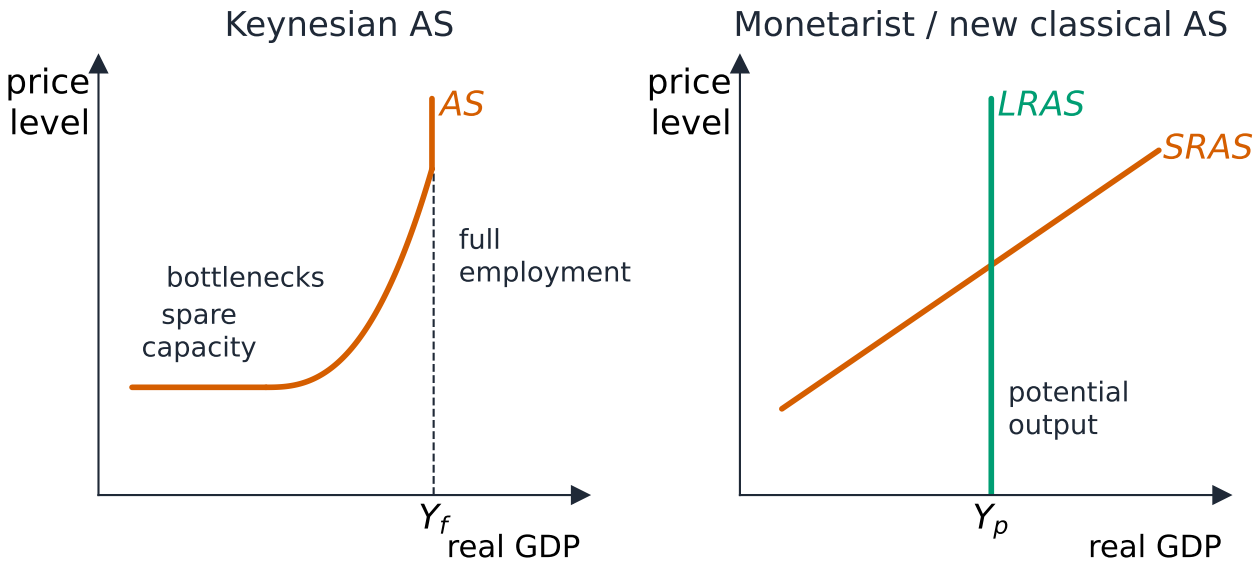
Exercise walk-through

5.5
Economics of inequality and poverty

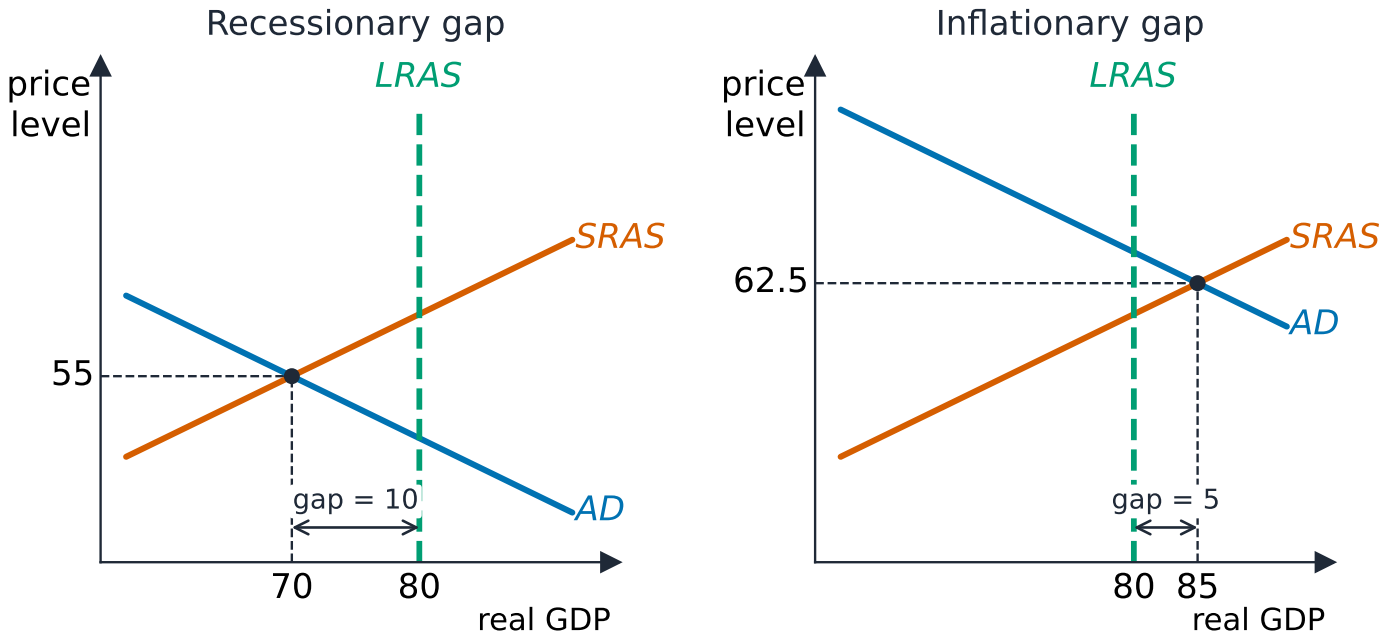
International Baccalaureate · IB Diploma · Economics · HL

Figure: Aggregate demand and aggregate supply



- **Keynesian** and **monetarist** views of aggregate supply
- Read the axes and units first.

Figure: Aggregate demand and aggregate supply ·



- A **recessionary gap** and an **inflationary gap** on the same SRAS and LRAS
- Match each part of the diagram to the text.

The economics of inequality and poverty

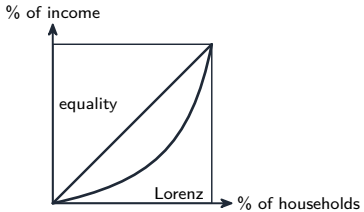
- **Absolute poverty** : **income** too low to buy basic needs. The World Bank's international poverty line is 3.00 US dollars a day per person (at 2021 PPP prices).
- **Relative poverty** : income far below others in the same country, often below 50% or 60% of the median income.
- The **Multidimensional Poverty Index** (MPI) counts lack of health, education and living standards (such as clean water, electricity and cooking fuel), not only income.

Exercises 2.1·2.2

2.1 Distinguish between absolute poverty and relative poverty. [2]

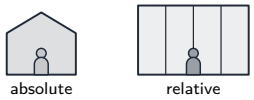


2.2 State what a Gini coefficient of 0 and of 1 would show. [2]



Exercises 2.1·2.2

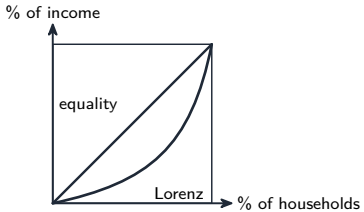
2.1 Distinguish between absolute poverty and relative poverty. [2]



2.1

absolute poverty: income too low to meet basic needs such as food, water and shelter; relative poverty: income well below the average or median income in a country

2.2 State what a Gini coefficient of 0 and of 1 would show. [2]



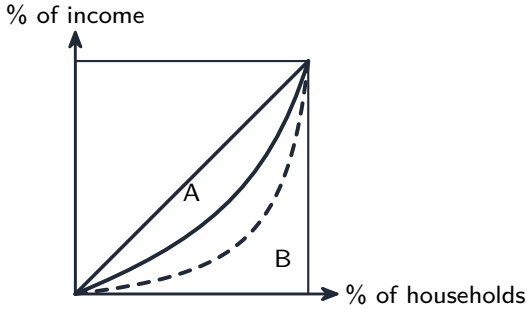
2.2

0: perfect equality: every household has the same income; 1: perfect inequality: one household has all the income

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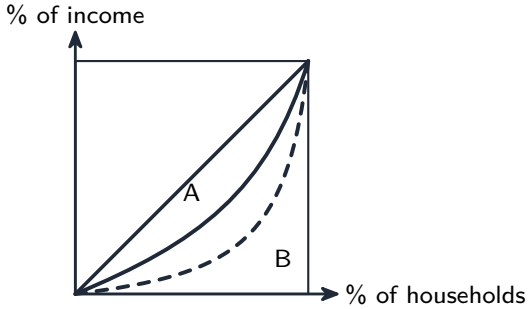
Exercise 2.3

2.3 Explain **two** reasons why the Lorenz curve of a country might move further from the line of equality. [4]



Exercise 2.3

2.3 Explain **two** reasons why the Lorenz curve of a country might move further from the line of equality. [4]



2.3

any two, explained: technology raises the pay of high-skilled workers relative to low-skilled; cuts in progressive taxes or benefits mean less redistribution; rising returns to capital and property increase incomes of the wealthy; weaker unions / falling real minimum wage

Exercises 2.4·2.5

2.4 Income tax is 0% on the first $10,000, 20% on income from $10,001 to $40,000 and 40% on income above $40,000. Calculate the tax paid on an income of $60,000, and the average and marginal tax rates. [3]



2.5 Using the tax system in the previous question, explain why it is progressive, and why a sales tax of 10% on all goods may be regressive. [3]



Exercises 2.4·2.5

2.4 Income tax is 0% on the first \$10,000, 20% on income from \$10,001 to \$40,000 and 40% on income above \$40,000. Calculate the tax paid on an income of \$60,000, and the average and marginal tax rates. [3]



2.4

tax $= 0 + 0.2 \times 30\,000 + 0.4 \times 20\,000 =$ \$**14 000**; average rate $= 14\,000 \div 60\,000 \approx$ **23.3**%; marginal rate = **40**%

2.5 Using the tax system in the previous question, explain why it is progressive, and why a sales tax of 10% on all goods may be regressive. [3]



2.5

the average tax rate rises as income rises; low-income households spend a larger share of their income than high-income households, who save more; so a sales tax takes a larger share of a poor household's income

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Exercise 3.1 (a)

3.1 A country's Gini coefficient has risen from 0.32 to 0.41 in 20 years.

(a) Describe what has happened to income distribution. [2]

Exercise 3.1 (a)

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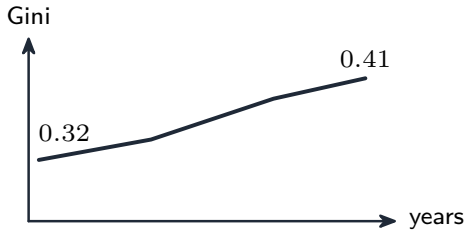
(a) Describe what has happened to income distribution. [2]

(a) income has become more unequal; a larger share of income goes to the richest households

Exercise 3.1 (b)

3.1 A country's Gini coefficient has risen from 0.32 to 0.41 in 20 years.

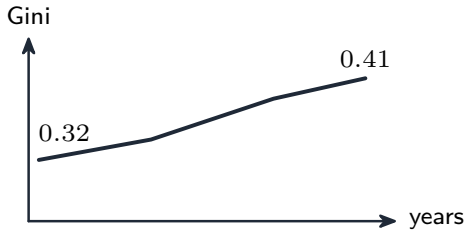
(b) Evaluate the use of transfer payments to reduce income inequality. [6]



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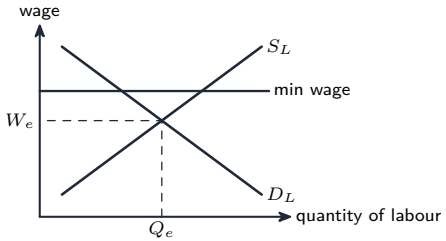
(b) Evaluate the use of transfer payments to reduce income inequality. [6]



(b) transfer payments (pensions, child benefits, unemployment benefits) raise the incomes of the poorest directly; they reduce poverty quickly and support spending (AD); but they are costly, with an opportunity cost for other spending, or need higher taxes; a poverty trap if benefits are withdrawn as earnings rise, reducing the incentive to work; they treat the symptom, not the causes such as low skills; judgement: needed in the short run, best combined with education and training

Exercise 3.2

3.2 A government is considering raising the national minimum wage by 15%.

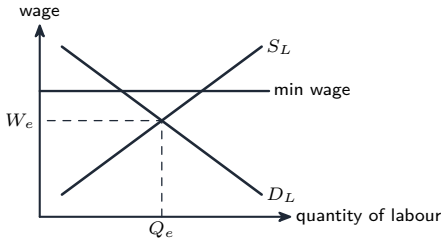


Using a labour market diagram, evaluate this policy as a way to reduce poverty. [8]

[[drawlines:9]]

Exercise 3.2

3.2 A government is considering raising the national minimum wage by 15%.



Using a labour market diagram, evaluate this policy as a way to reduce poverty. [8]

[[drawlines:9]]

3.2

award up to [8]: diagram: minimum wage above equilibrium wage, Q_s and Q_d of labour, excess supply (unemployment) shown; workers who keep their jobs earn more, reducing in-work poverty; higher pay may raise motivation and productivity, and spending (AD); but firms may hire fewer workers, especially the young and low-skilled; the effect depends on the elasticity of demand for labour and how high the minimum is relative to the median wage; many poor households have no one in work, so they do not benefit; judgement: helps if set carefully; combine with benefits and training