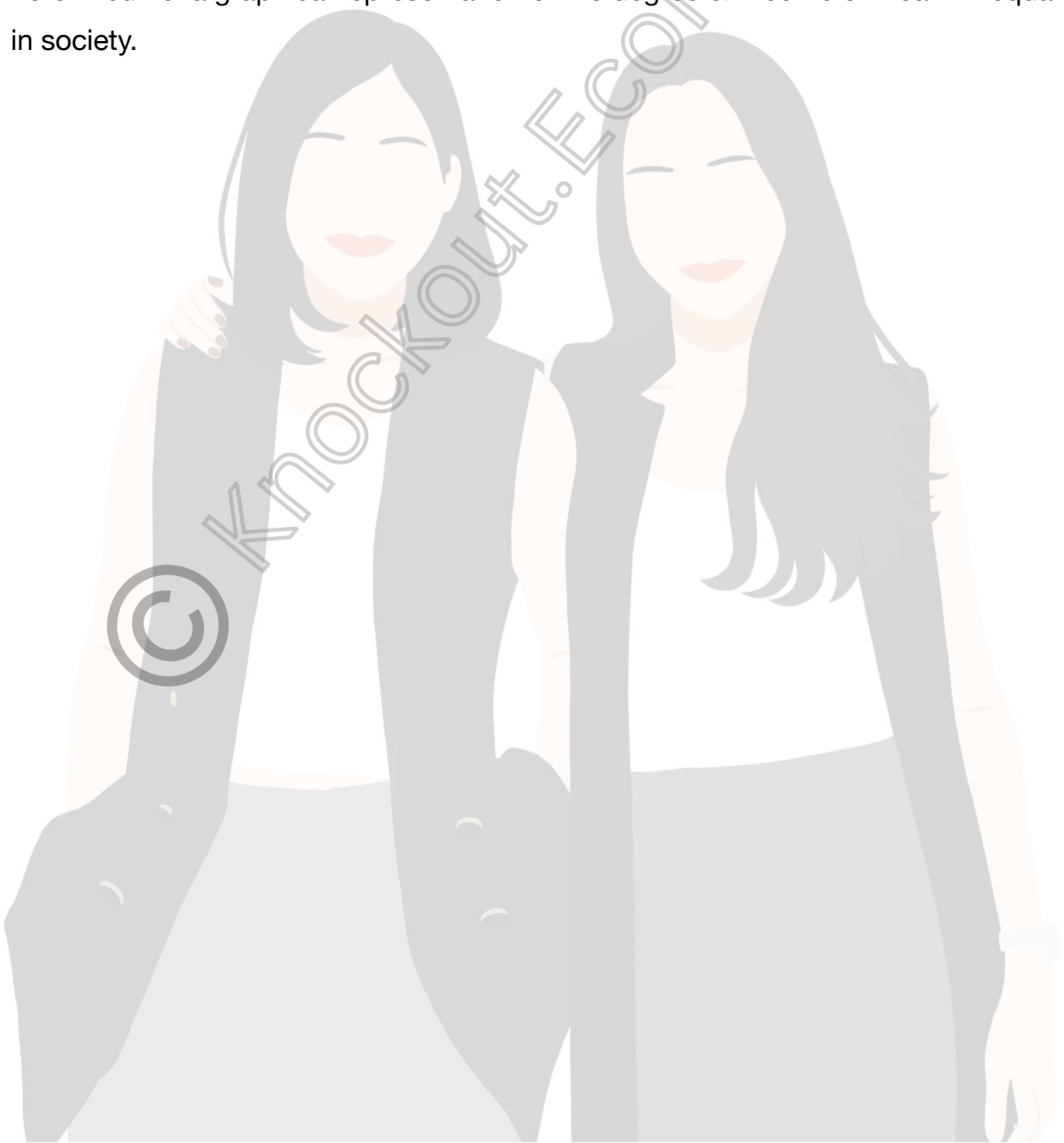
Chapter 33

Inequality

Key terms

1. Gini coefficient: a statical measure of inequality of income; its value ranges from 0, where there is perfect equality of income, to 1 where income is highly unequal with one person having all the income and everyone else having no income.
2. Gini index: the Gini coefficient times 100
3. Life expectancy: number of years a newborn infant could expect ro live typically within a country, assuming patterns of death remain as they are.
4. Lorenz curve: a graphical representation of the degree of income or wealth inequality in society.

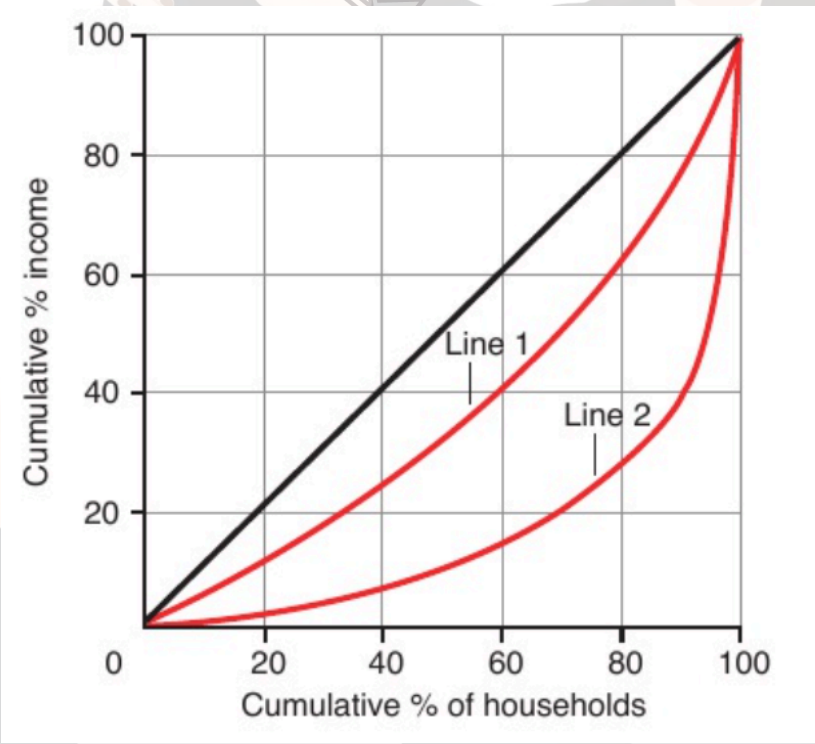


1. Income Vs Wealth

- **Income :** how much income an individual receives is based on the forces of supply and demand; individuals receive different incomes based on their ownership of the factors of production in the economy.
- **Wealth :** is a stock asset. Wealth for an individual can take a number of forms such as share, house and gold.

2. Measuring inequality

- **Lorenz curve** : a graphical representation of the degree of income or wealth inequality in society.
- **Gini coefficient** : a statistical measure of inequality of income;
  - its value ranges from 0 to 1
  - Gini coefficient = 0; where there is perfect equality of income
  - Gini coefficient = 1; where income is highly unequal with one person having all the income and everyone else having no income.
- Greater income inequality will shift Loren curve to the right.



3. Causes of income inequality within countries

3.1 The impact of globalisation

- Immigration of unskilled labour in some countries puts downward pressure on wages for those low income.

3.2 Technological advances

- Technology increases demand for skilled workers and destroy old jobs and create new one.

3.3 Education, training and skills

- Education and training can increase workers' productivities and increase income gap between skilled and unskilled workers.

3.4 Types of job

- Part time and short-term work as well as self employment have less employment protection for workers in these jobs.

3.5 Labour market deregulation

- Deregulation of labour markets is the process of removing government controls from labour markets.
- The regulation weaken trade union member, it widens income distribution.

3.6 Tax and welfare benefits

- Higher income tax and welfare benefits will reduce differences in income between rich and poor.

3.7 Economic systems

- In China and Russia, which are communist economies highly regulated economy causing greater inequality.

4. Causes of wealth inequality within countries

- Rising wealth inequalities within a country are related to rising income inequalities.
- This is because those on relatively higher incomes find it easier to build up their wealth : they can afford to save from their disposable income and they can get higher rates of return.

5. Causes of income inequality between countries

GNI per capita (average incomes) varies significantly between countries. Inequality between countries has fallen in recent decades. This was a period of rapid globalisation and high growth, particularly in China and India. Multiple factors explain income inequality between countries.

5.1 Differences in resource endowment

- Some countries may have natural resources advantage e.g. oil , educated skilled labour and fully functioning banking sector.

5.2 Differences in sectorial share of GDP

- Poor countries are likely to have large agriculture share of GDP and low level of productivity will limit growth of income.

5.3 Differences in infrastructure

- Problem with electricity and poor infrastructure causing a high in transport costs.
- This limits supply-side growth

5.4 Differences in the amount of FDI

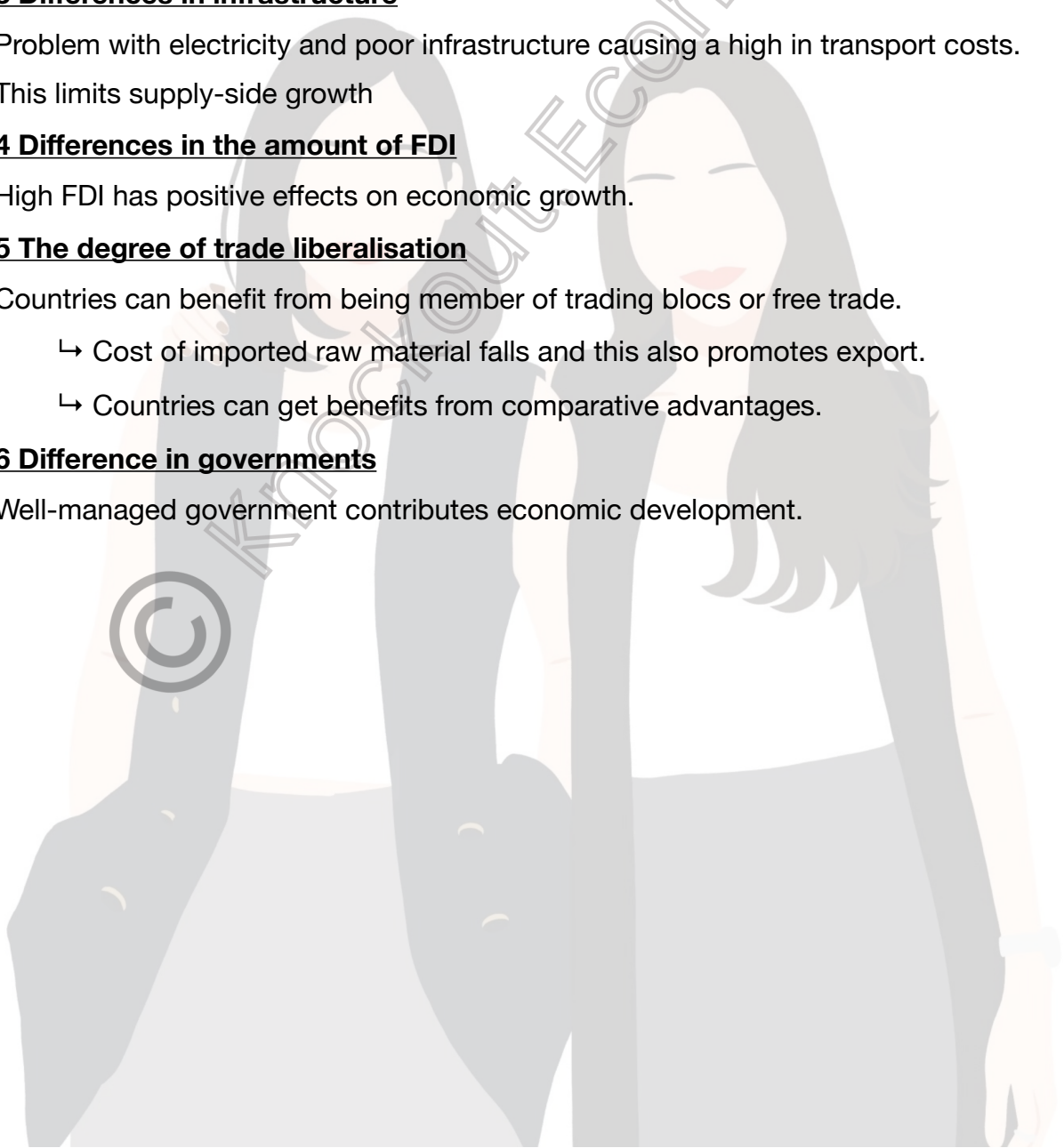
- High FDI has positive effects on economic growth.

5.5 The degree of trade liberalisation

- Countries can benefit from being member of trading blocs or free trade.
    - ↳ Cost of imported raw material falls and this also promotes export.
    - ↳ Countries can get benefits from comparative advantages.

5.6 Difference in governments

- Well-managed government contributes economic development.



6. Causes of wealth inequality between countries

- The average level of wealth held by individuals in a country will differ between countries. Individuals who live in less developed economies, with low incomes, will find it harder to build up their wealth compared to individuals in countries which have much higher average incomes.
- Some countries have also privatised many state-owned assets. For example, Russia, in its transition from a command economy to free market undertook large scale privatisation.
- Any country involved in a large privatisation programme will experience a rise in private wealth, so average wealth levels will rise.

7. The impact of inequality

7.1 Enterprise

- A certain level of inequality encourages entrepreneurship.
- However, some economists argue that greater inequality reduces enterprise. As people do not have enough money to start up business.

7.2 Incentives

- Inequality increases incentive to work. The decision to invest in education and training is partly motivated by the likelihood of higher monetary reward.

7.3 Saving

- If inequality falls meaning that more income is redistributed from rich to poor. However, the saving ratio falls.

7.4 Education

- Inequality, particularly in developing countries, means many children still do not go to school or do not have many years of school.

7.5 Migration

- Rising in inequality creates incentives for higher skilled immigrants to the countries since the monetary gains will be higher than emigrating to a country with greater income equality.

7.6 Life expectancy

- Rising income inequality can be caused by rising in absolute poverty which will reduce life expectancy.

8. The impact of economic change and development on inequality

The Kuznets curve, developed by the economist Simon Kuznets in 1955, shows the predicted relationship between income per capita and income inequality.

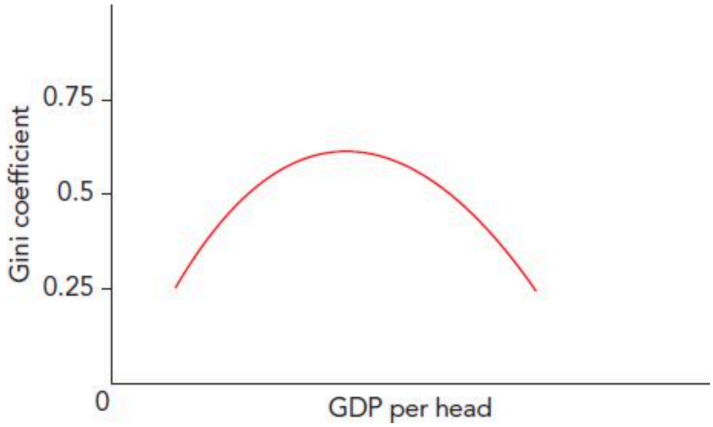


Figure 50.6: The Kuznets curve

- Kuznets hypothesis states that as society moves from agriculture to manufacturing, so it develops inequality with society increase.
- Since the wages of industrial workers rises faster than farmer. Then wealth is redistributed through government transfers and education.It argues that inequality in poor countries is just a transitional phase.
- Once nations become economically developed, inequality reduces. When country becomes more develop, rich people can generate jobs for poors and contribute tax revenue to help poors.

9. The significance of capitalism for inequality

In a capitalist economy, land and capital are owned by private individuals rather than the government, sometimes called the state. The working classes sell their labour to the owners of resources in exchange for wages. Typically, the owners will have more wealth and income than the workers in a capitalist system.

The market pays no attention to equality. In a capitalist society, those who earn high incomes can build up their wealth. This wealth can then be inherited by the next generation, which helps then in turn to earn high income on this capital. High wealth also increases access to the best education, which in turn leads to higher incomes. Therefore, both income and wealth inequalities are likely to become very wide.

Exercise

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1. **While globalisation has led to an increase in average incomes, it has also increased income inequality within some countries**

(A) Discuss whether globalisation always increases income inequality within countries. Refer to specific examples of countries in your answer (15 marks)

(B) Evaluate the economic impact of a significant increase in income inequality within a country (25 marks)

2.

(A) Discuss the likely causes of income inequality between countries of your choice (15 marks)

(B) Evaluate the economic impact of a significant decrease in income inequality within a country (25 marks)