Market Failures Table

Market Failure	How can the Government address
Information asymmetry: market participants can have different levels of information about projects that affect investment decisions.	Information asymmetry addressed – by government offering to take on initial default risks, the transaction can demonstrate where there are higher perceived risks than real risks associated with a project, business, or sector. A founding objective of the British Business Bank was to address an asymmetry of information for SMEs and improve their understanding of available finance options.
Short-termism: investors may focus on shorter-term profits and under-invest in longer-term projects that may ultimately deliver greater societal benefits.	Government can support long-term investment in innovative firms with high growth potential. They can do this by providing finance support for longer term, more patient investments, or provide specific support for follow-on investors.
Macroeconomic instability: during an economic downturn, there can be an under-supply of credit as investors may have reduced capital or risk appetite to invest, which means otherwise viable businesses cannot access finance.	Government can provide guarantees to signal policy intent and provide clarity over future of the market by investing into it. For example, the Coronavirus Business Interruption Loan Scheme provided 100% guarantees to the lending market for loans to viable firms during the pandemic.
Risk-tolerance absorption: the insolvency risk for investors means they have a lower risk appetite and will not invest in projects that are deemed riskier such as those often associated with social and ecological aims where the returns are uncertain or the technology needed is new.	Government can share the risk associated with the transaction across more participants. For example, the National Wealth Fund makes equity investments into infrastructure projects which may carry higher levels of risk than capital markets can absorb.
Market capacity constraints: investors may have reduced appetite for areas of investment, including due to regulatory constraints or reduced profit margins.	Government organisations can provide finance where commercial leaders do not. For example, the UK Export Finance and can provide loans to the buyers of UK goods and services allowing exports to be financed where commercial bank capacity is constrained.

Positive externality: some activities cause a positive spill-over effect that would not be realised by an investing business, which government can support through an investment at a more favourable repayment rate.	Government can support the market with a flexible repayment loan. For example, student loans tackle the externality of education whereby higher education has benefits on society beyond the individual.
Negative externality: Activities by individuals or companies that cause negative consequences for society such as pollution.	Government can subsidise actions to reduce these activities. For example, the UKRI Innovation Loans programme has funded various R&D projects to develop new technologies for clean power generation.
Policy Uncertainty: Private investors do not have sufficient confidence in the long-term prospects of the market	Signal policy intent and provide clarity over future of the market by increasing demand and demonstrating the technology. An example of this is the phase out of the sale of new internal combustion engine vehicles by 2030.