Distribution of Income and Wealth

11

Multiple Choice

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

Short Answers

Question 1

(a) Income is a flow of money representing the return from the sale of the factors of production in the form of rent, wages, interest or profits. Wealth, on the other hand, is the total stock of net 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.

(b) Wage and salaries comprise the greatest proportion of income at around 55 per cent. Next are business profits and capital investments, comprising around 20 per cent. Third is property income at around 12 per cent of total income. The last major category is government benefits which accounts for about 10 per cent of income in Australia.

(c) The majority of wealth in Australia continues to be owner occupied property. The next category is investment property. Both these have risen over the past decade due to rising house prices and the viewing of housing as a safe investment. However, in more recent years they have declined however, due to falling house prices and the tightening of credit requirements by banks after the Global Financial Crisis. The next major source is superannuation. This has risen since the introduction of compulsory superannuation and government policies encouraging superannuation investment. An important decline is consumer durables. This now comprises less of Australia's wealth as the prices of these are falling.

(d) One economic cost of inequality is poverty, as a greater number of people are on lower incomes. This can be a particular problem if it continues between generations causing a poverty trap. A second economic cost is that utility is reduced, as those on lower incomes are likely to gain more satisfaction from an increase in income than those on higher wages would. By contrast, one economic benefit of inequality is that the labour force is encouraged to improve their skills and education as well as work harder and longer. This is because of the opportunity to earn higher incomes. A second economic benefit is that entrepreneurs are encouraged to take on more risks to increase their incomes. This leads to higher economic growth, more jobs and more investment.

Question 2

(a) Economy B has a more equal distribution of wealth as it has a lower wealth Gini coefficient

(b) The Gini coefficient is a numerical measure of the degree of income (or wealth) inequality in an economy. Its value lies between zero (which represents perfect equality) and one (which represents perfect inequality).

(c) Income is a flow of money from the sale of the factors of production over a period of time, such as wages, profit, rent and interest. Wealth is a stock of net assets owned by an individual or household at a point in time, such as property or shares. Wealth generally represents the saved leftover income of a person, and so low income earners tend to have little wealth. Also, high levels of wealth can in turn generate income as they are used to fund investment in the economy and earn interest.

(d) Fiscal policy is used to improve the distribution of income and wealth. The progressive income tax system and welfare system aim to redistribute income from higher income earners to lower income earners, thus reducing income inequality. This is the most effective policy available to improve income inequality. If income inequality worsens, governments can increase taxation rates for high income earners whilst decreasing them for low income earners in a targeted fashion. The government policy of compulsory superannuation reduces wealth inequality by encouraging low income earners to save for retirement. It will also improve future income and wealth distributions, because it means that less people will be reliant upon the low aged pension in retirement. However, the effect of compound interest on superannuation can worsen wealth inequality as high income earners put more money aside and therefore, see their superannuation accounts grow at faster rates.

Question 3

(a) 0.15

(b) The Gini coefficient is a numerical value between zero (which presents perfect equality) and one (which presents perfect inequality) which measures the degree income or wealth inequality in the economy. The Lorenz curve is graphical depiction of the distribution of income within an economy. It is drawn by analyzing the percentage of total income earned across different quintiles.

(c) Increased income inequality prompts a more motivated society. This is because individuals work hard to not suffer from a low income.

(d) Income varies with a person's age. Income tends to reach its peak when people are aged 45-54. Income levels tend to be low at the beginning of a person's working life as they are inexperienced and unskilled. Similarly, income levels fall as people get older as they need to rely on aged pensions or their superannuation. 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.