

Please check the examination details below before entering your candidate information

Candidate surname <i>StemUp Model Solution</i>		Other names											
Pearson Edexcel Level 3 GCE		Centre Number <table border="1"><tr><td></td><td></td><td></td><td></td><td></td></tr></table>						Candidate Number <table border="1"><tr><td></td><td></td><td></td><td></td><td></td></tr></table>					
Tuesday 2 June 2020													
Morning (Time: 2 hours)		Paper Reference 9EB0/02											
Economics B Advanced Paper 2: Competing in the global economy													
You do not need any other materials.			Total Marks										

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **all** questions.
- Answer the questions in the spaces provided
– *there may be more space than you need.*

Information

- The total mark for this paper is 100.
- The marks for **each** question are shown in brackets
– *use this as a guide as to how much time to spend on each question.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Try to answer every question.
- Check your answers if you have time at the end.

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Answer ALL questions.

SECTION A

Read the following extracts (A to C) before answering Question 1.

Write your answers in the spaces provided.

Extract A

Sainsbury's Asda merger: Competition and Markets Authority (CMA) blocks merger

In its final report, published in April 2019, the CMA blocked the proposed merger between *Sainsbury's* and *Asda*. The two supermarket chains announced a deal in May 2018 that would have created a giant supermarket chain with around £51bn in sales.

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The CMA investigated the proposed merger after fears the combined company could reduce choice, raise prices or provide a worse quality of service for consumers. The investigation considered whether the merged company would squeeze suppliers by using its increased buying power. If the merger were successful, the combined firm would account for around 30% of UK grocery sales.

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Before the proposed merger was blocked, a spokesperson for *Sainsbury's* said: "The combination... will benefit consumers and the wider UK economy. We are confident in our case and we look forward to continuing to work closely with the CMA." An *Asda* spokesperson also said: "We are confident our reasons for the merger are justified and that the CMA will take a rigorous and evidence-based approach to their assessment of this deal and we will work closely with them to support the process."

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(Source: adapted from www.independent.co.uk/news/business/news/sainsburysasda-merger-competition-watchdog-launches-formal-investigation-a8504301.html)

Extract B

Tesco to take on budget supermarkets with a cut-price brand named after founder Jack Cohen

In 2018, *Tesco* unveiled its new chain *Jack's*, named after the *Tesco* founder Jack Cohen. It could be the UK's biggest supermarket challenge to the German discounters *Aldi* and *Lidl*. Mainstream supermarkets have been searching for a way to get into the fast-growing discount market, having seen *Aldi* and *Lidl* gain market share when rising food prices and falling real wages encouraged consumers to shop around for groceries. *Aldi* and *Lidl* controlled more than 13% of the UK grocery market in 2018, compared with less than 9% in 2014.

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Meanwhile, sales at discount retailer *B&M* increased by 23% to £970m in the three months to December 2017, up from 20% growth in the same period of 2016. Though it does not sell fresh food, *B&M's* range of cut-price branded staple foods, such as biscuits, crisps and breakfast cereals, pose an additional threat to the 67% market share of the 'big four' *Tesco*, *Sainsbury's*, *Morrisons* and *Asda*.

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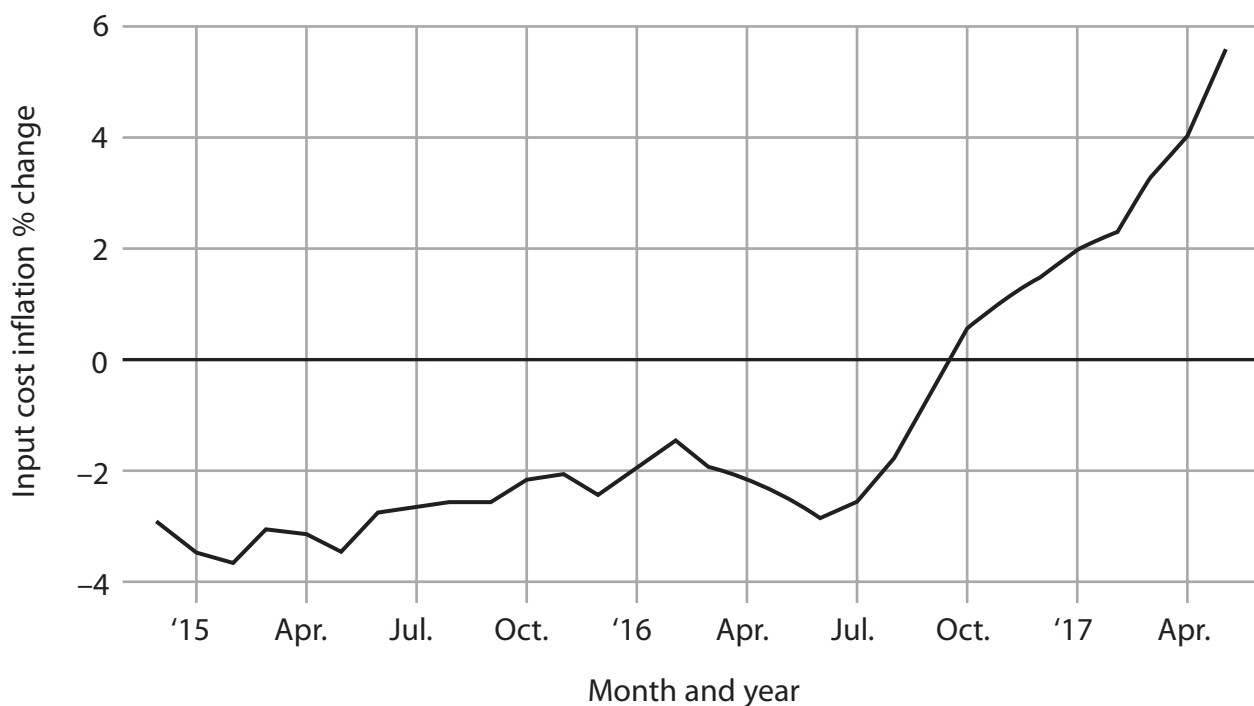
(Source: adapted from www.theguardian.com/business/2018/sep/19/tesco-opens-jacks-first-discount-store-battle-lidl-aldi)



Extract C**Index of UK butter prices, 2013 to 2018**

Year and month	Average price of butter (250g)	Index
July 2013	£1.51	100
July 2014	£1.58	105
July 2015	£1.58	105
July 2016	£1.36	90
July 2017	£1.50	99
July 2018	£1.80	

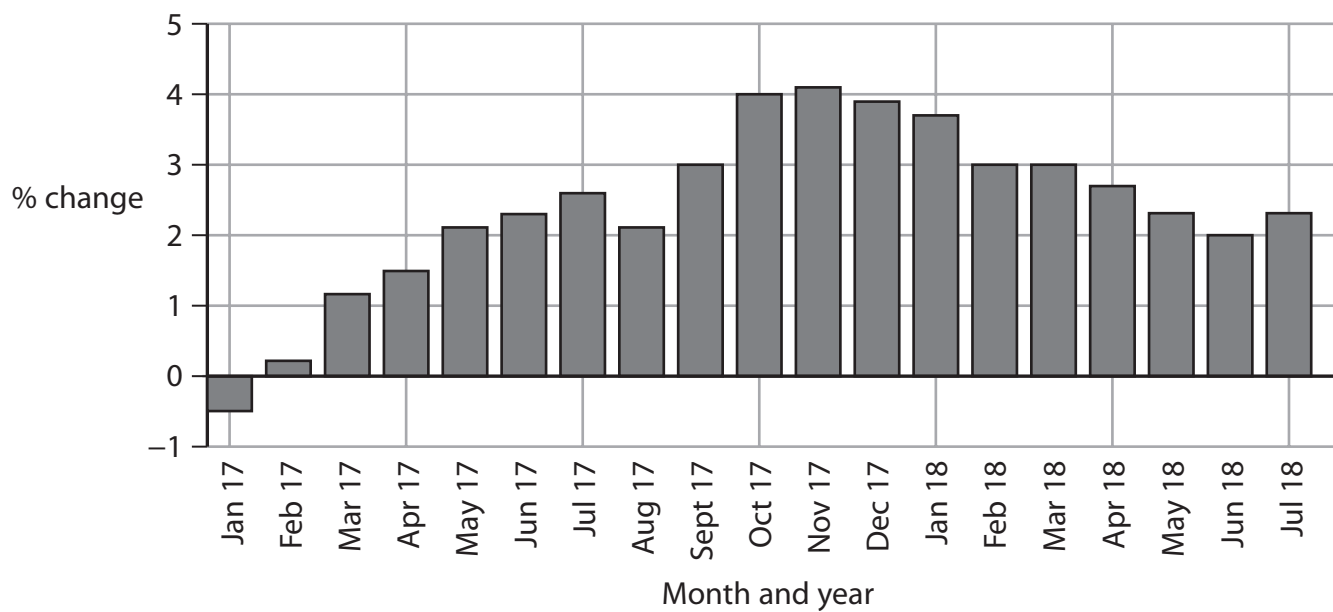
(Source: adapted from www.ons.gov.uk/economy/inflationandpriceindices/timeseries/kw9b/mm23)

UK producer input cost inflation % change: food products

(Source: adapted from <https://www.theatlantic.com/charts/SkmQ8rBBb>)



UK monthly food price inflation, January 2017 to July 2018



(Source: adapted from www.tradingeconomics.com/united-kingdom/food-inflation)

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- 1 (a) Using the information in Extract C, calculate the index for UK butter prices in July 2018. You are advised to show your working.

(4)

$$\text{Index} = (\text{price in current year} \div \text{price in base year}) \times 100$$

$$\text{Index for July 2018} = (£1.80 \div £1.51) \times 100$$

$$£1.80 \div £1.51 = 1.192$$

$$1.192 \times 100 = 119.2$$

$$\text{Index for July 2018} = 119$$



- (b) Using Extract A, explain **one** impact on competitors of the proposed merger between Sainsbury's and ASDA.

(4)

One impact is that competitors would lose market share. The merger would have created a giant supermarket chain with around £51bn in sales, and the combined firm would account for around 30% of UK grocery sales.

This increased market share and buying power would make it more difficult for competitors such as Tesco and Morrisons to compete on price, as the merged firm could negotiate lower prices from suppliers, so some smaller competitors might be forced to exit the market.



- (c) With reference to Extract B, explain **one** likely reason for the change in market share of the discount supermarkets.

(4)

One likely reason is rising food prices together with falling real wages. Aldi and Lidl controlled more than 13% of the UK grocery market in 2018, compared with less than 9% in 2014, an increase of over 4 percentage points.

As food prices rose faster than wages, consumers' purchasing power fell, so they became more willing to shop around for lower prices. They switched from the 'big four' to the cheaper discount supermarkets, so sales and market share of the discounters increased.



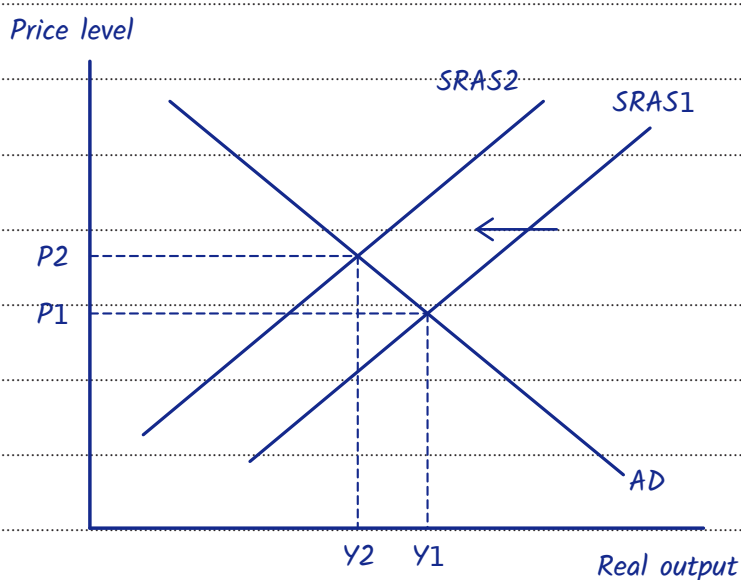
- (d) Using Extract C, analyse how an increase in cost-push inflation may affect economic growth.

(6)

Cost-push inflation occurs when firms' costs of production, such as raw materials and wages, rise. In response, firms raise their prices to protect their profit margins, causing a rise in the general price level.

Extract C shows a sustained increase in producer input cost inflation for food products from October 2016 to April 2017, from around 0% to over 4% by April 2017, having been negative throughout 2015 and early 2016.

This shifts SRAS to the left (SRAS1 to SRAS2), so the price level rises from P_1 to P_2 and real output falls from Y_1 to Y_2 . As prices rise, consumers are able to buy fewer goods and services with the same income, so consumption and AD fall and economic growth decreases.



- (e) With reference to Extract B, discuss the impact of falling real wages on the UK supermarket sector.

(8)

Real wages are wages adjusted for inflation, whereas nominal wages are not. Real wages fall when prices rise faster than nominal wages, so they give a better indication of purchasing power: if real wages fall, consumers can buy fewer goods and services than they previously did.

Extract B explains that rising food prices and falling real wages encouraged consumers to shop around for groceries. Falling real incomes reduce demand for normal goods, and demand for normal luxuries, such as premium own-brand ranges, falls by more than demand for necessities. However, demand for inferior goods, such as cheaper discount brands, may increase as real wages fall, because their income elasticity of demand is negative.

This explains why the discounters have gained: Aldi and Lidl controlled more than 13% of the UK grocery market in 2018 compared with less than 9% in 2014, and sales at B&M increased by 23% to £970m in the three months to December 2017. As a result, the 67% market share of the 'big four' is under threat, reducing their revenue and profits.

Mainstream supermarkets have responded. Tesco launched Jack's, a cut-price chain, to compete directly with Aldi and Lidl and capture the increase in demand for budget products. This increases price competition in the sector, which may lower prices and profit margins across all supermarkets.

However, the extent of the impact depends on how sustained the fall in real wages turns out to be: if nominal wages start to grow faster than inflation, consumers may return to the mainstream supermarkets. The effect also depends on whether inflation continues to rise in other sectors such as energy and housing costs, which would squeeze food budgets further. Finally, the impact depends on customer loyalty, since



grocery shopping is a habitual activity and many consumers value convenience, range and loyalty card schemes, so they may not switch. Overall, falling real wages have shifted market share towards discounters, but the long-term impact depends on how long real wages keep falling.

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- (f) Using the extracts, assess the likely impact on consumers and suppliers of the increased market power of supermarkets.

(10)

Market power is the ability of a firm to influence the price of its product and the terms on which it buys from suppliers. The 'big four' supermarkets hold a 67% market share (Extract B), so the market is an oligopoly, and a Sainsbury's and Asda merger would have created a firm with around 30% of UK grocery sales and £51bn in sales (Extract A), turning the 'big four' into a 'big three'.

For consumers, increased market power means supermarkets become price makers rather than price takers. With fewer competitors, the firms may behave like one large firm and charge higher prices than would otherwise be the case. They may also reduce choice, cut spending on customer service and advertising, or provide a worse quality of service, which is exactly what the CMA feared. Consumers would have to pay higher prices or switch to cheaper goods, reducing consumer surplus. This is why the CMA investigated and blocked the merger, to protect consumers.

For suppliers, Extract A notes the concern that the merged firm would squeeze suppliers by using its increased buying power. A dominant buyer can demand lower prices and longer payment terms, so suppliers' profit margins fall, and some may become loss making and exit the market, reducing choice and investment in the supply chain.

However, the impact may not all be negative. Increased buying power allows supermarkets to benefit from purchasing economies of scale, lowering their average costs. Sainsbury's argued the combination would benefit consumers, since these cost savings could be passed on as lower prices, especially as rising food prices are making consumers more price sensitive. The squeezing of suppliers may also force them to increase efficiency, which lowers costs in the long run.

Furthermore, the market power of the 'big four' is being reduced by competition. Aldi and Lidl increased their market share from less than 9% in 2014 to more than 13%



in 2018, and B&M's sales grew by 23%, so the market is contestable. This increased competition limits the ability of supermarkets to raise prices and may benefit both consumers and suppliers, who have alternative buyers.

Overall, increased market power is likely to harm suppliers more than consumers.

Consumers are protected by the growth of discounters and by the CMA, while suppliers have fewer large buyers to sell to. The impact on consumers depends on whether cost savings are passed on as lower prices or kept as higher profits.



(g) Assess the impact of food price inflation on UK living standards.

(12)

Food price inflation is the rate of increase in the average price level of food in the UK economy. Living standards refer to the material well-being of households, including their real income and ability to buy goods and services. All households spend on food, so it is an important component of the CPI, and the ability to buy food is a basic need and a key indicator of living standards.

Extract C shows food price inflation rose from -0.5% in January 2017 to around 4% in each month from October 2017 to January 2018, before falling to around 2.3% in July 2018. Butter prices rose from $\pounds 1.50$ in July 2017 to $\pounds 1.80$ in July 2018, a 20% increase. If nominal incomes do not rise as fast, real incomes fall, so households can buy fewer goods and services and living standards fall.

Food is a necessity with price inelastic demand, so as prices rise households must spend more of their income to maintain food purchases. This reduces disposable income available for other goods and services, so the opportunity cost of food may be energy, heating, lighting or clothing. Those on fixed and low incomes, such as pensioners and benefit claimants, will be more affected than those on rising or high incomes, because low income groups spend a larger percentage of their income on food. Food price inflation is therefore regressive and widens inequality in living standards.

Households may also substitute cheap, unhealthy food for more expensive, healthy food, which may contribute to rising obesity and type 2 diabetes, reducing quality of life and increasing NHS costs. Rising food bank use indicates that more households find it very difficult to buy basic food on a regular basis. In addition, much UK food is imported, so new tariffs or other barriers to imports, or a fall in the pound, could increase food price inflation further.

However, the long-term impact on living standards depends on how long food price

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inflation is sustained and its size. Food price inflation depends on many factors, including weather and transport costs, and as these change it may fall; it was negative in January 2017 and had fallen to 2% by June 2018, so the effect may be temporary. If wages rise faster than food prices, real incomes may still increase.

Also, as consumers become more price aware, firms have an incentive to become more price competitive to maintain market share, such as Tesco launching Jack's and the growth of Aldi and Lidl, which reduces the impact on living standards. Rising food prices might also reduce food waste, as consumers buy less and use more of what they buy, reducing environmental costs.

In conclusion, food price inflation of around 4% is likely to reduce the living standards of low income households significantly, but for higher income households the impact is small. The overall effect depends on how long it lasts and on wage growth relative to inflation.



- (h) With reference to Extract A, assess the likely problems for Sainsbury's and Asda of their proposed merger.

(12)

The proposed merger between Sainsbury's and Asda is an example of horizontal integration, as both firms are at the same stage of production in the same industry. It would have created a giant supermarket chain with around £51bn in sales and around 30% of UK grocery sales.

The most immediate problem was regulatory. The CMA investigated the merger due to fears it would reduce choice, raise prices or provide a worse quality of service, and in April 2019 it blocked the deal. Both firms had spent almost a year working with the CMA, so they incurred large legal and advisory costs and management time with nothing gained, and the cost of the merger, which depends on how it was financed, was wasted.

Even if the merger had been allowed, the new large firm might experience diseconomies of scale. As output increases, average total costs may rise due to inefficiency, as the firm becomes too big to manage efficiently. Chains of command may be extended, causing internal communication problems, and lead times may increase, making the new firm relatively slow to respond to changes in the market, such as the growth of Aldi and Lidl.

There may also be clashes of corporate culture: Asda is a low-price brand while Sainsbury's is more premium, so staff and managers may have different ways of working. Merging two established brands may diminish the brand identity of each, and if the merger is unsuccessful, both firms risk losing customers and their reputation.

However, there must be some reason the two firms sought to merge, such as falling revenues and market share as discounters grew. Both are established brands, so they do not have to invest in developing new products. The merged firm could benefit from purchasing and marketing economies of scale, using its buying power to lower costs,

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and could share supply chains across the larger firm. Synergy may result in the sharing of technology and increased dynamic efficiency, reducing the impact of diseconomies of scale, and the larger size and revenues may allow the firm to expand into overseas markets or invest in vertical integration.

In conclusion, the biggest problem for Sainsbury's and Asda was the CMA blocking the merger, which wasted time and money and left both firms facing growing competition from discounters alone. Diseconomies of scale and culture clashes are only potential problems, and their significance depends on how well the merger would have been managed and whether the economies of scale outweighed them.

(Total for Question 1 = 60 marks)

TOTAL FOR SECTION A = 60 MARKS



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QUESTION 2 BEGINS ON THE NEXT PAGE



P 6 1 8 5 2 A 0 1 7 2 8

SECTION B

Read the following extract (D) before answering Question 2.

Write your answer in the space provided.

Extract D

The United States-Mexico-Canada Agreement (USMCA)

In October 2018 after a bitter dispute, the USA, Canada and Mexico reached a deal to change the North American Free Trade Agreement (NAFTA). The new name for the world's second-biggest economic bloc after the European Union (EU) is the USMCA. According to President Trump, it "solves the many deficiencies and mistakes in NAFTA, greatly opens markets to our farmers and manufacturers, reduces trade barriers to the USA and will bring all three great nations together in competition with the rest of the world."

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However, analysts have warned that new tariffs threaten to reduce economic growth and the creation of new jobs across the region. In addition, the USA still faces several other trade disputes around the world, not least with China, where the US Government has applied tariffs of \$200bn on Chinese imports. President Trump has also said he could impose import tariffs on EU cars, further widening the global trade dispute.

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(Source: adapted from <https://www.theguardian.com/us-news/2018/oct/01/trump-hails-wonderful-new-trade-deal-with-mexico-and-canada>)

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- 2 With reference to Extract D, evaluate the extent to which being a member of a trade bloc promotes economic growth.

(20)

A trade bloc is a group of countries that agree to reduce or remove trade barriers, such as tariffs, quotas and non-tariff barriers like regulations, between member countries. The USMCA, which replaced NAFTA in 2018, is a free trade area between the USA, Canada and Mexico, and is the world's second-biggest economic bloc after the EU. Economic growth is an increase in real GDP.

Being a member of a trade bloc involves trade liberalisation, which may increase access to large developed markets, for example Canada and Mexico accessing the USA market.

Without tariffs, exporters face lower costs and can sell at lower prices, so sales revenue for firms and MNCs in the USA, Canada and Mexico rises. President Trump claimed the deal 'greatly opens markets to our farmers and manufacturers' and 'reduces trade barriers'. Higher exports increase net exports ($X - M$), a component of AD, so real GDP rises, and through the multiplier effect income rises by more than the initial injection.

Trade liberalisation also allows countries to develop their comparative advantage. Each country specialises in producing goods where it has the lowest opportunity cost, for example Mexico in labour-intensive manufacturing and the USA in high-technology goods, and trades with the others. This means more goods and services are produced from the same quantity of inputs, increasing efficiency and the productive capacity of the economy, so LRAS shifts right and long-run growth rises.

Membership also produces trade creation, where high-cost domestic production is replaced by lower-cost imports from a member country. Firms can access resources, commodities and components from other member countries more cheaply, promoting efficiency, adding value and increasing growth. Greater competition from firms in other member countries forces domestic firms to become more efficient and innovative, increasing dynamic efficiency. Firms also gain economies of scale from selling to a



larger market.

In addition, a trade bloc can attract foreign direct investment (FDI), as MNCs look to produce and sell in a large free market of three countries. For example, car

manufacturers have built plants in Mexico to supply the whole North American market.

FDI increases investment, a component of AD, as well as creating jobs and transferring technology and skills, increasing both short-run and long-run growth.

However, the creation of trade blocs can lead to trade diversion, where low-cost producers outside the bloc are excluded or subject to trade barriers, so trade is diverted to higher-cost producers inside the bloc. This leads to a less efficient allocation of resources and higher prices for consumers, which can reduce growth. Extract D shows the USA has applied tariffs of \$200bn on Chinese imports and could impose tariffs on EU cars, which raises costs for US firms that use imported components and reduces consumers' real incomes.

Trade blocs can also produce imbalanced growth, as MNCs locate production where costs are lowest. For example, USA firms locating in Mexico to benefit from lower wages may increase growth in Mexico but reduce growth and jobs in the USA, especially in manufacturing regions. This was one of the deficiencies that President Trump claimed NAFTA had, and is why the bloc was renegotiated.

Membership can also create trade surpluses in some economies and equivalent deficits in others. This can increase political tensions and uncertainty, as shown by the bitter dispute before the USMCA was agreed and the wider global trade dispute with China and the EU. Uncertainty reduces business confidence and investment, and retaliation from countries outside the bloc can reduce exports. Analysts have warned that new tariffs threaten to reduce economic growth and the creation of new jobs across the region, so the benefits of the bloc may be offset.

The extent to which membership promotes growth depends on several factors. It



depends on the size of the bloc and its members: being a member of a bloc containing a very large economy such as the USA is likely to benefit smaller members such as Mexico and Canada more, as they gain access to a much larger market. It depends on whether trade creation outweighs trade diversion, which is more likely if members are already major trading partners, as the USA, Canada and Mexico are. It also depends on the policies towards countries outside the bloc: if the bloc is used to raise barriers against China and the EU, any gains may be cancelled out by retaliation and a global trade war.

In conclusion, being a member of a trade bloc such as the USMCA is likely to promote economic growth through increased exports, specialisation, trade creation and FDI, particularly in the long run. However, the extent of the growth is limited by trade diversion, imbalanced gains between members and the political tensions and tariffs highlighted in Extract D. Overall, membership promotes growth to a significant extent for most members, but the gains are uneven and depend on the bloc not becoming protectionist towards the rest of the world.

(Total for Question 2 = 20 marks)

TOTAL FOR SECTION B = 20 MARKS



SECTION C

Read the following extracts (E and F) before answering Question 3.

Write your answer in the space provided.

Extract E

The poor pay higher taxes than the rich

The poorest 10% of households in the UK pay a greater proportion of their income in tax than the richest 10%, new analysis has revealed. Official statistics in April 2017 show the lowest 10% of earners pay an average of 42% of their income in the form of income tax, National Insurance, VAT and council tax. In contrast, the richest 10% see 34.4% of their earnings go in tax, according to analysis by The Equality Trust.

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Council tax and VAT were found to hit the poorest households particularly hard. Low earners pay an average of 7% of their income in council tax while the wealthiest households pay just 1.5%. A similar trend applies to VAT, on which the poor pay 12.5% of their income while the rich pay 5%. In an analysis that paints a stark picture of inequality in Britain, The Equality Trust found that the richest 10% of households have an average pre-tax income of £110 632 per year compared to just £19 992 for the poorest.

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(Source: adapted from <https://www.independent.co.uk/news/uk/home-news/lowest-earners-more-tax-richest-office-national-statistics-inequality-council-tax-vat-equality-trust-a7704331.html>)

Extract F

Income inequality in the United Kingdom

Inequality in household incomes in the UK has remained at a roughly similar level since the early 1990s, but is higher than during the 1960s and 1970s. While the share of income going to the top 1% of individuals by household income increased during the 1990s and 2000s, there was some reduction in inequality among the rest of the population (based on incomes before housing costs) with the result that inequality overall was fairly stable during this period.

5

Following the 2008 recession, there was a small fall in income inequality as higher income households saw a larger fall in income in real terms than households at the bottom of the distribution. This can be explained by the sharp fall in real earnings after the recession, while welfare benefits levels initially remained more stable.

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The Organisation for Economic Cooperation and Development (OECD) figures suggest that the UK has among the highest levels of income inequality in the EU (as measured by the Gini coefficient) although income inequality is lower than in the USA. Data published by Eurostat, the statistical office of the EU, gives a more positive picture, indicating income inequality in the UK is lower than in several other EU countries although it is slightly higher than the EU average.

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(Source: adapted from <http://researchbriefings.files.parliament.uk/documents/CBP-7484/CBP-7484.pdf>)

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- 3 Using Extracts E and F, evaluate the extent to which fiscal policy could be used to reduce inequality in the UK.

(20)

Fiscal policy is the use of taxation and government spending to achieve macroeconomic goals. Inequality relates to issues of equity in the allocation of income and wealth between households. A reduction in inequality, or redistribution of income, may be a government macroeconomic goal. Extract F shows the UK has among the highest levels of income inequality in the EU as measured by the Gini coefficient, slightly above the EU average but lower than the USA.

Taxation can be progressive and direct, such as income tax, where the rate of tax increases as income rises, or regressive and indirect, such as VAT, where the tax takes a larger proportion of a poor household's income because the rate is the same regardless of income. Extract E shows that the UK tax system is regressive overall: the poorest 10% pay 42% of their income in tax compared with 34.4% for the richest 10%. The poor pay 12.5% of their income in VAT compared with 5% for the rich, and 7% in council tax compared with just 1.5%.

Income inequality can therefore be reduced by increasing progressive taxation and decreasing regressive taxation. For example, the government could raise the higher and additional rates of income tax, introduce new council tax bands for expensive properties, or cut VAT, or zero-rate more essential goods. This would reduce the tax burden on the poorest households, whose average pre-tax income is £19 992, relative to the richest, whose average pre-tax income is £110 632, narrowing the gap in post-tax income and lowering the Gini coefficient.

Income inequality can also be reduced through government spending on benefits such as pensions, unemployment benefits and other welfare payments, which are a transfer of income from higher earners to lower income households. Extract F shows that after the 2008 recession there was a small fall in income inequality because welfare benefit



levels initially remained more stable while real earnings fell sharply, showing benefits can protect the incomes of the poorest. If inequality is to be reduced, benefits need to be increased in line with inflation so as to maintain their real value. Government spending on education, training and healthcare can also reduce inequality in the long run, by raising the skills and earning potential of low income workers.

However, fiscal policy has limitations. Government taxation and spending can have unintended consequences: high rates of direct taxation may reduce the incentive to work and invest, and can increase tax avoidance and evasion, so tax revenue may actually decrease, as the Laffer curve suggests. High earners and firms may move abroad.

Generous benefits may create a disincentive to work, causing a poverty or unemployment trap, which could increase dependency rather than reduce inequality.

There is also an opportunity cost: increasing benefits and spending may require higher borrowing, increasing the budget deficit and national debt, which may conflict with other macroeconomic goals. Cutting VAT reduces a major source of tax revenue, and is not well targeted, as the rich also benefit from lower prices. In the end, decisions about the distribution of income and wealth and the use of taxation and government spending are political decisions, so governments may be unwilling to raise taxes on high earners.

Furthermore, Extract F shows that inequality has remained at a roughly similar level since the early 1990s despite many changes in fiscal policy, and that the share of income going to the top 1% increased in the 1990s and 2000s, suggesting fiscal policy alone has had limited success. Inequality is also caused by factors such as wage differences, globalisation and wealth inheritance, which fiscal policy cannot fully address. Data also conflict: Eurostat gives a more positive picture than the OECD, so the scale of the problem is uncertain.

Alternatives may be needed alongside fiscal policy. Modern Money Theory (MMT)



suggests that job guarantee schemes could be created to reduce unemployment and income inequality without increasing taxation. Income guarantee schemes have been piloted in some places, such as Ontario, but have faced many of the same problems as the minimum wage when the income has been set too low to avoid absolute poverty. Supply-side policies such as the National Living Wage and improved education may also be needed.

In conclusion, fiscal policy could be used to a significant extent to reduce inequality in the UK, particularly by reducing regressive taxes such as VAT and council tax, which Extract E shows hit the poorest hardest, and by maintaining the real value of benefits. However, its effectiveness is limited by disincentive effects, tax avoidance, the cost to public finances and political will. It is most effective in the short run at redistributing income, while reducing inequality in the long run requires fiscal policy to be combined with spending on education and skills.

(Total for Question 3 = 20 marks)

TOTAL FOR SECTION C = 20 MARKS
TOTAL FOR PAPER = 100 MARKS



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