Poverty & Inequality

AQA A-Level Economics

Income · Wealth · Lorenz Curve · Gini · Absolute & Relative Poverty · Redistribution

Income vs Wealth

Two distinct but related concepts:
Economists carefully distinguish between income (a flow) and wealth (a stock). Both are distributed unequally — but wealth is far more unequally distributed than income.

Income (a Flow)

A flow of money received over a period of time — measured per week, month, or year.

Sources of income:

- Earned income: wages and salaries from employment
- Profit: returns to enterprise and shareholders
- Rental income: returns to landowners
- Transfer payments: benefits, pensions, tax credits

UK: richest 20% of households receive ~40% of total gross income. After tax and benefits, this falls to ~35%.

Wealth (a Stock)

A stock of assets accumulated at a point in time. Wealth generates income — the link between the two is powerful and self-reinforcing.

Forms of wealth:

- Physical wealth: property, land, vehicles, art
- Financial wealth: shares, bonds, savings, pensions
- Human capital: skills, qualifications, health

UK: richest 10% own over 43% of total household wealth. Wealth Gini ≈ 0.63 vs Income Gini ≈ 0.35 (ONS 2022).

The Lorenz Curve & Gini Coefficient

The Lorenz Curve:

A graphical representation of income (or wealth) distribution. Plots the cumulative share of income received against the cumulative share of the population (ranked from poorest to richest).

Line of perfect equality:

A 45° diagonal — if income were perfectly equal, the bottom 20% would earn 20% of income, the bottom 50% would earn 50%, and so on.

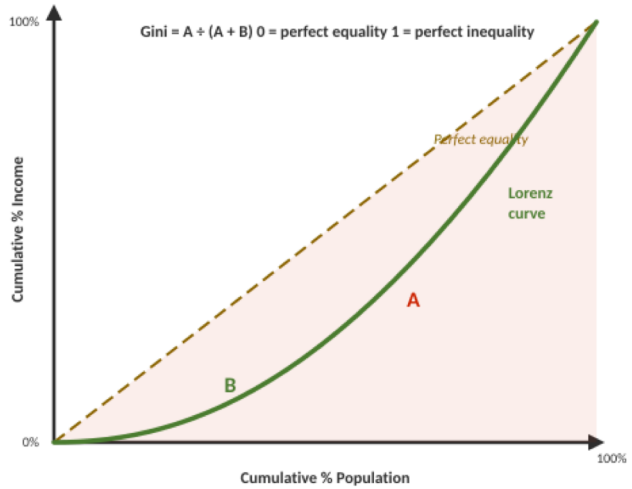
The actual Lorenz curve bows below the line of perfect equality. The further it bows, the greater the inequality.

The Gini Coefficient:

Gini = Area A ÷ (Area A + Area B)

Ranges from 0 (perfect equality) to 1 (perfect inequality). Higher Gini = more unequal.

UK comparisons: Income Gini ≈ 0.35. Wealth Gini ≈ 0.63. Nordic countries: ~0.27. USA: ~0.41. Brazil: ~0.53. Wealth is always distributed more unequally than income.



Real-World Example

UK Gini trends: income Gini rose sharply in the 1980s (from ~0.25 to ~0.34) under Thatcher's policies. Relatively stable since the mid-1990s at ~0.35, despite rising house prices dramatically widening wealth inequality. The UK is among the more unequal of developed economies.

Poverty: Absolute vs Relative

Absolute Poverty

A fixed minimum standard — lacking basic necessities required for survival and physical wellbeing: food, clean water, shelter, clothing.

Defined by an absolute threshold that does not change with rising average living standards. If real incomes rise broadly, absolute poverty can fall even if inequality persists.

World Bank measure: $2.15/day (2023 PPP terms) for international comparisons. This is the most commonly used global benchmark.

In the UK, true absolute poverty is rare — the welfare state provides a floor beneath incomes.

Real-world: ~700m people still live below the World Bank absolute poverty line globally — concentrated in Sub-Saharan Africa and South Asia. Dramatic progress since 1990 (was ~1.9bn) driven largely by China and India.

Relative Poverty

Defined relative to the living standards of the wider society. A person is relatively poor if their income falls significantly below the typical standard in their country.

UK official measure: households with income below 60% of median household income (after housing costs). This threshold rises as median incomes rise — relative poverty can increase even when absolute living standards improve.

Relative poverty is about social exclusion and the inability to participate in normal social activities — not just survival.

A strength: captures changing social norms. A weakness: can never be eliminated even with rising incomes if distribution is unchanged.

Real-world: UK 2023 — 14.4 million in relative poverty (JRF), including 4.2 million children. In-work poverty rising — ~half of UK poor households have at least one working adult.

Causes of Inequality and Poverty (1/2)

Multiple, overlapping factors drive inequality in income and wealth — and trap households in poverty:

Differences in Human Capital

Education, skills, and experience raise productivity and wages. Those with higher qualifications earn significantly more. Gaps in educational opportunity perpetuate inequality across generations.

e.g. UK graduates earn ~£10,000/year more than non-graduates on average (IFS). Returns to higher education remain high despite rising tuition costs.

Differences in MRP

Workers who generate high marginal revenue products command high wages. High-demand skills (e.g. software engineering, surgery) are rewarded far above lower-productivity roles.

e.g. Premier League footballers vs non-league: same sport, vastly different MRP (TV revenues). Pay reflects employer's ability to monetise the worker's output.

Inheritance and Intergenerational Wealth

Wealth transfers across generations via inheritance and gifts — giving children of wealthy parents huge advantages in education, housing, and business. Compounds inequality over time.

e.g. UK: ~25% of wealth comes from inheritance. Top-quintile parents' children are 5x more likely to end up in top quintile themselves (Social Mobility Commission).

Causes of Inequality and Poverty (2/2)

Further causes of inequality and poverty:

Discrimination

Pay gaps by gender, ethnicity, age, and disability persist despite equality legislation. Structural barriers limit access to high-paying jobs and wealth-building opportunities for affected groups.

e.g. UK gender pay gap ~14% (ONS 2024). Ethnic minority households have significantly lower median wealth than white British households — even controlling for education.

Unemployment and Underemployment

Those unable to find adequate work earn little or nothing. In-work poverty affects workers on low hours or pay. Zero-hours contracts create income volatility.

e.g. UK 2023: ~4m people in in-work poverty — a higher proportion than in previous decades. Rising minimum wage has helped but has not eliminated the problem.

Ownership of Capital and Assets

Asset owners earn returns (rent, dividends, interest) without working — compounding wealth advantage. Rising house and share prices since the 1980s have dramatically widened the wealth gap.

e.g. UK housing: homeowners gained enormous wealth as prices tripled in real terms since 2000. Renters — disproportionately younger and lower income — received no such windfall.

Consequences of Poverty and Inequality

High inequality and poverty impose costs on individuals, government, and the wider economy:

Individual and Social Costs

Health outcomes: poverty strongly associated with poor physical and mental health, lower life expectancy, higher rates of obesity, diabetes, and depression. NHS spending rises.

Educational attainment: children from low-income households perform significantly worse in school — perpetuating inequality across generations. 'Poverty premium' — poorer households pay more for the same goods and services.

Crime and social breakdown: high inequality correlates with higher crime rates, lower social trust, and weaker community cohesion (Wilkinson and Pickett, 'The Spirit Level').

Political instability: extreme inequality can undermine democratic institutions — eroding trust in government and fuelling populist movements.

e.g. UK: men in most deprived areas live on average 9.4 years less than those in least deprived — the starkest health inequality gap in Europe.

Economic Costs

Lost economic potential: poverty traps people in low productivity — skills go undeveloped, talent is wasted. The economy produces below its true potential LRAS.

Reduced aggregate demand: low-income households have the highest MPCs but the lowest incomes. More equal distribution raises aggregate C — boosting AD. Inequality can depress consumer spending.

Fiscal costs: government spending on benefits, healthcare, and criminal justice rises with poverty. Tax revenues fall as low earners pay less — widening the deficit.

Labour market inefficiency: inequality of educational opportunity means talent is allocated to roles based on background, not ability — reducing allocative efficiency.

e.g. IMF (2014): high inequality reduces the duration of economic growth spells — more unequal countries experience shorter and more fragile expansions.

Policies to Reduce Inequality and Poverty (1/2)

Governments use a mix of fiscal, labour market, and supply-side policies to reduce inequality and poverty:

Progressive Taxation

Higher earners pay a larger percentage of income in tax. Redistributes income from rich to poor via the tax system. UK income tax: 20/40/45% bands. Inheritance tax, capital gains tax, and corporation tax also reduce post-tax inequality.

Eval: High marginal rates may reduce work incentives (Laffer curve). Risk of capital flight. Avoidance by the wealthy reduces actual redistributive impact.

Benefits and Transfer Payments

Universal Credit, child benefit, housing benefit, and state pension directly raise the incomes of the lowest earners. Means-tested benefits target those most in need.

Eval: Generous benefits may create unemployment traps (high EMTRs). Cost to government is large. Risk of dependency. UC taper rate of 55p reduces this risk vs legacy benefits.

National Living Wage

A wage floor that directly raises incomes of the lowest paid. UK NLW £11.44/hr (2024). Most effective in monopsonistic labour markets where it raises both wages and employment.

Eval: May cause unemployment in competitive markets. Cannot help those not in work. Does not address wealth inequality — only wage income.

Policies to Reduce Inequality and Poverty (2/2)

Further policy options — each with evaluation points:

Education and Training

Investment in human capital raises productivity and earning potential of lower-income groups — reducing occupational immobility and structural unemployment. Key to long-run reduction in inequality.

Eval: Very long time lags. Does not help current poor. Market failure in education: under-investment by low-income families who cannot afford it.

Wealth Taxes

Taxes on wealth stocks rather than income flows — capital gains tax, inheritance tax, property taxes. Target the most unequal dimension of distribution. Many argue for a more comprehensive annual wealth tax.

Eval: Hard to value assets. Risk of capital flight. Political resistance from wealthy. Inheritance tax in UK raises little revenue and has many exemptions. UK has no annual wealth tax.

Regional Policy and Social Mobility

Targeted investment in deprived areas — enterprise zones, infrastructure, school improvement — addresses geographical concentration of poverty. Social mobility programmes give disadvantaged children better opportunities.

Eval: Risk of displacement (moving activity not creating it). Hard to evaluate. Political commitment problem — long-run policy undermined by short political cycles.

The Equity–Efficiency Trade-off

The fundamental trade-off:

Reducing inequality involves a fundamental tension between equity (fairness — the distribution of outcomes) and efficiency (maximising total output from given resources). Policies that improve equity often reduce efficiency, and vice versa.

The case FOR redistribution:

Diminishing marginal utility — £1 means more to a poor person than a rich one. Redistribution raises total utility even if it reduces total income slightly.

Reduces absolute poverty and improves welfare for the worst-off — a strong social justice argument regardless of efficiency effects.

Lower inequality → higher social trust, lower crime, better health outcomes. Evidence (Wilkinson and Pickett) that more equal societies perform better on almost every social indicator.

May boost AD — higher incomes for high-MPC households raises consumer spending and aggregate demand.

The case AGAINST excessive redistribution:

High marginal tax rates reduce incentives to work, invest, and take risks — potentially shrinking the total income to be redistributed (Laffer curve). Benefit dependency may reduce labour supply. Brain drain: very high taxes may drive skilled workers and firms abroad.

'Leaky Bucket' (Okun)

Arthur Okun's metaphor: redistribution is like carrying water in a leaky bucket — some is lost in transit (administration, reduced incentives). The policy question is how much leakage is acceptable for a given distributional gain.

Nordic countries

Sweden, Denmark, and Norway have Gini coefficients ~0.27 alongside high GDP per capita (~$60–70k). High taxes + strong redistribution coexist with strong economic performance — challenging the claim that equity and efficiency are always in conflict.

🌍 Real-World Example

Scandinavian model: universal childcare, free education, generous unemployment insurance, and active labour market policies. Result: high labour force participation, low poverty, and competitive economies. The trade-off is real but smaller than free-market economists often claim — design matters enormously.

★ Bonus: Poverty Traps

The Poverty Trap:

Individuals face little or no financial incentive to increase earnings when any rise in income is largely offset by benefit withdrawal and higher taxes — creating a high Effective Marginal Tax Rate (EMTR).

EMTR = (Income Tax + NI + Benefit Withdrawal) ÷ Gross Earnings Rise

In extreme cases, EMTRs exceed 80–90% — the worker keeps less than 20p of each extra £1 earned. UC's 55p taper was designed to reduce this vs the 100% effective rate in some legacy benefits.



Real-World Example

UK UC taper: for every £1 earned above the work allowance, UC is reduced by 55p — an EMTR of 55% before income tax and NI. A single parent with childcare costs can face EMTRs above 70%. UC's 2021 taper reduction (from 63p to 55p) was designed to 'make work pay' more.

★ Bonus: Universal Basic Income (UBI)

Universal Basic Income (UBI):

A regular unconditional cash payment to all citizens regardless of employment status or income. Replaces or supplements the welfare system.

Arguments FOR UBI: eliminates poverty traps (no means-testing); reduces stigma; provides security in gig economy; simple to administer; frees people to retrain or care.

Arguments AGAINST: very expensive (even a modest £10k/year × 55m adults = £550bn — UK's entire current spending); risk of inflation; may reduce work incentives; most benefit goes to non-poor (untargeted); may replace more generous targeted benefits.

Pilots in Finland (2017–18), Kenya (GiveDirectly), and Stockton, California showed modest positive effects — improved wellbeing and employment, no evidence of 'welfare dependency'.

Summary: Key Terms & Relationships

Key Term	Meaning
Income	A flow of money received over time — wages, profit, rent, transfers. Measured per period.
Wealth	A stock of assets at a point in time. Generates income. Distributed far more unequally than income.
Lorenz Curve	Plots cumulative % income against cumulative % population. Bows below 45° line under inequality.
Gini Coefficient	Area A ÷ (A+B). 0 = perfect equality; 1 = perfect inequality. UK income Gini ≈ 0.35; wealth ≈ 0.63.
Absolute poverty	Lacking basic necessities. Fixed threshold. World Bank: $2.15/day. Rare in UK.
Relative poverty	Income below 60% of median household income. Moves with median — cannot be eliminated by growth alone.
Progressive tax	Higher earners pay larger % in tax. Primary tool for reducing income inequality via redistribution.
Transfer payments	Benefits, pensions paid without exchange for goods/services. Raise incomes of lowest earners.
National Living Wage	Statutory wage floor. Reduces exploitation. Most effective in monopsonistic labour markets.
Poverty trap	High EMTRs mean extra earnings bring little net gain — benefit withdrawal and tax combine to deter work.
EMTR	Effective Marginal Tax Rate: income tax + NI + benefit withdrawal as % of gross earnings rise.
Equity–efficiency trade-off	Redistribution improves fairness but may reduce incentives. Central normative debate in policy design.