Distribution of Income & Wealth

AQA A-Level Economics

Income vs Wealth · Lorenz Curve · Gini · Poverty · Causes · Consequences · Policies

Income, Wealth & Equity

Definition:

How income and wealth are shared out between individuals and households in an economy.

Income is a flow; wealth is a stock

Key distinctions:

Income (a Flow)

Money received over a period of time — wages, salaries, rent, interest, dividends and state benefits.

e.g. UK median household disposable income is around £35,000 a year — but the richest 10% receive far more than the poorest 10%.

Wealth (a Stock)

The value of assets owned at a point in time — property, pensions, savings, shares and possessions. Wealth generates income and is much more unequally distributed than income.

e.g. ONS data show the wealthiest 10% of UK households hold around 43% of total wealth; the poorest 50% hold under 10%.

Equality vs Equity

Equality means everyone has the same income or wealth. Equity means a fair distribution — a normative judgement. Most economists argue for equity, not full equality.

e.g. Many people view it as fair for a surgeon to earn more than a cleaner — but not for children's life chances to depend on parents' wealth.

Measuring Inequality: Lorenz Curve & Gini

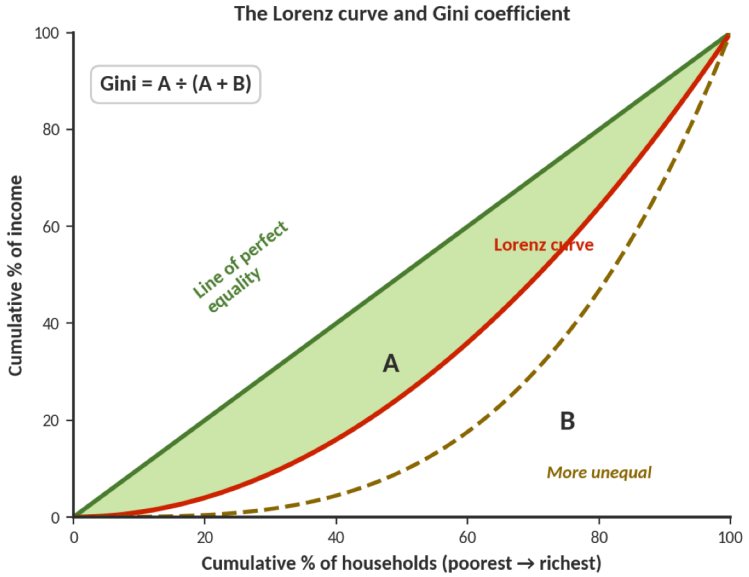
The Lorenz curve:
Shows the cumulative share of income (or wealth) received by the cumulative share of households, ranked from poorest to richest.

Reading the diagram:
The 45° line shows perfect equality — e.g. the poorest 20% receive 20% of income. The further the Lorenz curve bows away from this line, the greater the inequality.

Gini coefficient = A ÷ (A + B)

The Gini coefficient:
A single number from 0 (perfect equality) to 1 (one person has everything). It can also be shown as a percentage (0–100).

Limitation: two very different distributions can give the same Gini — it doesn't show where in the distribution inequality lies.



Real-World Example

UK Gini (disposable income) is around 0.33 — high for Western Europe. Sweden is ~0.28, the USA ~0.39 and South Africa ~0.63, among the world's highest.

Causes of Income & Wealth Inequality

Inequality arises from differences in what people earn, what they own and how the state redistributes:

Education & Skills

Higher qualifications and scarce skills command higher wages due to higher MRP and inelastic supply.

e.g. UK graduates earn significantly more on average over their lifetimes than non-graduates.

Inheritance & Wealth

Wealth is passed between generations and earns further income (rent, dividends), so inequality compounds over time.

e.g. Rising house prices have increased the gap between homeowners and renters.

Labour Market Factors

Wage differentials, the decline of trade unions, zero-hours contracts and discrimination widen gaps in pay.

e.g. FTSE 100 CEOs earn over 100 times the pay of a typical UK worker.

Technology & Globalisation

Skill-biased technical change raises demand for high-skilled workers; low-skilled jobs face automation and offshoring.

e.g. The decline of UK manufacturing hit wages in former industrial regions.

Taxes & Benefits

Cuts to top tax rates or to benefits increase inequality; more progressive systems reduce it.

e.g. The UK Gini rose sharply in the 1980s as top tax rates fell and benefits were cut.

Unemployment, Age & Health

Those out of work, retired on state pensions, or long-term sick tend to have lower incomes.

e.g. Households with no one in work are far more likely to be in poverty.

Poverty: Absolute vs Relative

Poverty can be measured in absolute terms (basic needs) or relative terms (compared with the rest of society):

Absolute Poverty

Definition: when a household's income is too low to afford the basic necessities of life — food, clean water, shelter and clothing.

Measured using a fixed poverty line — the World Bank's international extreme poverty line is $3.00 a day (2021 prices).

Mainly a problem in low-income developing countries.

Economic growth tends to reduce absolute poverty over time.

e.g. Around 800 million people worldwide still live in extreme poverty, mostly in sub-Saharan Africa.

Relative Poverty

Definition: when a household's income is significantly below the average for that society — usually below 60% of median income.

Measured before and after housing costs (BHC / AHC).

Focuses on inequality and social exclusion — being unable to take part in normal life.

Relative poverty can rise even as living standards improve, if the median rises faster than low incomes.

e.g. Around 14 million people in the UK — over 1 in 5 — are in relative poverty after housing costs, including ~4 million children.

Consequences of Inequality & Poverty

High inequality and poverty impose costs on individuals and society — but some inequality may be necessary:

Health & Social Costs

Poverty is linked to poorer health, shorter life expectancy, lower educational attainment and higher crime — raising costs for the NHS and public services. Healthy life expectancy differs by almost 20 years between the richest and poorest areas.

Lower Social Mobility

Children from poor households have fewer opportunities, so inequality persists across generations. Talent is wasted — a misallocation of resources that lowers potential output.

Effects on Growth & Demand

Low-income households have a higher MPC. Redistributing income towards them can raise consumption and AD. High inequality may also reduce long-run growth (IMF research).

Incentives (the Case For Some Inequality)

Differences in reward create incentives to work hard, train, take risks and start businesses. Wealth also provides savings to fund investment.

Normative issue: how much inequality is acceptable is a value judgement — economists can analyse its effects, but cannot say what the 'right' level is.

Policies to Reduce Inequality & Poverty

Governments redistribute income and wealth through taxes, benefits and spending — each has trade-offs:

Progressive Income Tax

Higher earners pay a larger share of their income in tax (UK rates: 20%, 40%, 45%).

Eval: very high rates may reduce incentives and encourage tax avoidance (Laffer curve).

Means-Tested Benefits

Benefits targeted at low-income households, e.g. Universal Credit. Directly raises the incomes of the poorest.

Eval: can create a poverty trap — high withdrawal rates reduce the gain from earning more.

Universal Benefits

Paid to everyone in a group regardless of income, e.g. the state pension and child benefit (partly).

Eval: no stigma and high take-up — but expensive, as the rich receive them too.

National Living Wage

Raises pay at the bottom of the labour market, reducing in-work poverty.

Eval: may cause some unemployment; many poor households have no one in work.

Education & Training

Improves skills and productivity of the low-paid — tackles a root cause of inequality in the long run.

Eval: long time lags; benefits depend on the quality of provision.

Wealth & Inheritance Taxes

Taxing large estates, property and capital gains reduces wealth concentration across generations.

Eval: often avoided through trusts and planning; wealth may move abroad.

The Equity–Efficiency Trade-Off

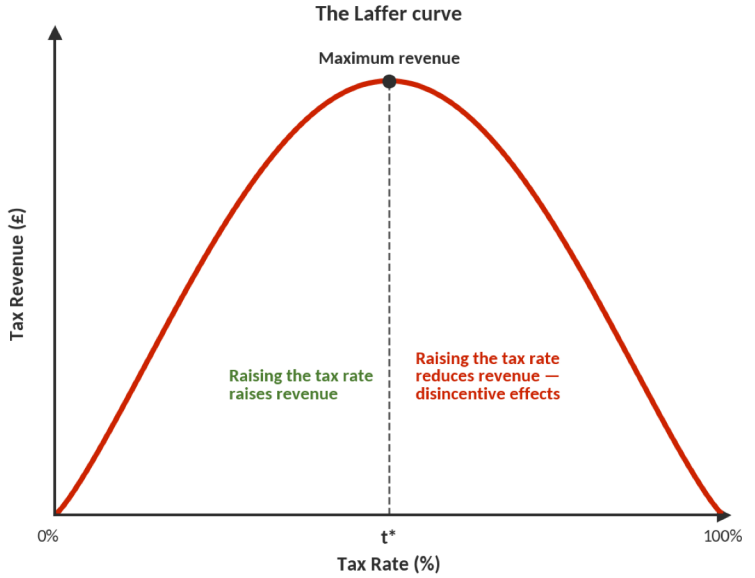
The trade-off:
Policies that make the distribution fairer (equity) may reduce incentives and efficiency — so the size of the economic 'pie' may shrink as it is shared more equally.

Disincentive effects of taxes:
High marginal tax rates may reduce the incentive to work, invest and take risks — and increase avoidance and evasion.

The Laffer curve:
Beyond a certain tax rate (t*), raising the rate further reduces total tax revenue, as people work less or avoid tax.

Disincentive effects of benefits:
Unemployment trap: benefits are close to the wage from a low-paid job. Poverty trap: as income rises, benefits are withdrawn and tax is paid, so the gain from earning more is very small.

Eval: evidence on how large these disincentive effects are is mixed — and the level of t is unknown.*



Real-World Example

In 2012 the UK top income tax rate was cut from 50p to 45p, partly on Laffer-curve grounds. A 2022 plan to scrap the 45p rate was dropped within ten days.

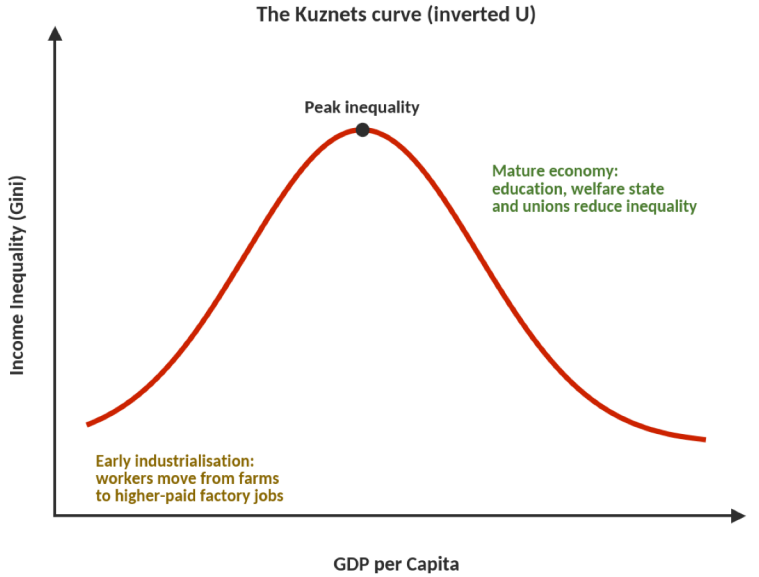
★ Bonus: The Kuznets Curve & Global Inequality

The Kuznets hypothesis (1955):
As a country develops, inequality first rises, then falls — forming an inverted U-shape.

Why inequality rises at first:
Workers move from low-paid farming to higher-paid industrial jobs in cities — the gap between rural and urban incomes widens.

Why it later falls:
Education spreads, the welfare state grows, trade unions strengthen and more workers share in higher productivity.

Evaluation:
Fits the experience of many Western economies in the 20th century. ✗ Inequality has risen again in the UK and USA since the 1980s — policy and technology matter more than the stage of development.



Real-World Example

China: rapid industrialisation since 1980 pushed its Gini from around 0.30 to about 0.49 by 2008, as coastal cities boomed. It has since eased slightly, to around 0.47.

Summary: Key Terms & Relationships

Key Term	Meaning
Income	A flow of money over time — wages, rent, interest, dividends and benefits.
Wealth	A stock of assets at a point in time — property, pensions, savings, shares.
Equality vs equity	Equality: equal shares. Equity: a fair distribution — a normative judgement.
Lorenz curve	Shows cumulative share of income against cumulative share of households.
Gini coefficient	A ÷ (A + B). 0 = perfect equality, 1 = total inequality. UK ≈ 0.33.
Absolute poverty	Income too low to meet basic needs. World Bank line: $3.00 a day.
Relative poverty	Income below 60% of the median. Around 14m people in the UK (after housing costs).
Progressive tax	A higher percentage of income is taken in tax as income rises.
Means-tested benefit	Only paid to those below an income threshold — e.g. Universal Credit.
Poverty trap	Benefit withdrawal and tax mean low earners gain little from earning more.
Unemployment trap	Benefits close to low-paid wages reduce the incentive to take a job.
Laffer curve	Above a certain tax rate, higher rates reduce total tax revenue.
Kuznets curve	Inequality rises then falls as a country develops — an inverted U.