

Distribution of Income and Wealth

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Multiple Choice Answers

1	C	6	B	11	C	16	A
2	C	7	D	12	B	17	A
3	A	8	C	13	B	18	C
4	B	9	B	14	C	19	B
5	C	10	D	15	D	20	A

Short Answer Questions

Question 1

- a) Lorenz curve.
- b) 0.15
- c) Income is a flow of money representing either the return from the factors of production in the form of rent, wages, interest or profits; or a payment by the government. Wealth, on the other hand, is the total stock of assets that a person owns at a particular point in time. Income and wealth are linked because income is generally needed before a person can acquire wealth. Wealth generally represents the saved leftover income of a person, and so persons on low incomes have very little wealth. Also, high levels of wealth can in turn generate income as they are used to fund investment in the economy and paid interest.

- d)** Government policy has a mixed impact on the distribution of income and wealth. Fiscal policy is used to improve the distribution of income and wealth. The progressive income tax system and the welfare system aim to improve the distribution of income by taxing higher income earners proportionally more than lower income earners and giving some of the money to lower income earners as welfare. This reduces the gap between the rich and the poor. In addition, some aspects of fiscal policy help to reduce inequality in the distribution of wealth. The government has policies which make it easier for lower income earners to acquire wealth such as compulsory superannuation (which provides a source of wealth to low income earners who may not have saved it on their own) and the first home buyers grant. Additionally, there are policies which tax people with high levels of wealth such as land tax and capital gains tax. Monetary policy has a temporary impact upon the distribution of income since low income earners tend to be borrowers who pay interest, and high income earners tend to be savers who receiving interest. When interest rates fall, low income earners pay less income to higher income earners, improving the distribution of income. However, when interest rates rise, low income earners must pay more income to higher income earners, worsening the distribution of income. Microeconomic policy tends to worsen the distribution of income. A common side-effect of microeconomic policy is an increase in structural unemployment as inefficient firms and industries are forced to close down. This increases the number of low income earners and worsens the distribution of income. The imposition of indirect taxes such as the goods and services tax may worsen the distribution of income as the tax represents a higher proportion of income to a low income earner than a higher income earner. However, microeconomic policy tends to encourage low inflation which is beneficial to the distribution of income (as it prevents the purchasing power of low income levels from being eroded).

Question 2

- a)** The gini coefficient has increased over time, indicating a worsened distribution of income.
- b)** Australia's distribution of income has generally worsened slightly over the past decade, as shown by the overall increase in the gini coefficient. Over that time, the highest income quintile has consistently earned an income almost four times as high as the lowest quintile.
- c)** The commonwealth budget contains policies to improve the distribution of income. The progressive income tax system taxes higher income earners at a higher marginal rate of tax than lower income earners. The welfare system then distributes the majority of this revenue to lower income earners as determined by financial need and circumstance. Thus, the commonwealth budget helps to reduce the gap between the rich and poor, improving the distribution of income.
- d)** Households of differing family structures tend to have different household incomes. Couples tend to earn higher household incomes than single parent or single person households due to the combined income of the couples. Couples with dependent children tend to earn slightly more than couples with no dependent children due to a generally higher age and experience level. Single parent houses tend to have the lowest income levels, often because they rely on government benefits as their primary source of income. Occupation is also a major influence on income levels, with occupations which require the most education, training and experience receiving the highest incomes. Such occupations include managers and professionals. Conversely, occupations which involve manual labour tend to receive lower incomes. These occupations include labourers and sales workers which require a relatively low level of training and education.

Question 3

- a)** The main source of wealth is owner occupied property. Other sources include investment property, superannuation and small businesses.
- b)** Income is a flow of money representing either the return from the factors of production in the form of rent, wages, interest or profits; or a payment by the government. Wealth, on the other hand, is the total stock of assets that a person owns at a particular point in time. Income and wealth are linked because income is generally needed before a person can acquire wealth.
- c)** Income inequality can result in the creation of different social classes which can create divisions in society. This can lead to undesirable social consequences such as crime and violence. Income inequality can also result in the creation of a class of relative poverty in society whereby the low income earners have a standard of living so far below average as to be in poverty within their society.

- d)** An unequal distribution of income has both negative and positive consequences for an economy. Income inequality can decrease the level of economic growth in an economy. Higher income earners tend to have lower marginal propensities to consume. Hence higher levels of income inequality are likely to cause lower levels of consumption. Income inequality also encourages conspicuous consumption which are often imported, worsening the balance of payments. Also, there are likely to be higher levels of welfare dependency and cost to the government. On the other hand, an unequal distribution of income encourages higher levels of investment in an economy. Entrepreneurs are more likely to take an investment risk, and since higher income earners tend to have higher marginal propensities to save, there will be more savings to fund investment. Income inequality also encourages workers to improve productivity since there is a greater opportunity to increase incomes.