AQA Economics A-level

Microeconomics

Topic 7: Distribution of Income and Wealth, Poverty and Inequality

7.3 Government policies to alleviate poverty and to influence the distribution of income and wealth

Notes

There can be income redistribution and wage equality through government intervention. For example, inheritance tax means rich families cannot keep their entire wealth.

Over the past century, sustained economic growth has helped reduced pre-War poverty in Britain, since wealth was redistributed to the poorest.

China's rapid economic growth between 1985 and 2001 helped 450 million people be lifted out of poverty. Similarly, India had strong economic growth in the 1980s and 1990s, and has had significant falls in poverty rates.

Governments could employ progressive taxes, such as higher rates of income tax for the richest earners. A progressive tax has an increase in the average rate of tax as income increases. As income increases, the proportion of income taxed increases. For example, in the UK income tax is progressive. People have a personal allowance of £10,600 where tax is not paid. For incomes below £31,785, people only pay the basic rate of 20%. For incomes between £31,786 and £150,000, people pay the higher rate of 40%. Above this, a 45% rate is paid. This should help reduce inequality, because those on lower incomes pay less tax. The tax is based on the payer's ability to pay. Higher income households are more able to pay higher rates of tax than lower income households. Generally, direct taxes are more progressive.

Progressive taxes allow the government to reduce regressive taxes and raise welfare payments. However, this could reduce incentives to work harder and earn more, and it could result in a fall in government revenue, as shown by the Laffer curve.

The US has a progressive tax system, but the welfare state is not effective at redistributing income. In countries such as Finland and Scandinavia, the tax system is less progressive, but the government collects a lot more tax revenue, which they are effective at redistributing.

The UK has a National Minimum Wage which ensures all workers can access a minimum standard of living. This aims to prevent employees exploiting their workers by paying them low wages, and it prevents people falling into extreme poverty.

In developing countries, governments might improve human capital by making education more widely available. Moreover, they might try and diversify the economy in order to stimulate economic growth and job creation. For example, countries such as Sri Lanka and tried to develop their tourism industry.

Also, government spending on housing and the provision of public services, such as education and healthcare, helps provide equal opportunities for people from all income backgrounds. This ensures that even those on low incomes can afford a good standard of healthcare and education. By providing these services, the government ensures that all members of society can achieve a minimum standard of living.