E-ISSN 2411-9725
ISSN 2410-759X

Balkan Journal of
Interdisciplinary Research

Vol.11 No.1
May, 2025

sciendo

Research Article

© 2025 Ejona Bardhi & Jona Gashi
This is an open access article licensed under the Creative Commons
Attribution-NonCommercial 4.0 International License
(https://creativecommons.org/licenses/by-nc/4.0/)

Market Failure and State Intervention – The Balance Between Economic Freedoms and Public Responsibility

Assoc. Prof. Dr. Ejona Bardhi
University of Tirana, Albania

PhD (C.) Jona Gashi
University of Tirana, Albania

DOI: https://doi.org/10.2478/bjir-2025-0005

Abstract

The market economy, at its core, operates on the principle of supply and demand, where economic actors—consumers and producers—make independent decisions based on their own interests. This economic freedom is often considered one of the main pillars of a developed society, allowing for innovation, competition, and economic growth. However, reality shows that the market is not always perfect and often faces challenges that lead to economic and social failures. These failures occur when market forces fail to allocate resources efficiently or ensure a fair balance between different actors.

One of the most debated issues in contemporary economics is the role of the state in dealing with market failures. On the one hand, classical economists and neoliberals argue that state intervention often undermines market efficiency, creating unnecessary bureaucracy and hindering free competition. They believe in a self-regulating market, where economic actors will naturally adapt to different conditions and correct problems without the need for outside intervention. According to them, any state intervention should be limited to ensuring legal order and protecting private property.

On the other hand, historical experience has shown that in many cases, market failure has led to major crises, social injustices and irreversible damage to the environment and public welfare. For example, industrial pollution, powerful monopolies that suppress competition and the lack of equal information between economic operators are some of the phenomena that require direct intervention by the state. In this context, the role of the state is transformed from a passive arbiter to an active factor that must establish rules and ensure a fair and sustainable economy for all.

This paper will analyze the main reasons that lead to market failure, examining the ways in which state intervention can help correct these problems. We will also explore the challenges that arise when the state becomes too involved in the economy, seeking to find a balance between economic freedoms and public responsibility. The main question that will be

addressed is: Is state intervention a necessity to ensure a fair and sustainable economy, or can it have negative consequences that harm competition and innovation?

Keywords: Market failure, state intervention, economic freedom, public responsibility.

1. Introduction

Market failure occurs when market mechanisms fail to allocate resources efficiently, leading to negative consequences for society. The main causes of this phenomenon are externalities, lack of public goods, imperfect information, lack of competition, and economies of scale.

Externalities occur when the actions of one firm or individual affect others without being reflected in the market price. There are two main types of externalities:

• Negative externalities: When an activity harms others without compensation, such as air pollution from factories or noise from construction. A classic example is water pollution from chemical industries, which negatively affects surrounding communities (Pigou, 1920);

• Positive externalities: When an activity creates benefits for others without being rewarded, such as vaccination, which helps reduce the spread of infectious diseases (Samuelson, 1954);

Without state intervention, the market does not take into account side effects, leading to overproduction of negative externalities and underproduction of positive externalities.

Public goods are those goods and services from which no one can be excluded and whose consumption by one individual does not affect the consumption of others. Because there is no incentive for the private sector to provide them, the state often intervenes to provide them (Musgrave & Musgrave, 1989). National security is a public good because protection from foreign attack benefits all citizens, regardless of whether they pay taxes or not. If left to the market, there will be a lack of funding for these services due to the "free-rider problem" (Olson, 1965).

A market only functions well if all participants have equal access to information. In reality, there is information asymmetry, where one party (the seller or the buyer) has more information than the other, which leads to wrong decision-making and market distortion (Akerlof, 1970). In the health insurance market, companies may not have complete information about the health risk of customers, which leads to problems such as adverse selection and moral hazard (Rothschild and Stiglitz, 1976).

Healthy markets are characterized by competition, but in some cases, firms become so large that they dominate the sector and suppress competition. Monopolies and oligopolies lead to higher prices and lower quality of products and services (Stiglitz, 2010). In some industries, as production increases, unit costs decrease. This creates an advantage for large firms, hindering the entry of new entrants into the market and leading to reduced competition (Baumol, Panzar & Willig, 1982).

Market failure is a complex phenomenon that occurs for a variety of reasons, including externalities, the absence of public goods, information asymmetry, market

monopolization, and economies of scale. In all of these cases, government intervention may be necessary to correct the problems and ensure a fairer and more efficient functioning of the economy. However, any intervention must be done carefully so as not to hinder the market mechanisms that stimulate innovation and economic development.

2. Cases when the state intervenes to correct the market – Examples from different countries

In many cases, the state is forced to intervene to correct market failures, ensuring that the economy functions more fairly and efficiently. Below are some concrete examples from different countries that show how governments have intervened to regulate issues such as negative externalities, information asymmetry, monopolization of markets, and the provision of public goods.

2.1 Fighting industrial pollution – Carbon taxes in Sweden

Negative externalities, such as air pollution and climate change, are one of the main reasons for market failure. In this context, Sweden is one of the countries that has effectively intervened to reduce pollution by imposing a carbon tax. Since 1991, the Swedish government imposed a high tax on carbon emissions to reduce the use of fossil fuels and encourage investment in renewable energy (Andersson, 2019). In this sense, Sweden's CO_2 emissions have fallen by over 25% since 1990, while the economy has grown by more than 75% over the same period. This is a successful example of how pollution taxes can correct negative externalities without harming economic growth (OECD, 2021).

2.2 Regulation of monopolies – The case of Microsoft in the EU

Monopolies often lead to a concentration of economic power and can harm competition, negatively affecting consumer choice and innovation. One of the most well-known interventions against a monopoly is the European Commission's case against Microsoft. In 2004, the European Union fined Microsoft €497 million for antitrust practices. The company was accused of abusing its dominant position by bundling its Windows operating system with its Media Player, thereby harming competition from other software firms (European Commission, 2004). As a result, Microsoft was forced to change its practices and offer a version of Windows without Media Player, creating a more open environment for competition. This intervention helped create a more equal market for all players.

2.3 Health care insurance – Universal health care system in Canada

A classic example of state intervention in the economy is the provision of health services. In the free market, health services often become inaccessible to the poorest

segments of the population, creating great inequalities. Canada has a government-funded health care system, where all citizens receive free or low-cost services. This system, called "Medicare," was established in 1966 and is funded through public taxes (Evans, 1992). As a result, Canada has one of the most equitable health systems in the world, with universal access to medical care, preventing situations where only those with money can receive quality medical treatment (OECD, 2020).

2.4 Regulation of financial markets – Consequences of the 2008 financial crisis and reforms in the US

In the absence of oversight, financial markets can speculate uncontrollably, leading to major economic crises. The 2008 financial crisis demonstrated the importance of state intervention in regulating financial markets. In 2010, the US passed the Dodd-Frank Act, one of the strictest laws for regulating banks and financial institutions. This law aimed to prevent financial fraud and better supervise risky loans (Blinder, 2013). As a result, after these rules were put in place, financial markets became more stable, while consumers were protected from unfair loans and risky speculation.

2.5 Providing public education – The case of free education in Finland

Education is a public good that can be underproduced by the private sector, as individuals may not be able to pay for quality higher education. Finland is an example of success in state intervention to ensure quality education for all. The Finnish government offers free education from primary to university level, to ensure equality in access to education (Sahlberg, 2011). As a result, Finland consistently ranks among the countries with the most successful education systems in the world, having one of the highest levels of literacy and economic development (PISA, 2018).
All these cases show that state intervention in the economy is often necessary to correct market failures. In some cases, such as pollution and monopolization of markets, state intervention helps to maintain fair competition and protect consumers. In other cases, such as health and education, the government intervenes to ensure equal access for all citizens. However, the success of state intervention depends on how it is implemented, as excessive regulation can lead to bureaucracy and stifling innovation.

3. The Consequences of state intervention in the economy

State intervention in the economy can have both positive and negative consequences. In some cases, it helps correct market failures, protecting consumers, providing public goods and services, and helping to stabilize the economy. However, excessive intervention can lead to unintended consequences, such as increased bureaucracy, reduced economic efficiency, and the creation of state dependence. These consequences are analyzed in detail below, illustrated with examples and references.

3.1 Improving efficiency and correcting market failures

One of the main positive effects of state intervention is the correction of market failures, such as negative externalities, information asymmetry, and the provision of public goods. Through a tax on carbon emissions, the Swedish government significantly reduced pollution and encouraged the use of renewable energy. This showed that the right intervention can steer the economy towards a more sustainable model (Andersson, 2019). EU has fined several large companies such as Google and Microsoft, preventing the abuse of their dominant position and creating a more open market for competition (European Commission, 2018). These interventions often improve social and economic well-being by reducing the negative effects of the free market.

3.2 Increase in Public Debt and Fiscal Burden

One of the negative consequences of state intervention is increased public spending, which can lead to high debt and increased taxes. During 2008-2010, Greece faced a severe debt crisis due to high government spending and lack of economic reforms. State interventions to maintain social stability led to unsustainable debt, forcing the country to seek assistance from the EU and the IMF (OECD, 2015).
On the other hand, systems such as Medicaid and Social Security are important for social protection, but at the same time they create a large fiscal burden on the US federal budget, increasing the need for high taxes (Congressional Budget Office, 2021).
If state interventions are not managed carefully, they can lead to a significant increase in public debt and taxes, negatively affecting economic growth.

3.3 Decrease in Innovation and Economic Efficiency

Excessive state intervention can reduce the motivation for innovation and economic efficiency, as companies may rely on subsidies and fail to improve their productivity. The European Union's Common Agricultural Policy (CAP) has provided large subsidies to farmers, but has also created problems such as overproduction and reduced innovation in the agricultural sector (European Court of Auditors, 2018).
Another case is the nationalization of the oil industry in Venezuela led to a lack of investment and mismanagement, bringing about a collapse of the energy sector and the entire economy of the country (Hausmann, 2017). These cases show that when the state intervenes excessively in the economy, it can hinder innovation and the development of key sectors.

3.4 Creating Dependence on the State and Reducing Economic Independence

When governments provide aid and subsidies without clear long-term strategies, they can create great dependence on the state, discouraging employment and private

initiative. France has one of the strongest social assistance systems in the world, but some studies show that it has created a "dependency trap", where some individuals prefer to live on benefits rather than look for work (OECD, 2019).
On the other hand, the Iranian government provides fuel at very low prices to the population, but this has led to high state spending and excessive energy use, harming the long-term economy (World Bank, 2020). When state interventions are not designed to foster economic self-sustainability, they can create a culture of state dependence.

3.5 Corruption and Mismanagement of Public Resources

In some cases, state intervention can lead to increased corruption and misuse of public resources. The state-owned oil company Petrobras was involved in a major corruption scandal, where billions of dollars were mismanaged and wasted for political interests (Moro, 2016).
Another bad example is the heavy administration and excessive bureaucracy in Italy, which have created major problems with the efficiency of public services and increased corruption in the public sector (Transparency International, 2021). When the state takes on a major role in the economy, it must implement strong controls to avoid abuses and mismanagement.
State intervention in the economy is necessary to correct market failures, provide public services, and ensure fair competition. However, when it is not well managed, it can lead to negative effects such as high debt, reduced innovation, the creation of economic dependence, and increased corruption. Therefore, it is important that state interventions are balanced and based on well-structured policies.

4. The Debate between classical economists and those who support state intervention

The debate over the role of the state in the economy is one of the most important and discussed issues in the history of economic thought. Classical economists support the principle of the free market, arguing that state intervention is unnecessary and even harmful. On the other hand, interventionist economists believe that the government has an important role in regulating the economy to correct market failures and ensure economic stability and social justice. This debate continues today, influencing the economic policies of various countries.
Classical economists, led by Adam Smith, David Ricardo, and John Stuart Mill, argue that the market mechanism is self-regulating and does not need state intervention. Ricardo (1817) defended the principle of comparative advantage, emphasizing that free trade improves global welfare. He believed that tariffs and subsidies harm the economy and reduce efficiency. Mill (1848) acknowledged some exceptions where state intervention could be beneficial, but in essence he supported the principle of free competition. In general, classical economists argue that government intervention leads to price distortions, decreases competition, and reduces economic efficiency.

Unlike classical economists, many economic theorists argue that state intervention is necessary to correct market failures and ensure economic stability. Keynes (1936) is one of the most important economists who supported government intervention. In his work The General Theory of Employment, Interest and Money, he argued that markets are not always self-regulating and that economic crises require government intervention. Keynes (1936) proposed that the state should use fiscal policy (increasing public spending and reducing taxes) to stimulate aggregate demand and reduce unemployment during a recession.
In this sense, the debate between classical economists and those who support state intervention continues to influence the economic policies of different countries. Some countries, such as the United States, follow a more free-market model, while countries such as Sweden and China apply various forms of state intervention. In practice, most economies today follow a mixed model, where the state intervenes when necessary to correct market failures, but without restricting private initiative and competition.

5. Conclusion

The role of the state in the economy is inevitable. Economic history has shown that markets are not always self-regulating and often face failures, such as financial crises, negative externalities, and information asymmetry. In such cases, state intervention is necessary to ensure stability and social welfare. Classical economists support the free market, but this approach is not always appropriate. Adam Smith's theory of the "invisible hand" and the efficiency of free markets has been fundamental to the development of the modern economy. However, historical events such as the Great Depression (1929) and the financial crisis of 2008 have shown that a lack of regulation can lead to devastating consequences. State intervention can correct market failures, but it must be balanced. Keynesian policies have proven that the state can positively influence the economy through fiscal and monetary policies, but excessive interventions can create high public debts and reduce economic efficiency. Successful models of state intervention vary by context. Models like the Nordic one (Sweden, Denmark) have managed to combine capitalism with strong social policies, while countries like China have developed a market economy with state supervision. On the other hand, some cases of state intervention have led to increased bureaucracy and corruption. A balanced economy requires a moderate approach. Combining the free market with a strategic role for the state seems to be the best path to sustainable economic development. Neither extreme liberalism nor full intervention have yielded sustainable results in all contexts.
State intervention must be based on accurate analysis and economic data. Governments should use economic models to assess the impact of their policies and intervene only where there are genuine market failures. State policies should aim to increase competition and innovation. Instead of restricting private initiative, the state should create a favorable environment for entrepreneurs and support strategic sectors. Fiscal and monetary policies must be flexible and adapted to economic cycles. In periods

of recession, it may be necessary to increase public spending and reduce taxes, while in times of economic growth, savings should be increased and public debt reduced.

References

Akerlof, GA (1970). "The Market for Lemons: Quality Uncertainty and the Market Mechanism". The Quarterly Journal of Economics, 84(3).
Andersson, J. (2019). "Carbon Taxes and CO_2 Emissions: Sweden as a Case Study". American Economic Journal: Economic Policy, 11(4).
Baumol, WJ, Panzar, JC, & Willig, RD (1982). Contestable Markets and the Theory of Industry Structure. Harcourt Brace Jovanovich Musgrave, RA, & Musgrave, PB (1989). Public Finance in Theory and Practice. McGraw-Hill.
Blinder, AS (2013). After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead Penguin Press.
European Commission (2004). "Case COMP/C-3/37.792 Microsoft". Official Journal of the European Union.
European Commission (2018). "Antitrust: Google Fined €4.34 Billion". Official Journal of the EU.
European Court of Auditors (2018). EU Agricultural Policy Review.
Evans, RG (1992). "Canadian Healthcare: Universal Coverage with Controlled Costs". Health Affairs, 11(1).
Hausmann, R. (2017). Venezuela's Collapse and State-Owned Enterprises Harvard University.
Moro, S. (2016). Petrobras Scandal: Corruption in Brazil.
OECD (2021). Environmental Performance Review: Sweden OECD Publishing.
OECD (2020). Health at a Glance 2020. OECD Publishing.
OECD (2019). Welfare State in France: Challenges and Solutions.
OECD (2015). Economic Survey of Greece. OECD Publishing.
Olson, M. (1965). The Logic of Collective Action: Public Goods and the Theory of Groups Harvard University Press.
Pigou, AC (1920). The Economics of Welfare. Macmillan.
Samuelson, PA (1954). "The Pure Theory of Public Expenditure". Review of Economics and Statistics, 36(4)
Rothschild, M., & Stiglitz, J. (1976). "Equilibrium in Competitive Insurance Markets". The Quarterly Journal of Economics, 90(4)
Sahlberg, P. (2011). Finnish Lessons: What Can the World Learn from Educational Change in Finland? Teachers College Press.
Shapiro, C., & Varian, HR (1999). Information Rules: A Strategic Guide to the Network Economy. Harvard Business School Press.
Stiglitz, JE (2010). Freefall: America, Free Markets, and the Sinking of the World Economy. W. W. Norton & Company.