

<p>Discuss the extent to which government failure is the main factor that a government should consider when addressing the various sources of market failure. [25]</p>		
<p>Introduction</p> <p>Market failure occurs when the free market fails to allocate resources efficiently and equitably. There are various sources of market failure that is <u>externalities, market dominance, income inequality, factor immobility and missing markets</u>.</p> <p>Based on the various sources of market failure, government intervention is deemed necessary to overcome the problem of inefficiency and inequity so that the microeconomic objectives of the government are attained. However, in some circumstances, government intervention aimed at solving the problem create greater inefficiencies which outweigh the benefits of government intervention. This is government failure, an unintended consequence of government intervention. The likelihood of government failure is influenced by the availability of information and the constraints, that is, whether government has the ability to finance the policy. There are also other factors that could influence government decision to address market failure. The extent of market failure and the nature of the economy will determine the severity of the problem and whether government intervention is necessary.</p>		
<p>Development</p> <p>Students need to consider the likelihood of government failure as well as other factors that go into a government decision when it addresses specific sources of market failure.</p> <ol style="list-style-type: none"> 1. Explain 2 sources of market failure 2. What contributes to govt failure → The need for intervention and type of intervention in the market (i) information failure [intended and unintended consequences as a result of intervention] (ii) efficiency due to the lack of profit motive 3. Other factors (i) severity of the market failure (ii) Nature of the economy 		
Source of market failure	Factors	Elaboration
<p>Externalities</p> <p>[E.g. Negative Externalities in Production due to industrial production]</p>	<p>Government Failure</p>	<p><i>Likelihood govt failure → The need for intervention and type of intervention in the market (i) information failure [intended and unintended consequences as a result of intervention]</i></p> <p>Need for government intervention: Negative Externalities in Production - industrial production that result to carbon emission → pollution reduces air quality which increased risk of respiratory problems → divergence of costs curve [MSC > MPC] → overallocation of resources → taxation required → socially optimal level achieved</p> <p>(i) Unintended consequences of govt intervention due to the lack of information available</p>

		<p>The lack of information → i) overestimation of externalities, i.e. MEC → Result to overtaxation that do not bring about positive outcomes in reducing pollution.</p> <p>→ ii) PED values unknown → inability for producers to measure the exact amount of taxes</p> <p>This could bring about inequity in resource allocation.</p>
	Severity of market failure	Due to increase in temperature and climatic changes due to global warming, it is evident that industrialisation has brought about huge negative externalities in production, increasing the severity of market failure.
	Nature of economy	<p>It is important to reduce negative externalities in production due to industrial production. This improves quality of economy and hence productivity of workforce and our infrastructure.</p> <p>This allows Singapore to remain attractive as a destination for Foreign Direct Investments which is essential for a small economy that is reliant on FDI.</p>
Public Goods [National Defence]	Government Failure	<p><i>Likelihood govt failure → The need for intervention and type of intervention in the market (i) information failure [intended and unintended consequences as a result of intervention] (ii) efficiency due to the lack of profit motive</i></p> <p>Need for government intervention: Characteristics of Public good → National Defence → Explain features of non-excludability and non-rivalry and how it results to missing market</p> <p>Unintended consequences of govt intervention</p> <ul style="list-style-type: none"> (i) The lack of information → no expression of dd so government may overestimate the dd required → result to overprovision of public goods → govt failure (ii) Inefficiency of state owned enterprise given the absence of profit and competition → higher cost with direct provision <p>Government may run into budget deficits when addressing the issue which pose a strain on government budget. It may not be feasible if the government is already accumulating fiscal debts.</p>
	Severity of market failure	Large because there are no goods that will be provided by the free market.
	Nature of economy	Being a small country that is vulnerable to external threats, there is a need for strong defence to ensure continued survival.
Factor Immobility	Government Failure	<i>Likelihood govt failure → The need for intervention and type of intervention in the market (i) information failure [intended and unintended consequences as a result of intervention]</i>

		<p>Need for government intervention: Factor immobility (occupational immobility) → productive and allocative inefficiency → underallocation of resources → Education to increase labour mobility to expanding industry</p> <p>Unintended consequences of govt intervention due to the lack of information available</p> <p>The lack of information i) Government may identify the wrong industries to develop because it is difficult to gain comparative advantage in production due to the dynamic changes in comparative advantage → workers who undergo training will be redundant because skills are no longer relevant to the expanding industry.</p> <p>ii) Furthermore, there might be time lags and the skills acquired will be obsolete by the time workers are being train because it takes a long time for workers to pick up the skills. → labour mobility may not improve</p> <p>iii) The receptivity of the workers cannot be predicted accurately → training may not improve workers' skills if workers are not receptive → labour mobility may not improve</p> <p>All these poses a strain on government budget. The government need to consider her budget position and only commit if they can afford it on a sustainable level.</p>
	Severity of the problem	<p>Besides inefficiency, factor immobility <u>brings about inequity</u>, another source of market failure. This adds on the severity of the problem.</p> <p>It causes structural unemployment → conflict with macro goals</p>
	Nature of the economy	<p>Labour is a key resource in SG → hurt country export competitiveness and also how attractive SG is for FDI.</p>
Market Dominance	Government Failure	<p>Need for government intervention: Market dominance → large market share → market power → i) ability to set prices such that price is greater than marginal cost → underallocation of resources due to allocative inefficiency</p> <p>Unintended consequences of govt intervention due to the lack of information available</p>

		The lack of information → law enforcers may lack the high level of technical knowledge required to understand the nature of the business for a fair verdict to be passed → too much competition is introduced → making it difficult to enjoy the advantages of internal economies of scale
	Severity of the problem:	(i) Types of goods – If the goods sold are necessities, the extent of market failure will be larger (ii) Contestability of market – If markets are contestable due to the advancement in technology or globalisation, there will be potential threat of competition which reduces the inefficiency by firms.
	Nature of the economy:	Singapore has a small and open economy that is bound to international competition. Bearing the characteristics of an open economy, together with the recent trends towards globalization and signing of FTAs → increased competition of SG firms in the international economy → more competition will result in greater efficiency in terms of allocation of resources → less need for government to intervene in the area of market dominance
Conclusion		
<p>Government will need to consider various factors when tackling the sources of market failure, which includes government failure as explained above. This is undergirded by the availability of information on the source of market failure (root cause of the problem), as well as the constraints before government can pinpoint on the best policy that could minimise government failure. With the information at hand, government will need to weigh the benefits and cost of the intervention and only intervene if benefits outweigh the costs of intervention. The government will also need to be mindful of the internal and external changes that will affect factors that government need to consider when tackling the sources of market failure. For instance, with increased globalisation, the problem of market dominance is less severe due to increased competition.</p> <p>Depending on the source of market failure, the most important factor may differ. For instance, for public goods such as national defence, Singapore's small land size and vulnerability of external threats is the main factor why government needs to provide national defence rather than considering government failure. However, it is important for the government to try to reduce the possibility of government failure by ensuring it has more information, and to ensure that there is greater efficiency for state owned enterprises which will bring about less unintended consequences such as excessive government spending which will affect the government budget.</p> <p>Hence, in the above case, government failure may be a key factor <u>only to a small extent</u> when a government decides on addressing the market failure.</p>		

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Level	Description	Marks
L3	For an answer that uses appropriate analysis to explain the 2-3 factors which affect government decision in tackling 2 sources of market failure. Answers should include why government might need to intervene in at least 2 source of market failure, considered the degree of effectiveness of one intervention from each source of market failure, how government failure will affect the choice of policy.	15 – 20 (18)
L2	For an answer that gives analytical explanation of 1 factor accompanied with many descriptive explanation of the other factors which affect government decision in tackling 2 sources of market failure OR analytical explanation of 3-4 factors of decision making framework which affect government decision in tackling a source of market failure.	9 – 14 (12)
L1	For an answer that shows some knowledge of government failure or cost and benefits that governments consider when making decision on policies taken to tackle market failure.	1 – 8 (5)
E3	For an answer that uses analysis to support an evaluative appraisal of the determinants and decide whether government failure is the key factor for government consideration.	4-5
E2	For an answer that makes some attempt at an evaluative appraisal of the determinants	2-3
E1	For an unexplained evaluative statement	1

