

Question 2

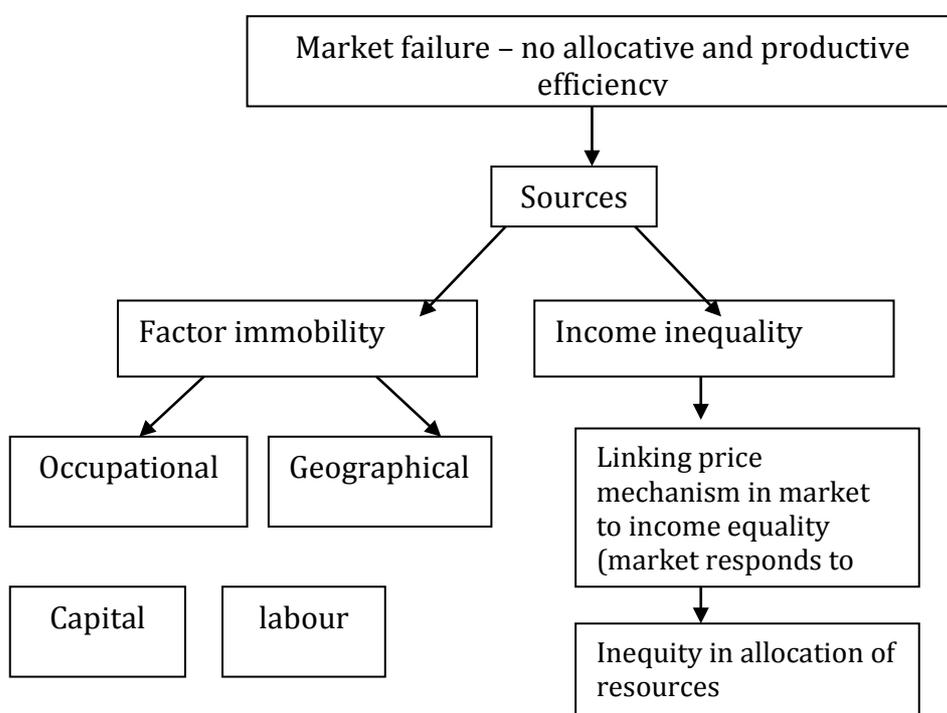
Governments are increasingly concerned with factor immobility which would lead to rising income inequality.

- a. Explain how immobility of factors of production and inequality in the distribution of income may lead to market failure. [10]
- b. Evaluate the policies currently used by the Singapore government to correct these causes of market failure. [15]

Suggested answer outline:

- a. Explain how immobility of factors of production and inequality in the distribution of income may lead to market failure.

Schematic plan



Introduction

- Meaning of market failure and how immobility of factors of production and income inequality may lead to market failure.

Body

1. Explain how immobility of factors of production leads to market failure

There are two common types – occupational and geographical mobility.

Occupational immobility occurs when there are barriers to the mobility of factors of production between different industries which leads to these factors remaining unemployed or inefficiently used. Some capital inputs are occupationally mobile – a computer can be put to use in many different industries. However many capitals are industry-specific (manufacturing plants and biohubs or digital media involved very different technologies).

Occupational immobility also applies to labour. Labor immobility describes a situation in which

manufacturing workers, when displaced due to closure of the sunset manufacturing industry in many developed economies, lack the relevant skills to become employed in the new sunrise industries such as clean energy or sciences. Thus they become structurally unemployed. Structural unemployment arises due to such a mismatch between the skills and jobs, is long-term and represents a waste of scarce resources.

Geographical immobility occurs when there are barriers to people moving from one area to another to find work. Some reasons why it might exist are family and other social ties, the financial costs involved in moving homes such as cost of selling houses, removal expenses and other associated expenditure, huge regional variations in house prices and differences in the general cost of living between regions. Backward and poorly developed transport system and infrastructures will worsen such immobility.

- Factor immobility prevents the switch to the production of new goods and services most valued by society, in the quantity required, thereby resulting in allocative inefficiency while the unemployment of immobile factors results in productive inefficiency.

2. Explain why income inequality is a concern

In a market / capitalist economy, the ability of individuals to consume goods depends upon the income and wealth of the household.

Hence, a key problem with markets in the context of inequality is that the willingness and ability to pay differs from needs. The market system will not respond to the needs and wants of those with insufficient economic votes to have any impact on market demand because what matters in a market based system is effective demand for goods and services. The free market responds to the economic question of "For whom to produce?" through the use of price mechanism. Price mechanism helps to distribute the limited amount of goods produced to those who want them and it is reflected by their willingness to pay and backed by their purchasing power.

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. This is evident from the production of bio-fuel (to satisfy wants of car owners and to enable firms to produce more consumer goods) that worsened the global food shortage in 2008 due to profitability of bio-fuel.

Unfair distribution of resources → **inequity** → society's welfare not maximized

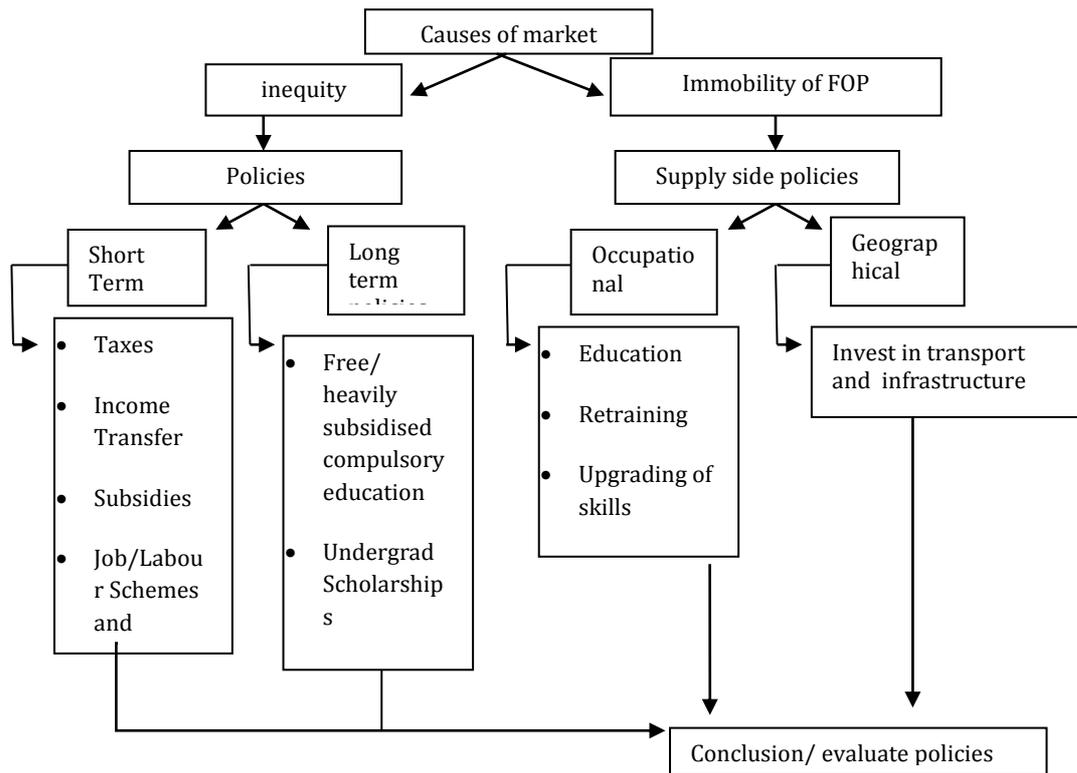
Conclusion

As immobility of factors of production may lead to market failure and income inequality may lead to unsatisfactory allocation of resources, there is a need for government intervention.

Requirements (overview) for part (a)

Candidates should show a good understanding of how immobility of factors of production leads to productive inefficiency and inequity leads to allocative inefficiency. Good candidates should be able to link the two concepts to market failure adequately.

(b) Evaluate the policies currently used by the Singapore government to correct these causes of

market failure.**Schematic plan****1. Policies used by the Singapore government to tackle immobility of factors of production:****To improve occupational mobility:**

To reduce structural unemployment among blue-collar manufacturing and older workers, supply-side policies have been implemented which aim to increase the efficiency in the labour market. Education, retraining and upgrading of Singapore's human capital via huge subsidies has always been the government's priority, given that workers are the most important capital in the land- and resource-scarce country. The Skills Programme for Upgrading and Resilience (SPUR) which provided higher course fee support for companies to send their workers for training and life-long learning individuals. The Workforce Development Agency (WDA) has been expanded by and the number of courses covered under SPUR including courses in human resource, healthcare, precision engineering, and ICT. Training has also stepped up across all levels of the workforce, including our PMETs (professionals, managers, executives and technicians).

To improve geographical mobility, Singapore government in the form of Urban Redevelopment Authority has been forward-looking in identifying the needs of an improvement in the transport system and infrastructure such as building of the Circle line and new stations to ensure accessibility in every corner of the country. This is despite that geographical immobility is not much a big problem due to Singapore's small geographical size relative to bigger countries.

Evaluate:

Singapore government has been relatively successful in ensuring that the skills and knowledge of Singapore's workforce stays relevant in the new and global economy, as reflected by her relatively low unemployment rate all these years. The fact that she has also been able to continue to attract foreign direct investment which require skilled labour is another evidence of the success of her policies in enhancing the quality of her labour force.

2. Policies used by the Singapore government to tackle income inequality:

Market failure caused by income inequality can be reduced through the implementation of

Progressive income tax where an additional dollar on income is taxed at a higher rate than the last. This tax system helps to narrow the income gap. However, tax rates have been adjusted downwards in recent years to attract foreign direct investment and foreign talent which has reduced its effectiveness in addressing the income gap. There may also be a tendency for self-declared incomes to be understated.

Transfer Payments by the Singapore government provides assistance to lower income families via Public Assistance Scheme for those unable to work and with little means of subsistence and Workfare Income Supplement (WIS) Scheme provides incentive for older low wage workers to find work and stay in work.

Subsidies by the government in critical areas such as public housing, healthcare, and education. This ensures that lower income families are not deprived of their basic necessities. More subsidies are enjoyed by those with lower incomes and greater needs. However, higher income families also get to enjoy highly subsidised education so while the needs of the poor are addressed, this may not serve to address the widening income gap. Even with the current means-testing system, the rich can still compete for limited lower-class wards even though the subsidies are a little lower at each corresponding ward class.

Evaluate

The Singapore government's policies to address the issue of income inequality have been fairly effective as reflected by the lowering of the Gini Coefficient (after adjusting for Government transfers and taxes) in 2014 which reflects the redistributive effect of Government transfers.

Requirements (overview) for part (b)

Candidates should show a good understanding of policies implemented by the Singapore government in correcting market failure due to immobility of FOP and inequity. An awareness of the possible limitations of policies and make a judgement.