**Essay – Market Failures**

**Essay Question 1**

**Singapore prides itself in having affordable basic healthcare available to all Singaporeans. The centrepiece of Singapore’s healthcare financing system is Medisave, Medishield and Medifund schemes where its citizens co-pay their medical expenses.**

**With reference to examples, evaluate the policies that the Singapore government currently adopts to achieve an optimal allocation of resources in the healthcare market. (25)**

1. **how the market failures occur in the healthcare industry**
2. **how healthcare industry market failures is solved under current situation**
3. **what policies can be used to attain optimal resource allocation**

Introduction

* Definition and Characteristics of social optimization of resource allocation
* State that the understanding of the causes of market failures in the health care industry would help to evaluate whether the current policies adopted by the government would help to ensure that there is social optimization of resource allocation in this industry.

Main body

**1) Explain how market failures would occur in the health care industry**

**Presence of positive externalities** can be reaped in terms of a healthy productive labour force as the health care service is a merit good which will contribute to the rise of external benefit seen in term of the cost saving as a result of higher productivity and this will cause the rise of deadweight loss at the market level of production seen in term of the loss production, employment and economic growth if the economy fails to reap the benefit of positive externalities.

Market failures in this industry will occur when there is **imperfect market information** in the industry which undermines the consumers’ ability to consume at higher level output that will optimise the social net benefit gain. Imperfect market condition in this industry occurs when the firms in the industry assume market power excessively to enable them to set price and thus conduct consumer exploitation. Consumer fails to have good understanding of the services provided in the industry as they lack information which will lead to under-consumption which will lead to lower consumer welfare.

Market failure in this industry can also occur when there is **unequal distribution of income and wealth** as this will contribute to unequal distribution of the net social benefit gain where the lower income group is unable to attain the services of the health care services as a result of higher price of services distributed under market determination.

**2) Explain how the nature of current policies (classify them as the policies that are given in your notes)**

* Medisave – the saving attained by the contribution from the CPF scheme which will enable the workers to accumulate saving to pay for their healthcare services when they need it. This scheme ensures the consumers have the purchasing power to pay for the services and will deny them to consume at the optimal level.
* Medishield – the insurance scheme is to create the ‘co-broke’ payment scheme to help individuals to pay for the medical cost through insurance payment. This will relieve the high cost of payment of medical services.
* Medifund – the scheme is the creation of a medical fund that will generate earning that will be used to fund the medical payment of the lower income group who cannot pay for the medical services.

**3) Explain and evaluate how these stated policies can be used to solve the occurrence of market failures so that the industry can attain social optimization of resource allocation.**

* The current system of the three types of medical scheme is developed to address the condition of market failures in the industry by ensuring the consumers will be able to consume at the optimal level.
* The medisave scheme will ensure that the consumers possess the purchasing power to consume the services but this greatly determines the income of the consumers. For lower income earners, their low income will mean that they may not be able to create enough saving to pay for the rising medical cost. If the saving rate is raised excessively, it will lower the current purchasing power of the consumers which means a reduction in the level of standard of living.
* The insurance co-payment scheme will raise the capacity of the consumer in paying the medical services as there is greater common pool of fund for the consumers. However, the consumers are constrained by the types of medical services they can use and it may also encourage excessive or unnecessary consumption as payment is partially covered by the insurance payment.
* As for the medifund, it can alleviate the problem of unequal distribution of resources that deprive the lower income group. However, this funding is difficult to introduce as the qualification of the fund is difficult to define and thus, not all consumers can enjoy the subsidy. Furthermore, the cost of financing will mean a strain on government expenditure which will undermine the government to increase fund during economic downturn.

**4) Explain and evaluate the other policies that the government has used in solving the occurrence of market failures**

* + Direct Provision of hospital services – It will enable the government to adjust the production level to the social optimal level as the production level is determined by the government. Such a measure can ensure that the consumers will receive medical services. Nonetheless, the standard of medical services may be lowered as the services are usually offered free to the consumers. Furthermore, such a measure will lead to excessive government spending which will raise government expenditure and thus, create budget strain which may lead to higher taxes and more government debt.
  + Direct Regulation – Free Competition Act – to prevent the private firms in the industry from creating market power to set higher price and lower output. However, in reality, such a measure is difficult to introduce as the nature of consumer exploitation is difficult to define and the need of having large firms in the industry to reap the benefits of economies of scale will deny the government the willingness to curb market power.
  + Provision of information – public education can be introduced to provide more information to ensure that consumer welfare can be enhanced with better information on the types of services and price level. However, if the public education campaigns fail to reach the targeted audience in an effective approach, the high cost of financing will render this approach inept.

Conclusion

**Essay Question 2**

**Resources are used to produce bottles for the water industry. Around the world, campaigns to ban bottled water are under way as consumers become aware of the environmental and economic costs involved.**

**The Straits Times, Tuesday, July 14 2009**

**Discuss if a ban on bottled water is the best way to reduce the environmental and economic costs involved. [25]**

Introductio

* State how the bottled water is seen as a demerit good with negative externalities that will contribute to a rise in external cost, resulting in market failure

Main Body

1. **Explain how bottled water is a source of negative externalities that will lead to market failure**

Negative Externalities: Dumping 🡪spread of diseases, contamination

External Cost: Cost of environmental treatment, hospital expenditures

DWL: Less funding available for other aspects of growth

(Economic Causation, Diagram and description of diagram)

1. **Explain how banning of bottle water will solve the effect of negative externalities**

Eradicate usage, reduce the contamination 🡪absence of negative externalities 🡪 Absence of negative externalities 🡪 No DWL/external cost

1. **Evaluate whether banning is justifiable**

Zero production 🡪 zero level of net social benefit gain 🡪 benefits seen in term of convenience, hygiene, development of water industry > cost of dumping and misuse of bottled water

1. **Explain how other solutions can be introduced and why it is justifiable**

Use infrastructure/facilities to supply water by government – too costly

Use bottled water – must encourage recycling and proper storage 🡪 maximise the use of bottled water without creating negative externalities

1. **Evaluation of the issue**

The use of bottled water is inevitable – complementary solutions to eliminate the negative externalities and maximize the net social benefit gain – public education and supporting facilities to ensure that there is no dumping