



AQA - A Level Economics

Individuals, Firms, Markets & Market Failure

7.1 The distribution of income & wealth: poverty and inequality

Revision Notes

Contents

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7.1.1 The distribution of income and wealth

Income vs Wealth

- **Wealth** is the total value of everything you own, your **assets**. Think houses, cars, savings, investments, and even that vintage comic book collection. Since wealth is something, you **accumulate over time**, it's considered a **stock** of resources.
- **Income**, on the other hand, is the money that flows into your pocket **regularly**. This includes wages from a job, interest from a savings account, or profits from a business. Because income is something you **earn over a period of time**, it's considered a **flow**.

Do wealth and income always go together?

Not necessarily. Some people have **high wealth but low income** (e.g., retirees with lots of assets but little regular income). Others have **high income but low wealth** (e.g., young professionals earning a big salary but with little savings).

While wealth and income are often linked, they don't always move together. A country can have **wealthy individuals** with **low-income inequality**, or **high-income earners** who haven't built much wealth yet.

7.1.1 The distribution of income and wealth

Causes of income and wealth inequality

Let's see why some people (or even whole countries) end up with more money, property, or resources than others.

Within Countries (Why people in the same country earn or own different amounts)

Wealth Levels: What You Already Own

If you already have **wealth** (like savings, property, or shares), it's easier to make more.

- Wealthy people can invest in things like property or stocks and when those go up in value, they get richer.
- Inheritance plays a big role. If your parents owned a house in a now-trendy area, you're probably better off today.

 Example: Someone buys a flat in Manchester for £150k. Ten years later, it's worth £300k. That's wealth growth.

Wages: What You Earn from Work

Some people get paid more than others, here's why:

- They may have better qualifications, more experience, or highly demanded skills.
- They might work longer hours or in harder jobs.
- Those not working (like retirees or people on benefits) usually have lower income.

 More income = more saving = more chances to build wealth. But if you're on a low income, most of your money might go on essentials like food and rent with little left to save.

 Example: A software engineer may earn £60k a year and invest in property. A supermarket cashier might earn £20k and just cover the bills.

7.1.1 The distribution of income and wealth

Causes of income and wealth inequality

Age: Where You Are in Life

- People in their 40s and 50s usually earn more as they're experienced and at their career peak.
- Younger people tend to earn less as they're just starting out.
- Older people might have more assets (like homes or pensions) but could also be using them to fund retirement.

 Example: A 25-year-old teacher may earn £28k, while a 50-year-old headteacher might earn £65k and own a house worth £400k.

Benefit System

- Countries that offer **financial help** (like unemployment benefits, housing support, or child payments) help **lift up the poorest households**.
- This makes income distribution **more equal**.

 Example: In France, generous unemployment support helps people avoid falling into poverty between jobs.

Employment Laws

- When **workers are protected by law**, they're less likely to be underpaid or fired unfairly.
- **Maternity benefits**, for example, ensure new mothers don't lose income while caring for a newborn.

 Example: In Norway, parents can take paid leave after having a baby, reducing financial stress and helping family income stay stable.

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7.1.1 The distribution of income and wealth

Causes of income and wealth inequality

Between Countries (Why some countries are richer than others)

Some countries have been **held back by big challenges**, like:

- **Wars, droughts, earthquakes, or famine**
- Historical colonisation, inequality, or exclusion from global trade deals

In contrast, richer countries often:

- Have stable governments and growing economies
- Trade with and support each other
- Invest more in infrastructure, healthcare, and education

 Example: A worker in Germany might have access to high-paying jobs, good healthcare, and free university. A worker in a conflict-affected area may not have those opportunities.

Education, Training & Skills

- People with **better skills and education** usually earn more.
- A country with a weak education system often sees **bigger income gaps**, because people aren't equipped for high-paying jobs.

 Example: A graphic designer with digital skills may earn more than someone who left school early and works in retail.

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7.1.1 The distribution of income and wealth

Equality vs equity

You might have heard these two words used a lot especially when talking about fairness, income, or social justice. But they don't mean the same thing.

Equality = Everyone Gets the Same

Equality is about treating everyone the same, no matter who they are or what they need.

-  Example: If every employee in a company is paid exactly £20 an hour no matter their job, experience, or qualifications, that's **income equality**.

Sounds fair, right? But in real life, this can sometimes ignore important differences like who needs more help or who brings more skills to the table.

Also:

- **Equality in income** can reduce poverty, but...
- It might not reward people fairly based on effort or ability.

7.1.1 The distribution of income and wealth

Equality vs equity

Equity = Everyone Gets What They Need to Succeed

Equity is about **fairness**, not sameness.

-  Think of it like this: Instead of giving everyone the same size bike, you give people bikes that actually fit them.

In economics, **equity in income** means people with higher skills, experience, or responsibility might get paid more but in a way that still feels fair and doesn't leave others behind.

It's about:

- Making sure **opportunities** are fair
- Ensuring **wage differences** are justified (not extreme or discriminatory)
- Supporting those who might start at a disadvantage

 Example: A brain surgeon and a delivery driver won't earn the same and that's okay. But equity asks: "Are both being paid fairly for what they do?"

Some Key Definitions:

- **Distribution of income:** How money (like wages or wealth) is spread across people in an economy.
- **Wage differentials:** Differences in pay between jobs or individuals.
- **Normative concept:** Something based on opinions or values—not just data or facts. Fairness is one of these.

7.1.1 The distribution of income and wealth

Wealth vs income inequality

Not all inequality is the same.

Wealth Inequality

- This is about the **stuff people own**, also called **assets** like houses, savings, cars, investments, and businesses.
- Some families own a lot (multiple homes, stocks, art collections), while others may own very little or nothing at all.

 Wealth is like a **pile of valuable things** someone has collected over time.

 Example: One person may inherit a house and stocks, while another has no savings and rents their home. That's wealth inequality.

Income Inequality

- This is about how **money coming in** (like wages, rent, interest, or profits) is shared across different households.
- Some people earn a lot, while others earn very little and that's **income inequality**.

 Think of income like a **stream of money** that flows into your life every week or month.

 Example: A doctor earning £100,000 a year and a cleaner earning £18,000, a big gap, right? That's income inequality.

In short:

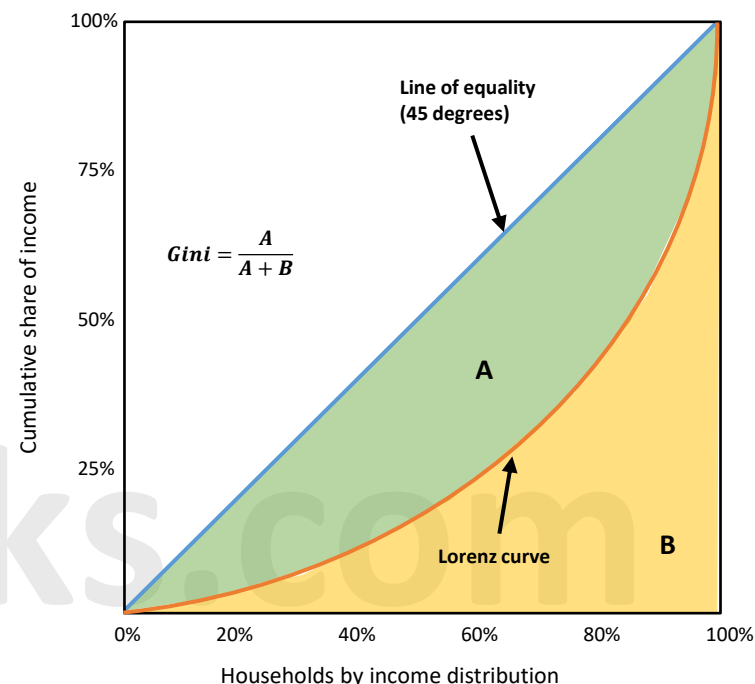
- **Wealth** = everything valuable you own.
- **Income** = money you earn regularly.

And while both types of inequality matter, **wealth inequality is usually much bigger** and harder to fix especially when it's passed down through generations.

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7.1.1 The distribution of income and wealth

The Lorenz curve and Gini coefficient



Lorenz Curve

The **Lorenz Curve** is like a visual cheat sheet for understanding **how evenly (or unevenly) income is shared** between households in a country.

What Does It Show?

- It compares **households** (from poorest to richest) on the x-axis to **how much of the total income they earn** on the y-axis.
- The **Line of Equality** (the diagonal 45° line) shows what the world would look like if everyone earned exactly the same amount; that's **perfect equality**.
- The **Lorenz Curve** shows how things actually are. The more it bends away from that perfect line, the **more unequal** the income distribution is.

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7.1.1 The distribution of income and wealth

The Lorenz curve and Gini coefficient

Lorenz Curve



Diagram Breakdown:

This Lorenz Curve comparison gives us a clear picture of income inequality:

- The **bottom 20%** of households only receive **about 5% of the income**.
- The **top 10%** receive **about 60%** of the total income.
- The Lorenz Curve bends sharply = **more inequality**.



Is Perfect Equality the Goal?

Not necessarily.

- If everyone got the same income no matter what, there'd be **no incentive to work harder or take risks**, which could slow down innovation and productivity.
- A more **balanced level of income inequality**, though, helps **reduce poverty and keep society fairer and more stable**.

Canada vs Brazil: A Real-World Lorenz Curve Example



In Canada:

- The **bottom 20%** (poorest households) earn about **8% of total income**.
- The **top 10%** earn around **30% of total income**.
- The Lorenz Curve is **slightly curved** – inequality exists but is moderate.

In Brazil:

- The **bottom 20%** only earn about **3% of total income**.
- The **top 10%** earn a huge **55% of total income**.
- The Lorenz Curve is **very curved** – showing **high inequality**.

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7.1.1 The distribution of income and wealth

The Lorenz curve and Gini coefficient

Lorenz Curve



Why It Matters:

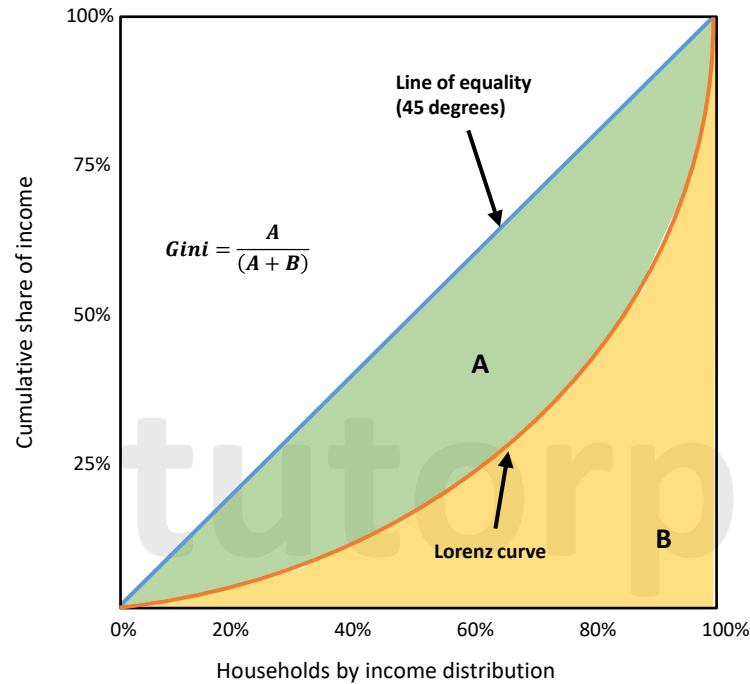
- More equal income distribution helps **reduce social tension, improve wellbeing, and build a fairer society**.
- Policymakers use these graphs to understand what's going on and decide whether taxes, benefits, or wage policies need adjusting.



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7.1.1 The distribution of income and wealth

The Lorenz curve and Gini coefficient



The Gini coefficient

The **Gini Coefficient** is a number that tells us how unequal a country's income distribution is. It's based on the **Lorenz Curve**, and it helps us understand who's getting what slice of the money pie.

7.1.1 The distribution of income and wealth

The Lorenz curve and Gini coefficient

The Gini coefficient

What Is It, Exactly?

We use the **Lorenz Curve** to calculate the Gini Coefficient by looking at two areas on the graph:

- **Area A** is the space **between** the perfect equality line (the 45° line) and the Lorenz Curve.
- **Area B** is the space **underneath** the Lorenz Curve.

The formula is:

$$Gini\ Coefficient = \frac{A}{(A + B)}$$

What Do the Numbers Mean?

- A **Gini of 0** means everyone earns the same. That's **perfect equality**.
- A **Gini of 1** means one person has all the income and everyone else has none. That's **complete inequality**.

Think of it like this:

- A country with a Gini of **0.25** is pretty fair.
- A country with a Gini of **0.60** has a big income gap between rich and poor.



7.1.1 The distribution of income and wealth

The Lorenz curve and Gini coefficient

The Gini coefficient

Real-World Examples (Updated!)

- **Norway** has a Gini around **0.27** – most people have similar incomes, and inequality is low.
- **South Africa** has one of the highest Gini scores at around **0.63** – a few are very rich, and many are very poor.

Why Does This Matter?

Knowing a country's Gini score helps us:

- Spot income inequality trends over time.
- Compare fairness between countries.
- Shape policy – governments can decide whether they need to raise taxes on the rich, increase benefits for the poor, or improve access to jobs and education.

7.1.1 The distribution of income and wealth

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7.1.1 The distribution of income and wealth

Benefits & costs of more equal and more unequal distributions

What Is Capitalism?

Capitalism is an economic system where businesses, land, and resources are mostly owned by individuals (not the government), and people make money through markets based on supply and demand. It's the core idea behind **free market economies** like the US or UK.

Inequality Is Built In

In capitalism, **inequality is pretty much guaranteed**. Here's why:

- People with **higher skills** (like doctors, engineers, or coders) earn more.
- People with **low or no skills** (like those just entering the workforce) usually earn less or may struggle to get a job.
- Those with **higher incomes** can afford to buy **assets** (like houses, stocks, or businesses).
 - These assets generate more income.
 - So, the rich can keep getting richer.

Meanwhile, people with lower incomes:

- Have a harder time buying assets.
- Stay stuck in a cycle where their wealth doesn't grow much, if at all.

 Example: Someone earning £80,000 can invest in property and shares. Someone earning £18,000 might be just trying to cover rent and bills.

7.1.1 The distribution of income and wealth

Benefits & costs of more equal and more unequal distributions

Incentives: Why Capitalism Values Inequality (To a Point)

Some economists argue that **perfect equality isn't possible (or even good)** in a capitalist system.

- The chance to **earn more** gives people a reason to work hard, take risks, and be creative.
- If everyone got the same pay no matter what, people might not bother working harder or starting businesses.

 Bottom line: **A bit of inequality helps the system run.**

But Too Much Inequality? That's a Problem

A **little inequality** keeps things moving but **too much** can lead to trouble:

- People at the bottom may feel stuck and lose motivation.
- It can create **unfair advantages**.
- It can even **slow down the economy** if people can't afford to spend or invest.

The Long-Term Problem

Over time, **wealth and resources (called "factors of production" like land, labour, and capital)** often end up in the hands of a small group of people. This can lead to:

- **Extreme inequality**
- Many people feeling left behind
- Social tension or unrest

7.1.1 The distribution of income and wealth

Benefits & costs of more equal and more unequal distributions

Why We Need Rules (aka Checks and Balances)

Some argue capitalism works best when it's **managed carefully**. Without rules:

- The gap between rich and poor grows too wide.
- It can become unfair, and even inefficient.

That's why we need **government intervention** (like taxes, benefits, free education, or minimum wage laws) to help level the playing field.

7.1.1 The distribution of income and wealth

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7.1.2 The problem of poverty

Absolute vs relative poverty

Absolute Poverty (a.k.a. "just trying to survive")

What is it?

Absolute poverty means you don't have enough money to meet the **basic needs of life**; we're talking about food, clean water, shelter, clothing, healthcare, and education.

Global benchmark:

The **World Bank** says that anyone living on **less than \$1.90 per day** is living in absolute poverty. That's about the price of a coffee in many places.

Where is it most common?

Absolute poverty is mostly found in **less developed countries**. As countries grow and improve economically, absolute poverty tends to decrease. In richer countries, governments often step in to provide basic services to help those in need.

Relative Poverty

Relative poverty means your income is **much lower than the average** in your country, making it hard to fully participate in everyday life even if you have a roof over your head and food on the table.

- In the UK, you're in relative poverty if your **household income is less than 60% of the median income** after housing costs.
- As of **2023**, the **median UK household income** (after housing costs) was around **£565 per week**, so **60% of that is about £339 per week**, or **£1,356 per month**.
- So, if a household earns **less than £1,356 per month**, they're officially classed as living in relative poverty.

According to the **Joseph Rowntree Foundation**, in 2023:

- About **14.4 million people** in the UK were living in relative poverty.
- That's more than **1 in 5 people**, including nearly **4.2 million children**.

 **Example:** A family in Manchester earning £1,200 a month may struggle to afford heating, school uniforms, or internet access. They're not starving, but they're cut off from what most others see as "normal" life.

7.1.2 The problem of poverty

The causes and effects of poverty

What Even Causes Poverty?

Poverty doesn't happen out of nowhere. Here are some common reasons:

- **Unemployment** – no job = no income.
- **Lack of skills** – without the right training or education, it's hard to find good-paying work.
- **Health problems** – being sick or disabled can limit your ability to work.
- **Income dependency** – some people rely on government support or family help because they can't earn enough.

Why Does Absolute Poverty Fall as Countries Get Richer?

Economic Growth = More Money for Everyone

When a country's economy grows, it creates jobs and raises incomes. This helps people move out of **absolute poverty**.

- For example, when a new factory opens, people in the area get jobs, earn more, and can afford basics like food and healthcare.

Government to the Rescue

Smart **tax and welfare policies** help those most in need like kids, the elderly, or people who can't work.

- In wealthy countries, governments often make sure **no one lives without essentials** by giving cash support or free services.

 **Example:** In countries like Vietnam, economic growth and government investment in education and rural development have dramatically reduced absolute poverty over the last 20 years.

7.1.2 The problem of poverty

The causes and effects of poverty

Why Relative Poverty Changes

Wage Gaps Are Growing

- People in top jobs (like CEOs or bankers) are getting huge pay rises.
- But many public sector workers (like nurses or teachers) have seen barely any increases, some even earn **less in real terms** (when you factor in inflation).
- Today, the richest earn about **170 times more than the average worker**. That used to be only 60 times more.

Good Jobs Have Vanished

- **De-industrialisation** means factories closed, especially in towns that depended on them.
- Now there are more **service jobs** (like retail or hospitality), which often **pay less** and are less secure.

Less Government Support = Trouble

- If a government cuts benefits like unemployment payments or child support, it can **make poor families poorer**. Less money coming in means they struggle to keep up with the average living standards around them.

7.1.2 The problem of poverty

The causes and effects of poverty

What's Happening in the UK?

Overall Poverty Rates

- **Relative Poverty:** In 2023/24, about **21%** of the UK population lived in relative poverty after housing costs, equating to **14.2 million people**.
- **Absolute Poverty:** Approximately **18%** were in absolute poverty after housing costs, totalling **12.3 million individuals**.

Child Poverty: A Growing Concern

- **Current Figures:** As of April 2024, **4.5 million children** (31% of all UK children) were living in relative poverty after housing costs.
- **Impact of Policies:** The two-child limit on Universal Credit has been linked to increasing child poverty rates, with calls for its removal to alleviate hardship.

Housing and Poverty

- **Private Renters:** In 2023/24, **49% of children** in private rented accommodations were in relative poverty after housing costs.
- **Social Renters:** Similarly, **50% of children** in social housing faced relative poverty after housing costs.

7.1.3 Government policies to reduce poverty and redistribute income and wealth

Policies to reduce poverty & redistribute income and wealth

Poverty isn't just about low income; it's a **cycle** that keeps people stuck. That's where the **poverty trap** comes in.

The Poverty Trap

It's like a vicious loop:

- Low income → poor education/health → fewer skills → low productivity → low wages → and back to low income again!

But here's the good news: **governments can break the cycle** using smart policies.

Policies That Can Break the Poverty Trap

1. Invest in Education

Definition:

Education is a **supply-side policy**, it helps improve the productive capacity of workers.

How it helps:

- Education boosts skills (aka **human capital**)
- Skilled workers are more productive and earn more

Real-world example:

Finland's investment in early childhood and school education led to one of the world's most skilled, high-income workforces.

Impact:

Better education → more skills → higher productivity → higher output → better-paying jobs

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7.1.3 Government policies to reduce poverty and redistribute income and wealth

Policies to reduce poverty & redistribute income and wealth

2. Set a National Minimum Wage

Definition:

The **minimum wage** is the lowest legal amount an employer can pay a worker.

How it helps:

- Lifts incomes at the bottom
- Prevents worker exploitation
- Helps working households afford basic needs

Real-world example:

In the UK, the National Living Wage has increased steadily, giving low-income earners a boost.

Impact:

Higher wages → more spending power → better access to healthcare, food, education → upward mobility

3. Use Progressive Taxation

Definition:

A **progressive tax system** means the more you earn, the higher the percentage of tax you pay.

How it helps:

- Taxes from high earners fund services for low-income groups (e.g. free education or healthcare)
- Reduces the gap between rich and poor

Real-world example:

Norway's tax system helps fund universal childcare, free higher education, and healthcare, levelling the playing field.

Impact:

More tax from the rich → funds for public services → better human capital → more equality and opportunity

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7.1.3 Government policies to reduce poverty and redistribute income and wealth

Policies to reduce poverty & redistribute income and wealth

4. 💰 Provide State Benefits

Definition:

State benefits are financial support for people who need it like disability payments, jobseekers' allowance, housing help, etc.

How it helps:

- Helps people meet basic needs
- Reduces poverty and supports vulnerable groups

Real-world example:

In Sweden, strong welfare programs have helped cut child poverty to less than half the UK level.

Impact:

Benefits = more money → better education/health → better job prospects → more income

7.1.3 Government policies to reduce poverty and redistribute income and wealth

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7.1.3 Government policies to reduce poverty and redistribute income and wealth

The economic consequences of such policies

When governments step in to reduce poverty or fix unfair income gaps, there are both **winners and risks**. These actions can affect:

- 💰 Government Finances
- 📈 Economic Growth
- 👤 Employment

💰 Government Finances

✅ The good news:

- More taxes = more **government revenue**, which can be spent on healthcare, education, and welfare.

⚠️ But here's the warning:

- If government spending rises **faster than revenue**, it causes **fiscal drag**.
- That's when higher tax income gets "eaten up" by things like rising benefit costs.
- Governments may then have to **borrow more**, which can harm future generations.

🧠 Definition:

Fiscal drag = when income tax rises pull people into higher brackets, but rising costs (like public spending) cancel out the benefits.

Example:

If the government collects more tax but spends even more on pensions and benefits, it might still end up in debt.

7.1.3 Government policies to reduce poverty and redistribute income and wealth

The economic consequences of such policies

📈 Economic Growth

✅ How it can help:

- When people earn more, they tend to **spend more**.
→ This boosts **demand**, encourages investment, and drives growth.

⚠️ But there's risk:

- **Higher taxes** can raise **business costs**, which might make companies move to countries with lower tax rates.
- That means less production and **lower growth** overall.

Example:

A company might move its operations from the UK to Ireland if corporate taxes are lower there.

👤 Employment

✅ How it can help:

- If **minimum wages** go up, people are more likely to take jobs (because working pays better).
- More people joining the workforce = **higher labour supply**

⚠️ But there's a catch:

- If **taxes on income** rise too high (progressive taxation), some people may feel it's not worth working more.
- Employers might also hire fewer workers if it becomes too expensive (due to taxes, wages, etc.)

🧠 Definition:

Progressive tax = a tax that takes a larger percentage from higher earners.

Example:

If the minimum wage rises from £10 to £12/hour, more people may apply for jobs, but small businesses might cut staff to manage costs.



7.1.3 Government policies to reduce poverty and redistribute income and wealth

The economic consequences of such policies

So What's the Balance?

Policies like minimum wages, benefits, and progressive taxes can do a lot of good, **if managed carefully**. But they need to avoid:

- Discouraging people or businesses from working/investing
- Causing government overspending

7.1.3 Government policies to reduce poverty and redistribute income and wealth

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