Creation and distribution of income and wealth as a contemporary economic issue

4.1 Income and wealth

Many people get income and wealth confused. As we shall see, they are not the same thing.

The nature of income

Each year in Australia, a total national income of over $1500 billion is generated from the production of goods and services. As shown in figure 4.1 on p. 134, income represents the flow of money to households measured over a period of time and is a major determinant of material living standards.

As shown in figure 4.1, most people gain income from selling their resources to the business sector. However, there are different types of income. Earned income comes from households selling their labour or supplying intellectual talents and physical power to businesses. Unearned income includes rent and interest and is received for allowing others to use your property and savings. Then, there is transfer income which is derived from government welfare payments. This is income, mainly collected from taxation, and transferred to the neediest individuals by means of government welfare payments. These transfers include cash benefits given to the aged, unemployed, families, students, war veterans and the sick. The cash benefits are not available to the relatively rich and higher income earners, since they are based on an assets (wealth) and/or means (income) test. Finally, there are other types of income — income from superannuation, or fringe benefits.

Earned income comes from households selling their labour; i.e. supplying intellectual talents and/or physical power to businesses.

Unearned income includes rent and interest and is received for allowing others to use your property and savings.

Transfer income is derived from government cash welfare payments made to the neediest individuals with little or no income and wealth.

A fringe benefit is a special non-monetary reward given by an employer to selected employees in lieu of income (e.g. a free house, company car).
(sometimes referred to as ‘perks’) such as the provision of a house or car, entertainment or school fees by companies that may be associated with some jobs.

*FIGURE 4.1* The creation of incomes in the circular flow model of the economy

Flow 4 — Total value of finished production (GDP) per year

Flow 2 — Total value of incomes (earned and unearned) paid per year

1. Wages and salaries
2. Rent
3. Interest, profits

Flow 1 — Total value of resources sold per year

1. Labour resources
2. Land resources
3. Capital resources

Flow 3 — Total value of spending per year on Australian-made production (AD)

**Wealth** consists of assets or things of value owned by private individuals (e.g. houses, shares, bonds, savings) or governments (e.g. public infrastructure including power, transport, health and education).

*FIGURE 4.2* The May 2013 edition of BRW listed Gina Rinehart (pictured) as the wealthiest person in Australia (supposedly worth over $22 billion). Rinehart is a mining entrepreneur and is the heiress of mining company Hancock Prospecting.

**The nature of wealth**

Wealth is different from income. **Wealth** consists of assets or things of value owned by private individuals or governments. In the case of *private wealth*, we normally think of property, houses, shares, bonds, savings, superannuation contributions and antiques or collectables. Government or *public wealth* includes land, buildings, equipment and other infrastructure associated with the provision of collective services such as power, transport, health and education. For most individuals, wealth takes years to accumulate. Those with high income can use their surplus income or savings to purchase and expand their assets or wealth to increase their level of unearned income. However, although it takes a lifetime for most to accumulate wealth, in Australia, considerable wealth is inherited or passed from one generation to the next, usually when family members die. These inherited assets can earn extra income for the owner, and so that inequality in the income-wealth cycle continues.

**Try applied economic exercise 1, p. 162**

**4.2 Measurement of the distribution of income and wealth**

It is important that Australia measures changes in how income and wealth are distributed, since these trends affect our wellbeing and living standards.
Measurement of income distribution

Income distribution refers to the way the nation’s ‘income cake’ is divided or shared between individuals and income units making up the population. The pattern of income distribution is regarded as fairly even if people receive similar-sized slices of the income cake. However, in Australia, the distribution pattern is uneven because people receive vastly different percentage shares of total national income. Despite this inequality, there would be even more unevenness if the Australian government did not attempt to reduce the level of inequality and try to ensure that everyone can access basic goods and services and enjoy reasonable living standards.

The Australian Bureau of Statistics (ABS) measures income distribution every few years (the last in 2011–12) using a survey of income units (i.e. family or other groupings of people living in the same household) in private dwellings throughout Australia. Trained interviewers go around to a small but representative cross-section of the population (i.e. about 0.2 per cent of the population). Typically, the interviewers collect a range of statistical data that measure the distribution of different types of incomes. Some of the common measures of income distribution include the following:

- **The distribution of market or ‘private’ incomes.** The distribution of market income (also called private income) refers to how equally or unequally personal incomes of all types (wages, salaries, profits of the self-employed, rent, interest, dividends) are divided, prior to any government efforts to redistribute income more evenly.
- **The distribution of ‘disposable weekly income’**. The distribution of disposable weekly income refers to how personal incomes (wages, salaries, profits of the self-employed, rent, interest, dividends plus the receipt of government welfare benefits, and after the payment of personal income tax), are divided between individuals.
- **The distribution of ‘equivalised disposable weekly income’**. The distribution of equivalised disposable income is a similar measure to disposable income (see above), except that there have been special statistical adjustments made (i.e. equivalence scales have been applied) to the disposable incomes of households, to allow for clearer comparisons of the economic wellbeing or living standards of households of different sizes and makeup or composition. For example, a household consisting of three people would normally need more income to enjoy the same living standard than a household with only one person. The resulting measure is a far better indicator of actual income distribution, and it is the main one to which we will refer in the pages that follow.
- **The distribution of final income**. The distribution of final income takes full account of the impact of government policies including the payment of welfare, income tax, provision of free or subsidised services and the payment of indirect taxes such as the GST, on the level of market or private incomes. This measure best indicates how evenly or unequally incomes are ultimately divided and whether individuals have access to basic goods and services.

In order to clearly expose the actual pattern of distribution of equivalised disposable weekly income more clearly, the ABS survey data are often reorganised and expressed as the income share received by each of five *quintiles* making up all members of the population. In other words, the data show what percentage of the total income cake is received by those making up quintile number 1 (i.e. the lowest 20 per cent of all income units), through quintiles 2, 3 and 4, up to quintile number 5 (i.e. the highest 20 per cent of all income units).

Five steps are involved in calculating income distribution by quintile. These are summarised here:

1. First, following the ABS survey, all income recipients are ranked or organised from the lowest to the highest income in ascending order. This establishes the ‘spread’ or range of all incomes.
2. Second, the overall group of income earners is divided into five equal-sized subgroups or quintiles and average incomes are calculated for each quintile. These results have been used to draw the column graph shown in figure 4.4.

Income distribution refers to the way the nation’s ‘income cake’ is divided or shared between individuals and income units making up the population.

The pattern of income distribution is regarded as fairly even if people receive similar-sized slices of Australia’s income cake, but uneven if the majority of the population receive only a relatively small share of the total income cake.

FIGURE 4.3 The Australian Bureau of Statistics helps us monitor the way the nation’s ‘income cake’ is sliced or divided. Every few years, the Australian Bureau of Statistics (ABS) measures people’s incomes and how these are divided or distributed within society and between different groups, states and occupations.

Market income is personal income from various private sources including wages, salaries, profits, rent, interest and dividends, prior to any government efforts to redistribute income more evenly.

Disposable weekly income is market income, plus any government welfare income, that is available for spending each week by individuals after the payment of personal income tax.

Equivalised disposable income refers to the level of spendable income available for individuals, after special equivalence adjustments have been made to reflect the effects of different-sized households. Disposable income includes market income plus any government welfare income minus personal income tax.

Final income refers to the level of market or private income after allowing for the effects of government income redistribution policies including welfare, free or subsidised public services, the payment of direct personal income tax and the payment of indirect taxes.

Quintiles represent the five equal-sized groups making up all income earners in Australia. Each quintile therefore represents 20 per cent or 1/5 of all income earners. Comparing income or wealth shares of the income cake by quintiles exposes the degree of inequality.
3. Third, calculations are made to determine what percentage share of Australia’s total equivalised disposable income is received by each of the five quintiles. Naturally, in even societies, all quintiles would receive exactly the same-sized slice of the income cake (i.e. 20 per cent). However, in uneven societies, quintile number 1 would receive a much smaller percentage share than quintile number 5. The results for Australia’s income distribution by quintile are shown in figure 4.5.

FIGURE 4.5 Comparing the share of Australia’s equivalised weekly disposable income by quintile, 2011–12
Source: Data derived from ABS 6523.0, Table 1.

A Lorenz diagram is used to show how evenly income or wealth is distributed between individuals.

4. Fourth, if we choose to do so, the income share by quintile can be used to construct a graph called a Lorenz diagram. Using figure 4.6 (p. 135), notice that this diagram plots cumulative quintiles numbered 1 to 5 along the lower horizontal axis, and the cumulative percentage of equivalised disposable income (i.e. gained by adding up each successive income share) up the vertical axis. Notice, too, that there is a diagonal line representing ‘total equality’ in income distribution where all quintiles
receive exactly the same-sized income share and potentially enjoy the same living standards. The diagram also contains the actual Lorenz curve for Australia. This bends downwards in the middle from the diagonal line that represents total equality. The greater this bend or deviation in the Lorenz curve, the greater the degree of inequality.

Figure 4.6 (p. 138) shows the distribution of Australia’s equivalised disposable income by cumulative quintile, 2011–12. The diagram illustrates how total income or wealth is shared between cumulative quintiles. The greater the deviation of the Lorenz curve from the diagonal line of total equality, the greater the degree of inequality.

<table>
<thead>
<tr>
<th>Quintile</th>
<th>Quintile 1 (lowest income)</th>
<th>Quintile 2</th>
<th>Quintile 3</th>
<th>Quintile 4</th>
<th>Quintile 5 (highest income)</th>
<th>Gini coefficient (zero is equality)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equivalised weekly disposable income ($) by individual quintile in 2011–12</td>
<td>346</td>
<td>581</td>
<td>793</td>
<td>1057</td>
<td>1814</td>
<td>0.320</td>
</tr>
<tr>
<td>Equivalised income share (percentage) by individual quintile in 2011–12</td>
<td>7.5</td>
<td>12.6</td>
<td>17.3</td>
<td>23.0</td>
<td>39.5</td>
<td>0.320</td>
</tr>
<tr>
<td>Equivalised income share by cumulative quintile in 2011–12</td>
<td>7.5</td>
<td>20.1</td>
<td>37.4</td>
<td>60.4</td>
<td>100</td>
<td>0.320</td>
</tr>
<tr>
<td>Total equality in income distribution</td>
<td>20%</td>
<td>40%</td>
<td>60%</td>
<td>80%</td>
<td>100%</td>
<td>0</td>
</tr>
<tr>
<td>Total inequality in income distribution</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
<td>1</td>
</tr>
</tbody>
</table>

5. Finally, the ABS also publishes a general indicator of the pattern of income distribution called the Gini coefficient. This is shown in the above table accompanying figure 4.6 and is a number between 0.00 (i.e. where there is total equality in income shares) and 1.00 (i.e. where there is total inequality in income shares). The Gini represents the area between the actual Lorenz curve and the line of total equality. The greater the deviation of the Lorenz curve from the diagonal line of total equality, the higher the Gini coefficient and the greater the inequality in the distribution of equivalised disposable weekly income. As we shall soon see (figure 4.8, p. 139), similar statistics are collected by the ABS for the distribution of wealth (i.e. net worth).

Figures 4.4, 4.5 and 4.6 (pp. 136–7) clearly show that Australia’s distribution of equivalised weekly income is fairly uneven. For instance, ABS data for 2011–12 shows that individuals in quintile 1 (the lowest 20 per cent of income earners) have an average equivalised disposable or after-tax income of only $346 per week (or only 7.5 per cent of Australia’s total income cake), while those in quintile 5 (the highest income quintile) received around $1814 per week (or a massive 39.5 per cent of total income cake). Put another way, some people receive a much larger share or slice of the nation’s income ‘cake’ than others.

In addition to this data, other information is also collected by the ABS about the sources of income and the level of relative income by state, gender, educational attainment, age and family type. Some of these statistics for 2011–12 are summarised in figure 4.7 (p. 138). Notice, for example, there is great inequality in the ratio of female to male average weekly earnings, higher incomes in the ACT and Western Australia relative to those in Tasmania and much more generous weekly wages for miners relative to those in retail and accommodation.

The Gini coefficient is a measure of the degree of inequality in the distribution of a nation’s income or wealth. On the Lorenz diagram, it represents the area between the diagonal line of total equality and the actual nation’s Lorenz curve. The bigger the area, the closer the Gini coefficient is to its maximum value of 1, but the smaller the area, the lower the degree of inequality and the closer the Gini coefficient is to 0.
How does Australia distribute average total weekly earnings between females and males ($)?

- Average all male weekly earnings ($) Nov 2013
- Average all female weekly earnings ($) Nov 2013

Average weekly earnings ($) Nov 2013

- $871.3 or 64.5% of male earnings

Inequality in average weekly income before tax ($) by state (based on 2011–12)

- State/territory
- ACT 2395, NT 2184, WA 2117, NSW 1906, Vic. 1767, SA 1589, Tas. 1443, Aust. 1847

Inequality in Australian average weekly income by occupation ($)
Measurement of wealth distribution

Until fairly recently, there was no up-to-date government statistical data showing the distribution of Australian wealth. We were forced to rely exclusively on private research from agencies like the National Centre for Social and Economic Modelling (NATSEM). However, in July 2013 (latest currently available), the ABS released its 2011–12 estimates of the distribution of Australian wealth, which is called net worth (net worth is positive when there is an excess of assets owned by households over their liabilities). These data, shown in figure 4.8 below, represent the percentage share of net worth by quintile, in the same way as those for the distribution of income. If required, a Lorenz curve could be drawn using these same data, and the Gini coefficient for wealth calculated from the information.

<table>
<thead>
<tr>
<th>Quintile</th>
<th>Quintile 1 (20%)</th>
<th>Quintile 2 (40%)</th>
<th>Quintile 3 (60%)</th>
<th>Quintile 4 (80%)</th>
<th>Quintile 5 (100%)</th>
<th>Gini coefficient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage share of wealth (net worth) by individual quintile 2011–12</td>
<td>0.9</td>
<td>5.2</td>
<td>12.2</td>
<td>20.9</td>
<td>60.8</td>
<td>0.63</td>
</tr>
<tr>
<td>Percentage share of wealth (net worth) by cumulative quintile 2011–12</td>
<td>0.9</td>
<td>6.1</td>
<td>18.3</td>
<td>39.2</td>
<td>100</td>
<td>0.63</td>
</tr>
<tr>
<td>Percentage share of wealth if there was total equality in wealth distribution</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>20</td>
<td>0</td>
</tr>
<tr>
<td>Percentage share in wealth if there was total inequality in wealth distribution</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>100</td>
<td>1</td>
</tr>
<tr>
<td>Equivalised income share (percentage) by individual quintile in 2011–12</td>
<td>7.5</td>
<td>12.6</td>
<td>17.3</td>
<td>23</td>
<td>39.6</td>
<td>0.32</td>
</tr>
<tr>
<td>Equivalised income share (percentage) by cumulative quintile in 2011–12</td>
<td>7.5</td>
<td>20.1</td>
<td>37.4</td>
<td>60.4</td>
<td>100</td>
<td>0.328</td>
</tr>
</tbody>
</table>

Looking at figure 4.8 and the accompanying table, notice that the distribution of Australia’s wealth is much more uneven than that for equivalised disposable income. For instance, quintile 1 (the least wealthy) only owned a miserly 1 per cent of our net wealth, while those in quintile 5 (the wealthiest quintile) owned a massive 60.8 per cent of all wealth — more than their fair share.

Measurement of poverty rates

When most of us think of ‘poverty’ we think of serious material deprivation and the absence of the real necessities to sustain life, as commonly found in Third World...
nations. However, despite pockets of absolute poverty like this (often in remote Indigenous communities), those measuring Australian poverty usually have relative poverty in mind where people’s material living standards are low or austere, relative to some changing level deemed acceptable to the community. In the 1960s, Professor Ronald Henderson developed a controversial measure called the poverty line. This was set at the amount of money required by different-sized income units each week to sustain an austere or basic living standard (i.e. to purchase essential food, shelter and clothing, perhaps equal to 50 per cent of the average Australian income). Subsequently, the data have been updated and modified, and the results published by the National Centre for Social and Economic Modelling (NATSEM). As indicated in figure 4.10, this information provides another clue to the pattern of income distribution in Australia. Relatively high poverty rates amongst all Australians (i.e. 12.3% in 2009–10) and especially amongst children (17.3% in 2009–10) mean that a surprisingly large proportion of the population cannot enjoy even austere living standards.

![Figure 4.9](image)

**Figure 4.9** Because income is shared unevenly in Australia, some people cannot enjoy reasonable living standards or gain access to basic goods and services at a level that is generally seen as acceptable to society. Indeed, Indigenous Australians sometimes live in Third World conditions.

The poverty line is set at the amount of money required by different-sized income units each week to sustain an austere or basic living standard, and purchase essential food, shelter and clothing. Income units are of different sizes and types and represent a group of people or an individual that is dependent on a given income to survive.

**Check Your Understanding**

1. What is meant by the distribution of income?
2. Outline the extent of income inequality in Australia.
3. How is the distribution of income measured by the ABS? Explain the steps.
4. There are different measures of income distribution. Explain the differences between the following:
   - a. private or market income
   - b. disposable income
   - c. final income.
5. What is the Lorenz diagram?
6. Concerning the Lorenz diagram, explain the following:
   - a. the distribution of income by quintile
   - b. the line of total equality
   - c. the Lorenz curve
   - d. the Gini coefficient.
7. What is meant by the distribution of wealth (net worth)?
8. What is poverty and how is it commonly measured in Australia?

The poverty line is set at the amount of money required by different-sized income units each week to sustain an austere or basic living standard, and purchase essential food, shelter and clothing. Income units are of different sizes and types and represent a group of people or an individual that is dependent on a given income to survive.

![Figure 4.10](image)

**Figure 4.10** Changes in Australian poverty rates (percentage below the poverty line set at 50% of median income) between 2003–04 and 2009–10.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Poverty</td>
<td>11.9</td>
<td>13.2</td>
<td>14.6</td>
<td>17.3</td>
</tr>
<tr>
<td>amongst all Australians (poverty line set at half median income level)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Poverty among children (poverty line set at half the median income level)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Sources:** Data derived from various sources including the ACOSS report November 2013, see www.acoss.org.au/policy/poverty/ which uses ABS data from the income survey 2009–10.

**Notes:** Poverty is defined by ACOSS as 50% of median income after housing costs based on ABS income survey data of 2009–10. However, because measures of income have changed slightly, comparisons between years are not totally reliable, but are a general guide.
4.3 Trends in Australia’s distribution of income and wealth

It is important for governments to know whether inequality in the distribution of income and wealth is getting bigger or smaller, since, among other things, this provides feedback about the success or otherwise of government policy.

Recent trends in the distribution of disposable income

From what you have seen the past few pages, it is clear that Australia distributes or divides its income and especially its wealth ‘cakes’ quite unevenly. The distribution of market or private incomes (i.e. before the Australian government redistributes income more equitably using taxes, welfare benefits and other measures) is especially uneven. In this section of the text, we want to explore whether or not these differences between rich and poor Australians are getting wider or narrower, using five key pieces of statistical data (shown in figures 4.11, 4.12, 4.13, 4.14 and 4.15).

1. Figure 4.11 below compares changes in quintile shares for equivalised disposable income (i.e. private income after allowing for the effects of government income taxes and welfare) between 1997–98 and 2011–12.

While the changes here were not huge, overall, there is a distinct shift towards a greater degree of income inequality in Australia. While quintile 5 managed to greatly increase its income share, quintiles 1, 2, 3 and 4 all lost ground. Having said this, the overall extent of inequality seen here is exaggerated because the equivalised disposable income measure fails to allow for the very beneficial effect of the government’s provision of free or subsidised community services to the poor (e.g. the value of cheaper public health, education, housing and transport).

2. Figure 4.12 reveals changes in Australia’s Gini coefficient for equivalised disposable income. Notice that there was a 3.2 per cent rise in the Gini coefficient between 1999–2000 and 2011–12 as shown by the upward sloping trend line. This measure also indicates increased levels of income inequality. Relatively, the
poor are now worse off than previously (at least before allowance is made for free or subsidised government services, such as public health and education). However, notice too the small 4.8 per cent reduction in the Gini coefficient (i.e., increased equality) recently between 2007–08 and 2011–12.

3. Figure 4.13 indicates trends in various poverty rates and the poverty level of income. As expected and shown in the graph, the poverty line level of weekly income needed by a standard family rose from $438 per week in 1997–98 to $883 in 2011–12. Despite this rise in the income needed to stay out of poverty, Australia’s overall poverty rate appeared to fall. However, it is alarming that there appeared to be a rise in child poverty.

4. Figure 4.14 below compares the distribution of average earnings between females and males. Notice that, while females have substantially increased their relative pay as a percentage of male average weekly earnings since 1979–80, in the past eleven years to 2012–13 there was a decline in the ratio, indicating increased income inequality.

5. Finally, figure 4.15 looks at the change in the distribution of wealth by quintile between 2003–04 and 2011–12 (the latest currently available). While changes were quite small, the data also shows rising inequality in wealth, with quintile 5 doing better at the expense of quintiles 2, 3 and 4.
From these five indicators, it can be seen that changes in the distribution of Australia’s income and wealth have been fairly small. Even so, most data show rising levels of inequality in the distribution of income and wealth.

4.4 Factors affecting Australia’s distribution of income and wealth

As we shall see, there are a host of factors affecting the distribution of income and wealth in Australia, causing large variations in people’s material living standards.

The operation of market forces causes wage inequality

Wage inequality largely reflects the normal operation of market forces (see microeconomic demand–supply analysis, chapter 1, pp. 22–7). Wages are decided in the labour market and are simply the price paid for labour. Wage levels in different occupations largely reflect the relative scarcity of different types of worker and are determined by the conditions of demand (D) for and supply (S) of labour for each. This is illustrated in figure 4.17.

Figure 4.17 below shows that wages for lawyers and cleaners are set at equilibrium where their demand and supply are exactly equal (i.e. where D = S). Well-paid jobs (e.g. successful AFL footballers, pop stars, CEOs, lawyers, ICT innovators) are those where the supply of labour is relatively limited. For example, $S_1$ shows the supply of successful lawyers or AFL footballers is less than the supply of cleaners at a given wage. The supply of labour may be limited due to the need for special talent, high educational qualifications, much skill, low likelihood of success, substantial on-the-job experience required, unattractive working conditions (e.g. long hours, dangerous or unpleasant environment) or very high levels of personal responsibility and care (e.g. brain surgeons, air traffic controllers). By contrast, low paid occupations (e.g. part-time junior workers at McDonald’s, cleaners) have few special

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**FIGURE 4.15** Trends in Australia’s distribution of wealth (net worth) by quintile share

*Sources: Data derived from various publications including ABS 6523.0.*

**FIGURE 4.16** The normal operation of the labour market, involving the demand and supply of labour, means that workers are paid according to their worth or relative scarcity. Those who work long hours and who sell skills that are relatively scarce and in short supply, normally earn higher wages and get bigger pay rises than those whose talents are plentiful or who work few hours.

**FIGURE 4.17** How the demand and supply of labour in an unregulated labour market cause wage inequality reflecting the relative scarcity of each occupation.
job requirements that limit the number of workers available ($S_2$ represents the supply of cleaners). In addition, *good wages* may also reflect a relatively *strong demand* for a person's services. Here, for example, a relatively high demand for a particular type of labour ($D_1$ represents the demand for successful lawyers or AFL footballers) may be the result of changing fashions and tastes (e.g. some pop stars and sporting heroes), technological advances or effective advertising. Against these conditions, *weak demand* for a given occupation ($D_2$ represents the demand for cleaners) will cause market wages to be fairly low. Whatever the reason, wage differences cause inequality in material living standards.

**Unemployment causes income and wealth inequality**

One of the most obvious causes of inequality in both income and wealth is *high unemployment* (e.g. over 30 per cent in the Great Depression of 1929–33, 11 per cent in the recession of 1992–93, a monthly peak of 5.8 per cent during 2009–10 following the global recession and 6 per cent in February 2014). Unemployment can follow a drop in aggregate demand (e.g. due to a fall in consumer or business confidence or a drop in income) which occurs in a recession, or it may be the result of supply-side structural change (e.g. firms restructure operations using new technology, closing unprofitable branches, relocating overseas, a mismatch of worker skills with the jobs available). Whatever the case, when individuals lose their job and cannot sell their labour resources, they are forced onto government welfare assistance. Typically, their income drops sharply from full-time adult average weekly earnings of over $1500 to, perhaps, only $260 to $300 a week on welfare. Part-time workers also face lower incomes than full-time employees. In addition, the unemployed run down their wealth and use up their assets, such as savings or shares, just trying to make ends meet. With less interest and dividends received from savings, this also causes their income to fall. In addition, being unable to meet home mortgage and other interest repayments, their assets are sometimes repossessed, lowering their share of wealth. As a result, material living standards fall.

**Inflation causes income inequality**

*Inflation* also alters the distribution of income and wealth, usually in favour of the better-off sections of society. For example, speculators buying shares and land when prices are low and selling them when inflation causes prices to rise, often do well from inflation (as in the middle to late 1980s, 2000–01, 2005–08 and 2009–11). Their share of the income cake increases. Typically, these people are the rich with sufficient savings or credit rating to permit such activities. By contrast, ordinary working families and retirees on relatively fixed incomes often find that their wages and incomes rise less quickly than prices, thereby reducing their purchasing power. In addition, workers in export- or import-competing industries facing strong competition, find that their wages lag behind inflation, eroding their material living standards.

**Overseas economic conditions cause income inequality**

Overseas economic conditions also have an impact on the distribution of income. When there is strong economic growth overseas among our trading partners (e.g. in China, 2009–12), Australian exporters and their workers find that rising commodity prices and sales cause their incomes to increase, often faster than others in the community. By comparison, the onset of a severe recession abroad (e.g. the global financial crisis and recession as in 2008–09 and again 2012–13–14) results in a drop in the income and living standards of our exporters, along with the value of assets.

**Inheritance of wealth causes inequality**

Perhaps the greatest cause of inequality in the ownership of Australian wealth is the existence of *inheritance*. Here, assets are handed down from older to younger generations, now uninhibited by the existence of death duties. Although around 80 per cent of Australia’s wealthiest 200 in 2013 had self-made fortunes (e.g. Westfield shopping centre chairman Frank Lowy, miner Clive Palmer), inheritance certainly gives the lucky few a great headstart financially. Their inherited wealth can be used to increase income and savings and, thus, generate even more wealth. Here we think of the late Kerry Packer
and now his son James, Janet Holmes à Court, Gina Rinehart (daughter of mining magnate Lang Hancock, who is now Australia’s richest woman) and Warwick Fairfax.

**Luck increases inequality in income and wealth**
Some people have a ‘lucky streak’ in them and stumble onto a fortune: each week’s lottery winners, successful speculators, chance discoveries of valuable minerals or technical inventions. This results in high incomes and wealth for some.

**Age can cause inequality**
For most people, the peak in their income-earning capacity occurs when they are in the 35–49 years age group. However, there are two age groups that often suffer low incomes and a lack of wealth. First, the very young sometimes find it hard to get their first job, perhaps because of a lack of work experience, training, skill or, in a few cases, a poor ‘work ethic’. Consequently, youth unemployment is relatively high (around 25 per cent in 2012–13) and income share is low. In addition, most of these individuals have not yet had time to accumulate assets or wealth. The second group that often suffers from low income is the aged who can no longer work. These people depend on welfare benefits (e.g. the age pension), past savings and, for the lucky few, superannuation. This also causes income inequality and contrasts in living standards.

**Education affects inequality**
Educational attainment has a powerful influence on income and material living standards. Those with no formal education or who left school by the age of 15 years, usually have incomes 40+ per cent lower than those with tertiary qualifications. This is because the labour market usually values educated people more highly than those without such training.

**Discrimination causes income inequality**
Unfortunately, not all groups of people in Australia are given the same opportunities to earn income and enjoy reasonable living standards because of the existence of discrimination in employment. As a result, their income is lower than otherwise. Despite anti-discrimination legislation, this problem is more commonly reported among females, the aged, the young, people with a disability and some ethnic groups (e.g. non-Europeans, Aboriginal and Torres Strait Islanders).

**Variations in personal ‘work ethic’ affect income inequality**
In some cases, a poor ‘work ethic’ or attitude results in individuals being unable to gain or keep their job. The problems could be rudeness or negative manner, lateness in arriving for work, lack of effort, or unsatisfactory dress and personal appearance. This can make some people less employable, and lead to lower income and material living standards. In addition, not everyone wants to spend their life working. For some, lifestyle is as important as money. However, casual employment and reduced work hours usually mean lower income relative to those working full time or overtime.

**FIGURE 4.18** In Australia, fortunes have been made (and lost) by investing in shares listed on the stock market. While making money through the stock market requires much skill and knowledge, some commentators believe that there is also an element of good luck involved. This leads to economic inequality.

**FIGURE 4.19** Many Indigenous Australians have low income and live in poverty, sometimes because of discrimination in employment, a lack of skills and few opportunities to gain good employment.
Declining unionism may increase inequality

In recent years, there has been a dramatic decline of union membership among workers. From a peak of over 50 per cent in the 1970s, the overall unionisation of the labour force has fallen to around 14 per cent in 2013. This means that there is less protection of workers from wage exploitation and unsafe working conditions than previously.

Charitable organisations reduce income inequality

Local charities — such as The Salvation Army, the Brotherhood of St Laurence, Society of St Vincent de Paul and United Way — all help to make the distribution of income more even than otherwise by helping to provide necessary goods and services (e.g. clothing, food vouchers, accommodation and care) for the needy.

Government policies that affect the ‘final’ distribution of income

The Australian government uses various policies to promote its goal of an equitable distribution of income and wealth where everyone can enjoy reasonable living standards. These strategies generally reduce the level of income inequality and differences in Australian living standards. Because these policies will be examined in detail later (see p. 147), they will only be listed here.

- **Progressive personal income tax** is levied on the rich at a higher rate than on the poor (e.g. in July 2012, a top marginal tax rate of 45 per cent was applied to taxable incomes over $180,000 per year down to a 0 per cent tax rate for people on less than $18,200 per year).
- **Cash welfare assistance** is given to the neediest individuals (e.g. the aged, families, sick, unemployed, carers, youths) who are identified using a ‘means’ (i.e. a cut-off level of income) or an ‘assets test’ (i.e. a cut-off level of wealth).
- **Important government community services** (e.g. public health, education, housing, transport) are usually provided free of direct charge or at a low subsidised price, sometimes below cost.
- There is a legal **minimum wage** to protect all low-paid workers from exploitation, even those on enterprise or workplace agreements. In 2013–14, the Fair Work commission set the minimum full-time wage at $622.20 per week, or $16.37 per hour.
- The government sometimes tries to help minimise the regressive effects of **indirect taxes** that are added onto the price of some goods and services sold (where the poor pay a larger percentage of their income in tax than the rich). For example, most essential items are exempt from the 10 per cent goods and services tax or GST (introduced in July 2000). These include unprocessed food, education, health, prescription drugs, council rates and banking. Additionally, there were rises in most welfare benefits to compensate low income individuals for the expected rise in the cost of goods and services following the introduction of the GST.
- The Australian Competition and Consumer Commission (ACCC) enforces the **Competition and Consumer Act 2010**. This act makes anti-competitive collusion between firms in setting prices illegal in an attempt to strengthen the level of competition between firms. Fierce competition helps to make goods and services more affordable for the poor by keeping prices down.

Despite serious attempts by the Australian government to reduce income inequality and improve material living standards, at least in the short term, some of the **microeconomic or aggregate supply policies** listed below have probably worsened the problem.

- **Tariff cuts** (e.g. those that occurred in 2010 and those proposed for 2015) may add to structural unemployment in the short term causing some to have lower incomes.
- **Privatisation of some government business enterprises** (e.g. the sale of shares in Telstra) results in staff cuts and structural unemployment in the short term.
- **Corporatisation of many government departments and business operations** result in staff cuts and structural unemployment as these operations try to cut costs and make a profit.
• The wider adoption of the ‘user-pays principle’ in the provision of community services makes them more expensive and less affordable for families and individuals.

• Deregulation of the labour market involving the promotion of enterprise bargaining or workplace agreements may, in the short term, result in higher efficiency, staff cuts and structural unemployment.

• Being unable to control tax avoidance to continue reduces government revenue available for welfare spending and the provision of good community services to help the poor.

• Making the system of personal tax rates less steeply progressive (over the years, the top marginal rate has been cut from 75 per cent in 1951–52, to 45 per cent for 2013–14)

• Introducing a partially regressive 10 per cent GST that is added onto the price of goods and services, where the extra tax burden for the poor expressed as a proportion of their income is heavier than for the rich

• Making welfare harder for some needy individuals to access affects income distribution.

Try applied economic exercises 4, 5, p. 162
Try class debate 1, p. 168

4.5 Effects of inequality in the distribution of income and wealth on living standards

As we shall see, both ‘equality’ and ‘inequality’ in the distribution of income and wealth are situations that can have good and bad effects for individuals, society, governments, the economy and general living standards.

The positive effects of inequality

Some economists argue that modest levels of inequality in income and wealth are beneficial. The inequality creates incentives to improve efficiency in production, promote stronger economic growth, expand employment opportunities, increase general incomes and raise living standards.

• Inequality provides increased incentive for employees to work hard. The promise of extra pay can motivate employees to work extra hours or overtime (and give up some of their leisure or holidays), try harder, and be more productive and efficient on the job. This helps strengthen living standards. However, if all pay rates were equal, there would be no such incentive. Productive capacity and the rate of economic growth would be lower, and goods and services would be more expensive, causing living standards to be lower than otherwise.

• Inequality provides increased incentive to gain improved skills and education. More skilled and educated workers usually receive higher pay since they are scarcer, and are more productive and efficient. An advantage of inequality is that it can provide young people with the incentive to stay at school longer and go into tertiary training. This also helps to promote stronger economic growth and better living standards.

• Inequality promotes increased incentives to relocate. Given the desire for self-improvement, income inequality can cause people to move from one job to another. Here, wage differences act as price signals to allocate labour to areas of greatest need.

Giving examples of particular occupations in Australia, explain how market forces operate to cause wage inequality.

1 Explain how rising levels of unemployment lead to increased income inequality.

2 Why does inflation cause growing inequality in living standards?

3 How do any two of the following help to explain income inequality?
   a Age
   b Discrimination
   c Inheritance
   d Education

4 Generally the Australian government seeks to promote the goal of equity in income distribution. However, some policies might actually reduce equity. Select and outline one specific federal government policy that might increase income inequality.

FIGURE 4.21 Inequality allows successful individuals on higher incomes to enjoy more varied choices including opportunities for international travel and purchasing more goods and services.
Pay differences also make it possible for firms to fill job vacancies, even if they are in different towns or states or involve unpleasant work. Again, inequality helps promote better living standards.

- **Inequality provides increased incentive for business risk and expansion.** Income inequality provides financial incentives to reward or compensate business people to take calculated risks with their money and undertake investment in new technology and equipment needed for expanding the firm. If there was no opportunity for entrepreneurs to earn extra profits through their decision making, Australia’s rate of economic growth would be much slower, employment opportunities reduced, incomes lower and material living standards diminished.

- **Inequality helps promote increased levels of savings to finance higher investment.** As a result of income inequality, the rich are more able to save a higher percentage of their income, than if it was shared more evenly. In turn, better savings help to increase investment in new technology and equipment, finance business expansion and create improved job opportunities and income for others, even the poor, thereby boosting material living standards.

- **Inequality rewards successful households and individuals.** In some ways, inequality in wealth and income acknowledges or displays success. It allows the fortunate to enjoy more opportunities for a great lifestyle and living standards, such as living comfortably in pleasant suburbs, gaining personal fulfilment, enjoying social interaction, international travel and increased leisure.

Because of these and other benefits of inequality, it is interesting to note that the Australian government (and most governments around the world, including former communist regimes), does not want to remove all traces of inequality in incomes and wealth.

### The negative effects of inequality

High levels of inequality, however, can cause serious social and economic problems that could reduce material and/or non-material living standards.

- **Inequality divides society and reduces social cohesion.** Inequality divides society into the ‘haves’ and ‘have nots’. In some parts of the city, there are families living comfortably in palatial dwellings located on tree-lined streets well away from the filth of factories and the noise of freeways and trains. However, in other areas, there are the over-crowded lower socioeconomic suburbs that include none of the luxuries of affluence. Here, unemployment, racial ghettos, crime, drugs, despair and poverty are far more commonplace. The people living in these areas may eventually start to resent those who are better off and start to see the system as unfair. This weakens the cohesion of society and can lead to great discontent, social unrest, crime, violence, political protest and even revolution. Figure 4.22, for instance, shows the poverty rates among different groups who are most susceptible. For some of these groups, there is no equality of opportunity to become rich.
• Inequality causes some types of beneficial goods and services to be over- or under-produced. Another drawback of vast inequality is that the economy can tend to overproduce luxury goods and services, and underproduce necessities (e.g. food, health, housing, public transport). In other words, inequality can distort the allocation of resources and thereby lower society’s average material living standards.

Try applied economic exercise 6, p. 162

4.6 Government policies to help promote an equitable distribution of income and wealth

The Australian government seeks to promote the goal of a fair or equitable distribution of income and wealth. This does not mean that the government wants to create total equality. It simply means that all people should have sufficient income to purchase or access basic goods and services, enjoy reasonable living standards and avoid living in poverty. By contrast, an inequitable distribution of income refers to a situation where income is divided unfairly and where many are unable to enjoy even basic living standards.

Having said this, it is very hard to objectively define what is meant by an equitable distribution of income and wealth. For instance, which of the following opinions is correct? On the one hand, is it ‘fair’ in a land of plenty that some Aboriginals and Torres Strait Islanders live in appalling conditions that are on a par with those of the Third World, or that there are perhaps 900 000 homeless children in Australia, or that the unemployed, single-parent families and the aged often suffer great material deprivation? However, is it also ‘fair’ that the skilled, diligent, well-motivated and those who work long and difficult hours be penalised by heavily progressive income tax rates and be deprived of access to welfare benefits?

Indeed, it is difficult to determine exactly where an equitable balance should be drawn between these opposing views. This is sometimes reflected in the different policies and approaches of successive governments, whether Labor or the Liberal Coalition.

As we shall now see, the federal government uses a number of strategies to help alleviate poverty and promote an equitable distribution of income.

Using progressive income taxes to promote equity

The Australian tax system has a range of taxes that alter the distribution of income. Direct progressive income taxes (e.g. PAYG or ‘pay as you go’ personal income tax, capital gains tax) are those where the marginal tax rate rises with income. Progressive taxes help to alleviate poverty by taking a larger proportion (percentage) of income from the rich than from those on low incomes, and use this to help provide welfare benefits and essential services (e.g. public health and education) to the poor. They use the ‘Robin Hood principle’. As indicated in table 4.1 (p. 150) Australia’s marginal tax rates on personal income are progressive, rising from zero per cent (on taxable incomes up to $18 200), up to 45 per cent (on taxable income above $180 000). Clearly this helps to narrow the income gap between high and low incomes, thereby promoting equity. Table 4.1 also shows that the federal government has changed the rates of personal income tax by making them less steeply progressive. The last change was in July 2012. The cut-off or thresholds for income tax brackets were also widened and changed upwards.

The goal of a fair and equitable distribution of income and wealth is a government objective and means that everyone should be able to have access to basic goods and services and enjoy reasonable living standards. This often means partly narrowing the gap or differences between the rich and poor.

Inequitable distribution of income refers to a situation where a nation’s income cake is divided unfairly and where many people are unable to enjoy access to basic goods and services and reasonable living standards.

The goal of a fair and equitable distribution of income and wealth is a government objective and means that everyone should be able to have access to basic goods and services and enjoy reasonable living standards. This often means partly narrowing the gap or differences between the rich and poor.

FIGURE 4.23 Income inequality exists but progressive income tax is used by the Australian government to help reduce the degree of income inequality. By especially targeting higher income earners, the gap between the rich and poor is reduced and the government can use the money raised from taxation to provide assistance to the neediest individuals.
TABLE 4.1 Actual changes in PAYG personal income tax rates (July 2006 to July 2010)

<table>
<thead>
<tr>
<th>Taxable income thresholds ($)</th>
<th>Marginal tax rates (percentage)</th>
<th>Taxable income thresholds ($)</th>
<th>Marginal tax rates (percentage)</th>
<th>Taxable income thresholds ($)</th>
<th>Marginal tax rates (percentage)</th>
<th>Taxable income thresholds ($)</th>
<th>Marginal tax rates (percentage)</th>
<th>Taxable income thresholds ($)</th>
<th>Marginal tax rates (percentage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 to $6000</td>
<td>0</td>
<td>$0 to $6000</td>
<td>0</td>
<td>$0 to $6000</td>
<td>0</td>
<td>$0 to $6000</td>
<td>0</td>
<td>$0 to $6000</td>
<td>0</td>
</tr>
<tr>
<td>$6001 to $30,000</td>
<td>15</td>
<td>$6001 to $34,000</td>
<td>15</td>
<td>$6001 to $35,000</td>
<td>15</td>
<td>$6001 to $37,000</td>
<td>15</td>
<td>$6001 to $37,000</td>
<td>15</td>
</tr>
<tr>
<td>$30,001 to $75,000</td>
<td>30</td>
<td>$30,001 to $80,000</td>
<td>30</td>
<td>$30,001 to $80,000</td>
<td>30</td>
<td>$30,001 to $80,000</td>
<td>30</td>
<td>$30,001 to $80,000</td>
<td>30</td>
</tr>
<tr>
<td>$75,001 to $150,000</td>
<td>40</td>
<td>$75,001 to $180,000</td>
<td>40</td>
<td>$75,001 to $180,000</td>
<td>40</td>
<td>$75,001 to $180,000</td>
<td>40</td>
<td>$75,001 to $180,000</td>
<td>40</td>
</tr>
<tr>
<td>$150,001 and over</td>
<td>45</td>
<td>$150,001 and over</td>
<td>45</td>
<td>$150,001 and over</td>
<td>45</td>
<td>$150,001 and over</td>
<td>45</td>
<td>$150,001 and over</td>
<td>45</td>
</tr>
</tbody>
</table>


While income tax is an example of a progressive tax, not all taxes are progressive. For example, there are proportional taxes where the tax rate remains constant as income rises (e.g. company tax is currently 30 per cent of each dollar of profit in 2014). Proportional taxes thus tend to have a neutral effect on the distribution of income. In addition, as we shall soon see, some taxes are in fact regressive (e.g. the Goods and Services Tax or GST and excise taxes on petrol and alcohol). This is because they tax the rich at a lower rate or percentage of income, than the poor (e.g. most indirect taxes are added onto the price of goods and services sold).

Some of the features of these progressive, regressive and proportional types of tax are illustrated in table 4.2 below.

TABLE 4.2 Features of hypothetical progressive, regressive and proportional taxes

<table>
<thead>
<tr>
<th>Annual taxable income ($)</th>
<th>Amount of tax ($) and average tax rate (%) applicable for a 'progressive' tax</th>
<th>Amount of tax ($) and average tax rate (%) applicable for a 'regressive' tax</th>
<th>Amount of tax ($) and average tax rate (%) applicable for a 'proportional' tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5000</td>
<td>$0 tax = a rate of 0%</td>
<td>$1000 tax = a rate of 20%</td>
<td>$1000 tax = a rate of 20%</td>
</tr>
<tr>
<td>$10,000</td>
<td>$1000 tax = a rate of 10%</td>
<td>$1500 tax = a rate of 15%</td>
<td>$2000 tax = a rate of 20%</td>
</tr>
<tr>
<td>$15,000</td>
<td>$3000 tax = a rate of 20%</td>
<td>$1800 tax = a rate of 12%</td>
<td>$3000 tax = a rate of 20%</td>
</tr>
</tbody>
</table>

Impact of tax on income distribution: Has a levelling effect on the distribution of incomes e.g. personal income tax is a progressive tax Causes income distribution to become more uneven e.g. the GST is a regressive tax Has a fairly neutral impact on the distribution of income e.g. company tax is a proportional tax

The effect of indirect taxes on the promotion of equity

Indirect taxes (e.g. the GST, excise tax on petrol, tobacco and alcohol, import duties, the carbon tax) are added onto the price of goods and services and, therefore, are paid by those making the purchase. For instance, the GST is levied at the flat rate of 10 per cent on all items, except some basic things gaining special exemption. Other examples of indirect tax are the excise taxes on petrol, tobacco and alcohol. In the case of petrol, this represents a tax of over 40 per cent of the cost of a litre of fuel. As a general rule, indirect taxes are regressive taxes and lead to increased inequality because a low-income buyer purchasing an item (such as a haircut involving a GST of, say, $2) will be paying a larger proportion of income in tax than a high income person making exactly the same purchase. This is illustrated in figure 4.24.
In fact, Australian estimates suggest that those low-income individuals in quintile 1 pay 20.5 per cent of their income in indirect taxes, while those in quintile 5 pay only 8.9 per cent. This is highly unfair and regressive.

Despite its general regressiveness, the problems of introducing the GST in 2000 were eased by exempting essential or basic items such as most unprocessed food, education, rent, medical treatment, banking, exports and government charges. In addition, higher welfare benefits and cuts in personal income tax rates were also used to help compensate families (including low-income earners) for the overall inflationary effects when the GST was introduced.

**Using cash welfare payments to promote equity**

The federal government provides a wide range of cash welfare assistance (i.e. transfer payments). Some of the major forms of income support are summarised in table 4.3 and include the age pension, family tax benefit, disability pension, parenting payment, Newstart unemployment allowance and youth allowance.

<table>
<thead>
<tr>
<th>Name of benefit</th>
<th>Target group</th>
<th>Maximum value ($) per fortnight (rounded, April 2014)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family tax benefit (one child)</td>
<td>lower income couples with one child</td>
<td>224</td>
</tr>
<tr>
<td>Age pension (single)</td>
<td>aged person who is retired (for a couple)</td>
<td>1270</td>
</tr>
<tr>
<td>Carer allowance</td>
<td>people prevented from working because they are caring for a dependant</td>
<td>118</td>
</tr>
<tr>
<td>Austudy (single with children)</td>
<td>those in full-time tertiary study</td>
<td>543</td>
</tr>
<tr>
<td>Newstart</td>
<td>unemployed, over 21 years, while looking for work</td>
<td>713</td>
</tr>
<tr>
<td>Youth allowance</td>
<td>unemployed, undertaking full-time training or study</td>
<td>713</td>
</tr>
<tr>
<td>Abstudy</td>
<td>Indigenous individuals to help cover the costs of education or training</td>
<td>973</td>
</tr>
<tr>
<td>Rent assistance</td>
<td>to help pay for housing and rent</td>
<td>441</td>
</tr>
<tr>
<td>Paid parental leave</td>
<td>to help cover living costs for up to 18 weeks of those who give birth to or adopt a child and meet other criteria</td>
<td>622</td>
</tr>
<tr>
<td>Illness, injury or disability payments</td>
<td>sick, injured or disabled people who temporarily cannot work</td>
<td>766</td>
</tr>
</tbody>
</table>

*Source: Derived from Centrelink publications. Also see Centrelink website.*
A means test (income test) or an assets test (wealth test) is used by the government to exclude high-income earners from gaining access to welfare and to better target those individuals that most need financial help.

An assets test (wealth test) is used by the government to exclude the rich from gaining access to welfare and to better target those in most need of help.

FIGURE 4.26 The cost of Australian government income support ($ billions)


Using free or cheap government services to promote equity

The federal and state governments provide a range of community services (e.g. public education, health, housing, transport) free of direct charge or at a relatively low, subsidised price. This makes these things more affordable for the poor than would otherwise be the case. In some instances, only the needy can gain access to services.

From the point of view of the poor, having access to these government services is as good as having extra income. Indeed, it has been estimated that government services provide a cost saving or benefit of around $300 a week for those individuals in the lowest two income quintiles (but less than half this for those in quintile 5). However, with the drive towards efficiency and the corporatisation and privatisation of government businesses, a worry in recent times is the increasing acceptance of the ‘user-pays principle’ in the delivery of these services (i.e. consumers of these services are expected to pay the cost to the government of producing these items). This tends to increase inequality.

Using the minimum wage to promote equity

For over 100 years, the federal government has regulated minimum wages and working conditions for many Australians. Since 2010, this has been done through an institution called Fair Work Australia (FWA). Nowadays, the annual wage decisions made by FWA directly affect around 1.4 million low-paid adults and youths (the youth minimum wage is set at a lower level). It provides a wage safety net and protects living standards. The aim is to keep wages up to a level where workers can avoid exploitation and at least enjoy a reasonable standard of living. Over the last 10 years to 2013–14, there have generally been annual rises in the minimum wage (by between zero and $27 per week) taking the full-time adult wage to $622.20 (or $16.37 per hour) in 2013–14. Until a few years ago, the main justification given for pay increases was to protect the purchasing power and living standards of low-paid workers from the effects of inflation (generally rising prices). However, more recent changes mean that the following considerations should be take account:

• the capacity of the low-paid to remain employed
• the capacity of the unemployed to get a job
• the competitiveness of the Australian economy and other economic circumstances.

Following the passing of new industrial relations legislation in 2009 and 2012, there were a number of changes. A ‘one-stop shop’ was created for all industrial relations matters, headed by a single workplace institution called the Fair Work Commission (FWC). Apart from deciding annual rises in the minimum wage, the FWC will apply the national employment standards. These included the following:
• weekly maximum of 38 hours of work (but employers can request more)
• flexible work arrangements
• 12 months parental or adoption leave
• 4 weeks paid annual leave
• 10 days personal or carer’s leave, or compassionate leave
• community service leave
• long service leave
• public holidays
• notice of termination and redundancy payments
• employers must distribute the Fair Work Information Statement.

These minimum standards even apply to those workers on enterprise agreements negotiated between workers and their boss, provided their incomes are below $118,300 (current level) a year. This is now called the Better Off Overall Test (BOOT) and is designed to protect workers’ living standards.

However, despite its protection of workers and other strengths, it is also recognised that this partly centralised wage system has significant weaknesses. Sometimes rises in minimum wages have been excessive and, usually, they are unrelated to a worker’s level of efficiency. In cases where the minimum wage in the labour market is set above the free market equilibrium level, as illustrated in figure 4.27, it adds to labour costs. This could make local firms internationally uncompetitive, cause firms to close down, add to structural unemployment (because there is a surplus of labour where the D for labour is less than the S, and equal to quantity Qd–Qs on figure 4.27), accelerate inflation and ultimately undermine our living standards.

**Using compulsory superannuation to promote equity**

Australia has an ageing population which is living longer, yet there is a declining proportion of the population who are of working age and paying taxes to support these older people. This has helped to create pressure on our welfare system. To ease this problem, in 1992 the federal government introduced the superannuation guarantee charge (SGC) which requires employers to make retirement contributions on behalf of their workers. In 1992, the contribution was 3 per cent of the employee’s pay, but this rose to 6 per cent in 1995, 7 per cent in 1998, 9 per cent in 2001 and is currently expected to rise slowly from 9.5 per cent 2014–15 to 12 per cent from July 2019. Additionally, personal superannuation contributions are encouraged by offering tax advantages or reductions in tax rates. By helping ordinary workers to retire with superannuation, the burden on the nation’s finances is eased and retirees should be able to enjoy better living standards and live above the poverty line.

**Using policies to help reduce inflation and unemployment, thus promoting equity**

The federal government tries to achieve the goal of low inflation (a low annual inflation rate averaging about 2–3 per cent a year) and the goal of full employment (a low unemployment rate of around 4.5 to 5 per cent of the labour force). One reason for this is that failure to achieve these aims would seriously undermine equity in the distribution of income and wealth.
of income and wealth, reduce incomes and purchasing power, and erode living standards. Typically, the poor suffer most from inflation, unemployment and hence reduced purchasing power, while the rich can better look after themselves, whatever the conditions. As previously explained, demand inflation and cyclical unemployment can be eased by the government adopting either a contractionary or expansionary approach to aggregate demand using appropriate budgetary and monetary policies (i.e. macroeconomic or aggregate demand policies) applied in a countercyclical way. However, the government can ease the problems of cost inflation and, in the long term, structural unemployment, by means of aggregate supply or microeconomic efficiency policies to cut costs, help make local firms more internationally competitive and expand business. This also helps to strengthen our material living standards.

4.7 An international perspective on the distribution of income and wealth

Having studied how income and wealth are distributed in Australia, before closing the topic it is important now to get a global perspective of inequality.

The distribution of income and wealth globally

Australia is a rich country and, despite government measures to redistribute incomes and wealth more equitably, we have seen that there is still considerable inequality. For instance, the top 20 per cent of income earners receive a slice of the nation’s income cake that is nearly five times as large as that received by the lowest 20 per cent of income earners. While this inequality leads to relative poverty (i.e. some people are very poor and on quite low incomes compared with what is normally regarded as reasonable living standards), few Australians would experience absolute poverty (where people’s basic survival needs for adequate food, shelter, clothing and health are not generally met).

Relative poverty exists when people are very poor and on quite low incomes compared with what are normally regarded as reasonable living standards. Absolute poverty occurs when people’s basic survival needs for adequate food, shelter, clothing and health are not generally met.
However, far more serious than local inequality, is the extreme inequality that exists in the distribution of the world’s income (over $60 trillion per year) between nations that are home to almost 7 billion people. So while there are around 1 billion people living in high income countries like Australia, Japan and the US, nearly 1.5 billion people living in the poorest Third World countries endure extreme or absolute poverty. It has also been estimated that the richest 5 per cent of the world has average incomes of over 160 times those of the poorest 5 per cent. Now that is serious inequality! For these people, most of the trappings that we take for granted (like access to clean drinking water, medical treatment, food, shelter, education and clothing) are not available, causing suffering and appallingly low living standards. In such conditions, it is not surprising that around 30,000 children die each day from preventable diseases caused by poverty.

**Measuring absolute poverty internationally**

There are various ways to measure absolute poverty but most rely on determining a level of income below which people’s basic needs are not met. As a rough guide, an income of US$1.25 a day has recently been used by the United Nations to make estimates of absolute poverty. In applying this figure, exchange rate adjustments are made so that the purchasing power of US$1.25 in each country is held constant. This is called adjusting the data to purchasing power parity or PPP.

On this basis, about 15 per cent of the world’s population lives at or below the absolute poverty line or income level. In addition, when the poverty line is increased to just US$2.00 per day (PPP), this means that 40 per cent of the world’s population live in either absolute or relative poverty where material living standards are poor or extremely low.

Figure 4.29 shows the distribution of poverty based on a poverty line of US$1.25 per day at PPP. Notice that poverty rates are highest in many Third World African countries, but are relatively low in First World countries and regions like Australia, North America, Europe and Russia. Surprisingly, poverty is fairly low in China and South America, reflecting substantial economic progress over the past two decades.

Various experts (including David Gordon, author of ‘Indicators of Poverty & Hunger’) have suggested that failure to meet the following *eight* basic needs means there is a high likelihood of absolute poverty.

1. **Food.** Low body mass index below 16 due to inadequate food and nutrition.
2. **Safe drinking water.** Poor availability of clean water (have to walk more than 15 minutes each way for drinking water).
3. **Sanitation facilities.** Toilets are not accessible in or near the home.
4. **Health.** There is a lack of medical treatment available for serious illnesses and childbirth.

---

**Purchasing power parity (PPP)** is used to make adjustments to the purchasing power of money in different countries so as to allow comparisons of incomes.

**FIGURE 4.29 Global comparisons of poverty rates based on the percentage of a country’s population living in extreme poverty on less than US$1.25 per day**

*Source: Data copied directly from Wikipedia, the free encyclopedia (Wikimedia Commons), [http://en.wikipedia.org/wiki/File:Percentage_population_living_on_less_than_$1.25_per_day_2009.svg](http://en.wikipedia.org/wiki/File:Percentage_population_living_on_less_than_$1.25_per_day_2009.svg)""
5. *Shelter.* More than four people live in each room in the house and floors are made of dirt.
6. *Education.* Most children do not attend school or are unable to read.
7. *Information.* There is no access to information via a newspaper, radio, television, computer or telephone at home.
8. *Access to services.* The absence of education, health, legal, social and financial services.

What this list suggests is that if a person is malnourished, lives in an overcrowded house with a dirt floor, cannot read and has never attended school, has no access to information or health services, and must walk long distances for water, they are likely to be living in absolute poverty.

**Some reasons for high poverty rates in some countries**

To understand how poverty rates can be reduced, we need to appreciate that poverty has both local and international causes. While it is true that each poor country faces unique problems, it seems that high poverty rates can be traced to nine common causes.

1. **Slow rate of economic growth.** Slow or negative rates of economic growth in low-income countries mean that production cannot keep up with the increase in population. This is perhaps the most important underlying reason for low incomes and widespread poverty. People could have access to more goods (e.g. food) and services (e.g. health and education) and enjoy a bigger slice of the nation’s income cake, if the country’s GDP was higher.

2. **Limited productive capacity.** In low-income countries, productive capacity (represented by the production possibility frontier) and GDP are small, usually because there is a limited quantity and quality (efficiency) of natural, labour and especially capital resources. Additionally, civil war, natural disasters and drought worsen supply-side conditions. You may recall that in chapter 2, pp. 00–0 we touched on the importance of living standards for growing a nation’s production possibility frontier.

3. **Inadequate infrastructure.** There is inadequate government and private investment in social infrastructure (e.g. water supply, schools and hospitals) and economic infrastructure (e.g. transport, communications and electricity) in low-income countries. This discourages production and business expansion, limiting job creation and adding to everyday hardship for ordinary families.

4. **Weak domestic spending.** For economic growth to occur there needs to be a market or demand for goods and services where people have money to spend. Unfortunately, incomes and AD are so low in low-income countries that there is limited incentive for business expansion.

5. **Low household savings.** In low-income countries, savings by households and governments are so low that there is limited finance available to help grow the economy. High interest rates on borrowed money discourage investment, depress efficiency, limit business expansion and lead to massive unemployment where many resources are lying idle.

6. **Limited opportunities for international trade.** Growing the level of trade is one way nations can increase their income and escape poverty. Unfortunately, poor countries find it difficult to export goods and services, partly because of high rates of tariff protection being applied by many richer countries.

7. **Poor government and high debt levels.** Commonly, government in low-income countries is inefficient, incompetent, unaccountable and corrupt. This leads to poor decision making and an inefficient use of resources. In addition, there is no effective tax or welfare system. Government debt repayments abroad to richer countries are a burden. They redirect money and resources away from projects that could help reduce poverty.

8. **Lack of democracy and economic freedom.** Due to the absence of democracy and freedom (of both speech and action) there is little incentive for those in power to be accountable for their poor leadership.

9. **Great inequality in income and wealth.** To reduce poverty, the nation’s income and wealth ‘cakes’ need to be shared fairly. Unfortunately in poor countries, there are usually high levels of inequality in the distribution of goods and services, and incomes. Typically, the Gini coefficient in these countries is very high. This is shown in figure 4.30 (p. 157). Notice that the Gini Coefficient is over 0.6 in parts of Africa and above 0.55 in parts of South America; areas with quite high poverty rates. By comparison, Australia’s Gini coefficient is just over 0.3 thanks to effective government redistribution policies.
Is global poverty falling?

Figure 4.31 below reveals that the percentage of the world’s population living in extreme poverty has more than halved from 42 per cent in 1981, to only 17 per cent in 2009. Clearly, the United Nations’ target of cutting extreme poverty by 50 per cent by 2015 (as outlined in its Millennium Development Goals) has already been achieved overall. This is the largely the result of strong economic progress (largely associated with increased international trade) in countries like China, India, Vietnam, Thailand and other parts of East and South Asia. However, progress has been painfully slow in parts of Africa due to a slowdown in the regional rate of economic growth (e.g. an average rise of just 2.5 per cent for 2009) against the pressures of rapid increases in population (a rapid rise of around 2.5 per cent a year).

International action designed to help reduce global poverty

From the dawn of the Industrial Revolution, higher rates of economic growth have been the main engine required to drag people out of poverty. For instance, in 1820 (near the start of the Industrial Revolution in England where, for the first time in history,
Economic globalisation involves a shift towards the creation of a single global market where barriers to the free movement of goods, services and money capital or investment across national borders are gradually removed. This leads to specialisation in production and the expansion of international trade.

Free trade agreements (FTAs) are designed to grow trade between countries by removing tariffs and other forms of industry protection.

1. **Promoting economic globalisation.** Most commentators believe that the promotion of economic globalisation (where barriers to the free movement of goods, services, and money capital or investment across national borders are removed and the world becomes more like a single economy) has helped to greatly reduce global poverty, especially in countries such as China, India, Vietnam and Brazil. Globalisation means that nations specialise in making those goods and services they produce best or where they have a comparative cost advantage. This has greatly increased both the volume of trade, and financial or investment flows between countries. Higher investment by richer nations in poorer countries has helped to grow industry capacity, expand the number of jobs and increase incomes, and hence reduced poverty in low-income nations.

2. **Pursuing trade liberalisation.** Especially in the last two decades, the policy of trade liberalisation has been widely applied in many countries around the world. It involves international governments gradually reducing their trade barriers including tariffs (taxes that are added onto the price of imported goods to protect local industries from competition) and a shift towards free trade. Reducing protection of local industry has caused countries to use resources more efficiently, lifting total production, growing national incomes and cutting poverty. In addition, trade liberalisation has involved a rapid expansion in the number of free trade agreements (FTAs) where two or more nations agree to reduce trade protection, thereby allowing goods, services and money to move more freely. If two nations are involved, this is known as a bilateral trade agreement, as exists between Thailand and Australia; if more than two nations, it is called a multi-national trade agreement, e.g. the World Trade Organization or WTO. This approach has accelerated the pace of globalisation and has helped open up global markets to poorer nations that otherwise would not be able to grow their exports, GDPs, incomes and living standards.

3. **International development agencies.** The United Nations, the World Bank and the International Monetary Fund (IMF) have all helped to provide specific advice to countries to help strengthen their economic and financial management (for details, see chapter 8). Loans have been made available to help particular countries undertake investment spending in important national infrastructure projects (power, highways, health and education) that, in turn, encourage business expansion, create employment, lift incomes and improve living conditions for ordinary people.

4. **Providing international aid.** Increasing levels of official development aid (provided by the government) and non-official aid (provided by private individuals) can help ease some of the problems experienced in economically poor countries. Aid is a form of welfare provided by richer countries and transferred to economically poorer countries. Aid might take the form of grants or gifts like food aid, it may involve conditions (tied aid that is linked to buying products from the donor country), and it may involve loans where an interest rate must be paid (either ‘hard loans’ at normal interest rates or ‘soft loans’ at lower, more favourable rates). Figure 4.32 (p. 159) shows the nature and extent of international aid. Notice that Australia is a donor country (recently providing around $4 billion a year in official aid), while Afghanistan is a recipient nation. In addition, figure 4.33 (p. 159) indicates that official development aid expressed as a percentage of GDP was 1.12 per cent in Sweden, but only 0.29 per cent in Australia (although more recently our figure increased to nearly 0.4 per cent of GDP, before cuts in 2012–13).

5. **Provide specialist personnel and experts to work in major areas.** Low-income countries often lack skilled staff to help devise and implement development measures designed to reduce poverty. An important aspect of international action has been the provision of skilled specialists and technicians to work in key areas within particular low-income countries. These people are commonly found in health (to help eradicate preventable diseases like smallpox), agriculture (to improve farming methods, encourage the use of high yield crops), finance and economics, education and training, legal and administrative systems, and improved application of effective technology. These people can make a huge difference to poverty rates and the daily lives of ordinary individuals in low-income countries.

Economic growth significantly accelerated) it is estimated that 75 per cent of humanity lived in severe poverty. By contrast, today the figure is a mere 17 per cent.

Realising this, international action over the last six decades has focused on strategies designed to accelerate economic growth and improve the daily lives of ordinary people. Listed below are just some of the international initiatives aimed at promoting economic development and reducing poverty.

- **Promoting economic globalisation.**
- **Pursuing trade liberalisation.**
- **International development agencies.**
- **Providing international aid.**
- **Provide specialist personnel and experts to work in major areas.**
FIGURE 4.32 Where does international development aid come from and go to?
Source: Map has been copied directly from http://world-poverty.org/solutionstopoverty.aspx from an article entitled ‘World Poverty, a look at causes and solutions’ quoting the data link, The World Bank. Note, only some of this aid went to alleviating poverty.

Try applied economic exercise 9, pp. 163-4
Try the multiple-choice test, pp. 160-62
Try terminology revision, p. 162

FIGURE 4.33 The dollar value of net official development aid as a percentage of GDP
Source: Graph copied directly from Wikipedia, the free encyclopaedia, using ... http://en.wikipedia.org/wiki/Official_Development_Assistance that was based on OECD data.
In order to satisfactorily complete VCE Economics Unit 1, Part 2, the teacher must decide whether the student has demonstrated the general achievement of the set of outcomes specified for the unit, including **key knowledge** and **key skills** for Outcome 2. The teacher’s decision should reflect results from a selection of school-based assessment tasks. Generally, this assessment should take place as part of the normal teaching and learning program. In addition, most assessment will be completed in class under a limited time frame. With this in mind, teachers may select from an appropriate range of tasks provided on the following pages.

**Multiple-choice test questions**

Using the multiple-choice answer grid below, select the letter (A, B, C, D) that represents the most appropriate answer for each question by marking it with a tick (√).

### Answer grid

<table>
<thead>
<tr>
<th>Question</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
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<td>1</td>
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</tbody>
</table>

**Question 1**

Concerning the concepts ‘wealth’ and ‘income’, which of the following is true?

A. All income is regarded as ‘earned income’, whereas all wealth is ‘inherited’.
B. Income is the flow of monetary rewards that is normally measured over a period of time, whereas wealth is the value of assets measured at a point in time.
C. Wealth does not generate income but it can help to generate even more wealth.
D. Interest is the income from property, whereas dividends are income from ownership of company shares.

**Question 2**

‘Wages’ represent:

A. earned income.
B. unearned income.
C. transfer income.
D. the reward for the sale of property.

**Question 3**

Which of the following statements is most correct? Transfer income from the government:

A. is usually payable only to those with low incomes and wealth.
B. helps to provide a minimum income and living standard for the poor.
C. is largely paid for by relatively richer households and companies.
D. Any or all of the above are largely correct.

**Question 4**

Concerning Australia’s measurement of income distribution, which statement is false?

A. Statistical data are collected by the ABS through its ‘income survey’.
B. Income distribution relates to the way wages and other forms of income are shared between individuals.
C. The greater the deviation of the Lorenz curve from the diagonal line, the less the degree of inequality.
D. The Gini coefficient is a number between 0.00 and 1.0. It measures the level of inequality and its value is related to the area between the diagonal on a Lorenz diagram and the actual Lorenz curve.

**Question 5**

The Australian government’s goal of ‘equity’ in the distribution of income and wealth does not mean:

A. that income should be divided totally evenly between individuals.
B. that poverty should be avoided.
C. that everyone should be able to access basic goods and services.
D. that everyone is entitled to basic living standards.

**Question 6**

Referring to the Lorenz diagram below (figure 4.34), which statement about curve B on the diagram is most correct?

**Figure 4.34**

A. The poorest 50 per cent of households receive around 50 per cent of the income cake.
B. The poorest 50 per cent of households receive around 70 per cent of total national income.
C. The poorest 50 per cent of households receive 0 per cent of income.
D. The poorest 50 per cent of households receive around 15 per cent of total national income.

**Question 7**

From the diagram above, the Gini coefficient for a country with a Lorenz curve B would be about:

A. 0.5.
B. 1.0.
C. 0.0.
D. 10.0.
Question 8
Examine table 4.4 showing equivalised disposable income distribution (non-cumulative figures) by quintile for four countries.

**TABLE 4.4** Equivalised disposable income distribution by quintile (non-cumulative percentage)

<table>
<thead>
<tr>
<th>Country</th>
<th>Quintile 1</th>
<th>Quintile 2</th>
<th>Quintile 3</th>
<th>Quintile 4</th>
<th>Quintile 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alpha (percentage of income)</td>
<td>1.0</td>
<td>4.0</td>
<td>11.0</td>
<td>20.0</td>
<td>64.0</td>
</tr>
<tr>
<td>Beta (percentage of income)</td>
<td>4.0</td>
<td>9.0</td>
<td>15.0</td>
<td>24.0</td>
<td>48.0</td>
</tr>
<tr>
<td>Gamma (percentage of income)</td>
<td>10.0</td>
<td>15.0</td>
<td>20.0</td>
<td>25.0</td>
<td>30.0</td>
</tr>
<tr>
<td>Delta (percentage of income)</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
</tr>
</tbody>
</table>

Which statement is *incorrect* about the distribution of equivalised disposable income in these four countries?
A Alpha has the most uneven distribution of income.
B The Gini coefficient for Delta would be 0.0.
C The poorest 60 per cent of households in Gamma would receive 25 per cent of the income cake.
D The richest 40 per cent of Beta households would receive 72 per cent of all equivalised disposable income.

Question 9
Nowadays in Australia, the poorest 20 per cent of households receive about:
A 4 per cent of equivalised disposable income.
B 7 per cent of equivalised disposable income.
C 12 per cent of equivalised disposable income.
D 16 per cent of equivalised disposable income.

Question 10
Concerning income and wealth distribution in Australia, which statement is *correct*?
A The poverty rate (before housing) is about 30 per cent of households.
B The poverty rate (before housing) is between 10 and 20 per cent of households.
C The Gini coefficient for the distribution of equivalised disposable income is more than 0.5.
D Wealth is distributed more evenly than income as judged by percentage shares by quintile.

Question 11
Often relatively well-paid workers in Australia:
A possess relatively scarce skills and talents.
B perform difficult, responsible or dangerous tasks.
C work longer hours.
D All of the above may be explanations that reflect the operation of the labour market.

Question 12
High wages are *least likely* to be gained by workers in industries where:
A firms operate in markets that resemble pure competition.
B a strong union operates in the industry.
C workers are usually employed full-time rather than part-time in the industry.
D firms are highly profitable and efficient.

Question 13
Which of the following is the *least likely* explanation of income inequality and lower material living standards?
A There is high unemployment.
B There is rapid inflation resulting in speculative gains by some groups.
C There is a progressive wealth tax on the inheritance of assets worth more than $10,000.
D Education to age 15 years is neither free nor compulsory, and unionism in the labour force has declined.

Question 14
Study the data in table 4.5 relating to three different types of income tax. From the data, which statement is *correct*?

**TABLE 4.5** Data relating to different types of income tax

<table>
<thead>
<tr>
<th>Annual taxable income</th>
<th>Annual value of revenue collected from the three types of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000</td>
<td>Tax no. 1</td>
</tr>
<tr>
<td>$20,000</td>
<td>$1000</td>
</tr>
</tbody>
</table>

A Tax no. 2 has regressive rates.
B Tax no. 1 and tax no. 3 have progressive rates.
C Tax no. 1 and tax no. 2 have proportional rates.
D Answers A, B and C are all incorrect.

Question 15
The introduction of a 10 per cent GST on all goods and services, in itself, tended to:
A make income distribution more even.
B make income distribution more uneven.
C have no effect on the distribution of income.
D have an effect on income distribution but it is impossible to predict the overall impact.

Question 16
If the distribution of income became more *uneven*, this is likely to:
A cause unemployment to rise because spending power is in the hands of too few people who save a larger proportion of their income than if income was spread more evenly.
B cause more resources to be allocated to the production of luxuries rather than to necessities.
C increase crime and social unrest.
D result in answers A, B and C.

Question 17
Concerning Australian government taxes, which statement is *true*?
A Company tax is a progressive tax.
B Personal tax is a progressive tax.
C The exemption of essential goods and services from the GST has made the tax more regressive than otherwise.
D A progressive tax is one where the amount of tax paid rises, even if this rise is at a slower rate than income.

Question 18
Which of the following policies is *least effective* in helping the poor to enjoy a reasonable living standard?
A The setting of minimum wages.
B The payment of government welfare benefits to those qualifying under the means and assets tests.
C The government’s provision of affordable community or public services such as education and health.
D Reducing the marginal rates of personal income tax across all tax brackets.

Question 19
Which of the following is *least likely* to help promote equity and improved material living standards?
A A 10 per cent excise tax imposed on milk and bread.
B Making superannuation contributions by employers compulsory on behalf of their workers.
C Government policies to lower both unemployment and inflation.
D Requiring that the young unemployed be involved in education if they want access to welfare.

Question 20
Which of the following would be *least damaging* to equity in the distribution of income?
A A move to abolish the ‘user-pays’ principle for the provision of government services made available to the poor.
SCHOOL ASSESSMENT TASKS AND LEARNING ACTIVITIES

Applied economic exercises

**Question 1**
A What are the main differences between income and wealth?
B How can income be used to increase your wealth?
C How can wealth help increase your income and material living standards?

**Question 2**
A What is meant by the distribution of income and how would this impact on living standards?
B Explain how the ABS measures the distribution of income.
C What is a Lorenz diagram?
D What does the Gini coefficient for equalised disposable income actually measure?
E Explain what is meant by the poverty line.

**Question 3**
Examine the statistics shown in table 4.7 relating to Australia’s distribution of equalised disposable income and wealth (net worth) by individual quintile and cumulative quintile.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Quintile 1</th>
<th>Quintile 2</th>
<th>Quintile 3</th>
<th>Quintile 4</th>
<th>Quintile 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equivalised disposable income share by individual quintile, 2011–12 (percentage of total income)</td>
<td>7.5</td>
<td>12.6</td>
<td>17.3</td>
<td>23.0</td>
<td>39.6</td>
</tr>
<tr>
<td>Equivalised disposable income share by cumulative quintile, 2011–12 (percentage of total income)</td>
<td>7.5</td>
<td>20.1</td>
<td>37.4</td>
<td>60.4</td>
<td>100</td>
</tr>
</tbody>
</table>

**Question 4**
A Clearly explain any three of the following causes of inequality in the distribution of income (and living standards) in Australia:
• the operation of demand and supply in the labour market
• unemployment
• inflation
• changes in overseas economic conditions.
B Explain any one of the following causes of inequality in the distribution of wealth in Australia:
• inheritance
• income inequality
• luck.

**Question 5**
Labour market forces of demand and supply play a big part in deciding personal incomes in Australia. From the following list, select one ‘high’ and one ‘low’ income occupation (two examples in total) and then identify the specific demand or supply factors in the labour market that are causing income to be either high or low for that particular occupation or person.
- The manager of the National Australia Bank
- A junior kitchen worker at McDonald’s
- A small-scale farmer
- A successful heart surgeon
- A brilliant computer engineer and designer
- A person with a poor ‘work ethic’
- An assembly line worker at Toyota, Altona
- Tennis player, Roger Federer (reported salary of over $61 million)

**Question 6**
A Most governments believe that inequality in income and wealth is beneficial for economic growth and living standards. Explain two important ways whereby inequality is beneficial in helping to strengthen economic growth and raise Australian living standards.
B In what ways does inequality in income lead to a misallocation or misuse of resources?

**Question 7**
A What is meant by the progressive tax on personal income? How does this differ from a regressive tax?
B Use the data in table 4.8 to create a graph showing how Australia’s marginal tax rate steps upward as personal income rises.
Before answering the next few questions, examine figure 4.29 on p. 155 showing extreme or absolute poverty rates by country.

B Referring to figure 4.29 (p. 155) and using an atlas, list and name five countries where there are poverty rates above 60 per cent. On which continent are all these countries located?

C Explain how each of the following might cause higher poverty rates in the countries you just named (in question B above):
   i. lack of skilled and educated workers
   ii. low levels of investment spending on infrastructure
   iii. high levels of tariff protection operated by some countries that restrict international trade
   iv. incompetent and corrupt government.

D Quoting statistics, describe the levels of extreme poverty in China, Brazil and Turkey.

Before answering the next question, study figure 4.35. This graph has been selected from the United Nations, Millennium Development Goals Report, 2013.

**TABLE 4.8 Marginal tax rates on personal incomes in Australia**

<table>
<thead>
<tr>
<th>Annual taxable income bracket ($)</th>
<th>Marginal tax rate (at July 2014)*</th>
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<tbody>
<tr>
<td>$0–$18,200</td>
<td>0</td>
</tr>
<tr>
<td>$18,201–$37,000</td>
<td>19</td>
</tr>
<tr>
<td>$37,001–$80,000</td>
<td>32.5</td>
</tr>
<tr>
<td>$80,001–$180,000</td>
<td>37</td>
</tr>
<tr>
<td>$180,001 and upwards</td>
<td>45</td>
</tr>
</tbody>
</table>

*Excludes Medicare levy of 2.0 per cent.

C Calculate the total amount (in dollars) of personal income tax payable on each of the following taxable incomes:
   • $18,201
   • $190,000.

D Using table 4.8, what is the tax-free threshold? In July 2012, the federal government raised the tax-free threshold to $18,200 from $6000. Additionally over the years it lowered the marginal tax rate on higher incomes, and tax bracket thresholds were generally increased. What effects would these changes tend to have on Australia’s pattern of distribution of income?

E In general, why are indirect taxes levied on goods and services purchased by households considered to be regressive? What are the features of the GST that have helped to limit the regressiveness of the tax?

F Assume that you were the treasurer revising the GST. Which six of the following items would you tax if you wanted to make this tax more progressive? Be prepared to justify your answers.
   • cosmetics
   • holidays
   • above-ground plastic swimming pools
   • public transport tickets
   • takeaway foods
   • restaurants
   • fresh fruit and vegetables
   • medical prescription drugs
   • contraceptives
   • textbooks
   • petrol
   • tax accountant fees
   • international departures
   • taxis
   • bread
   • imported French wines

**Question 8**
Explain how each of the following government economic policies would be likely to affect the level of equity in the distribution of income and wealth in Australia.

A An increase in the minimum wage to $622 (e.g. 2013–14)

B The extension of enterprise agreements (between 1991–2013)

C A tightening of the assets or means tests applied to welfare benefits (e.g. 1996–2013)

D An increase in the superannuation guarantee charge rate paid by employers on behalf of their employees (e.g. 1992–2006 and 2014–2019)

E Making the minimum wage for junior employees lower than that for adults in the same occupation

F A cut in interest rates to reduce unemployment levels (e.g. 2008–09, 2012–14)

G A move towards the ‘user-pays principle’ in the provision of government or public services (e.g. in state education, freeways, health in the 1990s, 2000s and 2010s)

H A rise in interest rates to slow inflationary pressures (e.g. 2002–08, 2009–11)

**Question 9**
A How does the United Nations currently define and measure the level of extreme poverty?

B Referring to figure 4.29 (p. 155) and using an atlas, list and name five countries where there are poverty rates above 60 per cent. On which continent are all these countries located?

C Explain how each of the following might cause higher poverty rates in the countries you just named (in question B above):
   i. lack of skilled and educated workers
   ii. low levels of investment spending on infrastructure
   iii. high levels of tariff protection operated by some countries that restrict international trade
   iv. incompetent and corrupt government.

D Quoting statistics, describe the levels of extreme poverty in China, Brazil and Turkey.

Before answering the next question, study figure 4.35. This graph has been selected from the United Nations, Millennium Development Goals Report, 2013.

**FIGURE 4.35 Proportion of people living on less than $1.25 a day, 1990, 2005 and 2010 (Percentage)**

**E Quoting supportive statistics from figure 4.35, in which regions of the world have poverty reduction programs been ... i most successful ii least successful?**

**Note**: No sufficient country data are available to calculate the aggregate values for Oceania.

In successful countries, what is likely to be the single most important reason for the reduction in rates of severe poverty in recent decades?

How might each of the following actions by the international community help to reduce extreme poverty and inequality?

i. The promotion of free trade agreements and trade liberalisation.

ii. In 2010–11, the provision of official foreign aid by the world’s 23 leading countries amounted to around US$125 billion. Of this, Australia donated nearly $4 billion.

Assume that you were in charge of how foreign aid was used in a low-income country like Chad in Central Africa. List three specific types of project you believe would most help to reduce extreme poverty. Giving reasons, explain your choice.

A report on an investigation into inequality

Question 1: Inequality in your economics class

Aim
Your task is to research the distribution of income and the distribution of wealth in your economics class, and report your findings.

Collecting the statistical information
You may proceed using the following steps:

1. Your teacher should photocopy the survey form shown in table 4.9 and distribute one to each member of the economics class for completion. There should be discussion about the nature of income and wealth. Income (e.g. wages from a job, gifts, tips, allowance or pocket money, interest from a savings account, dividends from shares) in the survey should represent an estimate for the last complete financial year (e.g. 2013–14). Wealth should be an estimate of the value of your assets (e.g. personal savings, shares, property, share of trust, possessions worth more than $500 per item) on the day of this survey. Forms should not put their name on their form).

2. Collect the completed survey forms (for privacy, students should not put their name on their form).

3. Process the completed forms. First, rank student income levels from lowest to highest and divide them into five equal-sized income groups or quintiles. Second, tally up the total income for each quintile and for the class as a whole. Third, work out what percentage each quintile’s total income is of the total class income. This will mean that you should now have percentage income shares by quintile from lowest income quintile through to the highest income quintile. Repeat the same process to gain the same information about the wealth distribution for your economics class. Use this information to complete a table similar to table 4.10 (which is only suitable for recording a survey result for 10 students, two per quintile).

4. Use these tables of survey results and, in particular, the cumulative results (i.e. the last column of each table) to neatly plot a Lorenz diagram or graph showing:
- the labelling of the two axes and scales (i.e. 0–100 per cent for each)
- a Lorenz curve showing the distribution of class income
- a Lorenz curve showing the distribution of class wealth
- the diagonal lines of total equality
- the lines of total inequality.

If you are mathematically inclined, you can roughly estimate the area (by counting up the squares on graph paper) between the diagonal line of total equality and the actual Lorenz curve. This allows you to calculate a Gini coefficient. Your answer will be a number between 0.00 and 1.00.

5. Write a brief report in which you analyse the causes of income and wealth inequality in your economics class. Try to identify and explain several factors that make students rich or poor.

Presentation
Your work could be presented as a wall chart, report or oral presentation in class illustrated using PowerPoint slides.

### TABLE 4.9 Survey form for the distribution of class income and wealth — your personal details

<table>
<thead>
<tr>
<th>‘Income’ survey — economics class</th>
<th>Value ($)</th>
<th>‘Wealth’ (net worth) survey — economics class</th>
<th>Value ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wages from a part-time job</td>
<td></td>
<td>Bank savings (total value or balance)</td>
<td></td>
</tr>
<tr>
<td>Tips</td>
<td></td>
<td>Current market value of shares owned</td>
<td></td>
</tr>
<tr>
<td>Pocket money or allowance</td>
<td></td>
<td>Personal possessions (items over $500 each)</td>
<td></td>
</tr>
<tr>
<td>Gifts or presents from family or friends</td>
<td></td>
<td>Valuables and antiques you own</td>
<td></td>
</tr>
<tr>
<td>Interest received from savings</td>
<td></td>
<td>Value of property held in your name</td>
<td></td>
</tr>
<tr>
<td>Dividends received from shares</td>
<td></td>
<td>Your value of a trust or inheritance</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Subtract any money owed by you</td>
<td></td>
</tr>
</tbody>
</table>

Your total income for the past 12 months

Your current total net value of assets or wealth

### TABLE 4.10 (a) Results for the economics class ‘income’ survey

<table>
<thead>
<tr>
<th>Rank income of class by quintile from lowest to highest income</th>
<th>Student income by rank order</th>
<th>Student total income ($) by quintile order</th>
<th>Quintile share (percentage) of total income by rank order</th>
<th>Cumulative (progressive total) quintile share (percentage) of income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quintile 1: student 1</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 2: student 2</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 3: student 3</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 4: student 4</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 5: student 5</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 6: student 6</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 7: student 7</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 8: student 8</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 9: student 9</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>Quintile 10: student 10</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
<tr>
<td>TOTAL incomes</td>
<td>$.........................</td>
<td>$......................... %</td>
<td></td>
<td>$......................... %</td>
</tr>
</tbody>
</table>

(= 100%) (= 100%) 100% N/A
Question 2: Inequality and Indigenous Australians

Aim
Indigenous Australians often endure severe poverty and have some of the lowest living standards in the world. Your task is to investigate the nature and level of inequality in living standards for Indigenous Australians, and present a report of your findings. This task will require that you contrast the living conditions and wellbeing of Indigenous people against those of other Australians. In addition, you need to outline what you feel are five practical policy suggestions about how the Australian government might improve everyday life for Indigenous Australians.

Structure of your investigation
Your report should be broken into two main parts.

1. How do the living standards of Indigenous Australians contrast with those of other Australians?
   - In conducting research on this aspect, you might consider some of the following:
     - unemployment rates, hours worked, types of work and access to jobs
     - the role of discrimination and commonly held views in the community
     - primary, secondary and tertiary education rates and attainment
     - health standards and disease rates
     - life expectancy
     - sources of income and income levels
     - geographic location
     - access to important services
     - family structures and attitudes
     - crime and violence.

2. Outline five important government policies for Indigenous people. From 2007 on, the federal government announced significant changes to aspects of its policy towards Indigenous Australians and acknowledged the limited success of past policies. In this section, you need to discuss five important aspects of government policy that you believe might help to improve the daily living standards of Indigenous Australians.

Getting started
Start by viewing the commercially available DVD called *The Fringe Dwellers* (PG). This is a thought-provoking, Australian-made film set in an outback town portraying the daily lives of a group of Indigenous Australians. Next, go online and complete some careful research, perhaps assisted by a search engine (e.g., Google). The ABS and other agencies publish relevant information. For example, note the following ABS publications:
- *Australian Social Trends* (2013), publication number 4102.0
- *Directory of Education and Training Statistics* (2009), publication number 1136.0
- *Directions in Aboriginal and Torres Strait Islander Statistics* (2007), publication number 4714.0
- *National Aboriginal and Torres Strait Islander Social Survey* (2009), publication number 4714.0
- *The Health and Welfare of Australia’s Aboriginal and Torres Strait Islander Peoples* (2012), 4704.0
- *Themes — Indigenous — Directions in Australia’s Aboriginal and Torres Strait Islander Statistics* (2013), publication number 4102.0

Additionally, you may conduct a newspaper search to find relevant articles. Your research should also include digital images and photographs to illustrate your report.

Presentation
You should present your report, either as:
- a document
- a PowerPoint slide show that highlights your talk to the class.

An annotated media commentary
Read the edited newspaper article ‘The great wealth divide’ before developing notes that answer the questions that follow.

The great wealth divide

20 per cent hold most of the assets
By TIM COLEBATCH
Economics Editor, Canberra

AUSTRALIA is egalitarian in style, but not in wealth.

A landmark Bureau of Statistics survey has found that almost 60 per cent of Australian households’ wealth is owned by the richest 20 per cent of households, while the bottom 20 per cent own just 1 per cent.

The ABS’s annual snapshot of social trends, released yesterday, found that the richest 20 per cent of Australian households has, on average, $1.4 million in net assets. By contrast, the bottom 20 per cent averages $24 000.

(continued)
It is the first time for almost a century that the bureau has conducted a wealth survey, so it is not known whether the disparity is growing or shrinking.

The report surveys trends in 25 aspects of society, ranging from housing to energy use, from work to family and from health to wealth.

The most stunning figures in the 200-page report, however, are those revealing the disparity in household wealth, with the richest 1.5 million households possessing, on average, more than 50 times as many assets as the poorest 1.5 million. Part of that is due to age.

The net worth of a household is greatest when its head is aged 60 to 64 — and of the richest 20 per cent of households, four in five are headed by someone 45 or over. Two-thirds of the poorest 20 per cent of households are headed by someone under 45.

In the richest households, 97 per cent own their home with an average equity of $573,000, as well as $257,000 in rental property. By contrast, among the poorest, only 4 per cent are home owners, and their average stake is just $4000.

For those at the bottom, their wealth is mostly in household items and cars. They own no shares or businesses, and average just $5000 in superannuation. Those at the top average $188,000 in super, $174,000 in their own businesses, $76,000 in shares and $62,000 in the bank.

The net worth of a household is greatest when its head is aged 60 to 64 — and of the richest 20 per cent of households, four in five are headed by someone 45 or over. Two-thirds of the poorest 20 per cent of households are headed by someone under 45.

### WHAT HOUSEHOLDS OWN

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Wealthiest 20%</th>
<th>Least wealthy 20%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total value of wealth ($’000, net assets or worth)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of equity or ownership in the family home ($’000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of superannuation ($’000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of household items ($’000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of businesses owned ($’000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Savings deposits ($’000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of shareholdings in companies ($’000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of cars owned ($’000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value of family trust assets ($’000)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Data from the ABS, survey of net worth.

### A presentation: oral, multimedia or visual

#### Question 1: Income distribution quest Presentation

Present your findings either orally or visually using multimedia (e.g. a PowerPoint presentation).

#### Instructions

Working in pairs, you have 3–5 lessons to brainstorm and conduct a web quest and other research about aspects of Australia’s income distribution. Efficient use of class and homework time, accuracy and neatness are important to win valuable prizes and marks. Ready or not, at the end of the allowed time, you and your partner will be asked to make a 3–4 minute marked presentation to the class about your research findings in a particular category (from 1 to 8, see below) that is randomly nominated.

To complete this research activity, select question(s) from each of the following eight categories (maximum or minimum points stated on each category) to make up a total of 100 points upon completion. Note that easier questions are worth fewer marks and some questions are compulsory. In total, this means potentially 100 marks for the survival quest!

1. Background to the theme of income inequality
2. Definitions
3. Causes of income inequality and poverty — propose a theory
4. Opinions about inequality
5. Evidence of income inequality
6. A scenario
7. Government policy
8. Create a concept map about the topic of Australia’s income distribution

Some references are included in this activity, but you are on your own for others. Search engines using the internet are a great help. Be brave!

#### Category 1: Background to the theme (5 points needed)

1. Find a poem or quotable quote about ‘poverty’, ‘the poor’ or ‘the rich’. (5 points)
2. Find or take a digital photograph, a picture or a painting that you feel best illustrates poverty and income and wealth inequality. (5 points)

#### Category 2: Definition (5 points needed)

1. What is meant by the term ‘income’? (5 points)
(4) What is meant by the term ‘wealth’? (5 points)
(5) Explain what comes into your mind when we use the term, ‘the distribution of income’? (5 points)

Category 3: Causes of income inequality and poverty — propose a theory (15 points needed)
(6) To a large extent, the demand and supply of each occupation determines the price of labour or weekly wages. Neatly complete and fully label the hypothetical D–S diagram for Australia’s labour market showing why successful CEOs of large companies get paid more than service station attendants. (10 points)
(7) What made James Packer (Kerry Packer’s son) or Gina Rinehart (Lang Hancock’s daughter) very rich? (5 points)
(8) What is the basic reason why some people (e.g. Justin Bieber, David Beckham) get high pay and others get low pay? (5 points)
(9) Currently, youths have a lower minimum wage than adults in a particular job. Why would it be a bad thing economically to pay 15- to 19-year-old youths the same pay as an adult in the same job? (5 points)
(10) Propose and explain an economic theory to explain why several CEOs in large Australian companies get paid between $10–30 million a year (an average of over $80,000 a day)! (10 points)

Category 4: Opinions about income inequality (5 points needed)
(11) Do you think that income inequality is a good thing? Explain one sound and important reason. (5 points)
(12) Draw a small but neat cartoon (with a caption) that is critical of the rich or upper class OR critical of the poor. (5 points)
(13) Outline the views of charitable organisations OR the Australian Council of Trade Unions (ACTU) about income distribution in Australia. (5 points)

Category 5: Researching evidence and level of income inequality (20 points needed)
(14) How much does a junior cook or counter assistant at McDonald’s receive per hour? Quote your sources accurately. (5 points)
(15) Do women get equal pay to men in the same job? Explain using statistics. Quote your sources accurately. (5 points)
(16) What is the distribution of income by quintile (20 per cent groups) or decile (10 per cent groups) shares (percentage of total ‘income cake’ for each group) in, say, Mexico or any South American nation? (5 points)
(17) In which two Australian states are average weekly wages highest and lowest? Explain using evidence derived from the ABS (see weblink). (5 points)
(18) Find out how much a well-known pop star or sportsperson gets paid (e.g. it does not matter whether it is per year, per game, per performance, etc). Quote your sources accurately. (5 points)

(19) What is the current level of the minimum wage set by Fair Work Australia? (5 points)
(20) What are the responsibilities of Fair Work Australia? (5 points)
(21) Collect two recent newspaper or internet job ads (one for a well-paid job, one for a low-paid job) that illustrate income differences between occupations. Mount these and use them to explain differences in the wages. Quote your sources accurately. (5 points)
(22) If you haven’t already done so, complete the survey of income and wealth distributions in your year 11 economics class (tables 4.9 and 4.10, pp. 164–5) and, on graph paper, neatly create and fully label two Lorenz diagrams that plot the two sets of results. Next, from your two graphs, estimate the two Gini coefficients (one for income, one for wealth). Make clear conclusions about (i) the level of inequality in the class and (ii) three likely and important reasons explaining the level of inequality in income and wealth. (15 points — compulsory question)

Category 6: Scenario about income inequality (30 points needed)
(23) Go to the Australian government’s Centrelink website and find out the most recent amount each of the following individuals would receive each fortnight. (30 points — compulsory question)
1. A single unemployed person, no children
2. A full-time tertiary student
3. A retired aged couple
4. A single mother with two children
5. A married veteran from World War II
6. A low income family with two children
• Select one of these Centrelink welfare recipients and imagine you are that person. You have only $100 in the bank and do not have a credit card.
• What are the particular conditions (e.g. means or assets tests) that apply to you receiving this assistance from Centrelink?
• Using Excel, draw up your detailed ‘personal budget’ for the fortnight, stating income and expenses. Assume that you have to:
  – rent a flat (select an actual newspaper cutting that you must present as evidence in your report, that offers a property for rent that you might be able to afford)
  – buy food (accompanying documents must show your meal menu), clothing, power, transport and the like
  – describe the effects of low income on your existence and living standards.

(24) ‘Indigenous Australians are generally among the poorest groups in Australia. In a nation of affluence, often they endure poverty and poor living standards equal to those in the Third World.’ Quoting ‘social indicators’, and other data from the ABS and elsewhere, write a short newspaper headline article that supports the view put in this quote about the social and economic effects of low incomes. (10 points)

View the TV program Broken Borders.

Category 7: Government policy to redistribute income more equitably (10 points needed)
(25) What is the top marginal rate (percentage) of personal income tax that was announced by Federal Treasurer Wayne Swan (in his most recent budget), and from what taxable
SCHOOL ASSESSMENT TASKS AND LEARNING ACTIVITIES

income level per year does that apply? Calculate the tax payable on $200 000 a year personal taxable income. (5 points)

Visit the Treasury website and view online the latest budget as reported in the newspapers. (26)

Find out why contributing to superannuation is one of the best and fastest ways to grow your personal wealth. (5 points)

Why might the Australian government have to cut the relative level of the aged allowance or pension in the next three to four decades or increase the pension age (e.g. to 67)? What must the future aged population try to do, with this in mind? (5 points)

What is wrong with having the minimum wage set above the equilibrium level of wages in the labour market? (5 points)

Be the treasurer for the day and change budgetary policy so that it helps the poor. Do this by playing the ‘Virtual economy’ and print out your policy changes and results from the site below. Print out your results as evidence of your policy changes. (10 points)

Category 8: Create a concept map summarising the topic of income distribution (10 points needed)

Create a concept map about income distribution showing measures for distribution, level of inequality, causes of inequality, effects of inequality, and government policies to promote the goal of greater equity in personal income distribution. You may like to use Mind Manager software to create your own mind map. (10 points — compulsory question)

Question 2: Explore a topic on wealth and income inequality through film

Presentation

Make a three to four minute DVD about one of the following topics related to income inequality:

• the causes of poverty
• the effects on our society of income inequality
  ‘rich man, poor man’
• ‘the unlucky, in the Lucky Country’.

Question 3: Create a wall chart on the causes, level and effect of income and wealth inequality

Presentation

Using ICT, prepare a wall chart for display about the causes, level and effects of inequality in Australia’s distribution of income and wealth, and government policy measures used to alleviate poverty. Using coloured cardboard, the chart could include a title, graphs, tables, callouts on graphs, cartoons, newspaper articles and point form blocks of text.

Alternatively, a comparison may be made between inequality of income and wealth in Australia and that in overseas countries. Perhaps try to find the countries with the most even and most uneven distribution of income. Briefly suggest possible reasons for these patterns in income distribution. For international statistics on income share by quintile or the Gini coefficient, try using the internet.

Economic simulation activity — want to be the treasurer for the day?

As treasurer for the day, students can explore the impact of changes in government policy (e.g. progressive tax, indirect tax, rebates and government spending) on the distribution of family incomes generally, by checking out the Virtual economy on the internet (try Floor 4), Biz Ed, UK.

A class debate

After dividing the class into teams (one for the affirmative and one for the negative), work with others to prepare a debate about one of the following topics.

1. ‘It is inevitable “that the poor are always with us”.’
2. ‘Welfare benefits are costly to taxpayers and government, and abused by recipients — they should hence be abolished.’
3. ‘The government should reintroduce death duties (a tax on the inheritance of wealth).’
4. ‘Australian society would be better off if there was less inequality in income and wealth’.

An essay

Write a 500-word essay about ‘the distribution of income and wealth in Australia’. You should examine the following areas.

1. Define what is meant by the federal government’s ‘goal of an equitable distribution of income and wealth’.
2. What is the extent of income inequality and poverty in Australia? In your answer, create and refer to graphs and other statistical evidence.
3. Identify and explain how the Australian government helps to promote a more equitable distribution of income.

View a DVD or program

To help understand the concept of income distribution, view some of the following DVDs or programs.

1. Economic Australia — Distribution of Income and Wealth (program 8), Australian Broadcasting Corporation
2. Some more Equal than Others — Inequality in Australia, VEA (rated E)
3. A Northern Town, SBS (rated PG), directed by Rachel Landers (the issue of racism)
4. Fringe Dwellers, ABC Films (rated M, fiction), directed by Bruce Beresford (starring Ernie Dingo and focusing on Indigenous issues)
5. Rabbit-Proof Fence, Fox (rated PG, fiction), directed by Philip Noyce (focusing on the Stolen Generation and Indigenous issues)
6. Food for All, New Atlantis (rated E, focusing on helping reduce global poverty).
7. Four corners — Gina Rinehart, the power of one (ABC 1, 25 June 2012)
8. Growing up poor (ABC 1, 3 October 2011)
9. Four corners — poor kids (ABC 1, 24 September 2012)
10. Four corners — on the brink (ABC 1, 1 July 2013)
11. Why poverty — program 1, Park Avenue — money, power and the American dream (ABC 2, 26 November 2012)
CHAPTER 4

SUMMARY

Income and wealth

- **Income** affects material living standards. It represents flow of money rewards over a
  time period, usually to those households selling resources.
- When labour is sold, this is called **earned income** as opposed to **unearned income** in
  the form of rent and interest, or **transfer income** from government welfare payments to
  the needy.
- **Wealth** is different — it is the value of assets (e.g. savings, shares, property, super-
  annuation, collectables) which often generate income for their owners (e.g. interest,
  dividends).

Measuring the distribution of income and wealth

- **Income distribution** refers to the way the income cake is shared or divided between
  individuals, groups or regions. This pattern of distribution affects living standards and
  may be fairly even or uneven.
- The ABS measures income distribution using a sample survey of households, to con-
  struct a range of measures. Three important measures of income distribution are:
  - market or **private income** (i.e. income from personal sources such as wages, interest,
    dividends, profits and rent, prior to government redistribution measures),
  - **equivalised disposable income** (i.e. income from all private sources after allowing
    for government welfare payments, the payment of income tax and adjustments
    made to reflect differences in household size and composition), and
  - **final income** (income from all private sources after allowing for the effects of govern-
    ment redistribution measures including welfare, income tax, provision of govern-
    ment services and payment of indirect taxes).
- From its survey data, the ABS calculates **quintile shares** (i.e. for five groups each repre-
  senting 20 per cent of households) of income. From this, a **Lorenz diagram** and curve
  can be drawn and a **Gini coefficient** calculated where 1.0 is total inequality and 0.0 is
  total equality in distribution.
- The ABS also calculates income by gender, state, occupation, educational attainment
  and age.
- The poverty line also provides a good guide to the pattern of income distribution and
  identifies those with very low living standards.
- Wealth surveys (net worth) are now also conducted by the ABS.

Recent trends in Australia’s distribution of income and wealth

- Both income and wealth are divided moderately unevenly in Australia, so material
  living standards will vary greatly between individuals.
- The distribution of **private income** (i.e. prior to government intervention to redis-
  tribute income) has become more uneven in the past decade, as has the distribution of
  **equivalised disposable income**. Between 1997–98 and 2011–12, there was a 3.2 per
  cent increase in inequality (i.e. an overall rise in the Gini coefficient. However, the was
  a 4.8 per cent fall in the Gini between 2007–08 and 2011–12).

Factors affecting Australia’s distribution of income and wealth

- A range of factors affect income and wealth distribution in Australia and, hence, mat-
  erial living standards.
- Foremost is the operation of the forces of demand for labour (e.g. affected by tastes,
  technology, economic conditions) and supply of labour (e.g. affected by education,
  skill, experience) in the labour market. Here, higher wages reflect greater scarcity
  and mean that supply is less than demand for labour, while lower pay means that supply is
  greater than demand.
- Incomes are also influenced by unemployment, hours worked, inflation, overseas econ-
  omic conditions, union effectiveness, luck, inheritance, age, education, discrimination,
  work ethic, charities and government policies designed to alter income distribution.

Effects of inequality in the distribution of income and wealth

- There are several effects of the distribution of income and wealth. Some are good,
  others are bad.
- In the **economy**, inequality may be good for compensating entrepreneurs for risk
  taking and business expansion, encouraging personal incentive and self-betterment,
  promoting higher efficiency and strengthening economic growth.
However, inequality also means that there are sharp social class divisions that can result in growing crime, unrest, political instability and lack of cohesion in society.

**Government policies for promoting an equitable distribution of income and wealth**

- A government goal is to promote an equitable distribution of income and wealth so that everyone has access to basic goods and services, and can enjoy reasonable living standards, thereby avoiding poverty.
- To better achieve equity and improve general living standards, the following government policies are used:
  - **Direct progressive income taxes** are used where the marginal tax rate rises with taxable income level (e.g. personal marginal tax rate range from 0–45 per cent, 2013–14). They take money from the rich which can then be used to pay for welfare and community services.
  - **Assets or means-tested cash welfare benefits** are paid only to the needy (e.g. aged, unemployed, families).
  - **Indirect taxes** on goods and services (e.g. GST, excise taxes on petrol, alcohol and tobacco, the carbon tax) are mostly regressive, but they are less so if necessities are exempted.
  - Governments sometimes provide free or subsidised community services (e.g. public health, education, housing, transport) to the needy at an affordable price, giving the poor access to basic goods and services. A recent concern is the move towards the ‘user-pays principle’ and privatisation.
  - The **minimum wage** is set by the Fair Work Australia and provides a ‘safety net’ to help ensure that workers are paid reasonable wages and can gain employment. However, recently, there has been some deregulation of the labour market. More workers have moved onto workplace or enterprise agreements negotiated firm by firm, causing greater income inequality than previously.
  - **Compulsory superannuation** contributions by employers on behalf of their employees help to provide retirement savings and ease the reliance on the pension.
  - The government has tried to **lower unemployment** (e.g. following the GFC in 2008–09–10) and **lower inflation** (e.g. during 2007–08 and 2011–13) using appropriate policies. By keeping unemployment and inflation down, the purchasing power of family incomes and general living standards are better protected.

**An international perspective on the distribution of income and wealth**

- There is much poverty in the world.
- **Comparative poverty** exists when people have quite low incomes relative to the standards deemed acceptable to the general community.
- **Extreme or absolute poverty** exists especially in low income, Third World countries. It occurs when people cannot satisfy even their basic needs for survival. This type of poverty is especially widespread in parts of Africa.
- One way to measure global poverty is to calculate what percentage of the world has an income of less than $1.25 per day after adjustments are made to reflect constant purchasing power (PPP). On this basis, 15 per cent of the world (i.e. over one billion people) still live in extreme poverty, despite dramatic reductions over the past 30 years.
- Normally, poverty reduction depends on countries lifting their productive capacity and GDP at a rate that is faster than population growth. This means overcoming problems commonly found in low income countries including limited resources, inadequate infrastructure, limited opportunities for international trade, incompetent and corrupt government, and great inequality in income and wealth.
- International action has helped to reduce the level of global poverty. Strategies have included the following:
  - Promoting economic globalisation
  - Pursuing trade liberalisation
  - The work of international development agencies
  - Providing international aid
  - Provision of specialist staff to work in low-income countries.
Creation and distribution of income and wealth as a contemporary economic issue

**FIGURE 4.36**

**Australian trends in distribution**

**Some factors causing inequality in income and wealth in Australia**

<table>
<thead>
<tr>
<th>Market forces—the operation of different conditions of supply and demand in the market for each type of labour. This reflects relative scarcity—skills, training, talent, responsibility, location, experience.</th>
<th>Unemployment levels and the participation rate amongst groups of individuals</th>
<th>Inflation levels</th>
<th>Overseas economic conditions</th>
<th>Luck</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unions</td>
<td>Inheritance</td>
<td>Age</td>
<td>Work ethic</td>
<td>Government policy</td>
</tr>
</tbody>
</table>

**Different trends are shown for different types of income and wealth:**
- Private or market income is distributed fairly unevenly, but wealth is divided far more unevenly.
- The Gini coefficient for equivalised disposable income has not charged greatly, but trended upwards overall between 1997–98 and 2011–12 showing increased inequality, despite a fall between 2007–08 and 2011–12.
- There was a fall in overall poverty rates, but a rise in child poverty.
- There is considerable inequality in wages between occupations, states and genders.

**Benefits, for example:**
- Increased incentive to work hard
- Increased incentive to gain skills
- Increased incentive to relocate
- Increased reward for risk taking and business expansion
- Higher savings and investment
- These help raise material our living standards.

**Costs, for example:**
- Divides society and reduces social cohesion
- Poverty and low living standards for some

**Australian government policies to reduce poverty and to promote the goal of an equitable distribution of income and wealth (i.e. everyone has access to basic goods and services and can enjoy reasonable living standards):**

- **Progressive taxes** with rates rising with income (apply Robin Hood principle) to lower the income of the rich and finance budget outlays
- **Assets and means tested cash welfare benefits** to lift the income of the neediest (e.g. unemployed, aged, sick)
- ** Provision of affordable or free government services** (e.g. health and education) improves living standards
- **Set the minimum wage and other conditions as a safety net for the low paid**
- **Introduce and increase compulsory superannuation to lift retirement incomes**
- **Use policies to keep unemployment and inflation low to maintain the purchasing power of incomes**

(continued)
Survey of absolute poverty—15% of world’s population live in extreme poverty, on less than $1.25 per day. Levels are falling.

Global poverty is characterised by lack of food safe water, health, housing, education.

Global poverty is caused by international factors and domestic conditions.

International action to help reduce poverty includes:
- Promoting globalisation
- Trade liberalisation
- International development agencies
- International aid.
- Provision of specialist personnel.

Elective for Unit 1, Outcome 2

A contemporary economic issue selected by the teacher or students

You may recall that Unit 1, Outcome 2, of the course requires that all students study the contemporary issue of economic growth and sustainable development. In addition, one of the following electives must be selected:

- creation and distribution of wealth and income
- inflation
- an economic issue selected by the teacher or students.

Already the first two of these electives have been covered in chapters 3 and 4 of this text. See the VCAA Economics Study Guide, 2010–16, for those wanting the freedom to explore the third elective — an economic issue selected by the teacher or students.