Solutions

Marking: **M1** a correct method, **A1** the correct answer, **B1** an independent mark.

Each answer shows the steps, then the **result**.

2.1

absolute poverty: income too low to meet basic needs such as food, water and shelter; relative poverty: income well below the average or median income in a country

2.2

0: perfect equality: every household has the same income; 1: perfect inequality: one household has all the income

2.3

any two, explained: technology raises the pay of high-skilled workers relative to low-skilled; cuts in progressive taxes or benefits mean less redistribution; rising returns to capital and property increase incomes of the wealthy; weaker unions / falling real minimum wage

2.4

tax $= 0 + 0.2 \times 30\,000 + 0.4 \times 20\,000 =$ \$**14 000**; average rate $= 14\,000 \div 60\,000 \approx$ **23.3**%; marginal rate = **40**%

2.5

the average tax rate rises as income rises; low-income households spend a larger share of their income than high-income households, who save more; so a sales tax takes a larger share of a poor household's income

3.1

(a) income has become more unequal; a larger share of income goes to the richest households

(b) transfer payments (pensions, child benefits, unemployment benefits) raise the incomes of the poorest directly; they reduce poverty quickly and support spending (AD); but they are costly, with an opportunity cost for other spending, or need higher taxes; a poverty trap if benefits are withdrawn as earnings rise, reducing the incentive to work; they treat the symptom, not the causes such as low skills; judgement: needed in the short run, best combined with education and training

3.2

award up to [8]: diagram: minimum wage above equilibrium wage, Q_s and Q_d of labour, excess supply (unemployment) shown; workers who keep their jobs earn more, reducing in-work poverty; higher pay may raise motivation and productivity, and spending (AD); but firms may hire fewer workers, especially the young and low-skilled; the effect depends on the elasticity of demand for labour and how high the minimum is relative to the median wage; many poor households have no one in work, so they do not benefit; judgement: helps if set carefully; combine with benefits and training

exercises.lol exercises.com.cn