

MARKET FAILURE

Application Oriented Questions

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Question 1

The following changes were introduced by government in a recent budget. What does the government aim to accomplish by the above budgetary measures?

- i) increase in taxes on expensive luxury items
- ii) subsidies for setting up solar panels
- iii) increased budgetary outlay for food items distributed through public distribution system and increased minimum wages of labourers
- iv) set apart Rs. 4,000 crores for development of arid zones and granted tax holidays for industries set up in backward regions.

Question 2

Reflect on the externalities present in each of the following and examine the market implications:

- i) The air force of country A spends substantial amount of money in training pilots to perfection. Many such pilots leave the forces after 20 years of service contract and are robust to fly safely for many more years. Several private civil aviation services hire these pilots to ensure quality service. Statistics confirm comparatively superior performance efficiency for retired air force pilots.
- ii) AGN Med Ltd. has invented a series of cost effective technologies for producing sophisticated medical equipments. The company demonstrates some these state-of-the-art technologies to local firms and improves their productivity.
- iii) A private school provides immunization against measles at a subsidized price to its staff and students
- iv) A research organisation publishes its research outcomes on scientific disease prevention and treatment which are accessible freely by any one
- v) A business firm installs a high mast light in its premises

- vi) A benevolent citizen decides to protect historical monument in his locality and incurs expenditure towards their preservation
- vii) A local body sets up a museum and charges a price for entry.
- viii) Beatacorp Ltd. spends Rs. 15 million to plant trees alongside highways as part of its corporate social responsibility initiative. It also establishes a large garden in one of the tourist centres.

Question 3

Application Based Questions related to Negative Externalities

- i) A chemical firm emits foul smell causing discomfort for people in the neighbourhood
- ii) X smokes cigarettes in public and causes toxic passive smoking for others
- iii) A group of students play loud stereo inside their apartment
- iv) Barking of dogs in the neighbouring houses obstructs peaceful sleep
- v) Too many vehicles on the road creates loud noise and distracts classes
- vi) A driver drives rashly under the influence of alcohol and kills a pedestrian
- vii) Households dump waste in neighbouring plots
- viii) Heavy traffic on the roads cause congestion and air pollution

Question 4

- i) City Y is an important commercial centre and over the years there has been an enormous increase in the number of private vehicles. There are long queues and vehicles travel at slower speeds because there are more vehicles than the road can handle. For a long time, motorists have been demanding measures to abate this. The Government imposes a tax on people who travel by cars in City Y to reduce traffic congestion and pollution. Taxes are also imposed on people who use private vehicles in certain areas during peak hours.

- ii) Occurrence of collapse of buildings has been reported from different parts of the country drawing immense attention from all quarters. With the objective of minimizing the incidence of building collapse, the government puts in place building codes and lays down strict regulations in respect of building construction activities. Stringent regulations guiding construction were issued to avert possible dangers from collapse of buildings such as mandatory standards of building materials, site surveys, soil testing and obtaining of license before construction.
- iii) Government has long been trying to reduce tobacco consumption by persuasive advertising, bans on tobacco products' advertisement and smoking in public. These measures have not found much positive results. The government increases the tax on tobacco products by 12.5% per year for four years.
- iv) Many countries provide subsidies production and tax incentives for the purchase of electric cars, since it is believed electric vehicles have various benefits.
- v) The production of smoke from factories creates higher than average clean-up costs to reduce air pollution by nearby residents.
- vi) X burns coal resulting in emission of carbon dioxide. This causes respiratory problems to Y

Question 5

Explain the economic theory that explain the following behaviours :

- i) A driver with comprehensive car insurance may drive less carefully than would a driver without such insurance.
- ii) A medical practitioner exhibiting tendency to prescribe excessive treatment for a patient who has insurance coverage
- iii) An employee confirmed in service and offered permanent tenure exhibits a tendency to put in less effort in work
- iv) A lethargic house owner who has a comprehensive householder insurance policy leaves valuable articles in the house and goes on long holidays abroad

- v) An all inclusive fire insurance policy limit the motivation to install sprinklers
- vi) Banks which enjoy generous bailouts from government showing tendency to take undue risks while lending

Question 6

Adverse Selection issues

- i) An insurance company which offered health insurance to the general public finds that majority of applicants were unhealthy people.
- ii) A company insuring cars finds that those living in high crime areas are more likely to avail of the facility of car insurance.
- iii) Workers in high-risk occupations, or with certain risks which they know, and of which the insurance company has no chance of knowing are more likely to seek out life insurance.
- iv) A company is more likely to offer stock when managers privately know that the current stock price exceeds the fundamental value of the firm
- v) A used car market tends to have only poor quality cars for sale

Application based Questions for eliminating market failure due to information failure

Question 7

- i) Government makes it mandatory to have accurate product labeling and content disclosures by producers.
- ii) The stock market is rigorously regulated by government. The SEBI has put in place stringent disclosure requirements for companies going public and all companies need to strictly adhere to these norms.

- iii) Government regulates advertising and sets advertising standards to make advertising more responsible and informative
- iv) Compulsory statutory labeling 'smoking is injurious to health' on cigarette packages with health warnings to reduce smoking
- v) Mandates on improved nutritional information on foods to counter the risks of growing obesity
- vi) Government takes initiatives towards public dissemination of information on prevention of COVID and many communicable diseases.
- vii) The Reserve Bank of India cautions the users, holders and traders of Virtual Currencies including Bitcoins, about the potential financial, operational, legal, customer protection and security related risks that they are exposing themselves
- viii) Government conducts information campaigns on the dangers of smoking, and alcohol addiction

Application based Questions for preventing depletion of common resources.

Question 8

- i) The government sets catch limits to fishing vessels and declares certain areas as closed fishing areas.
- ii) The Ontario Fishing Regulations have set rules for the size and number of fish you can catch and keep for recreational fishing in Ontario.
- iii) The National Oceanic and Atmospheric Administration of the US specify annual catch limits of fisheries and accountability measures.
- iv) CITES (the Convention on International Trade in Endangered Species of Wild Fauna and Flora) to ensure that international trade in specimens of wild animals and plants safeguard endangered species.
- v) The government allows private citizens to gather forest produce free of charge from a government-owned forest. State the economic rationale as to why this should be undesirable from the point of view of the society.

Question 9

Classify each of the following goods based on their characteristics. Mention the rationale.

- i) Highways without toll booths
- ii) A lighthouse on the coast
- iii) Street signs
- iv) Public health and welfare programs
- v) Public education
- vi) Basic research
- vii) National defence
- viii) Law Enforcement
- ix) Police

Question 10

Classify each of the following goods based on their characteristics. Mention the rationale.

- i) Grocery items
- ii) Film shows in theatres
- iii) Clothing,
- iv) Television,
- v) Cars,
- vi) House

Question 11

Classify each of the following goods based on their characteristics. Mention the rationale.

- i) A crowded beach
- ii) Public taps for supplying water in rural areas
- iii) Congested highway

- iv) Fisheries
- v) Forests
- vi) Wildlife

Question 12

Classify each of the following goods based on their characteristics. Mention the rationale.

- i) Open-access Wi-Fi networks
- ii) Roads with toll booths
- iii) Bridges with toll booths
- iv) Parks

Question 13

Classify each of the following goods based on their characteristics. Mention the rationale.

- i) Cable television.
- ii) Cinemas
- iii) Stadiums
- iv) Swimming pools
- v) Fitness centres
- vi) Museum

Question 14

What would be the consequences if people are asked to pay voluntary subscriptions for the public broadcasting service?

Question 15

Do you agree with the proposition that healthcare and education in developing countries like India should be left to markets? Substantiate your answer.

Suggest reasons why education and health care might be considered as merit goods to be provided by government?

Question 16

The social welfare department finds that the rate of smoking has increased substantially over the years. What possible consequences do you propose if cigarette is left to market mechanism? How does government intervene?