Innova Junior College
Prelim 2 2011
H1 Economics Essay Question 3
a) Using appropriate examples, explain why the existence of positive externalities and public good causes market failure. [10]
b) Discuss the view the Singapore government currently adopts the most appropriate policies in correcting the above sources of market failure. [15]

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How Public Goods cause markets to fail:
- Private sector will not be willing to provide such public goods as the free rider problem make it difficult to charge people.
- Important to highlight the non-excludable and non-rival nature of public goods with the use of appropriate examples
- It is impossible for the producer to know where, when, how much and who to charge and hence no profits can be made.
- But public goods are vital or essential to the nation Eg: *National Defence, Policing for keeping law and order* ….etc
- Provision of public goods results in positive externalities (MSB>MPB),
- No resources will be allocated to the production of public goods in the private sector.
- Market fails as there is no provision of public goods at all.

How existence of positive externalities cause markets to fail:
- Private sector capable of producing goods with positive externalities.
- However, market fails as goods are under-produced/consumed by the private sector and too few resources will be allocated to its production.
- *E.g. Education, healthcare etc.*
- Existence of positive externalities → MSB>MPB. Diagrams are necessary
- Consumers tend to under-consume because they do not take into account the external benefits that accompany their consumption.
- Deadweight loss results.

L3	Uses relevant examples to clearly explain how public goods and existence of positive externalities lead to market failure.	7 - 10
L2	Under-developed answer with insufficient depth in economic analysis	5 – 6
L1	Some attempt to explain how public goods and existence of positive externalities lead to market failure	1- 4

b) Discuss the view the Singapore government currently adopts the most appropriate policies in correcting the above sources of market failure. [15]

Public goods
- Government adopts appropriate policies in correcting non-provision of public goods
- E.g. National defence [Students should strategize and use education as example in part (a)]
- Evaluate appropriateness of policies
    - Economic analysis of how the non-provision is being addressed
    - Evaluation: Can analyse amount of deadweight loss before and after government intervention → Defence takes up the largest proportion of government budget in Singapore. Could be a case of government failure → over-consumption
    However, situation has been improved from a case of non-provision
    In view of the increasing threat of terrorism (Changing situations) → requires govt to constantly review their policies e.g. Cyber security – are we spending sufficiently on that?

Positive externalities – link to merit goods
- Government adopts appropriate policies in correcting under-provision of goods with positive externalities e.g. education [Students should strategize and use education as example in part (a)]
- Evaluate appropriateness of policies
    - Economic analysis of how the under-consumption is being addressed
    - E.g. Subsidies → move MPB upwards to meet MSB
    - Draw diagram to illustrate
    - Evaluation: Amount of subsidies vary in different levels of education → Hard to measure. Complicated by different strengths of individuals e.g. medicine vs law vs architecture at the university level
    - There may need to be refining of different amount of subsidies required

L3	For an analytical discussion referring to policies employed by the Singapore government with well developed evaluative comments.	9 - 11
L2	Under-developed answer with insufficient depth in economic analysis	6 – 8
L1	Sputtering of points	1 – 5
E2	For evaluative assessment based on economic analysis on most appropriate policies	3 – 4
E1	For unexplained assessment	1 – 2