Edexcel (B) Economics A-level

Theme 3: The Global Economy

3.6 Inequality and Redistribution

3.6.1 Poverty and inequality

Notes

Absolute and relative poverty

Absolute poverty is defined as living below subsistence. This means that the person is unable to meet their basic needs of food, clean water, sanitation, health, shelter and education. The World Bank uses a measurement based on the number of people living on less than $1.25 per day.

Relative poverty is measured by comparison to the average in the country. In the UK, those with below 60% of the median income are considered to be in relative poverty. In the US, a basket of goods which maintains the average standard of living of society is used. Relative poverty can be seen as one way of measuring income inequality.

This article from The Guardian describes the difference between poverty and inequality in the UK: http://www.theguardian.com/society/2014/sep/05/poverty-uk-better-calling-it-inequality

Measures of poverty:

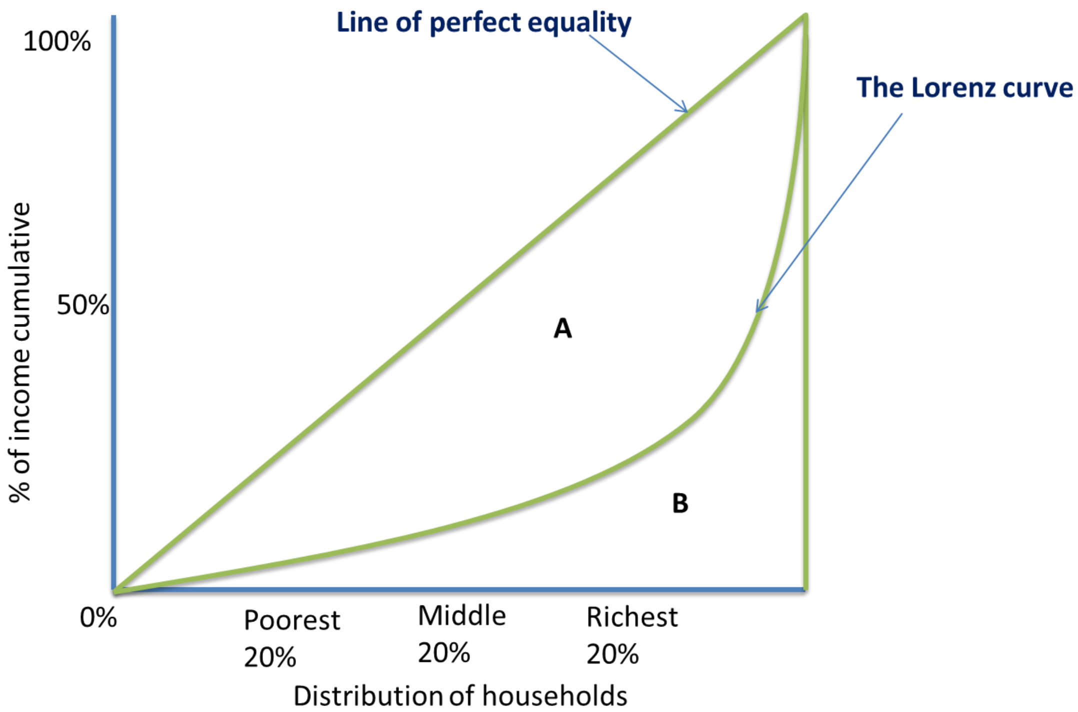
- **Human Poverty Index (HPI):** measures life expectancy, education and the ability of citizens to meet basic needs. There are two types: HPI-1 and HPI-2. The former measures poverty in developing countries and the latter measures poverty in developed countries.

  In HPI-1, the longevity part of the index measures the probability of living to the age of 40. The education component considers the adult literacy rate. The ability of citizens to meet basic needs is measured by the percentage of underweight children and the percentage of people not using improved water sources.

  For HPI-2, the probability of not surviving to at least the age of 60 is used. The percentage of adults which do not have literacy skills is calculated, and poverty is calculated by those living below the poverty line. This is below 50% of median income.

Measures of inequality:

- **The Lorenz curve and the Gini coefficient**



The Lorenz curve measures the distribution of income and wealth in a country. The line of perfect equality shows the distribution of income when the richest *x*% of the population owns *x*% of the cumulative income.

The Lorenz curve shows the actual distribution of income and wealth. The one in the diagram shows a significant level of inequality. The richest 20% own a higher proportion of income than the poorest.

The Gini coefficient gives a numerical value for inequality and is derived from the Lorenz curve. It is calculated by the areas:

$$\text{Gini}=\frac{A}{A+B}$$

A value of 0 indicates perfect equality, so everyone has the same income and wealth. A value of 1 is perfect inequality i.e. all of the wealth in the country is concentrated in the hands of one individual or household.