
Markets and Government Influence

Vollkommener Markt / Perfect Competition

Homogenität: gleichartige Güter, keine Präferenzen

Homogeneity: fully comparable goods, no preferences



Freier Marktein- und austritt

No barriers to entry or exit

Transparenz: alle Informationen für alle vorhanden

Full transparency: all information can be obtained at any time

Schnelle Reaktionen der Marktteilnehmer auf Veränderungen

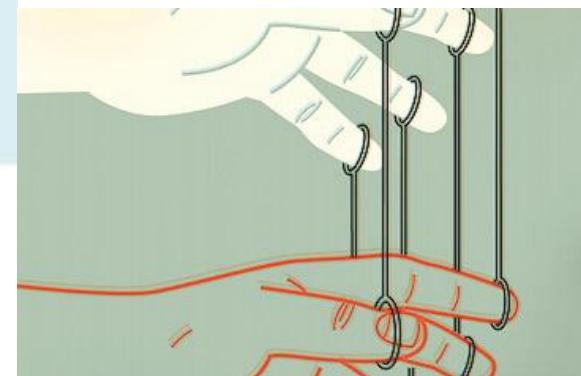
Any market player can instantly react to changes

Adam Smith – „invisible hand“

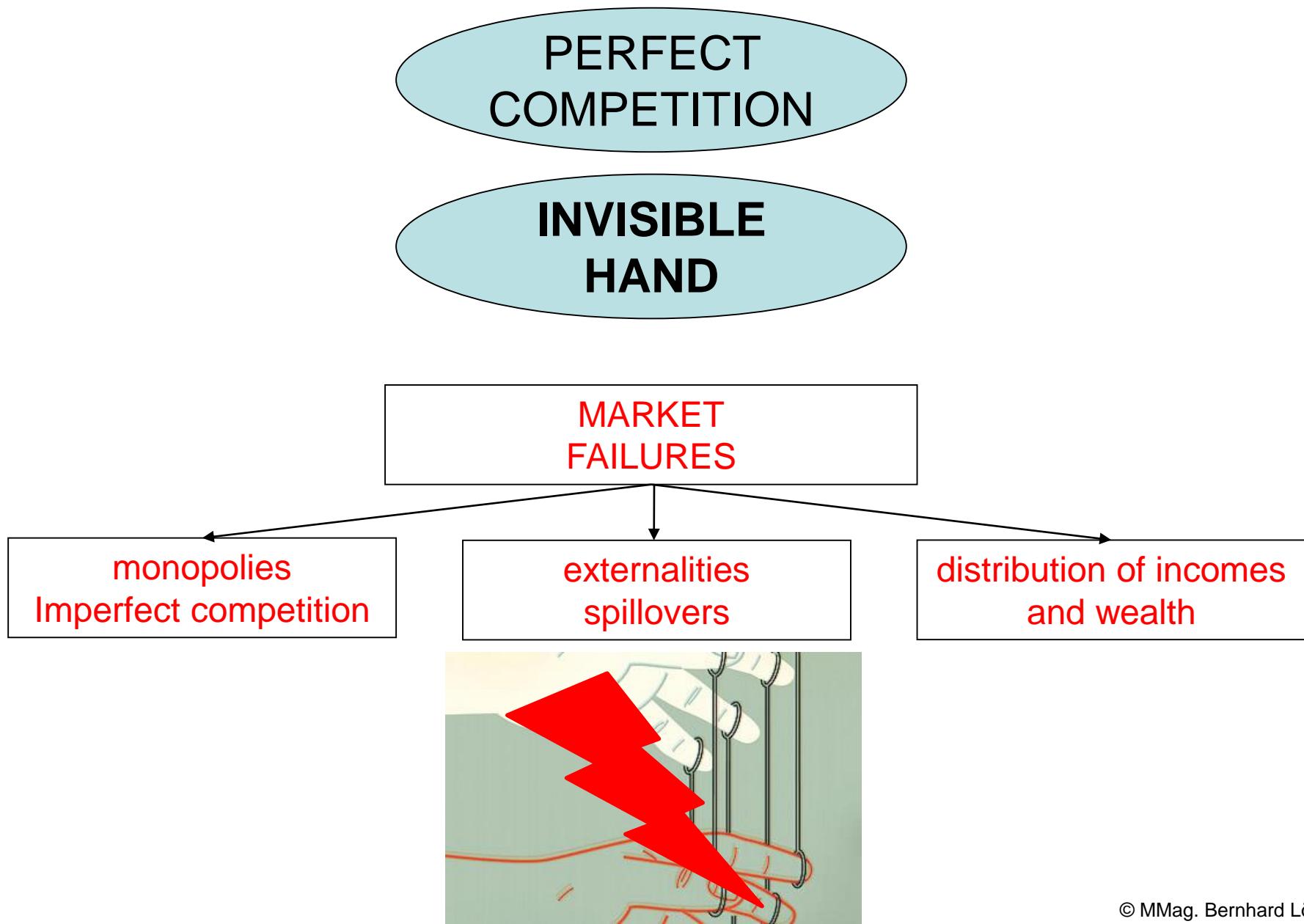
Adam Smith (1723 – 1790)

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).

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Why does the „Invisible Hand“ tremble?



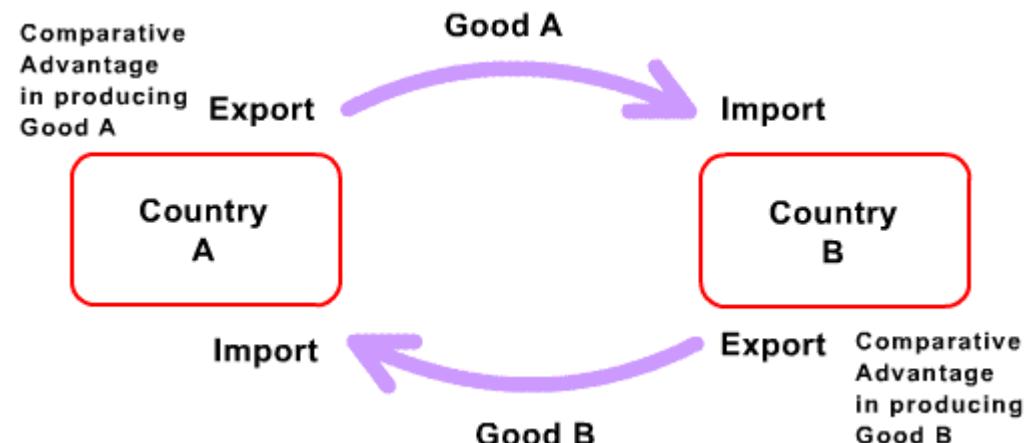
David Ricardo – „comparative advantage“

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, ...

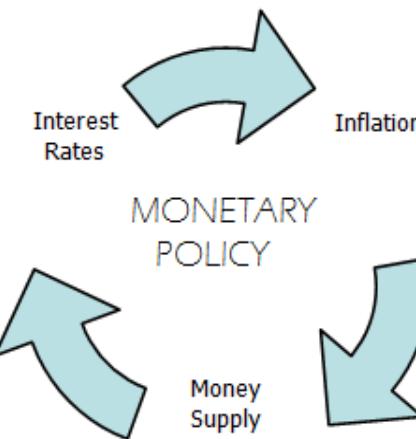
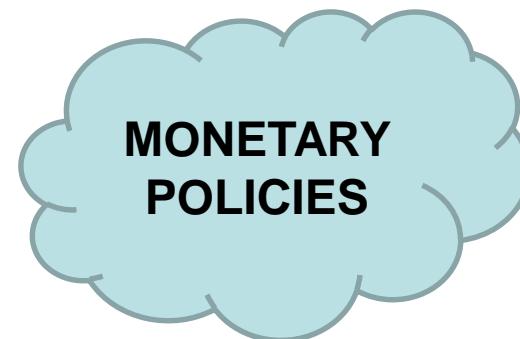
REDUCTION OF EXTERNALITIES

- subsidise R&D
- finance public investments

RE-DISTRIBUTION OF INCOME

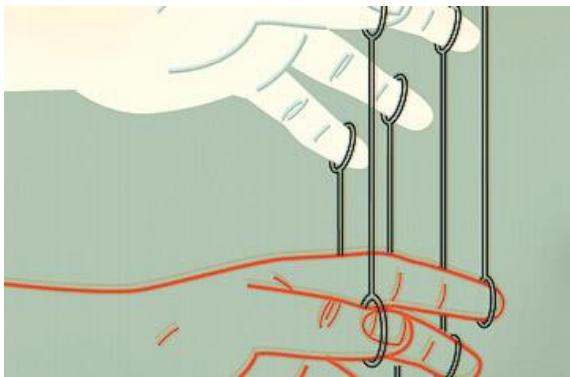
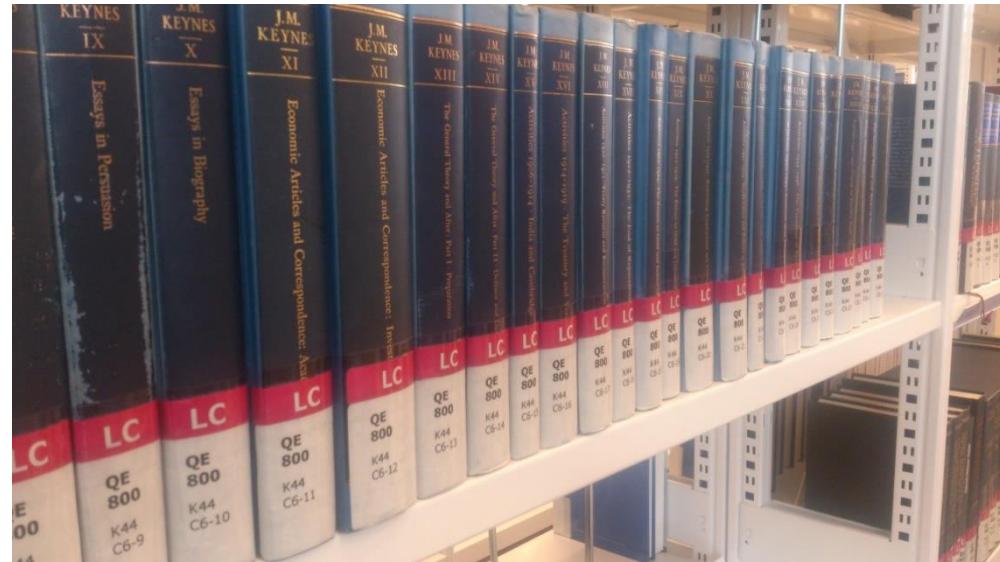
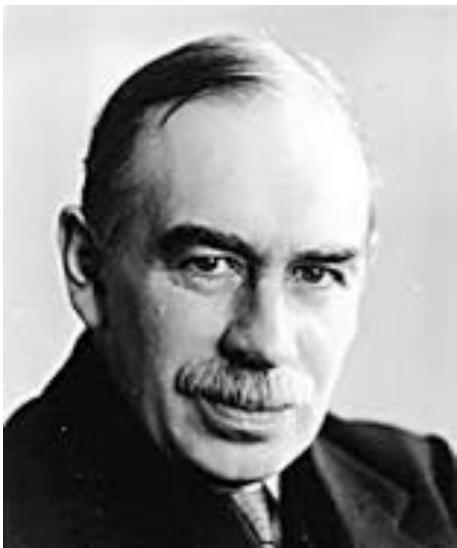
- progressive tax system
- transfer payments

(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

