

5 The distribution of income and wealth: poverty and inequality — answers

Case studies

Case study 5.1

- 1 The extract states that in 2012, 4.21% of people were in receipt of incomes of £75,000 or more a year. Within this percentile, the top 1% would have earned incomes well above £75,000. At the other extreme, the extract states that 48.45% had to live on incomes of £25,000 or less. Again, within this percentile, the very poor, say the bottom 1%, would have received incomes considerably below £25,000.
- 2 The answer to this question depends on a person's normative view on whether governments should attempt to redistribute income. My personal view is that a government should attempt to redistribute income, while being aware of the disadvantageous disincentive effects of too much redistribution.

Case study 5.2

- 1 Writing this answer in January 2016, it is too early to say what has happened to Duncan Smith's proposals, which were made in July 2015.
- 2 I disagree with the proposed new definition of child poverty, which harks back to the old Victorian distinction between the deserving and undeserving poor. Back in 2013, when Duncan Smith's proposals were being put forward, the Child Poverty Action Group stated that 'the old right rhetoric of the deserving and undeserving poor has been resuscitated, fed by an increasingly hostile media campaign towards those on benefits. The number of times the word "scrounger" has been used annually in UK newspapers rose to over 2,500 in 2012 from an average of 250 between 1994 and 2009.'

Case study 5.3

- 1 The higher the value of the Gini index (or Gini coefficient), the more unequal is the distribution of income. Figure 5.7 shows the index increasing from about 24 to 33 over the whole period from 1978 to 2013, reaching a peak of about 35 in the recession of 2008/09. However, in the years from 2006 to 2010, the Gini index was unchanged at around this level. The reasons for this could be: (i) the incomes of both many of the rich and many of the poor fell by similar percentages during the recession; and (ii) the incomes of old people relying on the state pension were protected by the so-called 'triple lock' — the state pension rises every year by the highest of price inflation, earnings growth or 2.5%.
- 2 Writing this answer in January 2016, it is too early to say whether Universal Credit (UC) has reduced the poverty trap, or increased poverty and drawn more people into the poverty trap. Although elements of UC were introduced in 2013, the full 'roll out' is occurring in 2016 and 2017. However, given the possibility that entitlement to UC may be more restrictive than that for Tax Credit, which is one of the benefits UC is replacing, poverty is likely to increase. Time will tell whether more people will be drawn into the poverty trap. As Universal Credit embodies the means-testing principle, the poverty trap will still exist.

Case study 5.4

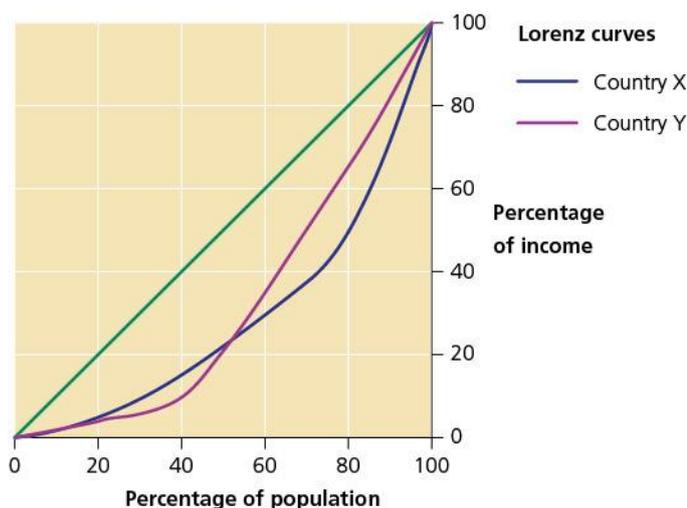
- 1 £5,000 at 2016 prices indicates how many goods and services £5,000 can buy in 2016. If prices then rise in 2017, £5,000 will obviously buy fewer goods and services (if the prices of these rise in line with the rate of inflation).
- 2 According to the UK government, zero-hour contracts, which are also known as casual contracts, cover 'on call' work, which means that workers are on call to work when the employer needs them, employers don't have to give employees work, and workers don't have to do work when asked.

Test yourself

Test yourself 5.1

In part, this question is testing your understanding of the difference between positive and normative statements. In a highly competitive market, the price mechanism can function efficiently (a positive statement), but the outcome is likely to be unfair (a normative statement). Statement A provides the correct answer as both parts of it are true. All the other possible answers state or imply that the outcome is fair, so these statements do not provide correct answers.

Test yourself 5.2



The graph above shows the Lorenz curves for Country X and Country Y, plotted from the data provided in the question. If you go back to Chapter 5 and read the Extension Material on Comparing different Lorenz curves on page 127 in the chapter, we have made a brief note that when Lorenz curves cross each other, it is not possible to make a definite statement about which represents the more equal distribution of income. You will see, however, that for roughly the 50 percent of the populations with lower incomes, the distribution of income is more unequal in Country Y than in Country X. However, the reverse is true for the quintiles with higher incomes.

Test yourself 5.3

Statements A and D reflect a move towards a more equal distribution of income. If the share of income of lower-income groups increases (statement A), the income distribution must be getting more equal. And as the last sentence states in our answer to Test yourself 5.2, the lower the value of the Gini coefficient, the more equally income is distributed (statement D).

Test yourself 5.4

According to the World Bank, absolute poverty is defined in terms of low incomes and the inability to acquire the basic goods and services necessary for survival with dignity. Poverty also encompasses low levels of health and education, poor access to clean water and sanitation, inadequate physical security, lack of voice, and insufficient capacity and opportunity to better one's life. Statement C is consistent with this definition, so provides the correct answer. It must not be confused with statement A (relative poverty) and the definition given is not part of the definition of obesity or idleness (statements B and D).

Questions

- 1 The gap between the top and bottom quintiles in the UK income distribution peaked toward the end of the twentieth century, but income inequality after tax and the receipt of government benefits fell in 2011/12 back to its 1987 level. This was mostly due to changes in the tax and benefits system, as original income inequality remained about the same over the period. Without the tax and benefit system being used to redistribute income, the bottom 20% of the population would have received just 3% of the total income, and the second poorest 20% would have received the same as the poorest 20% do today. In contrast, the richest 20% would have received over 50% of the national income.

While the distribution of income in the UK is unequal, the distribution of wealth is significantly more unequal than the distribution of income. In 2010/12, the less wealthy half of all households owned just 9% of all the wealth between them. The top fifth owned 62% of all the wealth. The UK is the only G7 country to record rising wealth inequality in 2000–14. Wealth inequality has risen four times faster in the seven years since the crash compared with the seven years before. The rich in the UK are becoming richer faster than ever. Wealth inequality rose under Labour; it rose faster under the coalition; and it appears to be continuing to grow under the Conservative government elected in 2015.

- 2 Pro-free-market economists generally support the view that progressive taxation and transfers should not be used to reduce income inequalities and poverty, whereas Keynesian-inspired economists usually reject the view. The difference in views reflects their different approaches to the nature of incentives in the economy. Free-market economists argue that progressive taxation and transfers to the less well-off destroy incentives to hard work and effort, and that this in turn destroys the country's competitiveness in world markets. The end result is a lower rate of economic growth. Keynesian-inspired economists disagree. Evidence gathered from countries such as Singapore supports the free-market view. By contrast, evidence gathered from Scandinavian countries casts doubt on the view.
- 3 Although it does not mention progressive taxation and transfers, this question is much the same as question 2, and a similar line of analysis and evaluation should be used.
- 4 According to The Poverty Site on the World Wide Web (www.poverty.org.uk), absolute poverty refers to a set standard which is the same in all countries and which does not change over time, whereas relative poverty refers to a standard which is defined in terms of the society in which an individual lives and which therefore differs between countries and over time — for example, living on less than 35% of average UK income.
- 5 Analysis and evaluation similar to that suggested for questions 2 and 3 should be used when answering this question.