

# AQA Economics A-level **Microeconomics**

## Topic 7: Distribution of Income and Wealth, Poverty and Inequality

### 7.1 The distribution of income and wealth

#### Notes

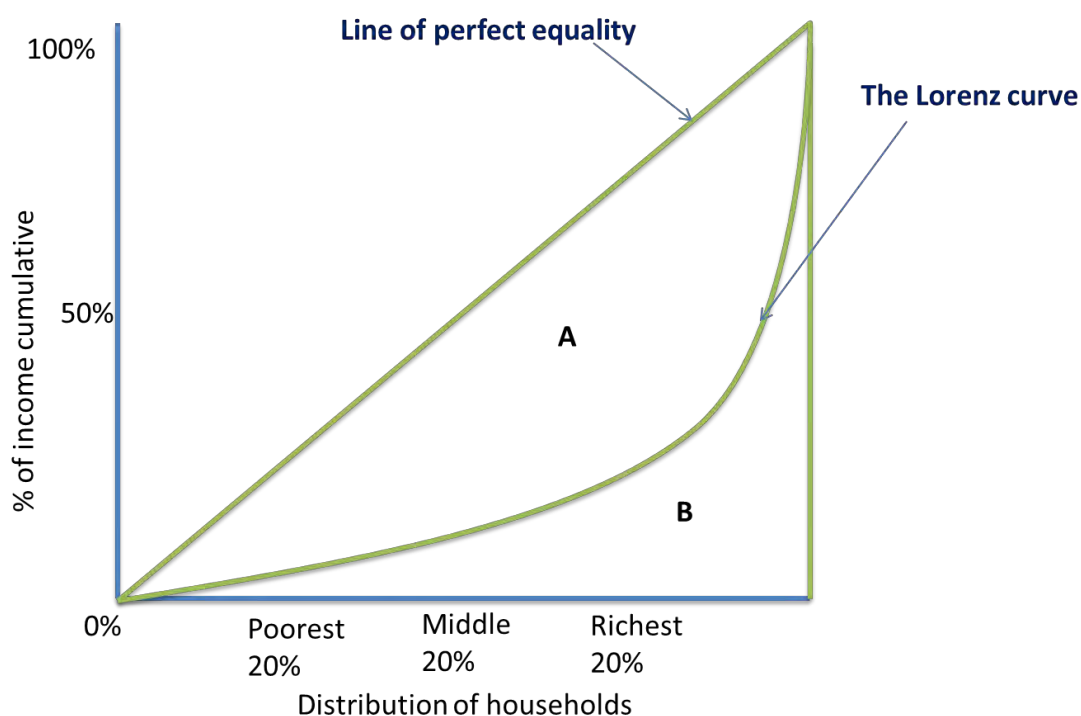
### Distinction between wealth and income inequality

Wealth is defined as a stock of assets, such as a house, shares, land, cars and savings. Wealth inequality is the unequal distribution of these assets.

Income is money received on a regular basis. For example, it could be from a job, welfare payments, interest or dividends. When income is unevenly distributed across a nation, income inequality is said to exist.

### Measurements of income inequality

- The Lorenz curve and the Gini coefficient



The Lorenz curve measures the distribution of income and wealth in a country. The line of perfect equality shows the distribution of income when the richest  $x\%$  of the population owns  $x\%$  of the cumulative income.

The Lorenz curve shows the actual distribution of income and wealth. The one in the diagram shows a significant level of inequality. The richest 20% own a higher proportion of income than the poorest.

The Gini coefficient gives a numerical value for inequality and is derived from the Lorenz curve. It is calculated by the areas:

$$\text{Gini} = \frac{A}{A+B}$$

A value of 0 indicates perfect equality, so everyone has the same income and wealth. A value of 1 is perfect inequality i.e. all of the wealth in the country is concentrated in the hands of one individual or household.

### **The difference between equality and equity in relation to the distribution of income and wealth**

Equality refers to the equal distribution of wealth and income in society, so that everyone has the same income.

Equity refers to fairness, or what is considered to be an acceptable distribution of income and wealth in society. This could be subjective.

### **Causes of income and wealth inequality within and between countries**

#### **Inequality in wages**

Recently, more part-time and temporary jobs have been available rather than full time jobs. This leaves people underemployed, and it limits how much they can earn. It became a problem during the Great Recession.

On average, those with a degree earn more over their lifetime than those who gain just A Levels. The wage gap between skilled and unskilled workers has increased in the UK recently. Jobs in the low-skilled service industries, especially in the public sector, tend to pay less than jobs in the private sector.

Even with equal pay laws, women still earn less than men on average. This could be due to career breaks and fewer hours worked on average than men, or because women are crowded into low-paid or part-time jobs, which may only require low skill levels. Women could also be discriminated against when it comes to promotions, which effectively locks out higher paying jobs. Although a gap still exists, it is narrowing.

Workers might be discriminated against due to age, disabilities, gender and race.

### **Welfare payments and taxes**

State pensions and welfare payments tend to increase less than wages, even though they are index-linked to inflation. This means that those on benefits see a smaller real increase in their income compared to those in jobs. This increases inequality. Moreover, recently welfare payments have been cut. Although this might encourage some people to find jobs, many people might be unable to work, so it lowers their income more.

In the UK, some taxes are regressive, which means that those on lower incomes bear a larger burden of the tax. This can increase inequality.

### **Unemployment**

This can cause relative poverty (and therefore increase income inequality), and it is particularly detrimental where no one in a household is working, since they are left to rely on state benefits.

### **Changes to the UK tax system**

Over the last 2-3 decades, the UK has switched towards indirect taxes, which tend to be more regressive. The top income tax rate fell from 83% in 1979 to 40% in 1988, and it is still at this rate today.

The basic income tax rate fell from 33% to 22%, which helps workers keep more income. However, the benefits of this disproportionately favour the richest households. This has led to an increase in income inequality.

### **Inequality between countries**

Globally, there is inequality between countries. Some of this is caused by certain social groups being excluded and marginalised based on ethnicity, gender, sexual orientation and disabilities.

Some countries have been held back by wars, droughts, famines and earthquakes, which has kept their populations in poverty. Across Africa, population issues are complicating efforts to reduce poverty and eliminate hunger. Their population of 1.1 billion is expected to double by 2050.

Two people born in two countries can have very different opportunities open to them, depending on where they were born. This inequality of opportunity can be seen between countries such as Japan and Sierra Leone, where the difference between life expectancies is significant. In Japan, women can expect to live to the age of 87, whilst in Sierra Leone, women can expect to live to 46.

Recently, developing countries have been growing faster and are catching up with the developed world. This is helping to narrow the gap between the rich and poor countries.

The bulk of economic development happened in the Western world, even though China was the technological leader until the 1500s. This could be because British society was more open to social mobility and political liberty, and had free speech supported by Parliament which led to the growth of new ideas. Britain then became the centre of scientific revolution and experienced the Industrial Revolution. This increased output per farmer, reduced food prices and led to higher wages.

Moreover, exploitation of the poor through colonial rule led to more inequality between countries. The fast spread of ideas meant the Industrial Revolution reached much of Europe. In many countries which are poor today, war and famine held back this development. The gap in wealth, which grew during the Industrial Revolution, led to an inequality in power, and consequently was a causal factor in the exploitation of poorer countries.

#### **Impact of economic change and development on inequality**

Kuznets hypothesis states that as society moves from agriculture to industry, so it develops, inequality within society increases, since the wages of industrial workers rises faster than farmers. Kuznets curve is shown below.



Then, wealth is redistributed through government transfers and education. He essentially argued that inequality in poor countries is just a transitional phase, and once nations become economically developed, inequality reduces.

Thomas Piketty famously discredited this theory in 2014 by arguing that the capitalist free market system inevitably leads to continued inequality. The rate of return on capital increases, so as the rich get richer with higher returns on their investments, inequality increases.

### **The likely benefits and costs of more equal and more unequal distributions**

Inequality motivates workers, which encourages them to learn new skills and work hard. A higher wage reflects higher productivity in a capitalist society, which results in wage inequality.

Monopolies can exploit consumers with higher prices, and exploit their consumers with lower wages. This allows them to earn even higher profits.

Inheritance is passed down generations, which means wealth is often concentrated in the hands of a few families. Those who inherit lots have more wealth. They can also access the best education and therefore the best jobs, which is not accessible by those with less wealth. It results in an inequality of opportunity and income. Wealth can generate more income for the rich, which widens inequality.

There can be income redistribution and wage equality through government intervention. For example, inheritance tax means rich families cannot keep their entire wealth. Moreover, state education means everyone can access education, and there is regulation for firms with monopoly power.

Inequality could discourage and demotivate those on lower incomes from participating in society. An unequal distribution can lead to negative externalities, such as social unrest.

In a market economy, an individual's ability to consume goods and services depends upon their income and wealth and an inequitable distribution of income and wealth is likely to lead to a misallocation of resources and hence market failure. Some consumers might not be able to buy goods and services at all.