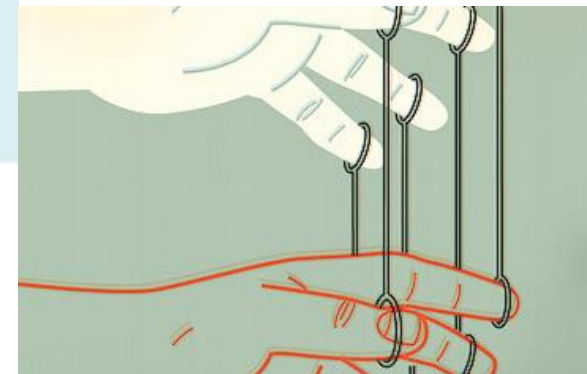
Any market player can instantly react to changes

Adam Smith – „invisible hand“

Adam Smith (1723 – 1790)

Scottish philosopher, considered by many to be the founder of modern economic science as we know it. Famous for the ‘invisible hand’, that is how people pursuing their own self-interest actually benefit the society as a whole, and the advantages of increasing ‘specialisation’. Major publications are *‘The Theory of Moral Sentiments’* (1759) and *‘An Inquiry into the Nature and Causes of the Wealth of Nations’* (1776).

Page 3



Why does the „Invisible Hand“ tremble?

PERFECT
COMPETITION

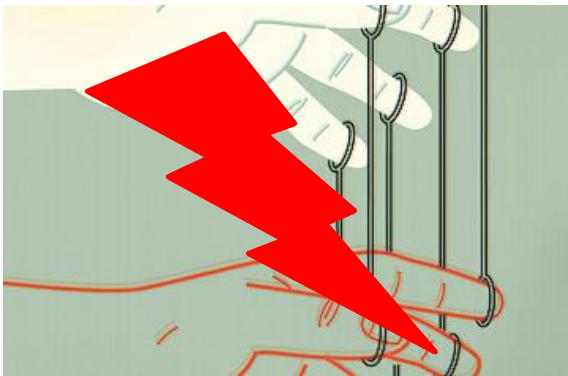
INVISIBLE
HAND

MARKET
FAILURES

monopolies
Imperfect competition

externalities
spillovers

distribution of incomes
and wealth



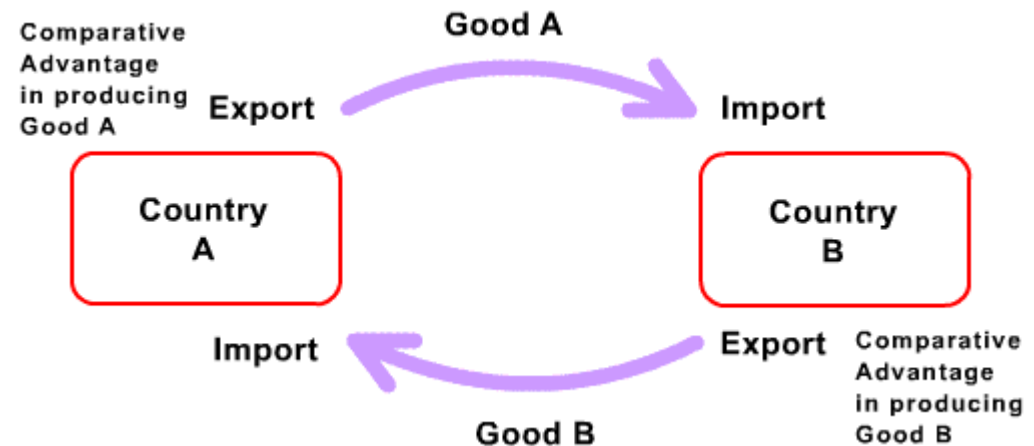
David Ricardo – „comparative advantage“

David Ricardo



- In his 1816 book **David Ricardo** developed the free trade theory based on **comparative advantage**

- **Absolute Advantage:** when a country can produce a good more **efficiently**
 - produce a good using *fewer resources*
- **Comparative Advantage:** when a country can produce a good at a **lower opportunity cost**
 - country gives up *less* when they produce a good



Characteristics of Advanced Industrialised Economies



**ADVANCED
INDUSTRIALISED
ECONOMIES**



(Global) Trade

money
facilitates trade

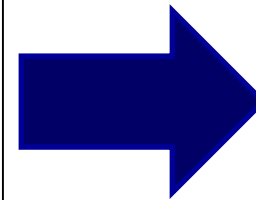


specialisation of individuals
companies
countries

division of labour

increase of
efficiency
&
productivity

**RAISE LIVING
STANDARDS** of
PARTICIPANTS
(of trade
agreements, etc.)



investments into capital
(influenced by the rate of
savings) → enhancing
the future productivity of
the economy



How do governments (try to) correct market failures?



PUBLIC GOODS

- offer what wouldn't be offered at reasonable prices
- e.g. infrastructure, security, education,

...

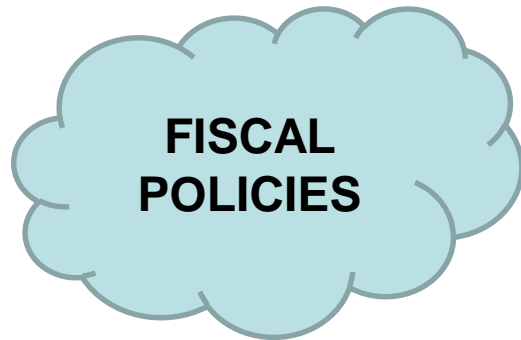
REDUCTION OF EXTERNALITIES

- subsidise R&D
- finance public investments

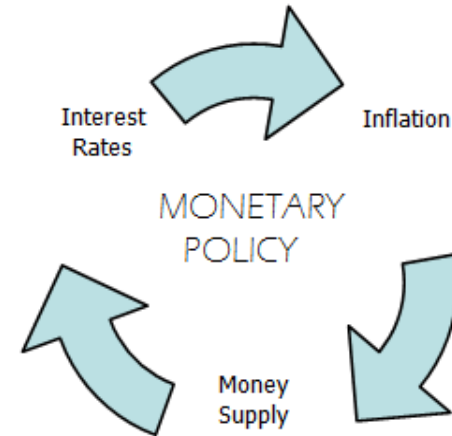
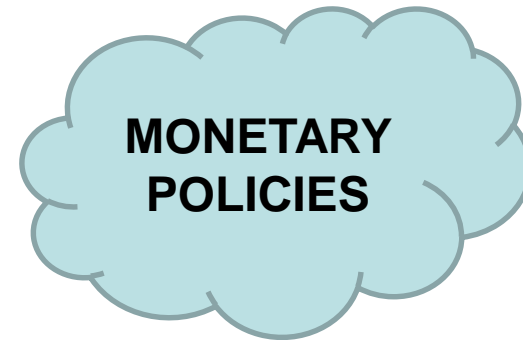
RE-DISTRIBUTION OF INCOME

- progressive tax system
- transfer payments

(General) Approaches to correct Market Failures

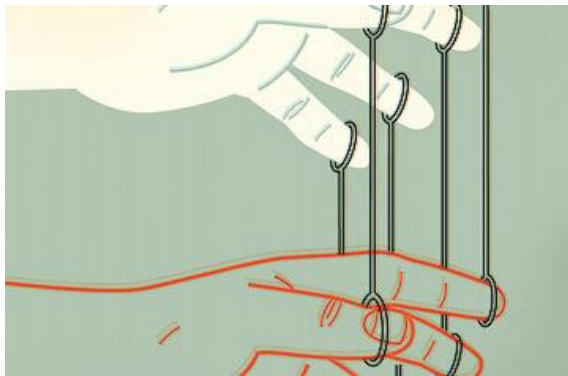
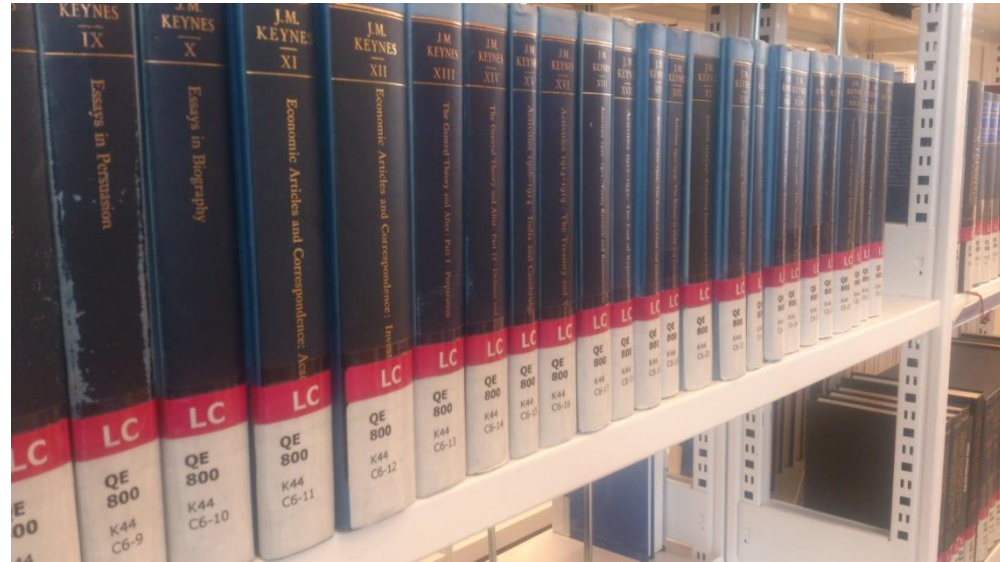
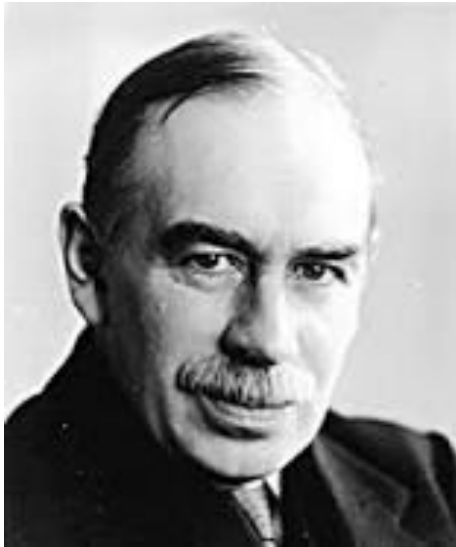


- direct influence on level of total spending by governments
- indirect influence on level of unemployment



- (in)direct influence on level of inflation

John Maynard Keynes



- “Invisible hand” needs support!
- Governments are supposed to invest in order to stimulate the economy when demand is too low

**FISCAL
POLICIES**