

Chapter 29 Income distribution and welfare

Answers to Knowledge checks

- 29.1** An example of an asset that is part of a household's wealth is a house where the occupier has paid off the mortgage, so it is owned outright.
- 29.2** The decile ratios are 8.5 for the UK, 17.8 for the USA and 5.8 for Norway. These are the same rankings as for the quintile ratio, but the difference for the USA is more marked.
- 29.3** The Lorenz curve for Brazil is further from the equality line than that for the USA.
- 29.4** As the value of the poverty line is measured in terms of international (PPP) dollars, it is important to make sure that the line continues to represent the threshold for the support of human life in the face of changing prices over time.
- 29.5** The UK's poverty threshold level (which is 60% of the median income) in 2015 was £12,567, so the median must have been $12567/0.6 = £20,945$.
- 29.6** Rising house prices affect the prices of assets held by households (in the form of housing), so the key influence is on inequality of wealth. However, there are likely to be indirect effects on income as well.
- 29.7** Equal opportunity legislation has tried to root out discrimination in the workplace. However, there are many factors that lead to differences in pay between individuals, which may make it difficult to prove discrimination. Differences in skills and experience create differences in productivity between individuals, and women may make choices about education and training that may affect the occupations open to them. Nonetheless, the persistence of the gender wage gap remains a concern, and the difference in the size of the gap between countries suggests that more needs to be done in some countries.

Answers to Exercises and Case studies

Exercise 29.1

Table A29.1 shows the ratios of top decile to bottom decile and top quintile to bottom quintile, together with the results for the UK and Norway, for comparison purposes.

Table A29.1 Decile and quintile ratios

Country	Ratio of top decile to poorest decile	Ratio of top quintile to poorest quintile
South Africa	57.0	27.6
Belarus	5.8	3.9
UK	8.5	5.3
Norway	5.8	3.8

These calculations seem to suggest that South Africa is characterised by much higher inequality than any of the countries considered so far. The ratios of top decile (quintile) to bottom decile (quintile) for South Africa are far larger than for the other countries, reflecting the fact that the richer households in South Africa receive a far greater percentage of household income — and the poor a far smaller share. In contrast, Belarus shows a more equitable distribution than the other countries.

These results are confirmed by the Lorenz curves shown in Figure A29.1, with those for the UK and Brazil drawn for comparison. This shows that the Lorenz curve for South Africa is much further from the equality line, and the one for Belarus is much closer. You might like to compare

this figure with Figure 29.1 (*see* page 398 of the book). In that figure, Brazil was included as an example of a country with substantial inequality.

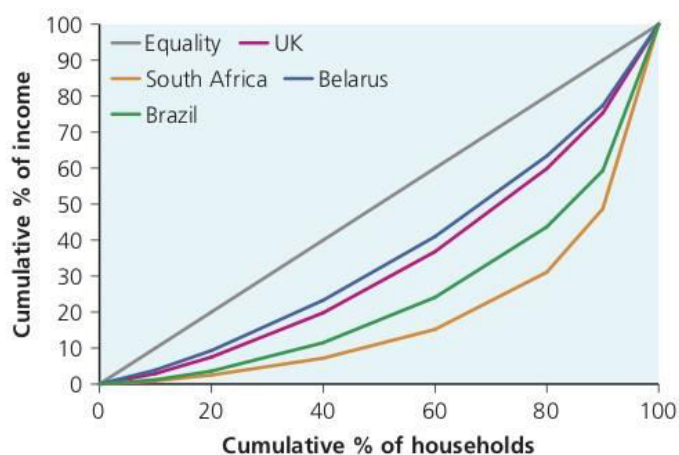


Figure A29.1 Lorenz curves

I hope you noticed that when you drew the Lorenz curves for South Africa and Belarus, you had to be careful with the arithmetic at the bottom end of the distribution. In order to compile the data for the Lorenz curve you need to calculate the cumulative percentages. However, the 'lowest decile' is part of the 'lowest quintile' — so for South Africa you should have plotted the sequence of points shown in Table A29.2.

Table A29.2 Coordinates for the Lorenz curve for South Africa

Cumulative % of households	Cumulative % of household income
0	0
10	0.9
20	2.5
40	7.2 (2.5 + 4.7)
60	15.2 (7.2 + 8.0)
80	31.1 (15.2 + 15.9)
90	68.8 (31.1 + 48.7)
100	100

Exercise 29.2

- If the prime concern is to reach the most needy, the funds would be channelled to group 2, bringing the income of individuals in this group up from \$250 to \$300 per person.
- The best way of raising the incomes of people to the poverty line is to channel the funds to group 1, raising their incomes from \$450 to \$500 and thereby halving the number of people living below the poverty line.
- The strategy that has the biggest impact on the poverty line has the effect of neglecting the most needy in society. If the objective is to help those most in need, setting the target in terms of the poverty line causes policy to be misdirected, as the poverty line ignores the intensity of poverty.

A similar sort of argument has come into play at national level, where there is a choice to be made in directing overseas assistance. The question here is whether to direct aid at the

countries most in need of assistance, or to direct it to the countries best equipped to make use of the funds.

Exercise 29.3

The UK has been committed to devoting 0.7% of GDP to overseas assistance since 1974, but it is only relatively recently that it has actually achieved the target. Given the funding problems with the NHS, education and student loans (to mention a few), there has been pressure on many spending items, and in 2018 a proposal was put forward to alter the definition of the items that constitute aid, which would have made it easier to reach the committed target. I am sure that your discussion will have explored the question of how to reconcile different commitments and how to balance domestic and external commitment, but I will not try to influence the outcome of your discussions.

Case study 29.1

Inequality and economic growth

- a** The key causes of inequality include:
- inequality in the distribution of assets, including land or mineral resources
 - inequality in the distribution of wages
 - a rural-urban divide
 - differences in skill levels between individuals
 - differing access to education etc.
- b** Wealth confers economic power of those in possession of it. Ownership of assets such as land, mineral resources, property or financial assets generates income, which entrenches the position of the wealthy in the income distribution as well.
- c** Inequality in income and/or wealth can engender feelings of unfairness, which can turn into distrust of those in authority, and civil unrest. The Brexit referendum vote partly reflected this sense of unfairness and distrust of remote politicians. The period that followed was not the most stable political environment that the UK has experienced...
- d** The question asks you to outline things in your own words, so I will refrain from doing it for you!

Answers to end-of-chapter questions

A Multiple-choice questions

- 1 c. The Gini coefficient
- 2 b. Household income is below 60% of median adjusted household income
- 3 d. 43.1

B Knowledge and understanding questions

- 4 Income is the flow of wages, salaries and other income in a period, whereas wealth is the stock of accumulated assets.

A full explanation of the difference between income and wealth	2 marks
A vague or partial explanation of the difference between income and wealth	1 mark

- 5 Reasons may include:
 - To improve the standard of living

- To reduce poverty
- May improve the marginal propensity to consume
- To aid development

Two reasons explained	4 marks
One reason explained AND one reason identified	3 marks
One reason explained OR two reasons identified	2 marks
One reason identified	1 mark

6 Causes may include:

- Access to education
- Ownership of factors of production
- Inheritance
- Unemployment
- Taxation policies
- Geographic differences

Two causes explained	4 marks
One cause explained AND one cause identified	3 marks
One cause explained OR two causes identified	2 marks
One cause identified	1 mark

D Essay question

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AO1 Knowledge	6 marks
AO2 Application	6 marks
AO3 Analysis	6 marks
AO4 Evaluation	7 marks

Knowledge (6 marks) is likely to include:

- Poverty
- Inequality

Application (6 marks) is likely to include:

- Application of the consequences of poverty to an economy

Analysis (6 marks) is likely to include:

Analysis of the consequences of poverty, for example:

- Poor standards of living
- Poor levels of education
- Poor levels of healthcare
- Social exclusion
- Increasing levels of crime

Evaluation (7 marks) is likely to include:

Evaluation of how significant the consequences may to an economy:

- Depends upon the level of poverty
- Depends upon the level of state provision for people/families in poverty
- Depends upon the state of the rest of the economy
- Depends upon the timescale
- Depends upon other factors influencing the economy

A judgement of the most significant consequences of poverty in an economy