

Question 3

(a) Explain the economic case for government intervention in the market for healthcare. [10]

Government intervenes in the market for healthcare because the equilibrium in an unregulated healthcare market fails to achieve a socially optimal efficient allocation of resources and market failure arises. Market failure in the healthcare market arises mainly due to positive externalities from the consumption of healthcare, imperfect information and income inequity.

Healthcare is considered a merit good as it is deemed desirable by the government but perceived to be under-consumed. This under-consumption and hence market failure, can be attributed to individuals disregarding the positive externalities of consuming healthcare and under-estimating their private benefits of doing so due to imperfect information.

Positive externalities are beneficial side effects of production or consumption on persons other than the producers and consumers themselves (i.e. third parties). These third parties do not make payment to enjoy the external benefits. In the market for healthcare, market failure arises because of the presence of these positive externalities.

Due to the presence of positive externalities, the marginal social benefit (MSB) diverges from the marginal private benefit (MPB). In the context of healthcare, consumers only take into account their own private benefit, such as staying healthy and being able to perform to their full potential in their daily activities, when deciding how much healthcare to consume. However, there are marginal external benefits (MEB) that third parties around the person such as family, friends and colleagues, can enjoy. These third parties also benefit because the chances of getting sick is much reduced and as such productivity as a whole can be increased. The presence of MEB results in MSB being higher than the MPB.

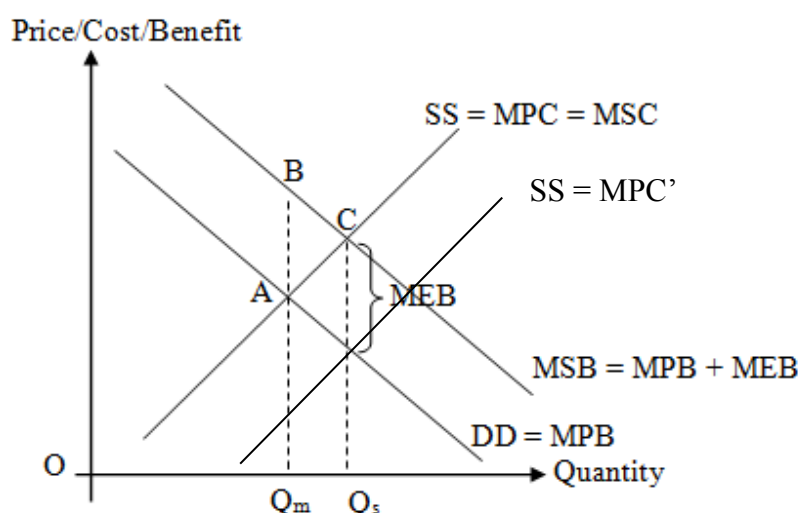


Figure 1: Market for Healthcare Services

With reference to Figure 1, the MSB is greater than the MPB as private individuals do not take into consideration the MEB from the consumption of healthcare. Assuming no negative

externalities, the marginal social cost (MSC) is equal to the marginal private cost (MPC). The MPC in the healthcare market is the cost of providing healthcare services to an additional consumer. These costs include consultation costs as well as costs of treatments for patients. The socially optimal level of output is at Q_s where, MSB intersects the MSC. However, since individuals only consider their own private benefit and disregard the benefit to external parties, they will consume at Q_m where MPB intersects MPC. Q_m is less than Q_s , so individuals are not consuming enough healthcare and allocative inefficiency results. This under-consumption leads to a deadweight loss of area ABC.

Besides positive externalities, consumers might also under-consume healthcare services due to imperfect information. Individuals may not be able to accurately estimate the private benefits of consuming healthcare due to ignorance. They may not value their private benefits correctly, especially when individuals do not realise the long term benefits of staying healthy. As such, they may underestimate the private benefits of consuming healthcare leading to under-consumption of healthcare. Thus, the government needs to intervene to ensure that individuals are fully aware of the benefits of consuming healthcare in order to correct the under-consumption.

Income inequity also contributes to market failure in the healthcare market. Market failure arises when income earned from the labour market is insufficient to enable an individual to buy essential products and access essential services like healthcare. The government will have to intervene to ensure the lower-income individuals are able to access basic healthcare services.

In conclusion, government needs to intervene in the market for healthcare due to the market failure that arises from the presence of positive externalities, imperfect information and income inequity.

LORMS

L3	Developed explanation of at least 2 sources of market failure in the market for healthcare as economic case for government intervention. Government intervention due to the presence of positive externalities must be included.	8-10
L2	Undeveloped explanation of the sources of market failure in the market for healthcare.	4-7
L1	Smattering of valid points.	1-3

(b) Discuss the factors that influence Singapore's approach to addressing market failure in healthcare. [15]

Currently, the Singapore government intervenes in the market for healthcare through a mix of policies which include legislation, subsidies and grants, direct provision of healthcare, and moral suasion in order to tackle the various problems brought about by market failure. They aim to increase either the demand or supply of healthcare in order to correct the under-consumption. To help Singaporeans pay for their medical expenses, the government has put in place a financing framework, which consists of Medisave, MediShield Life and Medifund. Such an approach is largely influenced by a few key factors, namely its relevance in tackling the nature of the sources of market failure, its strengths and weaknesses as well as the government's economic philosophy.

Firstly, the nature of the sources of market failure has a large influence on Singapore's approach to addressing market failure in healthcare because policies adopted have to be specific in tackling the various sources of market failure as mentioned in part (a) in order to be effective in correcting the market failure.

In order to correct the under-consumption caused by the presence of positive externalities, the government chooses to adopt the approach of providing subsidies and grants as well as direct provision in order to increase the consumption of healthcare. When the government subsidises the producers of healthcare, it decreases producers' cost of production and increase the supply of healthcare. With reference to Figure 1, the supply curve or the MPC will shift to the right from MPC to MPC' so that Q_m coincides with Q_s and corrects the under-consumption. The government also provides grants to consumers to encourage consumption of healthcare. This comes in the form of Medifund where the government helps needy Singaporeans pay for their medical expenses.

On the other hand, in order to tackle under-consumption caused by imperfect information, the government chooses to adopt the approach of legislation and moral suasion. Due to imperfect information, individuals usually underestimate their private benefits of healthcare and under-consume. Hence, the Singapore government made it compulsory for Singaporeans earning an income to contribute to their own Medisave accounts to meet their personal or their dependents' hospitalisation expenses, especially after retirement. Besides helping Singaporeans put aside a sum of money to handle their medical bills, the government also put in place MediShield Life, a basic medical insurance plan that ensures Singaporeans can meet the medical expenses from major or prolonged illnesses from which their Medisave balance would not be sufficient to cover. Such forms of legislation will help to reduce the problem of under-consumption caused by imperfect information.

Due to imperfect information, the government also uses moral suasion so that individuals can more accurately estimate their private benefits of consuming healthcare. Through advertisements and health promotion campaigns, the Health Promotion Board (HPB) consistently encourages Singaporeans to stay healthy through preventive healthcare programmes and promoting a healthy lifestyle. These include anti-smoking campaigns, creating awareness for AIDS and encouraging women to have regular check-ups for breast and cervical cancer. Such programmes equip individuals with better healthcare knowledge and help to reduce the problem of under-consumption.

In order to tackle the issue of income inequity, the government puts in place Medifund, the third component of the financing framework besides Medisave and MediShield Life. Medifund is an endowment fund that works like a financial safety net to help needy Singaporeans who cannot afford the subsidised bill charges despite Medisave and MediShield coverage. By providing such a safety net, the government ensures that the lower income group in Singapore can access basic healthcare.

Secondly, the government's approach will also be influenced by the strengths and weaknesses of the policies. They have to weigh the costs and benefits of the policies before deciding to implement them. For instance, it is difficult to determine the required size of the subsidy or grant as it is difficult to calculate the MEB derived from the consumption of healthcare by the society. If the amount of MEB is under-estimated, it may not be adequate to push equilibrium quantity to the socially optimal level as some individuals are still unable to afford healthcare. If the amount of MEB is over-estimated, it will lead to over-consumption and substantial wastages of resources, which can result in an even greater welfare loss than without government intervention. Effectiveness of moral suasion is also not guaranteed as it depends on the receptiveness and mind-set of the people. Since there is no one policy that can effectively solve the problem of market failure, the government will have to consider implementing a mix of these policies in order to work towards achieving the ideal outcome.

In addition, since these healthcare policies are likely to incur a substantial financial cost on the government, the choice and number of policies implemented will have to take into account their impact on the country's budget. For instance, Singapore's good fiscal position has allowed the government to set aside \$8 billion under a Pioneer Generation Fund in 2014 that is aimed at reducing the medical cost burden of first-generation Singaporeans. *However, in view of future challenges in terms of further demographic changes and rising healthcare costs, the government may have to consider increasing taxes in order to fund its healthcare policies without incurring a budget deficit.*

Lastly, the government's economic philosophy will also influence the approach that they take to address the market failure in healthcare. The Singapore government believes in the philosophy of individual responsibility so that people will not be over-reliant on state welfare and the state will not be over-burdened to provide for healthcare of its citizens. The individual responsibility for one's healthcare needs is clearly promoted through the features of deductibles and co-payment in MediShield Life where patients share part of the responsibility for his medical expenses. This aims to prevent unnecessary over-consumption of healthcare services.

In conclusion, Singapore's approach to addressing market failure in healthcare are largely influenced by the sources of market failure, the effectiveness of the policies as well as the government's economic philosophy. *However, as the demographic conditions in Singapore changes, the current approach may need to be reassessed to remain relevant and to ensure that healthcare remain affordable and accessible in the years to come.*

LORMS

L3	Developed discussion of the key factors that influence Singapore's approach to address market failure in healthcare. Discussion should include well-supported explanation and examples in the context of Singapore.	8-11
L2	Undeveloped discussion of the key factors that influence Singapore's approach to address market failure in healthcare. Incomplete explanation with little or no examples in the context of Singapore.	4-7
L1	Smattering of valid points	1-3
E2	Reasoned judgement with proper economic analysis.	3-4
E1	Judgement without proper economic analysis	1-2