**Economics 1 Lesson 4: The Free Market**

**What is the Free Market?**

When we looked at the market previously, we described it as a powerful and invisible force, or as Adam Smith called it, the invisible hand. The **free market** is the idea that markets operate best when they are left alone to act naturally and without the intervention of government. It is highly controversial to be at the extreme end of this, and to believe that there either shouldn’t be governments, or that governments should stay out of almost everything except defending the nation and keeping law and order. Similarly, to be at the other end, and to believe that government should control everything, is also controversial, and is often called Communism (there is more to it than that). Clearly, therefore, most people are not at either end of this idea of free markets, but are somewhere between, and it works as a sort of line in which some people are more to the right or to the left. A strong belief in free markets would have you labelled as being right wing, whilst a strong belief in government intervention would have you labelled as being left wing. In this area, economics and politics are strongly linked.

Government’s intervene in lots of different ways in our life. In the UK, the NHS is a government run health system, whilst most people are educated in state provided schools. In a completely free market system, health would be privatised (as it is in the US) and so would education (in the US children can be educated for free, but college is extremely expensive). Every country has some degree of government regulation, that is to say the government intervenes to run services, or it creates strict guidelines for companies to follow in providing key services, but some country’s governments have more involvement than others. The Scandinavian countries, Sweden, Norway, Denmark etc, are known for high levels of state involvement in the lives of their people, through high quality healthcare, education and free or discounted childcare. In Switzerland the state does not pay for healthcare, but has made it the law that everyone must have health insurance, placing the burden on individuals, but within regulations that make sure people can afford healthcare in a way that is not the case in the US.

Whilst every market has some sort of intervention by government, to different levels, a free market is basically one in which companies are mostly able to act without too many restrictive rules, and in which competition between companies is normal, and leads to lower prices for customers, through supply and demand. **Competition** for business means that companies will look for ways to make their product cheaper or to improve what they give their customers, and the change in demand from one company’s version of the product to another will lead to changes in the price. You can find examples for this in most markets – the market for chocolate bars has some big players such as Nestle and Cadbury, and lots of smaller companies too, and they must compete for business, partly on improving their recipe or products, but also on being at a price customers will pay. Free Marketeers, as supporters are called, would argue that every market should be open to competition; however, that is not always the case, and there are many state-owned companies around the world, though **privatisation** in the UK led to most of these being sold off here.

**Privatisation:**

In the UK, companies such as British Telecom (BT), British Airways (BA) and the Royal Mail were once state owned, but were sold off to private shareholders, a process known as privatisation. One of the main ideas behind privatisation is to take the state out of that market, be it for air travel, or sending parcels, and to encourage private companies to compete with each other. The theory behind this is that it leads to a better service and to lower prices, as there are more companies for people to choose from, and you could argue that those flying in the UK now have the choice of very cheap travel with EasyJet and Ryanair, or more expensive, but perhaps more comfortable, travel with BA or Virgin, among many other providers.

Privatisation has many critics though, as whilst competition does bring new companies to the market, it also means that people are trying to make money doing something that the government was previously involved in providing. Left wing politicians in the UK have fought hard against any attempts to privatise the NHS, as they say that it would lead to a US style system of multiple providers and more expensive treatment. Supporters argue that competition would improve the quality of the service provided, though that is also the subject of debate.

One UK industry in which privatisation remains controversial, is the railway. Most trains in the UK are run by private companies, using lines that the state put in and maintains (and for which they pay a fee to use). The difficulty is that competition is very hard in that market, as there are only limited routes, therefore because people who need to travel by train don’t have much choice, the prices are very high in comparison with other countries – the UK has the most expensive rail fares in Europe according to some studies (depending on which routes you compare).

**Milton Freidman:**

One of the leading influences of economics in the UK and around the world throughout the 20th century was Milton Freidman, and he was a passionate believer in free markets. He was an official advisor to both Margaret Thatcher, the UK Prime Minster throughout the 1980’s, and Ronald Reagan, the US President at the same time. During that time, there was extensive privatisation in the UK, and Britain’s economy was changed forever. Freidman won the Nobel Prize for Economics for some of his work, and he is seen as one of the greatest thinkers of the 21st Century; however, he is a divisive figure and not popular with everyone.

He held strong views that the state should stay out of almost everything, and he was against benefit payments to the poor, state health systems (the NHS) and state-owned companies. He supported tax decreases, which lowered the income of the government and their ability to provide services but kept more money in the hands of individuals. He did, however, have some opinions that are not as well-known and many of his biggest supporters don’t realise that he was in favour of the complete legalisation of all drugs (he disagreed with strict regulations in the market for drugs), and that his solution to poverty was a negative income tax, where the government would ensure a minimum income for all citizens by giving money to those who did not earn enough to pay tax. He was a controversial and influential figure, and one who will always be associated with the free market.

**Market Failure:**

One consequence of allowing markets to operate free of interference is that they are prone to **market failures**. There are many ways in which markets can fail, and many markets that require government intervention in order to function properly. It is in itself a controversial topic, because not every economist agrees on what counts as a market failure and what doesn’t, but it is clear that in some markets regulation is essential. It may be that protective equipment is required by the workers, which eats into the company’s profits, therefore it requires government action (the law) to make it a requirement to provide this, otherwise companies would not pay for this.

Similarly, if one company has the whole market to themselves, known as a **monopoly**, then they can charge whatever they want, which would be unfair on customers. Governments regulate the price of some goods such as water, gas and electricity all over the world as these goods are essential, but there is limited (if any) competition in the markets because it would be too expensive to have more than one company provide that service (for example Scottish Water provide every Scottish household with water, and are funded by government to do so, but in some countries water is provided by private companies).

Perhaps the most obvious market failure, though, is when the actions of a company produce negative externalities, that is that the actions of that company lead to consequences for other people such as pollution. For centuries, since **the Industrial Revolution**, companies have sent clouds of smoke into the air, discharged dirty water into our rivers and sea, and discarded waste that has killed animals or damaged our environment. Over time, the impact of this was better understood, and it became clear that this was an obvious market failure. Companies had no reason to reduce their pollution or to cut their profits by spending money on the issue, and the market would never make them do so. It required government intervention, such as minimum standards, penalties including prison time for not complying, and regular inspections. Preventing **negative externalities**, or things that harm people not involved in the production of the product being made, is an essential part of government regulation and one of the reasons why a purely free market, with no government, cannot exist safely.

**Economics 1 Task 4: The Free Market**

Please complete this week’s task as a word document and return it as an attachment on teams. The document title should be PUPIL NAME Economics week 4.

**Part A:**

One market which has not been fully privatised in the UK, is the market for healthcare, with the NHS free at the point of use. Read this article - <https://www.theweek.co.uk/nhs/63360/privatising-the-nhs-pros-and-cons> which suggests arguments for both sides of the debate, and then give your own opinion on whether the NHS should be privatised or remain state run, and why you think this.

**Part B:**

When looking at negative externalities, we saw that in order to control pollution the government had to regulate the output of factories. Today, one of the biggest negative externalities which is not regulated is abuse on social media. Given that it is linked to bullying, mental health issues and even suicide in some tragic cases, would you suggest regulation, and if so why, and what would that look like? Feel free to argue against regulation if you would not support it. Please keep your answer **below 300 words.**

**Part C:**

Finally, if you wish to maintain a glossary of economic terms, then the words in bold from the lesson would be a good addition to that. Once again this part of the task is voluntary.

**Next Time:**

In the next lesson we will be looking closer at the British economy, building on the knowledge we picked up of the changes made in the 1980s and looking at how the modern British economy operates.

**Further Reading:**

If you enjoyed learning about privatisation, and would like to learn more about the privatisation of the Railway, this Financial Times short documentary (15 minutes) is excellent and gives a balanced view, with a mixture of right and left wing views - <https://www.youtube.com/watch?v=U6V-HDbX9A8>

One of the ideas of Milton Freidman, a negative income tax, is very similar to the idea of a citizen's basic income, or universal basic income, which is gaining momentum around the world and has been trialled in some places. This article discusses the situation from the position of Los Angeles - <https://www.latimes.com/business/story/2020-05-22/covid-19-universal-basic-income> and this excellent article look at where it has been tried and whether it would work in the UK <https://www.nationalgeographic.co.uk/history-and-civilisation/2020/05/universal-basic-income-is-gathering-support-has-it-ever-worked-and>