1.19 The Poverty Trap and the Equity-Efficiency Trade-Off in Redistribution: Test Pack

AQA 7136 · Calculators not allowed · about 25 minutes

Total Marks

Name: _____ Date: ____ / ____ / _____

Answer all questions. Full sentences are required for explanations and the essay. Time guidance: 25 minutes total.

1 Multiple choice, household incentives context: A single-parent household receives means-tested benefits which are withdrawn as earnings rise. Which of the following describes the poverty trap?

- ☐ A. A situation where higher earnings lead to a larger rise in disposable income than expected, encouraging more work
- ☐ B. A situation where increases in gross earnings are largely offset by higher taxes and benefit withdrawal, leaving little or no extra disposable income
- ☐ C. A situation where benefits are paid irrespective of income
- ☐ D. A situation where public spending is so low it causes absolute poverty

(Total for Question 1 is 1 mark)

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2 Explain how tapering benefit withdrawal more gradually (a lower marginal withdrawal rate) differs in effect from providing a small universal basic income paid to all households, in terms of both equity and work incentives.

(Total for Question 2 is 4 marks)

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3 Define the term 'poverty trap' as used in UK redistributive policy debates, naming the mechanisms involved.

(Total for Question 3 is 2 marks)

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4 Explain, with two linked reasons, why a high combined effective marginal tax rate (EMTR) weakens the incentive of a low-income household to increase their paid hours.

(Total for Question 4 is 4 marks)

5 State, in one sentence, what is meant by the equity-efficiency trade-off in redistributive policy.

(Total for Question 5 is 2 marks)

6 State one policy, other than lowering taper rates, that could help a household escape the poverty trap, and give one short reason why it would help.

(Total for Question 6 is 2 marks)

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Mark scheme · 1.19 The Poverty Trap and the Equity-Efficiency Trade-Off in Redistribution: Test Pack

Question 1

Correct option B, which states that higher gross earnings are largely offset by taxes and benefit withdrawal, producing little extra disposable income — **B1**

Answer: B

Question 2

identifies that lowering taper rates reduces EMTRs only for benefit recipients, improving work incentives at the margin for them — **M1**

develops: a lower taper increases net gain from extra earnings, encouraging labour supply among low-income households — **A1**

identifies that a universal basic income (UBI) gives payments to everyone, so it changes equity by raising incomes universally rather than targeting the poorest — **M1**

develops: UBI may have smaller work disincentive effects for recipients if it replaces means-tested withdrawal, but it is costly and less targeted, so its equity impact differs from a tapered benefit reform — **A1**

Answer: Lowering taper rates directly reduces EMTRs for benefit recipients, improving marginal work incentives for the poorest, whereas a UBI gives everyone a payment, changing the pattern of redistribution and costing more. UBI may remove some withdrawal disincentives if it replaces means-tested benefits, but it is less targeted and affects equity differently.

Question 3

a definition that identifies the poverty trap as where increases in earned income produce little or no rise in disposable income — **B1**

explicit mention of the mechanisms, such as means-tested benefit withdrawal and marginal tax rates reducing the net gain from extra earnings — **B1**

Answer: The poverty trap occurs when increases in earned income are largely offset by taxes and the withdrawal of means-tested benefits, so the household gains little extra disposable income, reducing the incentive to increase work effort.

Question 4

identifies that EMTR is the sum of income tax, national insurance and benefit withdrawal on an extra pound — **M1**

explains that a higher EMTR means a smaller marginal increase in disposable income, reducing the financial reward for extra hours — **A1**

identifies behavioural effect, e.g. substitution effect or reduced marginal benefit of labour — **M1**

develops by linking the reduced financial reward to likely choices, such as preferring leisure, informal work or reducing hours because the net gain is too small — **A1**

Answer: A high EMTR, being the sum of income tax, national insurance and benefit withdrawal on an extra pound, means each extra pound earned yields only a small rise in disposable income, so the financial reward for extra hours is small. Behaviourally, this reduces the incentive to work more as households substitute leisure or non-declared work for paid hours when the marginal monetary gain is tiny.

Question 5

statement that equity-efficiency trade-off means greater redistribution to improve fairness can reduce incentives for work, saving or investment, harming economic efficiency — **B1**

explicit link: redistribution improves equity but can reduce efficiency by lowering incentives — **B1**

Answer: The equity-efficiency trade-off is the idea that policies which redistribute income to achieve greater fairness can reduce incentives to work, save or invest, thereby lowering economic efficiency.

Question 6

identifies a valid policy, e.g. improving access to affordable childcare, in-work tax credits, or training and skills provision — **B1**

gives a short reason why it helps, e.g. affordable childcare reduces the fixed cost of working more, increasing the net gain from extra hours — **B1**

Answer: Example: subsidised childcare, because it cuts a major fixed cost for working parents, increasing the net benefit from working additional hours and making employment more attractive.

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