

Internal Assessment Resource

Economics Level 2

Notes For Achievement Standard 91228

Analyse a contemporary economic issue of special interest using economic concepts and models

Resource title: Poverty, Inequity and Inequality in New Zealand

Internal - 4 credits

Achievement	Achievement with Merit	Achievement with Excellence
<ul style="list-style-type: none">Analyse a contemporary economic issue of special interest using economic concepts and models.	<ul style="list-style-type: none">Analyse in depth a contemporary economic issue of special interest using economic concepts and models.	<ul style="list-style-type: none">Analyse comprehensively a contemporary economic issue of special interest using economic concepts and models.

Some Basic Terms:

Income is a flow of factor incomes to households such as wages and earnings from work; rent from the ownership of land and interest & dividends from savings and the ownership of shares

Wealth is a stock of financial and real assets such as property, savings in bank and building society accounts, ownership of land and rights to private pensions, equities, bonds etc

EQUITY AND EQUALITY

Equity and equality have slightly different shades of meaning:

- **Equity - *what is fair – this is a matter of opinion – what some people see as fair, others may not.***
- **Equality means - being equal – people are treated the same or are on the same level.**

Achieving economic equity involves taking into account all the individual circumstances before doing what is fair. But who decides what is economically equitable is often the subject of heated debate.

- **Horizontal equity looks at treating people in the same situation the same. so for example all children in new zealand are able to receive a free education – they are all treated the same.**
- **Vertical equity looks at what it is fair to people in different situations. people are treated according to their individual circumstances.**

Equity is a hugely important issue among economists. You should be looking to make a comment on equity on a wide range of economic and social issues – for example the future of the free hospital care, the funding of higher education and the effects of globalisation.

Equity is a **non measurable concept** and concerns the fairness with which scarce resources are allocated among competing ends. Inevitably there are huge disagreements between people as to what an equitable distribution of resources should be.

Some people argue for much great **equality** in the post-tax distribution of income and wealth achieved by making the tax and benefit system much more progressive. They believe that a lack of equity leads to **market failure** because each dollar of income equates to an economic vote. And since resources tend to flow to those markets where economics votes are highest, a high level of inequality can lead to what is perceived as being an unfair allocation of goods and services.

Reducing the scale of income inequality is justified on the grounds of the social (such as crime, poor health) arising from high levels of poverty and social exclusion. Effectively the case for having a more progressive tax and benefits system rests on a belief that the state can play an active role in achieving greater social justice.

Other “free-market” economists believe that deliberate attempts by the government to artificially make the distribution of income and wealth more equal will penalise entrepreneurial risk-taking, damage work incentives, and ultimately undermine the competitiveness and success of market-based economic systems.

Vertical equity is the unequal treatment of unequals. **Horizontal equity** is the equal treatment of equals.

Horizontal equity is the principle that people on the same incomes should pay the same amount in income tax. In order to achieve vertical equity, taxpayers with different resources must be treated differently, for example, by having a progressive tax system.

We talk about the tax system operating fairly and we consider the welfare state as a mechanism for providing a fair basic standard of living for people living in this country. Inevitably though, our perceptions about what is "fair" are wrapped up in our own valued-judgements and beliefs.

The difference between absolute and relative poverty

Absolute poverty

Absolute poverty measures the number of households unable to afford what are agreed to be basic or essential goods and services. There is always a degree of subjectivity in deciding which goods and services should be included in a definition of a basic standard of living. The concept of absolute poverty for people living in Britain is clearly different for poor households in less economically developed countries.

Relative poverty

Relative poverty measures the extent to which a household's financial resources falls below an average income level. There is little doubt that Britain has become a more unequal society over the last 25 years reflected in a persistently high level of relative poverty.

The official relative poverty line

The poverty line is currently measured at 60 per cent of median income level – where the median is the

level of income after direct taxes and benefits, adjusted for household size, such that half the population is above the level and half below it. This definition is a standard that changes as median income levels change; it is a measure of relative poverty.

There are numerous explanations both for the existence and persistence of a huge divide in incomes and wealth within NZ. Most of them are directly economic in origin, but some are linked to social change. A summary is provided below:

- *Culture and values can influence the decisions some families make regarding education or the accumulation of material things.*
- *Access to opportunities can be hindered by regional differences in resource endowment, support for education is lacking or isn't a high priority for some families.*
- *Unequal opportunities can also include gender income differences—the gender statistics consistently show that women are paid less than men in each ethnic group, which students should view as inequitable.*
- *The forces of supply and demand determine what people get paid so a professional sports person or movie actor can be paid a lot more than many professional people like doctors or lawyers. This is evidence of inequity of market income. However, generally a professional will be paid more than a labourer, which is evidence to support the equity of income inequality.*
- *Tertiary education indicates future income potential. Generally a degree increases your earning potential as shown by wage/salary statistics, which can be argued as being equitable or fair due to the effort and cost involved in getting a tertiary education.*
- *Age and experience affects income. As we get older our income usually increases due to experience or job promotions. Age income statistics provide evidence of this, which may be argued as being equitable due to work experience.*
- *People who inherit wealth have a head start, and already have the money to set up businesses or invest in income-generating assets—this advantage may be viewed as inequitable.*
- *Some people are willing to take risks and set up businesses. Successful business owners and/or major shareholders generally receive more income than a person on wages or salary; statistics provide evidence of this as well, and this is evidence of the argument for income inequality being an incentive to work harder or take risks.*

Differences in pay in different jobs and industries

High growth industries have enjoyed above average increases in pay and earnings. These include financial and business services and information technology. Jobs where labour demand is high and there are persistent shortages of skilled labour tend to offer more generous pay packages for employees. In contrast, public sector service jobs have seen a decline in relative pay levels because pay in private sector jobs has tended to out-strip earnings growth.

The worst paid jobs are still found in low-skill service sector industries - often where there is little trade union protection and where job insecurity is endemic.

Income inequality tends to rise during periods of rapid wage growth because the poorest households are the most likely to contain non-working individuals. And because wages will rise most quickly for those workers with skills that are in high demand.

Falling relative incomes of people dependent on state benefits

State welfare benefits normally rise in line with prices (they are index-linked) rather than with earnings. Therefore, households dependent on welfare assistance see their relative incomes fall over time. This is a particular problem for many thousands of pensioner household.

The effects of unemployment

Unemployment is a key cause of relative poverty (i.e. an increase in income inequality). For example, a serious problem is the increase in the number of households where no one is in paid employment and where a family is dependent on state welfare aid.

Changes to the tax and benefit system

Changes to direct and indirect taxes have contributed to an increase in relative poverty. Income tax rates have fallen over the last two decades. The top marginal rate of tax fell from 69% in 1981 to 33% in 1986 where it has remained. These tax reductions allow people in work to keep a higher proportion of their earned income. The benefits from lower taxes have flowed disproportionately to people on above-average incomes because of a fall in the progressive nature of the NZ's direct tax system.

There has been a switch towards indirect taxes since the 1980's including higher rates of GST and higher excise duties on petrol, alcohol and cigarettes. Some of these indirect taxes have a **regressive** effect on the distribution of income.

QUESTIONS:

1.

(a) Explain the difference between equity of income and equality of income.

(b) Match up the words in the table below with the words listed.

Fair	Unfair	Equal	Unequal
(i) Equity		(ii) Equality	
(iii) Inequality		(iv) Inequity	

(c) Indicate if the following statements are correct or incorrect.

- (i) Equality of income is a matter of opinion. _____
- (ii) Equality of income is a matter of fact. _____
- (iii) Equity of income is a matter of fact. _____
- (iv) Equity of income is a matter of opinion. _____
- (v) What is fair and what isn't fair, will differ from person to person _____
- (vi) Equality of income, is not necessarily fair. _____
- (vii) Equality of income and equity of income are the same thing. _____
- (viii) Income and wealth are the same thing. _____
- (ix) Inequality of income is not necessarily unfair. _____
- (x) More equality must mean more efficient. _____
- (xi) More equal means less equitable. _____
- (xii) More equitable means more efficient. _____
- (xiii) Equality has the same meaning as equity. _____
- (xiv) Equity refers to what is fair _____

(d) Complete the statements.

- (i) _____ is a _____ as it is concerned with how much exists at a point in time.
- (ii) _____ is a _____ because it refers to an amount of money earned over a period of time.
- (iii) The return from working is an individual's _____.

2.

(a) Describe the difference between equality and equity.

(b) Explain a situation where incomes could be equal but inequitable.

(c) Explain a situation where a system of taxation could be unequal but equitable.

3.

Indicate if the following statements are correct or incorrect.

- (a) Wealth is a stock because it is concerned with how much exists at a point in time.
- (b) Inequality does not necessarily mean unfair.
- (c) Income is a flow because it refers to an amount of money earned over a period of time.
- (d) A high income means a person is wealthy.
- (e) A person can be wealthy, but not necessarily have a high income.
- (f) Luck can mean the difference between being wealthy or not.
- (g) Equity of income is a subjective concept.
- (h) Equality of income is a measurable concept.
- (i) Views on equity can vary from person to person.

Place the number of the following situations into the appropriate box in the table below.

- (i) Two students who both earn the minimum wage per hour when they start work at the local takeaway bar.
- (ii) A school receives additional funding for special needs students.
- (iii) Two schools of equal size in the same city that draw students from the same socio-economic backgrounds are funded differently.
- (iv) Two students who deliver papers receive the same pay, despite one student's round involving delivering papers over a much wider area.

	Equal (Equality)	Unequal (Inequality)
Equity (Fair)		
Inequity (Unfair)		

Positive and Negative Impacts of Inequality

The positive social impacts of income inequality on New Zealand is

- *the incentive this creates to show innovation, invention, entrepreneurship, and more efficient use of resources.*
- *Investment finance becomes available due to the savings or surplus income from the top decile households.*
- *Some of these households also donate to charities and public assets.*
- *There is also the economic argument that some income inequality is necessary for efficiency in a free market economy. The trade-off for all these government provisions may be disincentives for people to work if they are receiving substantial transfer payments (benefits), to take risks (entrepreneurs), an increase in compliance costs, no clear price signals for resource allocation, and disequilibrium in the labour market.*

The negative impacts of income inequality are

- *poverty and lack of opportunities like tertiary education.*
- *There can be a feeling of political isolation because low income earners don't have the income to create a loud voice in the media.*
- *When a country has a large discrepancy in household income distribution we see some households (top 20 to 40 percent deciles) with substantial assets and wealth and others (lowest 20 to 40 percent deciles) with few assets and no wealth. This can lead to anti-social behaviour like crime and domestic violence.*
- *Ill health, low self esteem, and a build up of resentment as the "have-nots" see the "haves wealth.*
- *A poverty cycle can develop where low incomes leads to poor health and lack of education and therefore poor employment opportunities which means low paying jobs.*

MEASURING INEQUALITY.

We measure the distribution of income and wealth by using concepts such as the **Lorenz Curve** and the

Gini Coefficient.

The Lorenz Curve

The **Lorenz curve** attempts to show the extent of the **inequality** of income in an economy.

As no economy has ever sustained a system of an equal distribution of income, the aim is to achieve equity in the distribution of income.

One measure of **equity** in income distribution is to achieve a situation where there are no extremes of wealth and poverty in the economy. The wealthy are moderately wealthy and do not exert undue power over the economy, while the poor have enough income to live above the level of poverty and are able to enjoy the basic rights of access to education, health and opportunity.

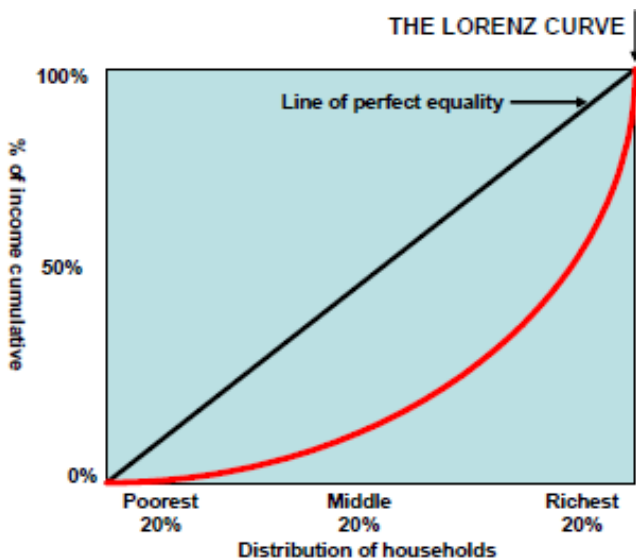
The Lorenz curve shows on the vertical axis the percentage of national income, and on the other the percentage of households. Depending on the relationship between the line and the curve it is possible to read such information as:

10% of the households receive 40% of the national income
or 50% of the households receive 20% of the national income.

Absolute equality of income would result in situations such as:

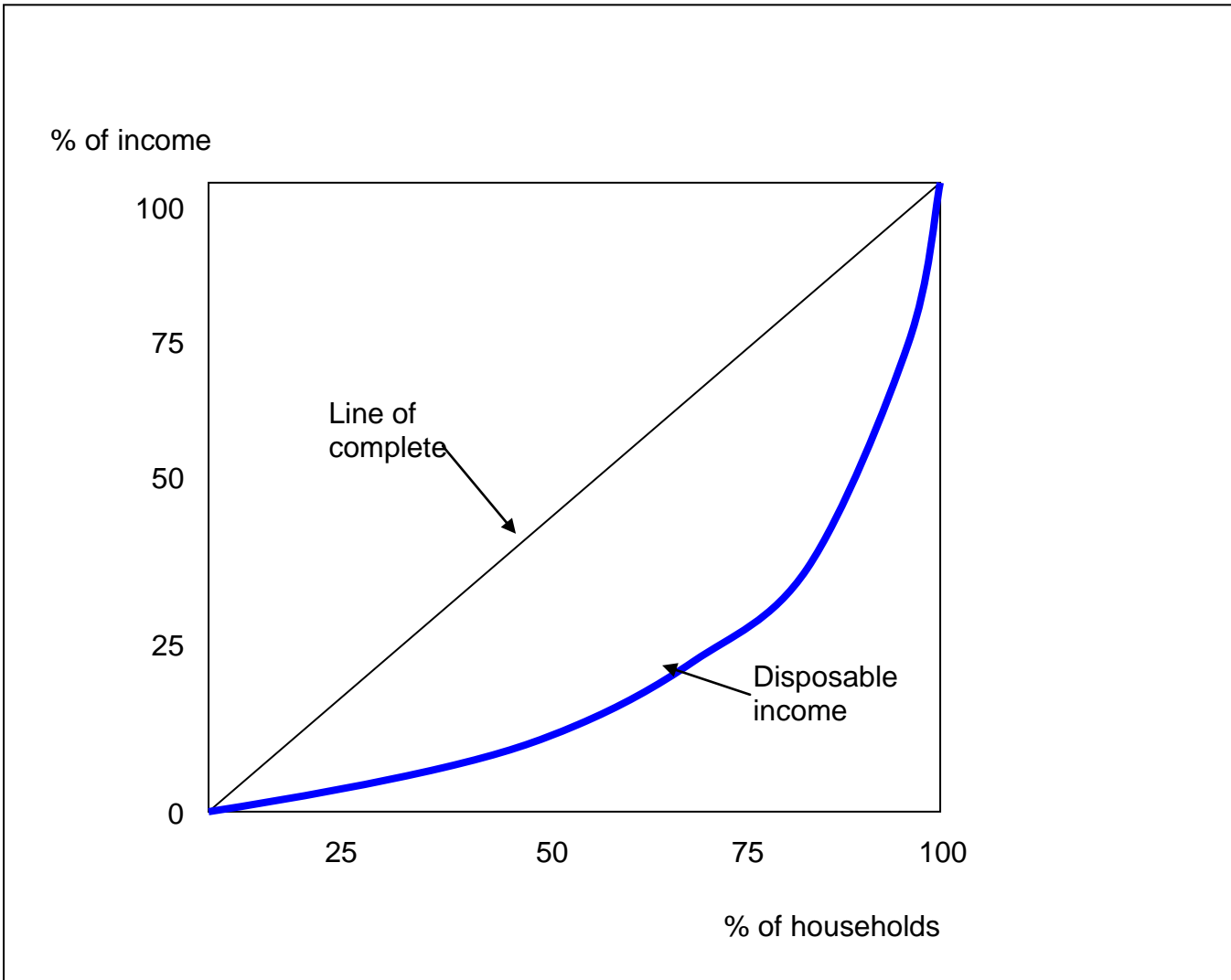
10% of the households receive 10% of the national income
or 50% of the households receive 50% of the national income.

The Lorenz curve concentrates on disposable income, not gross income. This is the money households have available to spend after the payment of taxes.



The further the Lorenz curve lies below the line of equality, the more unequal is the distribution of income. There are problems with the Lorenz curve – particularly if we are inaccurate in our measure of incomes across the distribution of households in a country

A HYPOTHETICAL LORENZ CURVE



In this hypothetical economy, the Lorenz curve shows that 25% of households only receive about 5% of this economy's income. This indicates that there are a number of very poor people in this economy.

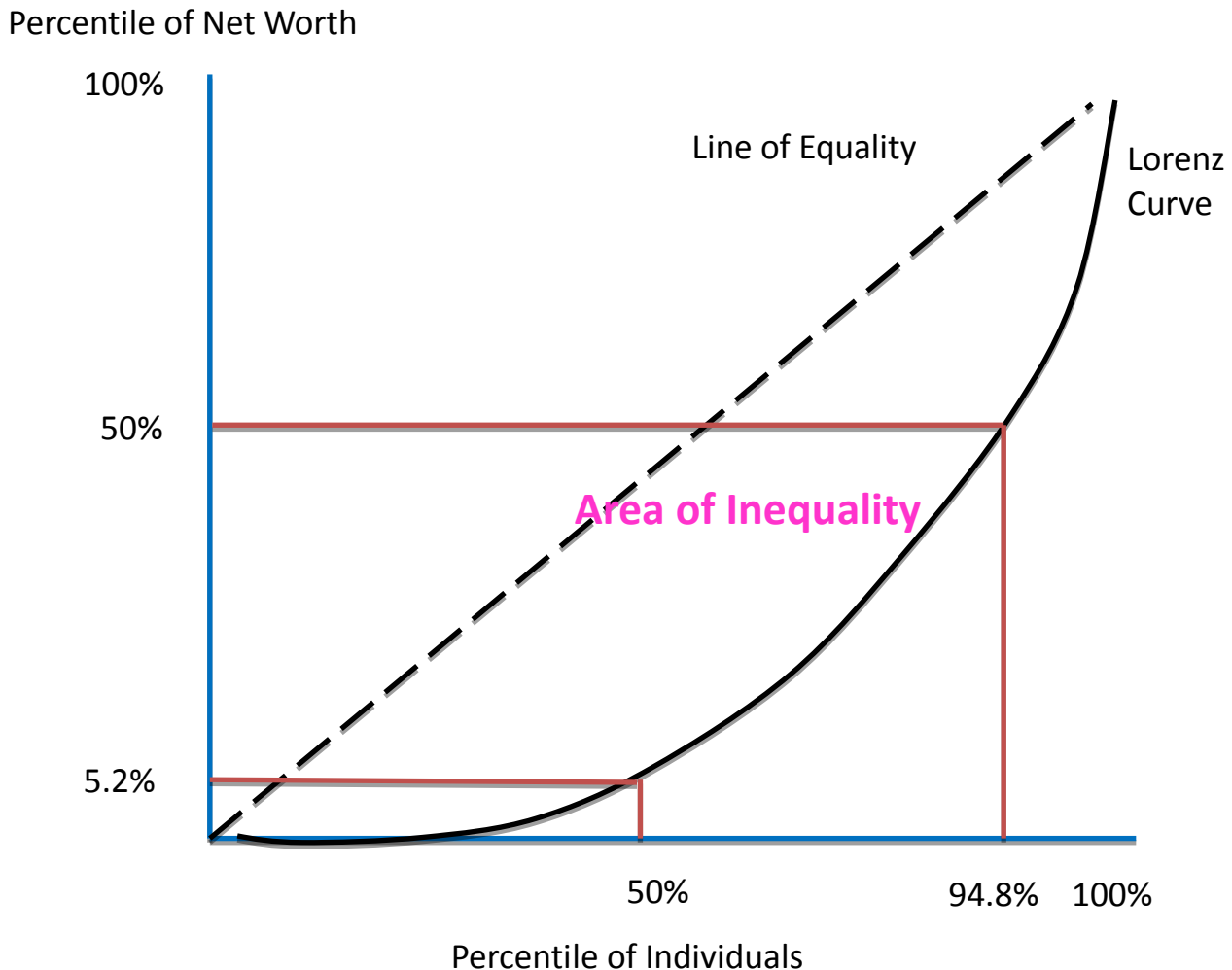
The last 10% of the population receive slightly more than the last 40% of national income. There are some extremely rich people in this economy.

The more the Lorenz curve **bows away from the 45 degrees line, the greater the inequality of income in the economy.**

Wealth and Income

The Lorenz curve concerns itself only with income, not **with the stock of wealth**. It might be assumed that a high income brings with it a higher level of wealth and vice versa, but this is not always the case particularly if the economy has an aging population or has suffered some type of disaster or war. For example, a super annuitant may be asset-rich (have a large stock OF accumulated wealth) but be on a low income. For this person rates on a large family home can be a great burden. Wealth can be converted into cash, but it takes time. income is cash available for spending almost immediately.

NEW ZEALAND NET WORTH LORENZ CURVE



- New Zealand's Lorenz Curve
- In between the Line of Equality and the Lorenz curve is the Area of Inequality
- In New Zealand the bottom 50% of individuals have 5.2% of the Net Wealth while the upper 5.2% of individuals have 50% of the wealth

THE GINI COEFFICIENT.

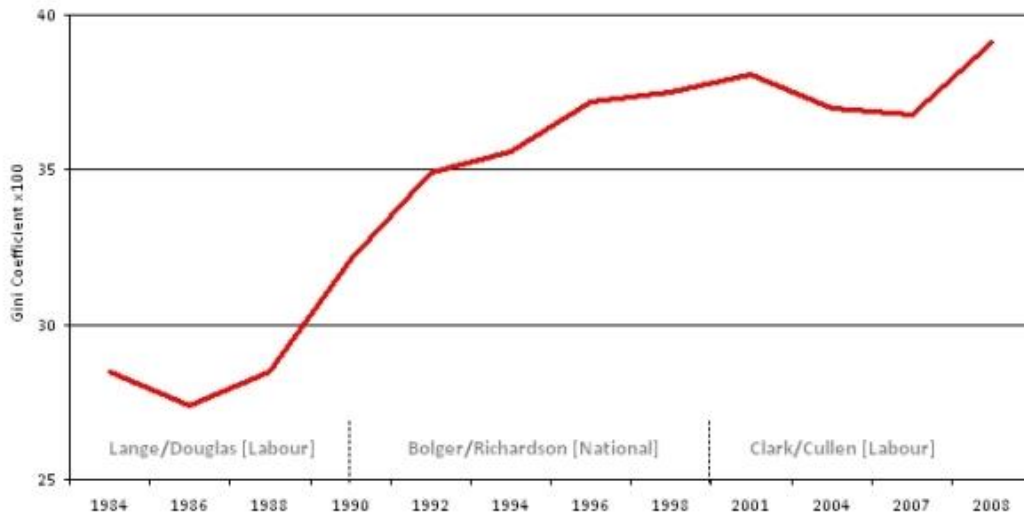
The Gini Coefficient is derived from the same information used to create a Lorenz Curve.

The Gini Coefficient can take values from 0 to 100 per cent where a value of zero would indicate that each household had an equal share of income, while higher values indicate greater inequality.

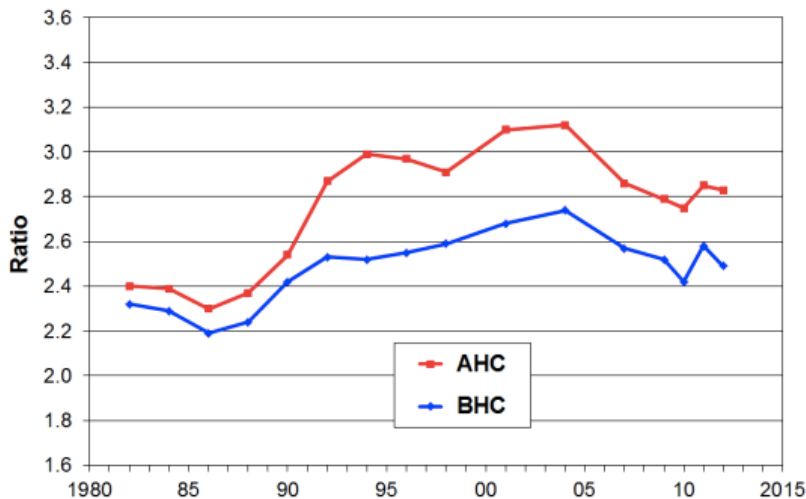
The Gini Coefficient can take values from 0 to 100 per cent where a value of zero would indicate that each household had an equal share of income, while higher values indicate greater inequality.

The chart below shows the trend in the Gini Coefficient for original and disposable incomes of NZ households since the 1980's. Inequality of disposable income was fairly low in the first half of the 1980s then increased during the second half of the 1980s. Inequality was relatively flat in the late 1990s and declined in the early 2000's.

Inequality in New Zealand: the Gini coefficient



Income inequality in New Zealand: the P80/P20 ratio, 1982 to 2012, total population



THE GOVERNMENT AND EQUITY

EQUITY OF INCOME: a progressive taxation system for income tax, plus GST to ensure that people who can avoid paying income tax must pay at least some tax on their expenditures. Those who are unable to earn income are paid welfare.

Equality of opportunity: through the provision of compulsory primary and secondary education, public hospitals, public libraries, parks and the provision of socially desirable monopolies.

Spending for equity: The government may decide to allocate extra funds to the welfare of specific groups which may be considered underprivileged in order to make up for market inadequacies and to give people an equal chance alongside others.
Legislation as well as spending, may also be part of the package. Affirmative action programmes and positive discrimination may also be put in place.

IN NEW ZEALAND THE GOVERNMENT ATTEMPTS TO ACHIEVE EQUITY THROUGH A NUMBER OF SOCIAL AND ECONOMIC MEASURES. THESE INVOLVE

Equality of bargaining power – the government recognises that not all groups in society have equal bargaining strength. Consumers are protected by laws such as the Consumer Guarantees Act etc.
Minimum employment conditions go some way to prevent unscrupulous employers from exploiting workers with less bargaining power.
Trade agreements and government participation in world trade talks assist new Zealand exporters to compete against overseas rivals who may have unfair advantages.

ACTIVITIES:

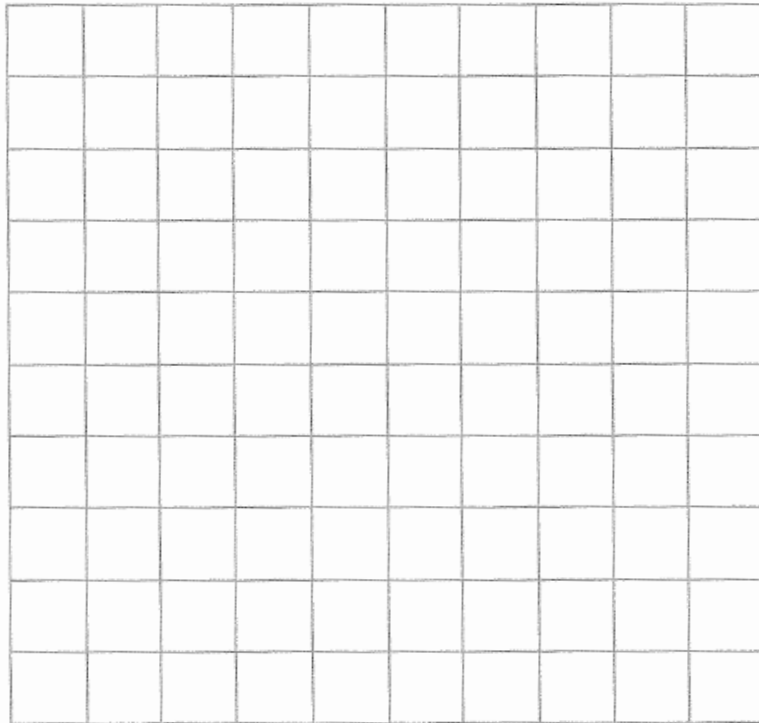
1. Distinguish between equity and equality. _____

2. Indicate whether each of the following concerns equity or equality, and explain your choice.
- a) All newcomers to the job market receive the same level of disposable income. _____
 - b) Income earners are rewarded according to their productivity _____
 - c) Those unable to earn an income receive a welfare benefit. _____
 - d) Households on low incomes receive subsidised health care _____

3.

- (a) Use the grid provided below to plot a Lorenz Curve using the information in the table. Fully label the graph.

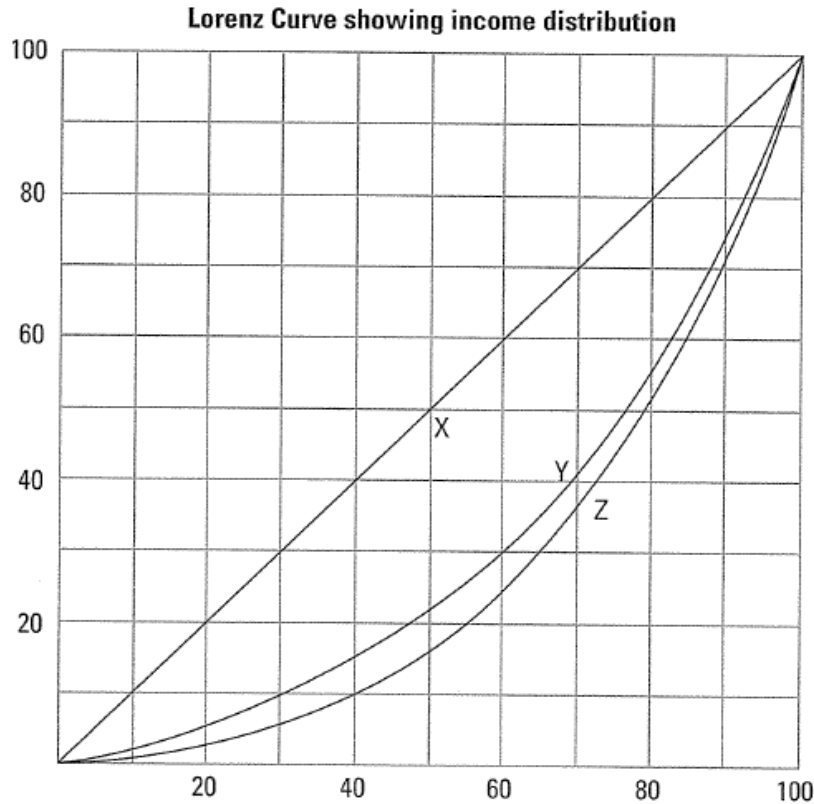
% of Households	% of Income	Cumulative % of Households	Cumulative % of Income
Lowest 20 %	5	20	5
Second 20%	11	40	16
Middle 20%	16	60	32
Fourth 20%	24	80	56
Richest 20%	44	100	100



- (b) Show on your graph the rich getting richer. Label the line RR.
- (c) What does the 45° line on the graph above indicate and explain its significance in displaying equitable income distribution.

4.

(a) Label the curves and axes below then answer the questions that follow.



(b) Which line, X or Y or Z shows:

- (i) the most unequal distribution of income? _____
- (ii) 40% of households earn 40% of income? _____
- (iii) 40% of households earn 10% of the income? _____
- (iv) the most equal distribution of income (most equitable) apart from the line of absolute equality of income? _____

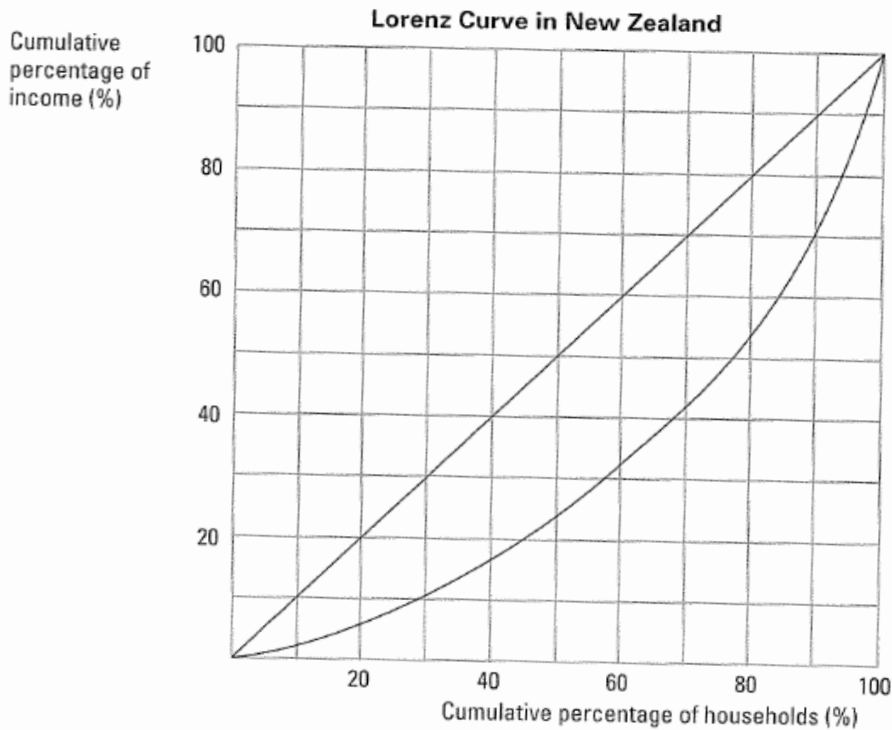
(c) Draw a line to show the likely distribution of wealth in an economy and label it W.

(d) Complete the statements below.

- (i) The _____ is the line of complete equality of income.
- (ii) The line of _____ shows a distribution of income that is more equal than the line of _____ which doesn't take into account progressive taxes or transfers.
- (iii) The distribution of wealth is likely to be _____ away from the line of complete equality of income than that showing the distribution of income (_____).
- (iv) A reduction in income taxes would make the distribution of income _____.
- (v) A _____ is a graphical way to show the extent of inequality in income or wealth.
- (vi) A straight diagonal line depicts _____ equality of income.
- (vii) The _____ the Lorenz Curve is to the 45° line the more equal the distribution of income.

5.

(a) Use the Lorenz Curve drawn to complete the table below.

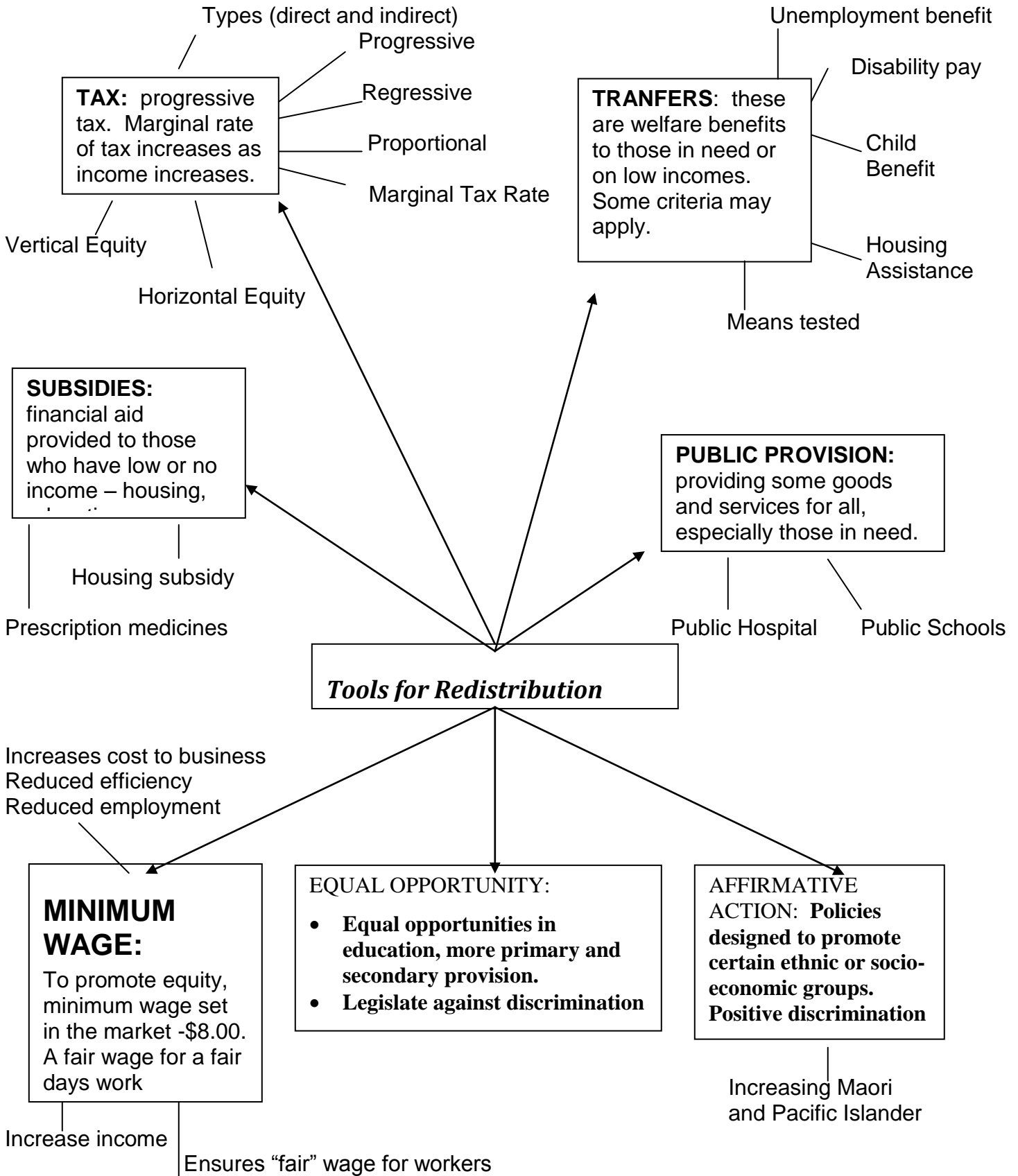


Cumulative percentage of households	Cumulative percentage of income
20%	
40%	
60%	
80%	
100%	

(b) Indicate if the following statements are correct or incorrect.

- (i) It is almost impossible to prove one person's opinion on income distribution is right because it involves a value judgement. _____
- (ii) The distribution of wealth is likely to be more equal than the distribution of income. _____
- (iii) If disposable incomes are the same this is called equity. _____
- (iv) The income distribution considered fair is equality of income. _____
- (v) The distribution of wealth is likely to be the same as the distribution of income. _____
- (vi) The distribution of income is likely to be less equal than the distribution of wealth. _____
- (vii) The distribution of wealth is likely to be less equal than the distribution of income. _____
- (viii) The degree of inequality of income is indicated by the extent of the curvature of the Lorenz Curve away from the 45° line. _____

Redistribution Tools



Which policies are most effective in reducing poverty?

A government truly committed to making a serious dent in relative poverty would

- Invest more resources in **skills training** and **life-long education** for all households – particularly those of low income families in a bid to make a real effect on child poverty
- **Making the tax system more progressive** – for example raising the higher rate of tax from 40% for the top-earning households
- Analysing carefully the **effects of changes in indirect taxes** such as VAT and excise duty in case they have a regressive effect on the overall distribution of income
- **Focus more on targeting benefits** by means-testing them according to financial need
- **Increase the value of welfare benefits / tax credits** in line with the annual percentage growth in median earnings so that the relative value of these benefits does not decline

No policies to relieve poverty are risk free. Many are highly expensive and their effects often take many years to show through properly. The consensus among the leading academic researchers is that high employment, and a commitment to raise the skills and potential earnings of people towards the bottom of the pay ladder are the most effective and sustainable policies in the long term.

Redressing Inequalities with Taxation

Horizontal Equity

If the aim of government is to achieve equity through horizontal equity the government will choose a tax system which requires that people who earn the same amount of income pay the same amount of tax. It would not be considered fair if two people, each earning the same income, were required to pay different amounts of tax — unless their circumstances were different.

This concept has undergone a re-think in New Zealand recently. In order to be fair, the government used to take into account the family circumstances of the income earner but not the wealth or accumulated assets. An income earner with a spouse and dependent children paid less tax than a single income earner on the same income. A person on an income considered to be less than the basic minimum paid no tax at all.

Today, the level of income is the sole consideration — family circumstances are not taken into account in the tax system as such. Now income support (a separate package) is directed towards lower income families, and even the low paid are required to pay tax, even if the only income into the family is the unemployment benefit.

Vertical Equity

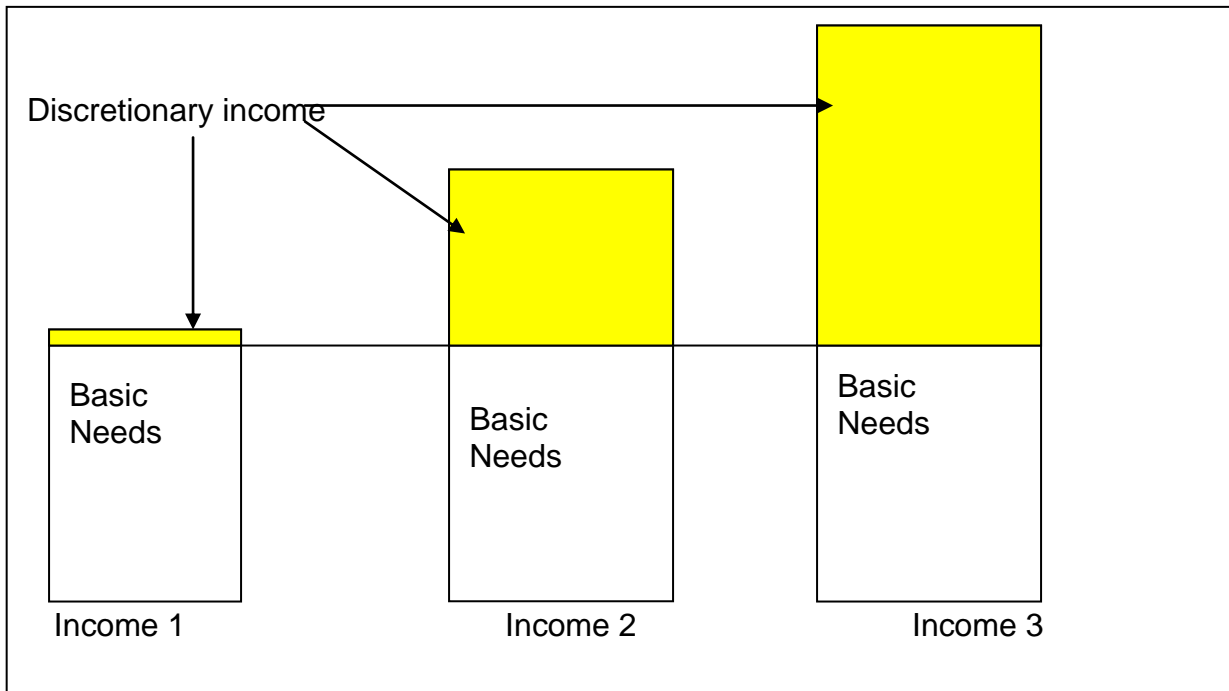
Vertical equity looks **AT WHAT IT IS FAIR TO DEMAND FROM PEOPLE ON DIFFERENT LEVELS OF INCOME.**

Progressive Taxation

Progressive taxation **takes a higher percentage in tax from a higher income earner and a lower percentage from a lower income earner.**

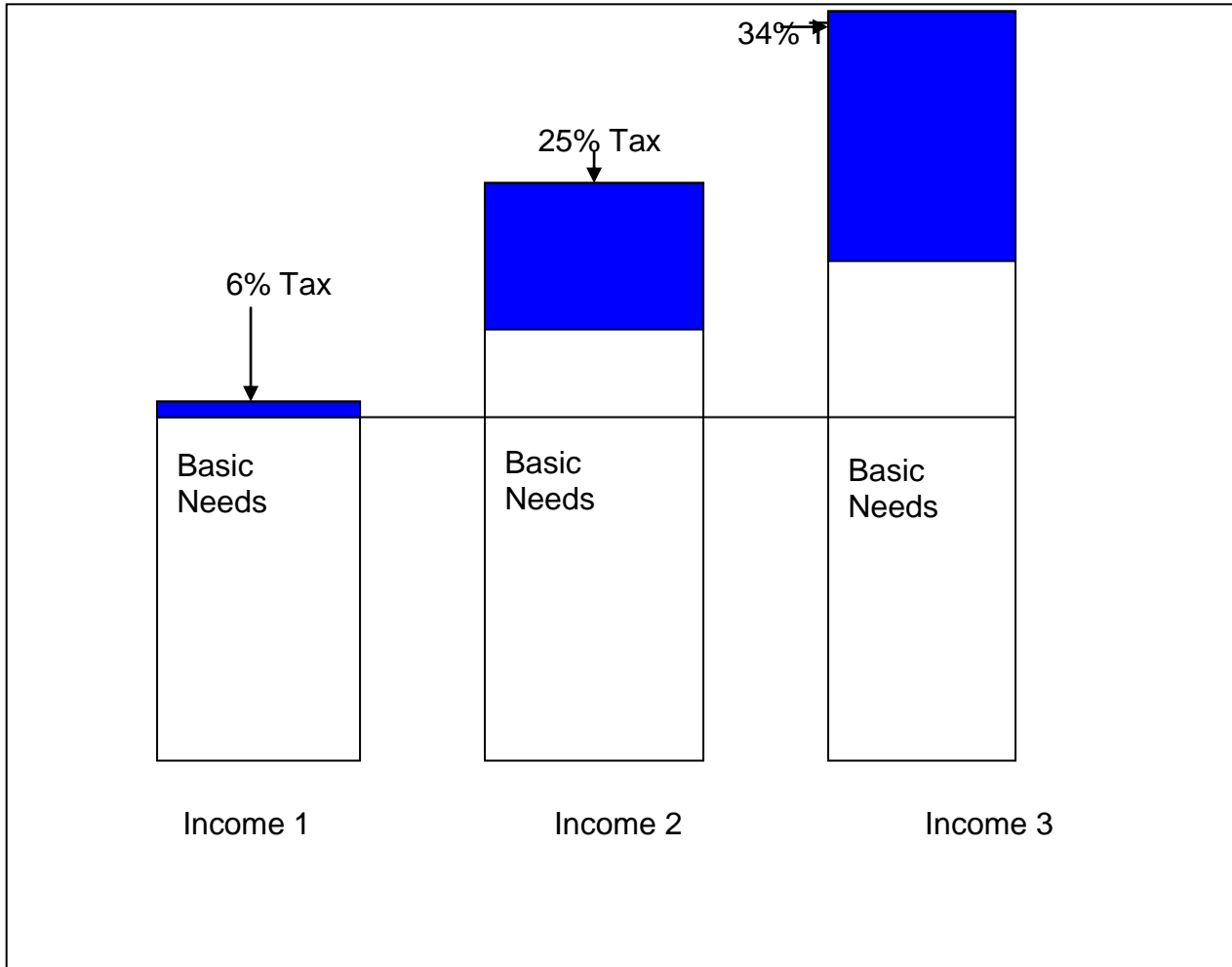
For example, a high income earner under this system may pay 33% of their income in tax, where as a lower paid person may pay only 25% of their income in tax.

The equity of this system relies on the premise that everyone has to pay out a basic minimum for food, housing, clothing and transport. After this is paid, the lower income earner may have very little money left to make genuine choices about what to buy very little discretionary income. A higher income earner, after paying for the basics, may have much more money left over to buy other things a higher discretionary income.



A progressive taxation system attempts to tax discretionary income.

Under a progressive tax **system higher income earners pay a higher proportion of their incomes in tax**. In the diagram on the bottom of the previous page it has been assumed that Income Earner One pays 6% of their income in tax, Earner Two pays 25% of their income in tax, and Earner Three pays 34%. Even after paying tax, every earner should have enough over to meet their basic needs, and Income Earners Two and Three should still have some discretionary income left.

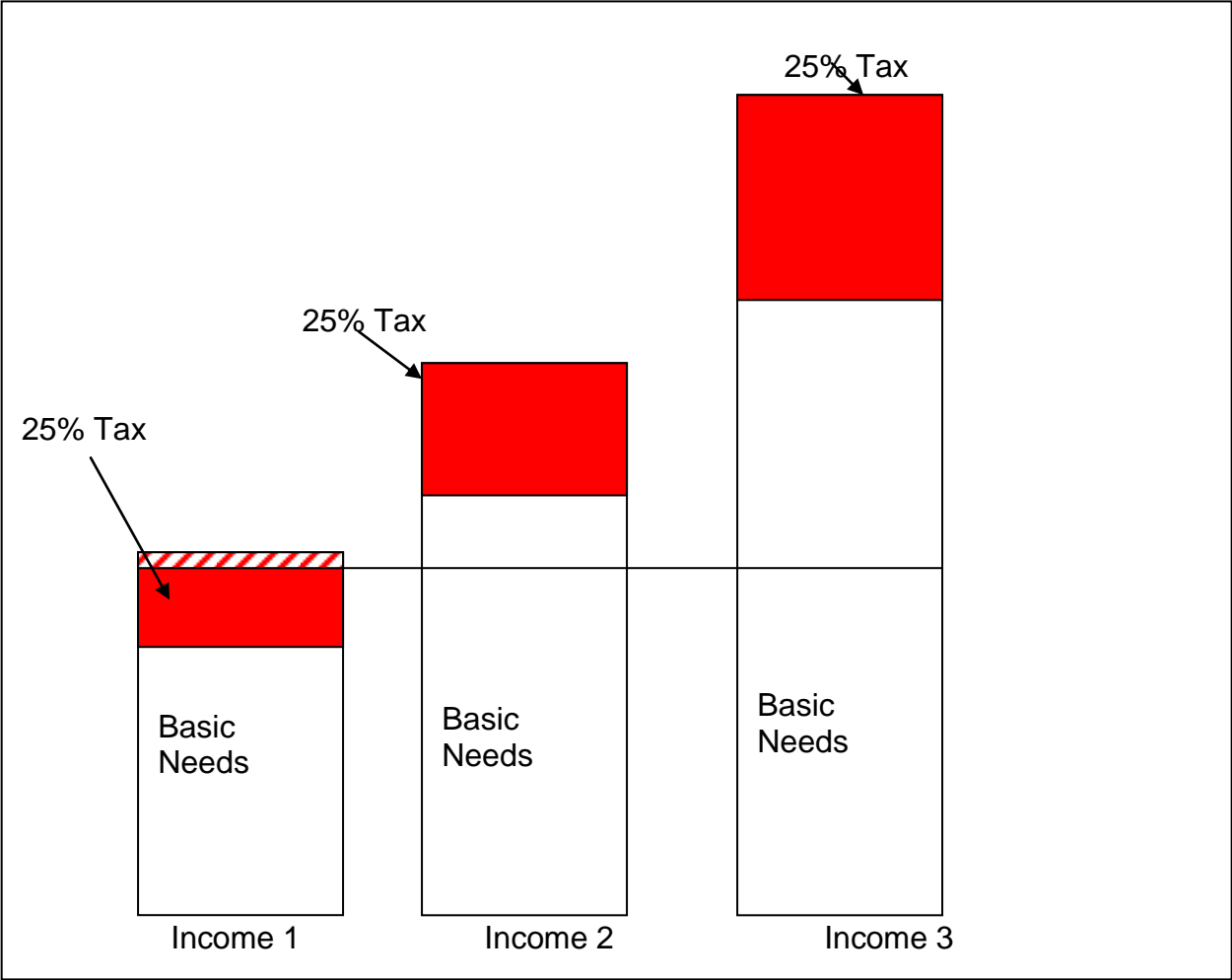


Progressive tax attempts to be equitable rather than equal.

Problems: If it becomes too steeply progressive then-

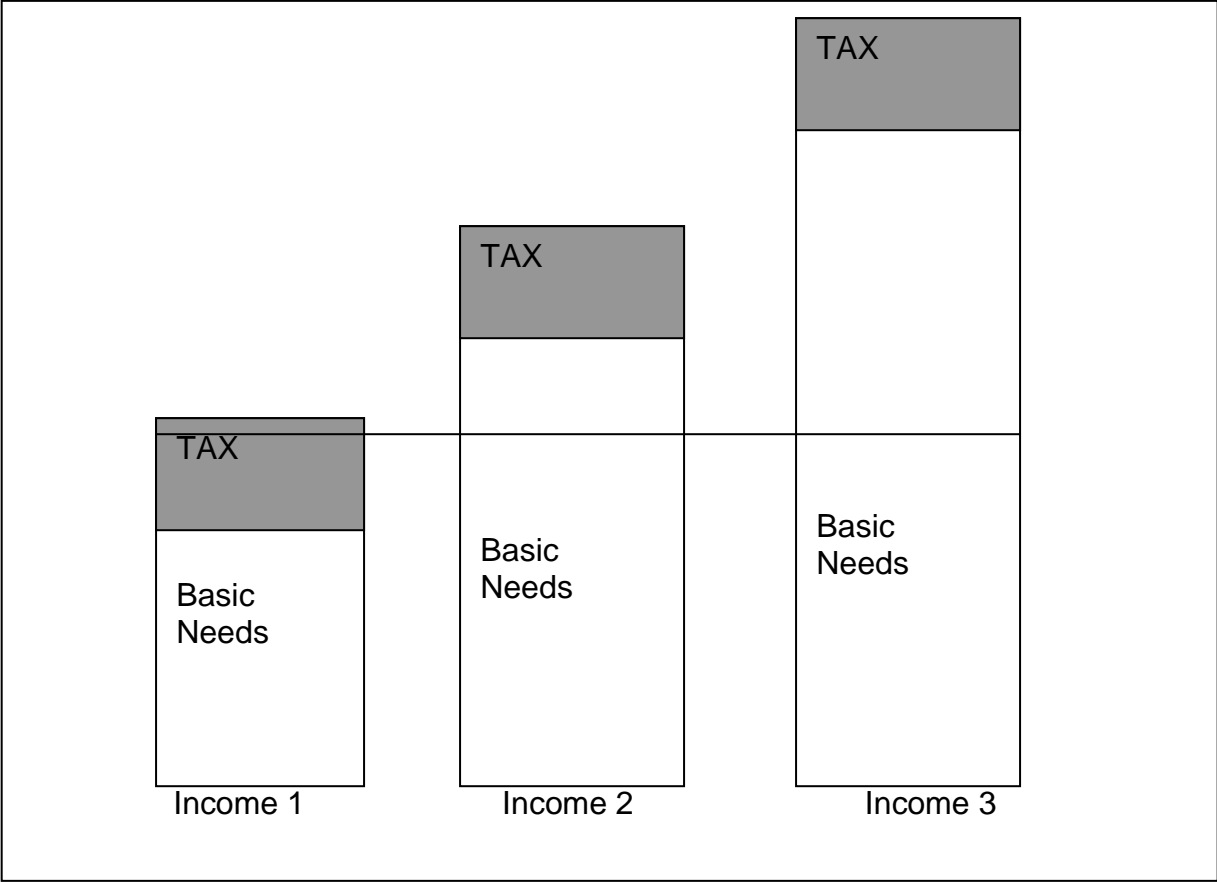
- 🐞 **The basic needs income of the middle earner may be taxed.**
- 🐞 **There is a disincentive to work harder and produce more.**
- 🐞 **There may be too little discretionary income left in the economy for private savings or investment.**

Proportional Tax under proportional taxation, everyone pays the same of their income percentage in tax. A lower income earner pays the same percentage of tax as a high income earner, but not the same absolute amounts. The tax paid by the high income earner will be higher in actual dollar amounts than the low income earner.



income earner 1 has all of their discretionary income taxed away as well as some of the income needed to cover basic needs. earner 2 has some discretionary income left, but income earner 3 is very well off.

Regressive taxation is where everyone pays the same amount of tax. their tax burdens are absolutely equal. This may sound fair, but in terms of ability to pay it may be inequitable.



If everyone pays the same dollar amount, then this will represent a much higher percentage of a poorer persons income than in the case of a person with a higher income. Rates, GST are all examples of a regressive tax.

The Equity/Efficiency Trade Off

When higher income earners are taxed, there is a cost both social and private. The private cost may seem obvious less disposable income, less discretionary income, less money to spend on non-essential items, but the social cost needs to be examined also.

Social Costs:

(a) **Less Saving:** saving is usually the first casualty of reduced discretionary income. Before cutting back on their standard of living, most people first cut their savings. As saving is disposable income which is not consumed, only those with discretionary income can afford to save at all. Savings are essential for economic growth — they form the pool of money from which investment expenditure can be made. Less savings may mean less investment, and less investment may mean less economic growth. The cost to the economy is a lower standard of living than perhaps may have been possible.

(b) **Lower Consumption:** if a newly introduced tax is steeply progressive and a large portion of discretionary income is taxed away the income earner is not able to buy as much as before. If demand falls in any industry, ultimately workers may be laid off. Postpone-able consumption industries suffer most —during the recent recession the building industry suffered badly, as did suppliers of new cars, white goods, fashion clothing, books and travel, just to mention a few. It is not only high income earners who work in these industries — lower paid workers do too.

This loss of savings and expenditure is called the '**TRICKLE DOWN EFFECT**__The higher income earners have less to spend and this cut-back trickles through the whole economy.

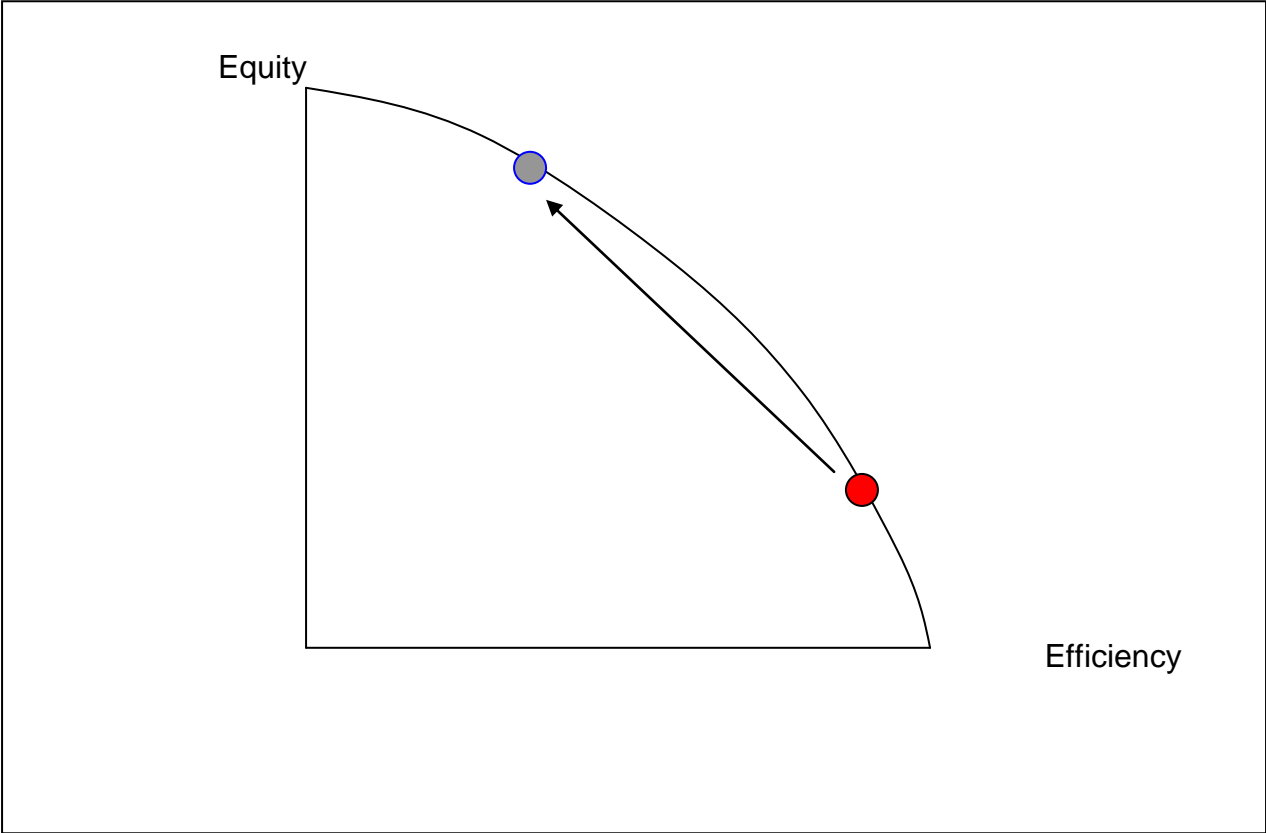
The opposite can happen when the higher income earners are taxed less, savings increase and consumption increases.

(c) **Lower incentive to work:** if a tax is too steeply progressive it may sap the incentive to work in order to achieve a higher income. Overtime may become less attractive, as may working unsociable hours. There may be less incentive to go looking for extra work, or being available at times to suit the buyer.

(d) The raising of taxes can create a deadweight loss to society.

(e) WELFARE BENEFITS SOMETIMES ENCOURAGE PEOPLE NOT TO WORK.

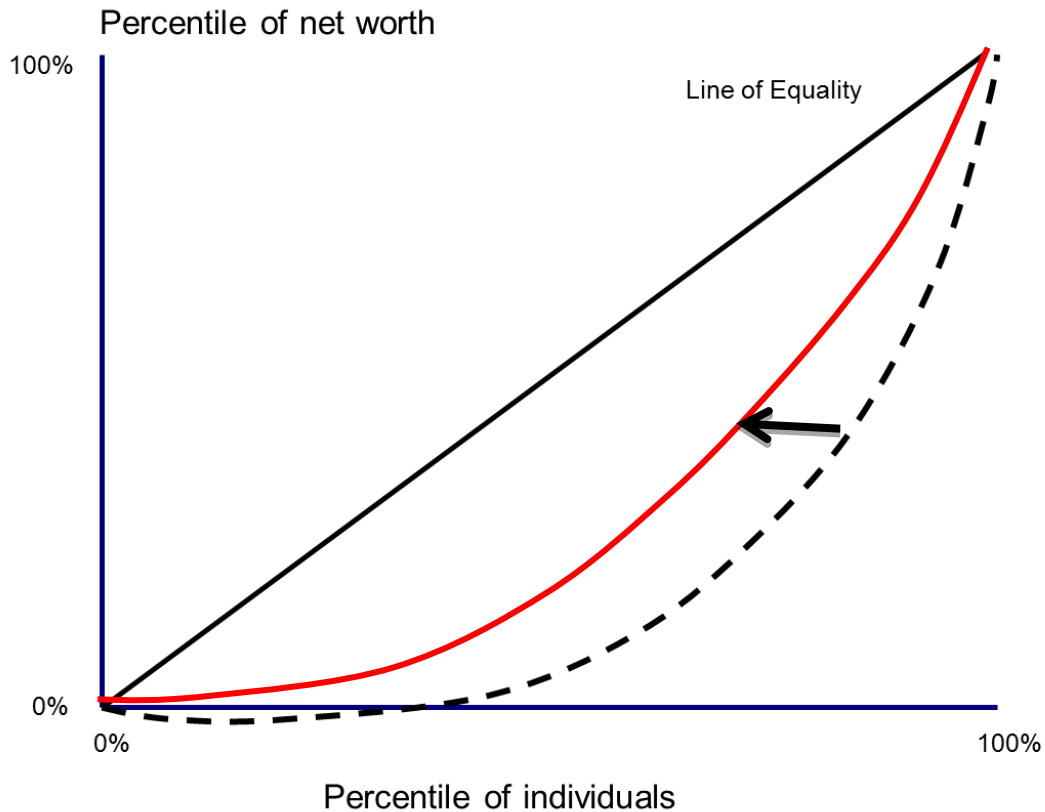
EQUITY AND EFFICIENCY TRADE-OFF



An increase in equity may result in a loss of efficiency as resources are directed away from one area by the government to another.

EXAMPLES

Policy One – Working for Families



Poor families – receive benefit

- Increases Income
- Therefore greater opportunity to succeed at school. This is due to a healthier life style leading to improved school attendance

Current and future income of poor families increases moving them closer to the line of equality

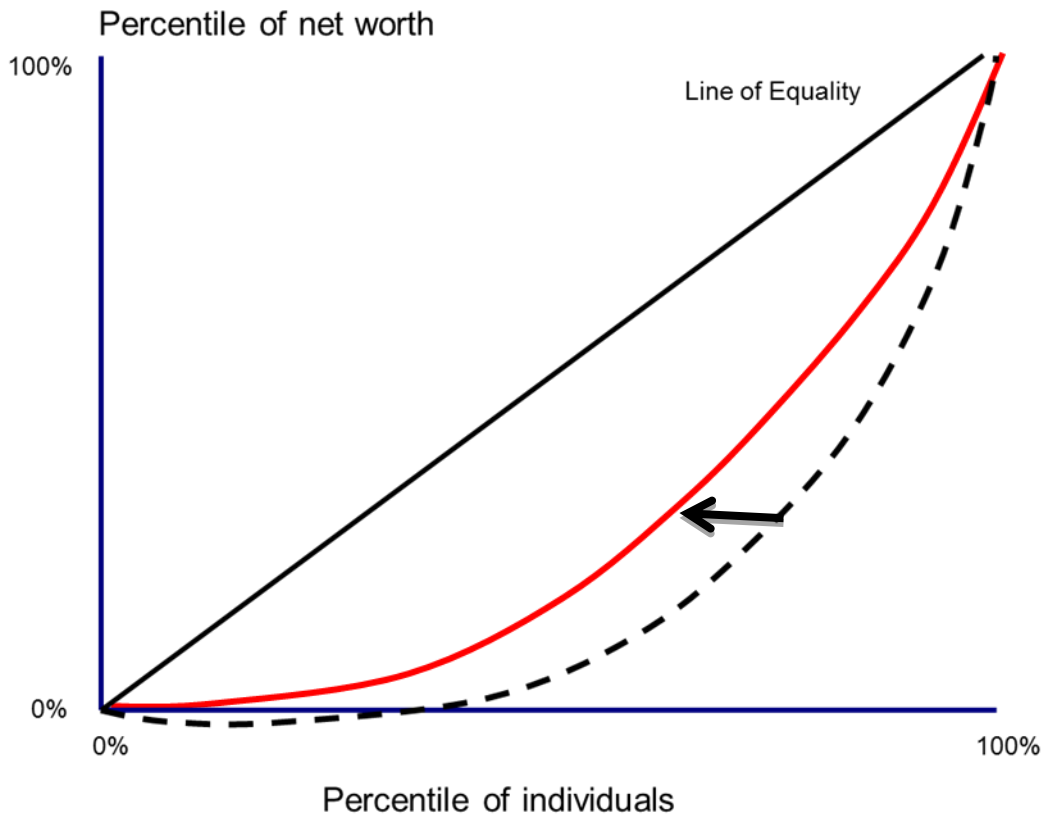
Equity

By increasing the income of low to middle income earners with dependable children, this group seen as poor by society will now earn a relatively higher income. This will move the income of the poor closer to the line of equality thus being more equitable in the eyes of society.

Efficiency

Due to the policy being a 'targeted' policy (benefits based on assets and incomes of the families) it reduces the drive of the individual within the working family to increase their current level of assets and income as they may move out of the benefit bracket. As the individual has no motivation to improve income due to government rewards outweighing personal rewards a decrease in efficiency occurs. Under motivated human capital causes a decrease in efficiency resulting in a decrease in output.

Policy Two – Progressive Tax system



- Individuals are taxed using marginal tax brackets.
- This essentially makes the poor relatively richer therefore distributing income in a more equitable way.

Equity

The progressive Tax brackets move the Lorenz curve closer to the Line of Equality. Both High and Low income earners are taxed proportionally to their income therefore redistributing income in a more equitable way (positive equity effect).

It is vertically equitable because different people with different incomes are taxed proportionally.

It is horizontally inequitable as capital gains are not taxed.

Efficiency

Due to the marginal Tax brackets where higher income is taxed at a proportionally higher rate, lower income earners have no desire to increase their income as that section of their income over the tax bracket will be taxed at the proportionally higher rate. Therefore workers will be unmotivated to increase their income so productivity will decrease (negative efficiency effect).

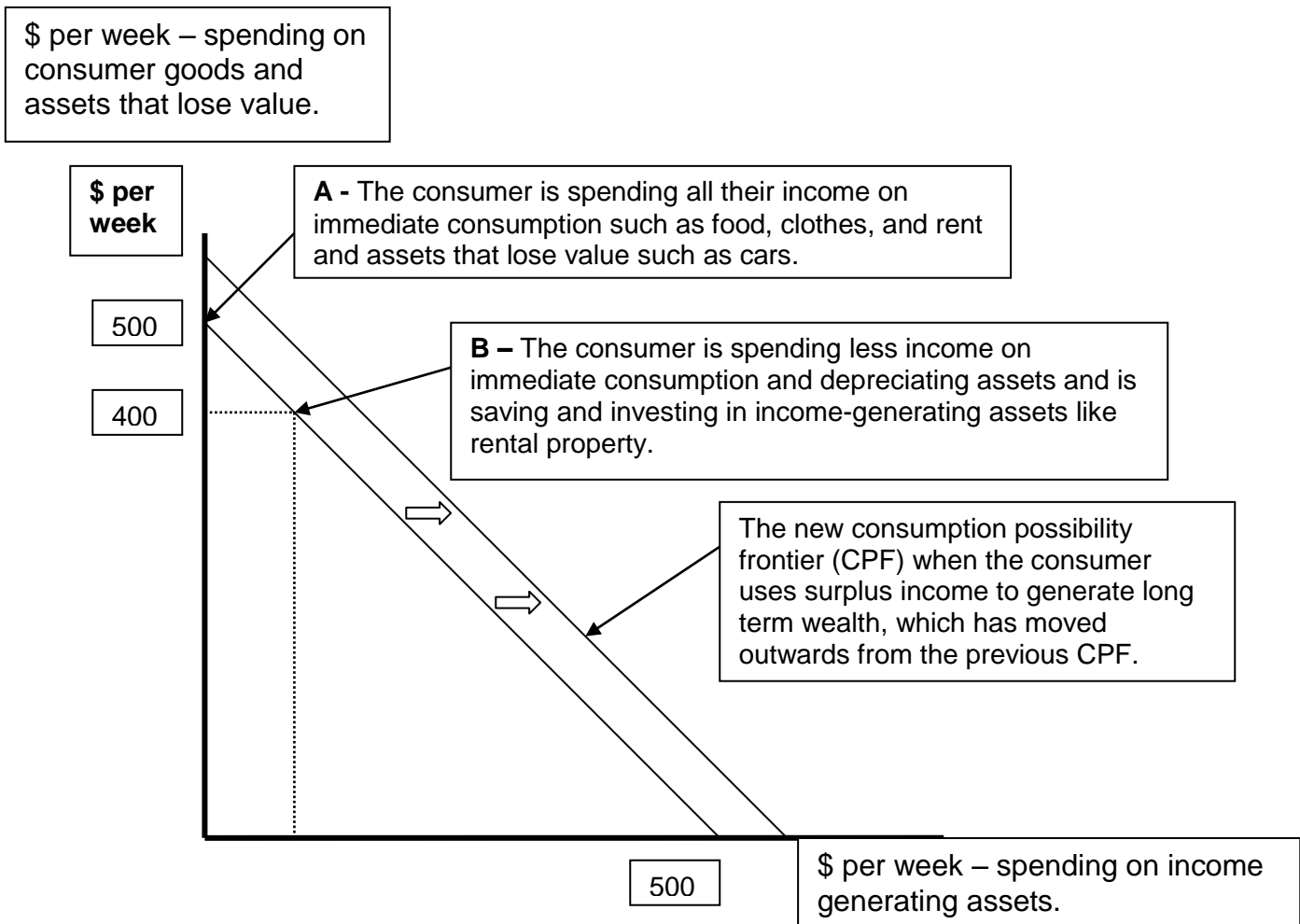
In conclusion the policy that offers the best solution is the Working for Families policy.

This is because of both the short term and long term effects of the policy.

Short Term - The lower income earners with a family receive benefit from the government meaning they will have a relatively higher disposable income therefore moving them closer to the line of Equality.

Long Term – As the disposable income of the lower income families increase the opportunity to succeed at school and tertiary study becomes greater due to healthier living and increased attendance. In turn this leads to better qualifications and in the future a greater number of human resources (skilled workers). This expansion is able to stimulate positive economic growth.

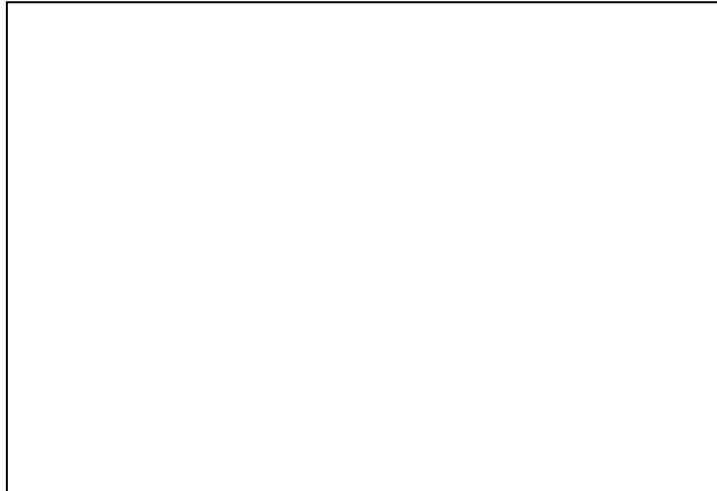
Consumption Possibility Curve



This model illustrates the link between income and wealth, when a consumer earns enough income they can save their surplus income and invest in income-generating financial assets such as term deposits, shares, gold, and rental property. This highlights the gap between people who are able to create wealth and those who either have to spend all their limited income or choose to spend it all. The people in a position to generate long-term wealth expand their future consumption possibilities by increasing their income through income-generating assets.

ACTIVITIES:

1. Draw a Lorenz curve to show the effect of the following policies
 - a) all benefits are cut by 10%
 - b) Income taxes become more progressive.
 - c) there is a return to universal benefits.
 - d) previously high marginal tax rates are cut.



2. Which of the policies listed above will improve equity? _____

3. How can equality of opportunity improve equity? _____

4. Why do governments intervene to improve equity? _____

5. Explain the equity versus efficiency trade-off. _____

6. What measures or policy does the government use to improve equity? _____

7. Show the effect on equity and efficiency of the following:
- a) an increase in the minimum wage.
 - b) a decrease in the top rate of taxation.

8.

Study the extract and answer the questions that follow.

The New Zealand government can reduce inequality through laws designed to promote equality of opportunity or protect the incomes of workers.

- (i) Outline how the New Zealand government promotes equality of opportunity with regard to education.

- ii) What is the name given to a law that ensures that workers wages are not below a subsistence level?

9.

Read the extract and answer the questions that follow.

The government has announced that it will be reviewing its policies in an attempt to reduce inequality in New Zealand.

(a) Explain how increased benefits could be used to reduce income inequality in New Zealand.

(b) Identify and explain one effect that increased benefits will have on economic growth.

Effect: _____

Explanation: _____

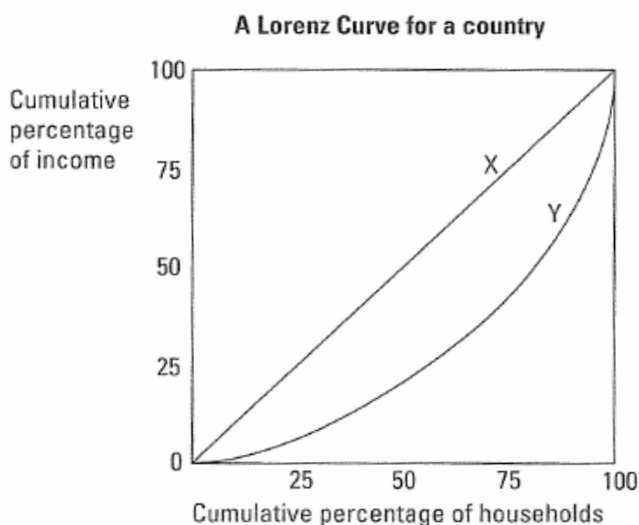
(c) Consider how increased benefits to people on low incomes may not be effective in reducing inequality.

(d) Indicate if the following government measures are likely to increase or decrease economic inequality.

Statement	Increase/decrease economic inequality
(i) User-pay charges are increased	_____
(ii) The government decides to raise state housing rents to reflect market rates	_____
(iii) Transfer payments are increased	_____
(iv) Equity legislation is passed	_____
(v) Unequal funding per student for schools in lower decile schools	_____
(vi) Free health for children under six is extended to include children under eight	_____
(vii) User-pay charges are decreased	_____
(viii) Subsidies are removed on a wide range of basic necessities	_____

10.

Study the Lorenz Curve graph below and answer the questions that follow.



(a) Describe the difference between what curve X and curve Y represent on the Lorenz Curve graph.

(b) Give one positive consequence and one negative consequence of income inequality in a country.

Positive consequence: _____

Negative consequence: _____

(c) (i) Will the government focusing on increased education opportunities for all New Zealanders lead to income distribution moving towards curve X or curve Y?

(ii) Explain your answer to (i).

(d) How will income inequalities in the economy help the government in its aim for New Zealand businesses to move from old ('sunset') industries to innovative ('sunrise') industries based on new ideas?
