(3) To solve income inequality, the USA usesa minimum wage law while Singapore believes that improving the skills of workers is thebest solution.

    a) Explain why income inequality is a source of market failure.   [10]
    b) Using economic theory, analyse whether the above view is justified.   [15]

a)

Introduction

Development 1: Explain why govt. intervenes in the case of income inequality

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Government intervenes when the market fails.

Explain what is meant by market failure:

→ Occurs when the market mechanism fails to allocate resources **efficiently** and **equitably**.

Efficiency

- Productive efficiency
  - o Occurs when firm use the least cost method of production to produce and incur the lowest unit cost of production. Productive inefficiency occurs when the firms produce the quantity corresponding with the **minimum point of LRAC curve.**
- Allocative efficiency
  - o Right amount of the right kind of goods is produced.
  - o Occurs when firms set price = MC.

→**Equity**

→Fair and just distribution of resources

Govt. intervenes in such markets due to income inequality → results in inequity →markets fail

i)   Explain how Income inequality may arise due to the interactions of forces of demand and supply of labour.

ii) Explain how Income inequality may also arise because of market dominance. Illustrate with market dominance diagram, showing profits of monopoly firms

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Iii) Explain how Income inequality results in inequity and hence markets fails

- Because income and wealth are unevenly distributed →people with most income and wealth will be able to determine what should be produced as they are able to cast higher money votes for the goods that they want→resources will be diverted to produce luxury goods for the rich, while the needs of the poor will not be satisfied
- Unfair distribution of resources →**inequity**→ society's welfare not maximised

Conclusion:

Because of the unfair allocation of resources → need for govt to intervene through various policies to correct the market failure of income inequality

| Knowledge, Application, Understanding and Analysis		
L3	For a well-developed explanation and relevant analysis of the causes of income inequality and how income inequality results in market failure.	**7-10**
L2	For an underdeveloped explanation which describes the causes of income inequality with the links unexplainedand/or with conceptual errors. E.g. focusing only on how income inequality results in market failure without linking to the causes of income inequality like factor immobility or market dominance	**4-6**
L1	A descriptive answer which showssome knowledge about market failure and income inequality. Answers contain inaccuracies.	**1-3**

b)

View Presented

    i)   Minimum wage law can be used to solve income inequality

    ii)   Singapore believes improving the skills of workers is the **best** solution.

Dev: Assess the policies used to correct the income inequality

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i) <u>Minimum wage laws for low-skilled workers</u>

ɔr a good or service

Labour market for low skilled workers
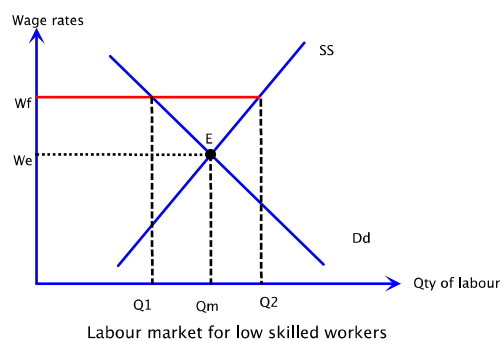
rkers, wages are

Ve→ reduces the

inequality as

unemployed earn 0 income

Evaluation:Extent of unemployment depends on the extent of the elasticity of the curves as well as the level of the min wage. PED + PES more elastic → greater the unemployment. Plus the size of the resulting unemployment also depends on the extent of the size of the min wage, how high this is relative to the We. The bigger the gap between the min wage and the original wage We, the greater the resulting unemployment.

ii) Education and training to improve the skills of workers

- Education and training of low skilled

    Impact on the market for low skilled workers
- Increase in skills level + productivity → DD for these workers increase
- At the same time, this → reduce SS for unskilled workers
    → Wages increase
    → Higher income for low-skilled workers → reduce income inequality
    → Illustrate with dd/ss diagram

Evaluation:
- Effects will not be felt immediately as compared to other policies like price controls and as it takes time to train workers

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C ompare improving the skills of workers to minimum wage laws & assess which is a better solution

In the case of SG, she relies heavily on FDIs and export competitiveness as source of growth → min wage laws may not be that effective as it increases COP reducing SG's attractiveness as a destination for investments by foreign investors. At the same time, higher COP → reduces price competitiveness for exports → with $PED_x>1$ due to the large availability of substitutes, export revenue is likely to fall. Hence, use of policy like min wage law not suited for a country like SG as it might conflict with its macro goals of growth and employment.

Explain which is a better solution also depends on the current economic situation , the resources available to the govt as well as the priorities of the govt.

Consider how other policies that can be used to solve income inequality may be better or may complement the above policies

- Govt. could also give out transfer payments to the low-income group to increase their disposable income → reduce income inequality
- Govt. could also solving the inequity problem by subsidizing basic necessities like healthcare and education→ allowing the lower income group to have equal access to basic services → reduce unfair distribution of resources → reducing inequity
- Progressive income taxes → The higher the rate of tax, the lower the proportion of disposable income remaining, therefore allowing for more equal distribution of income.

Synthesis and conclusion

Minimum wage laws and education and retraining to improve the skills of low skilled workers do improve income inequality and reduce market failure. Education and training of the low skilled does seem to be a better policy as it tackles the root cause of income inequality. It might be better for SG due to the nature of its economy. Implementing a minimum wage law will conflict with its macroconomic goal of high and sustained economic growth. For the case of the US, minimum wage laws do seem a better policy than education and training due to the budget deficit that the govt. is currently facing..

Knowledge, Application, Understanding and Analysis		
L3	For a well-developed and balanced answer, showing comparisons of both policy based on criteria and also mentions one other policy that solves income inequality	9-11
L2	For underdeveloped answer which does not address the question fully e.g. does not show comparison with regards to the policies mentioned or an answer that lacks rigour in explanation.	6-8
L1	An answer which showssome knowledge about policies to address income inequality but does not respond to the signpost. Answers contain inaccuracies.	1-5

Allow up to 4 additional marks for Evaluation		
E2	For an evaluative discussion based on economic analysis	3-4
E1	For an unexplained judgement, or one that is not supported by economicanalysis.	1-2