AQA A-LEVEL ECONOMICS · 7136

# ECONOMICS



EXAM QUESTION PACK

## 3.1.7.3 GOVERNMENT POLICIES TO ALLEVIATE POVERTY

| SCORE | PERCENTAGE |
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**1.**

## THE EUROPEAN UNION CONTEXT

### Extract D: Policies for fairness

The European Union is one of the richest areas in the world but both absolute poverty and relative poverty exist within the EU. Although unemployment is a major cause of poverty, the working poor, whose wages are at or below the 'poverty line', are estimated to number 20 million across the EU.

The EU named 2010 as the 'European Year for Combating Poverty and Social Exclusion', but this hardly featured at all in the UK media. However, the concept of fairness is very much on the national agenda. For example, the UK Prime Minister, David Cameron, did at one stage suggest that the earnings of the highest paid public servant should be no more than 20 times that of the lowest. Furthermore, many commentators have suggested that, if such a formula were introduced, the idea could spread to the private sector.
The UK is one of 20 out of 27 EU member states with a minimum wage. Across those 20 countries, minimum wages are between 30% and 50% of average earnings. The European Parliament has floated the idea of an all-EU 'minimum income' but this is not expected to be taken up by governments just yet. And how long before there are also serious proposals for a national, or even an all-EU, maximum wage?

Between 1980 and 2005, the distribution of income in the UK became less equal. In 1980, the top 1% of earners received 12% of all income. However, by 2005 the top 1% of earners received 16% of all income, with bonuses in the financial sector pushing this figure nearer to 18%. The trend towards greater income inequality in the UK in recent years has largely been justified by the idea that market forces provide 'incentives' for successful businesses and that the spending power of high earners 'trickles down' to the rest of society.

Fairness is difficult to define. One view, suggested by the UK's *Institute for Public Policy Research,* is that fairness involves basic minimum entitlements and equal opportunities, plus an absence of obstacles created by factors such as where an individual is born or where they happen to live. Addressing unfairness in the UK tends to focus on policies to redistribute income after it has been earned: for example, through the tax and benefits system. On the other hand, much EU policy is aimed at reducing the unequal distribution of income at source, through what are called cohesion policies to target supply-side obstacles.

EU policies are, to a large extent, aimed at boosting the employability and earning potential of workers through measures such as skills training and business advice. They work on the 'supply side' of the labour market but the demand for labour cannot be ignored. For example, despite receiving significant levels of EU funding, recently Wales lost 900 well-paid, skilled jobs when the German company *Robert Bosch* moved its factory to Hungary, where wages are much lower. Perhaps an all-EU minimum wage would have helped to prevent this.

Source: news reports, 2010

**2.**

'*The Spirit Level*, a book by Richard Wilkinson and Kate Pickett published in 2009, is subtitled: *Why More Equal Societies Almost Always Do Better*.'

Evaluate the view that the government should rely less on market forces to determine the distribution of income and wealth in the UK and should increase its intervention to make the UK more equal.

**[25 marks]**



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**3.** ‘Addressing unfairness in the UK tends to focus on policies to redistribute income after it has been earned… On the other hand, much EU policy is aimed at reducing the unequal distribution of income at source…’ (**The European Union Context Extract D**, lines 25 − 28).

Using the data and your economic knowledge, evaluate the view that a fair distribution of income can better be achieved by policies which aim to redistribute income after it is earned rather than by policies which tackle supply-side obstacles in the economy.

**[25 marks]**

**4.** Explain the distinction between absolute poverty and relative poverty (**The European Union Context Extract D**, lines 1− 2) **and** analyse **two** causes of poverty.

**[9 marks]**

**5.** **THE GLOBAL CONTEXT**

**Extract C: Pensions and poverty**

A major factor in tackling global poverty is the provision of adequate pensions. According to the think tank, Pensionwatch, four out of five older people around the world have no access to a pension, with many millions living in poverty or working well into their old age. Around 80 countries have some form of state pension which gives a basic income in old age.

An important question is whether individuals should take responsibility for their old age by choosing to contribute to a scheme provided by the state, or an employer, or via the insurance industry. Only a few wealthier countries also have a basic ‘universal’ state pension, financed from general taxation rather than contributions. These have a cost to the taxpayer but they reduce the social costs of old age poverty.

Statisticians can make long-term predictions of population changes and yet many private and public sector pension schemes are in crisis as countries are faced with ageing populations and rising levels of national debt. This can be seen as government failure, caused by poor forward planning. There has also been some market failure. For instance, due to the selling of inappropriate insurance-based private pension schemes, and a significant fall in the value of pensions being provided by even the better schemes, many consumers have lost trust in the private sector pensions industry.

It could be that many people are simply too poor to be able to afford to save, or it might be that people often prefer current consumption over future consumption. This form of market failure could be tackled by the government imposing a high rate of compulsory pension saving, as in Chile and Singapore. There was a small step in this direction in the UK in 2012 when the government launched ‘auto-enrolment’, an occupational pension scheme pioneered in Australia and New Zealand where employees are automatically included unless they opt out. While rich countries argue over who should pay for pensions, and by what methods, in poor countries, where pensions are needed the most, they are likely not to exist at all.

Sources: news reports, government statistics, 2013

**6.** ‘The supply and use of water result in many externalities, both positive and negative’ ( **The Global Context Extract B**, line 16).

Using the data and your economic knowledge, evaluate UK government policies that could be used to deal with problems associated with the supply and use of water.

**[25 marks]**



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**7.** **THE GLOBAL CONTEXT**

**Extract B: Water, water everywhere**

Access to clean water is closely linked to production, income and wealth, both within and free good. However, only a small proportion can be used to support human life and even this is not freely available to all.

As underground water levels drop in industrialised countries, and as waterways become polluted, some places, like southern Spain, are desperately short of water. Meanwhile, poorer countries, such as Bangladesh, sometimes suffer from too much water, with sudden disastrous floods. Unlike developed countries, such as the Netherlands, they cannot afford flood defence infrastructure. In Kenya, people living in villages without drinkable water can see irrigation systems in nearby fields spraying water over vegetables and flowers being grown for export to Europe.

There are problems with property rights to water. Indeed, some experts have predicted that, during the twenty-first century, countries controlling the world's fresh water supplies will be in a similarly powerful position to that of the twentieth century's oil producers, and that wars might even take place because of disputes over water.

The supply and use of water result in many externalities, both positive and negative. One-third of the water used by UK households is flushed down the toilet. The water used to carry human waste through sewers has to be kept separate from drinking water. When the water industry was privatised by the UK Government, shares were sold in 'water and sewerage businesses', and these companies were regulated by OFWAT (The Water Services Regulation Authority) for their commercial activities as regional monopolies, and by the Environment Agency for their wider impact such as the extraction of water from rivers.

In recent years, several regions of the UK have repeatedly been declared to be suffering from 'drought', and there has been some debate over which policy responses are appropriate. These include hosepipe bans, metering of water supplies, a national 'grid' for transporting water around rivers and canals, and more reservoirs. The privatised companies have made massive investment in infrastructure which has transformed polluted rivers such as the Wandle, near London, from open sewers into trout streams, but further measures are necessary to prevent annual droughts.

**8.** Assess the economic costs **and** benefits of government action which results in the UK becoming a less equal society.

**[25 marks]**

**9.** A government has a policy of reducing taxes on income while increasing taxes on spending, such as Value Added Tax (VAT).

Distinguish between equity **and** equality and explain the effects of this government policy on both equity **and** equality.

**[15 marks]**



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**10.** '…children from poor families are likely to grow into poor adults, and remain poor into old age' (**The Global Context Extract B**, lines 7−8).

Using the data and your economic knowledge, evaluate whether it is better for the UK government to reduce poverty by using policies to improve people's ability to earn higher wages during their working lives, rather than through the provision of state benefits to those who are poor for various reasons.

**[25 marks]**

**11.** Explain what is meant by 'market failure' ( **The Global Context Extract C**, line 13) **and** analyse **two** reasons why markets might fail to provide adequate pensions.

**[9 marks]**

**12.** 'Government should be concerned about incentives and disincentives to work. They should not be concerned with fairness in the treatment of various income groups.'

Assess the case for and against governments intervening in labour markets to achieve a fairer distribution of income.

**[25 marks]**

**13.**

**THE GLOBAL CONTEXT**

**Extract B: Poverty and age**

The UN estimates that half the children in the world live in poverty. The 40 poorest countries in the world contain 500 million people who share a total annual income which is less than the total personal wealth of the 40 richest people in the world.

When measuring poverty within countries, economists generally use an indicator of relative poverty. In the UK, government statisticians generally view people as being 'at risk of poverty' if their household disposable income after housing costs is less than 60% of the average. Politicians in the UK often focus on child poverty, because children from poor families are likely to grow into poor adults, and remain poor into old age. In 1999, the then Prime Minister, Tony Blair, promised to eliminate child poverty by 2020. In 2012, the Office for National Statistics (ONS) reported that relative poverty, as measured by the gap between a family's income and the national average, had fallen since 2008. However, this was likely to be because people in the middle had become worse off, rather than the poorest becoming better off. People aged 18 to 24 saw their risk of poverty rise, due to rising unemployment among that age group. However, it is not necessary to be unemployed to be poor. It has been said that some UK government benefits, such as tax credits, subsidise low wages paid by employers to many workers whose jobs are essential but may require few specialist skills. Training schemes and minimum wage legislation are among government policies aimed at reducing the number of 'working poor' in the labour market.

Sources: news reports, government statistics, 2013



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**14.** The authors of a report published by the Institute of Economic Affairs have recommended that the NMW for apprentices and under 18 year olds should be abolished and that each region of the UK should have its own minimum wage.

Taking into account the information in **The National Minimum Wage After 15 Years Extract E** and the original evidence, do you support these recommendations? Justify your answer.

**[25 marks]**

**15.** It has been suggested that the NMW should be increased so that it is the same as the Living Wage.

Using **The National Minimum Wage After 15 Years**, explain the possible effects on individuals and the economy if the government were to adopt this suggestion.

**[15 marks]**



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**1.** The economist Greg Mankiw has written that 'society faces a trade-off between efficiency and equity. Efficiency means that society is getting the maximum benefits from its scarce resources. Equity means that those benefits are distributed fairly among society's members. Often, when government policies are designed, these two goals conflict.'

Evaluate the view that government intervention to reduce inequality will lead to an improvement in economic welfare.

**[25 marks]**

**2.** **The National Minimum Wage after 15 years**

**Extract E: The National Minimum Wage: silver bullet or poisoned chalice?**

Since its introduction in 1999, the NMW has increased by 75%, whilst average earnings have risen by 61% and the Retail Price Index by 53%. A new report, published by the Institute of Economic Affairs, argues that the NMW should be abolished for apprentices and under 18-year-olds in the UK to tackle persistently high youth unemployment. The rate for 16 and 17 year olds is due to rise to £3.79 per hour in October 2014 and to £2.73 per hour for apprentices. The authors of the report also believe that setting a single NMW is likely to have adverse effects on private sector employment in the regions. In Wales, for example, the NMW is 70% of median hourly earnings in the private sector, compared to just 42% in London. The report recommends that the minimum wage should be regionalised. When determining the minimum wage for each region, differences in productivity and economic conditions should be taken into consideration.

Source: News Reports accessed May 2104

**3.** **The National Minimum Wage after 15 years**

**Extract A: The role of the National Minimum Wage**

The purpose of the NMW is to provide a wage floor, in order to protect low-paid workers against exploitation, without causing job losses. Many economists have been wary of statutory minimum wages: unless they raise the price of labour at the bottom of the wage distribution above what it would otherwise be they are pointless; but if they raise it then the fear is that they will curb demand for labour, and curb it to the particular detriment of the least skilled.

However, others have pointed out that labour markets are not perfectly competitive. There are costs and risks for workers who want to change jobs, and some employers enjoy a degree of monopsony power in local labour markets. As a result workers may be paid at levels below the market-clearing rate. The implication is that a statutory wage floor may raise the pay of the lowest earners without adverse employment effects. The challenge is to set the level as high as possible short of causing people to lose jobs.

Source: The Future Path of the National Minimum Wage - Low Pay Commission 2014

## 4. The National Minimum Wage after 15 years

### Extract D: Calls for employers to commit to paying the Living Wage as the pay gap widens

The TUC, the Archbishop of Canterbury and Boris Johnson, the Mayor of London, are just a few of those who have called on employers to pay their workers a living wage. The Living Wage is defined as 'the wage that can meet the basic needs to maintain a safe, decent standard of living within the community'. The Living Wage differs from the minimum wage in that the latter is set by law and may fail to provide people with enough income to have a reasonable quality of life. It has been claimed that five million people are paid less than the Living Wage, which is estimated at £8.80 an hour in London and £7.65 elsewhere.

Proponents argue that paying the Living Wage means workers can live with dignity and not just exist. By paying the Living Wage, employers can lift their employees out of poverty, debt, and illness, which will improve family life. Employers benefit because it is easier to recruit and retain staff, productivity increases, and there is a reduction in sickness and absenteeism. Government spending on welfare is also reduced. Everyone is a winner.

Source: News Reports accessed May 2104



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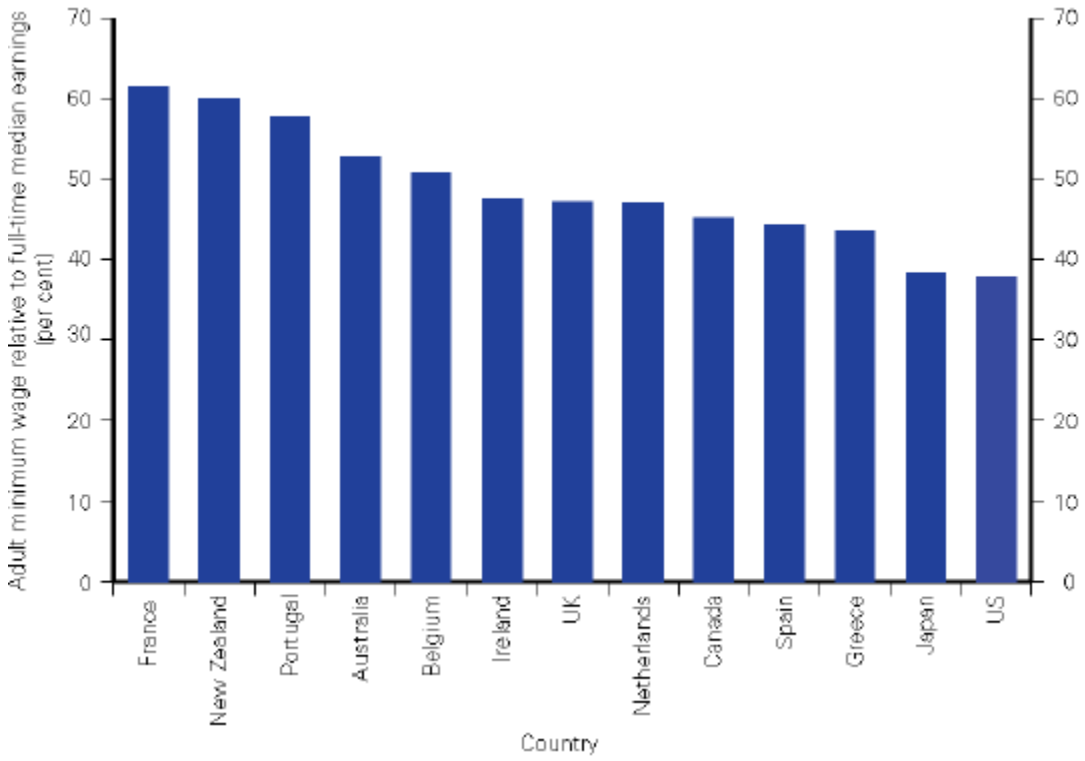
**5.** **The National Minimum Wage after 15 years**

**Extract C: International comparison of adult minimum wages by country, December 2013**

| **Country** | **Minimum wage in UK £s, using purchasing power parity exchange rates** |
|---|---|
| Australia | 7.79 |
| France | 7.77 |
| Belgium | 7.02 |
| Netherlands | 6.97 |
| Ireland | 6.80 |
| New Zealand | 6.35 |
| UK | 6.31 |
| Canada | 5.89 |
| USA | 5.31 |
| Japan | 4.80 |
| Spain | 3.48 |
| Greece | 3.40 |
| Portugal | 2.91 |

Source: Extracted from National Minimum Wage – Low Pay Commission 2014

**Adult minimum wages relative to full-time median earnings, by country, 2012**




Source: The Future Path of the National Minimum Wage - Low Pay Commission 2014

Some countries, such as China and India, do not have a single national minimum wage. In China, each province sets its own minimum wage to reflect local conditions. In November the hourly rate in Beijing was equivalent to approximately £1.74, whereas in Hunan it was around £0.93.

**International comparisons of productivity, final estimates for 2012**

**Current price GDP per hour worked**

UK = 100

| | |
|---|---|
| Canada | 105 |
| France | 132 |
| Germany | 131 |
| Italy | 111 |
| Japan | 89 |
| UK | 100 |
| USA | 135 |
| G7 average | 120 |

Source: ONS 20 February 2014



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**6.**

**The National Minimum Wage after 15 years**

**Extract B: The National Minimum Wage to rise to £6.50 in October 2014**

Will a rise in the National Minimum Wage (NMW) damage the competitiveness of the UK economy? Representatives of businesses in the UK have claimed that the recently announced 3% increase in the National Minimum Wage is 'unwelcome in today's economic climate'. Critics of the increase maintain that 'it is essential that businesses remain competitive and that the above inflation increase in the NMW will add significantly to business costs'. Yet competitiveness is not just about wages, it also, for example, depends on productivity, the exchange rate and innovation.

Source: News Reports accessed May 2104

**7.**

**Inequality Extract E** (lines 6−7) states that 'growing inequality would create incentives, kick-start enterprise, boost growth and is good for us all'.

Using the data in the extracts and your economic knowledge, assess the view that inequality is 'good for us all.'

**[25 marks]**

**8.**

Over the past 35 years, successive governments have reduced taxes on income whilst increasing taxes on spending, such as excise duties and Value Added Tax (VAT).

Assess the economic costs **and** benefits of government action which results in greater inequality in the distribution of income and wealth in the UK.

**[25 marks]**

**9.**

Explain how the data in **Inequality Extract D** show that taxes and benefits have been successful in reducing inequalities in household income in the UK.

**[4 marks]**

**10.**

Over the past 35 years, successive governments have reduced taxes on income whilst increasing taxes on spending, such as excise duties and Value Added Tax (VAT).

Distinguish between equity **and** equality and explain the effects of this government policy on the distribution of income.

**[15 marks]**

**11.**

**Inequality Extract F** (lines 9−10) states that 'concentrating income in fewer and fewer hands eventually leads to bubble economies in which the prices of assets, such as houses and shares, rise continuously'.

With the help of a diagram, explain how growing inequality might lead to a persistent rise in the price of houses.

**[9 marks]**



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**12.** **Inequality**

**Extract F: Against inequality**

The main outcome of the post-1980 experiment in neo-liberal (market) economics has been an economy that is much more divided and unhealthy, both of which are closely related. There are three powerful reasons why the global financial crisis of 2008 and 2009 had its roots in excessive concentrations of income and wealth.

First, above a certain limit of inequality, economies develop a natural tendency to deflation. In the UK and US, by cutting the purchasing power to buy the extra output being produced, the long wage squeeze has created consumer societies without enough consumers. The solution has been to allow an unsustainable increase in private debt to fill the gap.

Second, concentrating income in fewer and fewer hands eventually leads to bubble economies in which the prices of assets, such as houses and shares, rise continuously until the 'bubbles' eventually burst. From the early 1990s, the growing inequality created a global mix of increasing company profits, excessive bank lending and rapidly growing personal wealth, all of which contributed to the bubbles in property and share prices. This eventually brought the global economy to its knees.

Finally, excessive concentrations of wealth create dangerous concentrations of economic power. Corporate lobby groups, which promote the interests of the financial sector, are able to promote measures such as weak financial regulation by the state and lower taxes on the wealthy.

Source: Copyright Guardian News & Media Ltd 2011

**13.** Attempts by governments to equalise incomes are well-intentioned but counter-productive. They destroy incentives for people to lift themselves out of poverty.

To what extent can the problem of poverty in the UK be solved through the operation of market forces? Justify your answer.

**[25 marks]**



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## 14.

### Inequality

### Extract E: In favour of inequality

The way in which society's resources are distributed has long been of major concern to economists, directly affecting as it does the level of social welfare. Changes in the size and distribution of national output raise important questions of efficiency and also involve basic issues of equality. However, what is equitable is a matter of considerable debate amongst economists of different political persuasions.

It has been argued by the supporters of free-market capitalism that growing inequality would create incentives, kick-start enterprise, boost growth and is good for us all. Free market economists would argue that justice automatically arises from the interaction of demand and supply and the existence of competitive markets. In such a scenario, each factor receives what it is worth in terms of the value of its marginal revenue product. Disparities in income and wealth are justified by such factors as greater levels of innate or acquired skills which enable some factors to be more productive than others and earn a greater amount. Differences in the distribution of income and wealth are therefore viewed as inevitable and also desirable in that they provide the necessary incentives for individuals to study, train, supply their factor services and set up new businesses. These differences help the smooth operation of the price system and lead to an efficient resource allocation.

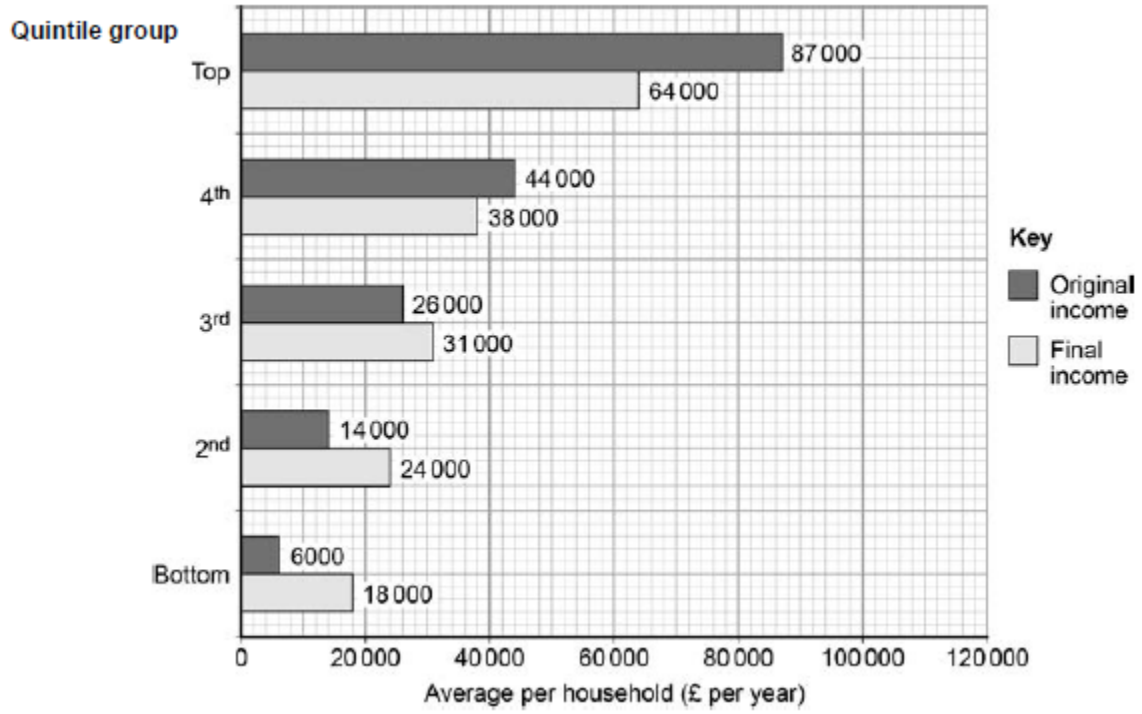
Moreover, an unequal distribution of income is seen as necessary to ensure economic efficiency and a faster growth rate – by making the rich richer, the size of the national cake, that is real GDP, will grow, and the benefits will trickle down to the less well off.

Source: News reports, November 2013

## 15.

### Inequality

### Extract D: The effects of taxes and benefits in the UK on household income by quintile groups, 2011−2012




Source: Office for National Statistics licensed under the Open Government Licence v. 1.0.



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**16.** ‘Each time the Government imposes a minimum price or wage, the result is almost always excess supply. What matters is the extent to which this is a problem.’

Discuss the view that a national minimum wage is beneficial for an economy.

**[25 marks]**

**17.** Attempts by governments to equalise incomes are well-intentioned but counter-productive. They destroy incentives for people to lift themselves out of poverty.

Explain the main causes of poverty in the UK.

**[15 marks]**

**18.** Which one of the following policies is most likely to have an immediate effect in helping to reduce the amount of poverty in the UK?

| | | |
|---|---|---|
| **A** | An increase in government subsidies for buyers of electric cars | ⬭ |
| **B** | A shift in the burden of taxation from direct to indirect taxes | ⬭ |
| **C** | Setting a price floor for basic foods | ⬭ |
| **D** | The introduction of a price ceiling for household energy | ⬭ |

**[1 mark]**

**19.** The Resolution Foundation estimates that 1% of adults, about 488 000 people, own 14% of the UK’s assets – worth about £11 trillion. At the other end of the scale, 15% of adults, about 7.3 million people, either own no assets at all, or are in debt. Meanwhile, income is also unequally distributed, but not to the same extent as wealth.

Assess the view that, in the UK, the consequences of wealth inequality are more damaging than the consequences of income inequality.

**[25 marks]**

**20.** **INVESTIGATION**

**Scenario**

You are an economist working for the Ministry of Housing, Communities and Local Government (MHCLG).
You have been asked to investigate the state of the UK housing market.
As part of this investigation, you are to provide answers to three questions.

Referring to the **Extracts A**, **B**, **C** and **D**, use them and your knowledge of economics to help you answer this question.

After considering **Extract E**, and the original evidence in Extracts **A**, **B**, **C** and **D**, would you recommend that the Government should increase its spending on housing? Justify your recommendation.

**[25 marks]**



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