

3. 'Complete ban on smoking is the best measure to achieve efficient allocation of resources.'

(a) Compare and contrast between merit and demerit goods. [10]

(b) To what extent do you agree with the above statement? [15]

A. Synopsis of Question Requirement:

- a) Students are to show ability to illustrate (preferably with the aid of examples) the apparent similarities and differences of private goods that are considered socially desirable and undesirable given the externalities emitted.
- b) Students are to show knowledge of the mechanism and limitations as well as ability to judge whether intervention measures via legal restrictions (complete ban) or any other intervention measures is a better way to help correct market failure and achieved allocative efficiency in a context of a private good consumption activity emitting negative externalities.

B. Question Analysis/Unpacking:

Technique	Part (a)	Part (b)
(a) Content words:	"merit"; "demerit"	"Complete ban" (legal restriction); "best measure" & "efficient resource allocation"
(b) Context words:	No pre-defined context; generic; or freedom of choice of examples to be used	"smoking" (private good consumption emitting negative externalities; demerit good)
(c) Command words:	"Compare and contrast" (ie. highlighting similarities and differences)	"To what extent" (an evaluation of degree of validity of a presented assertion/position).

C. Suggested Approach:

Part (a)

Introduction: Define concepts

1. Merit Goods - commodities that the government/society values and judges everyone should have regardless whether an individual wants them.
2. Demerit Goods -- commodities that the government/society values and judges everyone should not have regardless whether an individual wants them.

Body: Make comparisons of similarities and differences of both concepts making use of relevant examples.

Criterion	Merit Goods	Demerit Goods
Similarities	• Private goods characterized by rivalry and excludability in consumption • No free rider problem → hence goods are marketable • Divisible into small units and can be individually consumed • Cost incurred in providing additional unit (MC is positive)	
Differences	• Accorded socially desirable status; high social benefits • Generates positive externality (MSB > MPB) • Under-produced/under-consumed → inefficient resource allocation ($Q_{\text{socially optimum output}} > Q_{\text{equilibrium output}}$)	• Accorded socially undesirable status; high social costs • Generates negative externality (MSC > MPC) • Over-produced/over-consumed → inefficient resources allocation ($Q_{\text{socially optimum output}} < Q_{\text{equilibrium output}}$)

Conclusion:

Both are sources of market failure that necessitates government intervention so that the economy's scarce resources are more optimally allocated.

Level	Descriptor	Marks
3	Applied description (using examples & diagrams) of the similarities and differences of <u>both</u> concepts. Answer is well explained	7-10
2	Applied description (using examples) of the similarities and differences of the 2 goods but answer is not well explained. OR a well-developed answer on just the differences.	5-6
1	Misconception-laden theoretical description of the similarities and differences of <u>both</u> concepts.	1-4

Part (b)

Introduction

Define “efficient resource allocation” – where adequate available resources are used in the production of goods or services to bring about maximum total economic surplus (ie. sum of consumer and producer surplus) so as to maximize societal welfare.

Background: Explain how smoking causes an inefficient resource allocation.

- Decisions made by smokers are aimed at maximizing the net private benefits in consumption (where $MPB = MPC$)
- Act of smoking generates negative externalities on third parties (MEC of polluted air and passive smoke)
- Smokers may be (knowingly or unknowingly) ignorant of external effects (& costs) inflicted on third parties but does nothing to benefit/compensate them
- External effects imposes deadweight loss to society ($MSC > MSB$) implying current activity levels (Q_p) has allocated more than adequate resources into the cigarette consumption (ie. smoking) activity (Q_s)
- Smoking activity may be considered as a demerit good (ie. socially undesirable)
[Supporting framework/diagram to be included and made reference to.]

Body (Thesis): Explain how and why a complete ban is the best measure to achieve an efficient resource allocation.

- Policy mechanism: A complete ban is
 - A command and control policy tool (legal restriction) → result in consumption falls to zero & hence eliminates the deadweight loss.
 - Effective if the deadweight loss is totally eliminated as the socially optimum output level or if the new area of deadweight loss is smaller than the original deadweight loss. (Make reference to either diagram)

Body (Anti-thesis): Explain how and why a complete ban is not the best measure to achieve an efficient resource allocation.

- Limitations: Limits to effectiveness of a complete ban
 - Penalties for non-compliance must be sufficiently harsh to discourage people from flouting the law.
 - Inspections must be sufficiently frequent and rigorous to be an efficient means towards reducing external costs → use of additional scarce resources which may pose a strain on the efficient resource allocation in other markets.
 - May lead to government failure if without the complete ban the deadweight loss is smaller than after the complete ban. [Make reference to diagram]
- Other possible measures to implement:
 - Impose (higher) indirect taxes to affect price (MPC) of smoking activity – raises MPC to coincide with MSC → consumption will be at the socially optimum output level.

- **Limitations**
 - Difficult to assess the monetary value of the external costs, hence under- or over-taxation may not help achieve an efficient allocation of resources.
 - Demand for cigarettes is price inelastic → may not be responsive to price increases.
- b. Create awareness of the social ill-effects of smoking – public education to discourage smoking by making the ignorant consumer (with imperfect knowledge) be more aware of the private and external benefits – reduces MPB to coincide with MSB → consumption will be at the socially optimum output level.
- **Limitations**
 - Difficult to change mindset since smoking is addictive
 - Need a long time to change mindset → drain on government resources which could have been used on other areas of development of the economy.
- c. Restricting/limiting permitted places to smoke or widening smoke-free public areas (ie. partial bans on smoking in certain public places) – aims to make smoking less convenient and hence reducing the MPB that would maximize net private benefit
- **Limitations**
 - Manpower costs incurred in monitoring and supervision.
 - There is no incentive to reduce smoking at the smoke-free areas.

Conclusion/Synthesis/Evaluation

A reasoned judgment considering the following questions :

- Is smoking a serious issue that warrant a complete ban? How about a partial ban?
- What are the relative effectiveness of the policies mentioned?
- Would a combination of short term measures (regulations & taxes) and long term measures (public education) be more effective than just a complete ban?

Level	Descriptor	Mark
3	• A detailed explanation of how <u>both</u> a complete ban <u>and</u> another intervention measure can achieve an efficient resource allocation including the policy limitations.	9-11
2	• A <u>brief</u> explanation of how <u>both</u> a complete ban <u>and</u> another intervention measure can achieve an efficient resource allocation. • A detailed explanation of how <u>either</u> a complete ban <u>or</u> another intervention measure can achieve an efficient resource allocation including the policy limitations.	7-8 6
1	• A theoretical explanation of how a good emitting negative externality in consumption (smoking) causes an inefficient allocation of resources.	1-5
E2	• A judgment which is supported by economic reasoning/analysis.	3-4
E1	• A judgment which is not supported by economic reasoning/analysis.	1-2