



## 3055 BA SANGAM COLLEGE

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### LESSON NOTES Term 3: Worksheet 18

Subject: Economics Year / Level: 13 Name: \_\_\_\_\_

Strand	5 – Development Economics
Sub Strand	5.2 Equity and Efficiency
Content Learning Outcome	5.2.1 Explore how market fails to achieve equitable outcomes and how government gets equity at cost of efficiency.

#### EQUITY AND EFFICIENCY

#### **Equity, Equality and Distribution of Income**

**Equity** means fairness or justice in a particular situation.

Equality means same or everyone. No one gets more than the other one all gets the same sized share.

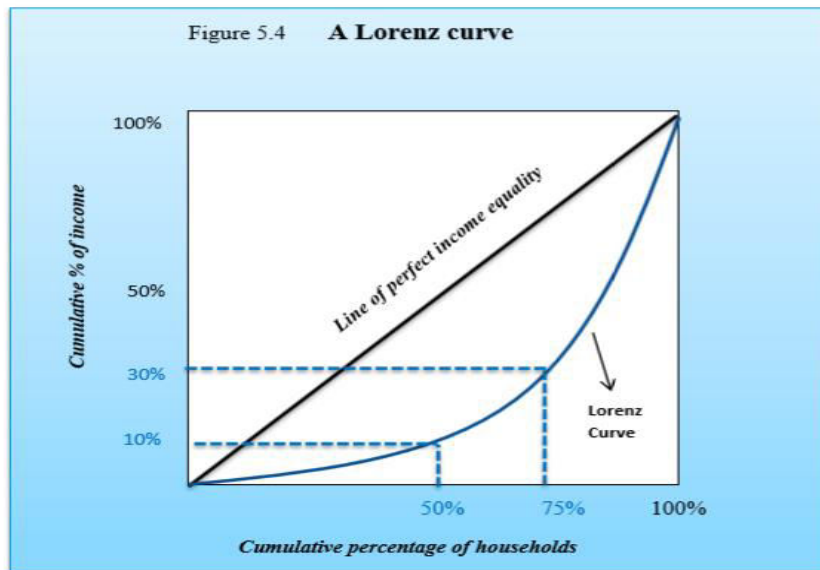
#### **Some factors for equitable distribution of income**

- (i) Accepting market outcomes- Complete reliance on market would not be tolerated for long. There need to be equality in opportunity such needs of all should be met.
- (ii) Accepting market outcomes but ensuring equity of opportunity.
- (iii) Reducing inequalities with progressive taxation and transfers.
- (iv) Accepting market outcomes but providing a safety net for those who cannot earn.
- (v) Creating complete equality.

#### **Causes of inequality**

- (i) The market- market favours those resources high in demand thus different level of income distribution in economy due to supply and demand for labour in each industry.
- (ii) Life cycle- example a child will get pocket income, young adults such a professional couple will get good income and retired couple maybe on pension.
- (iii) Wealth- Those with more wealth will generate more income and vice versa.

### Distribution of Income using Lorenz Curve



**The Lorenz curve** shows degree of inequality in income distribution for an economy.

It is a square which represents on the vertical axis cumulative percentage of all income earned and on the horizontal axis represents cumulative percentage of households. The 45 degree line represents line of perfect income equality.

#### Note:

- ❖ The further away the Lorenz curve from the line of equality, the less equal income distribution is.
- ❖ The closer the Lorenz curve from the line of equality, the more equal income distribution is.

#### How does the Government intervene to correct unequal income distribution

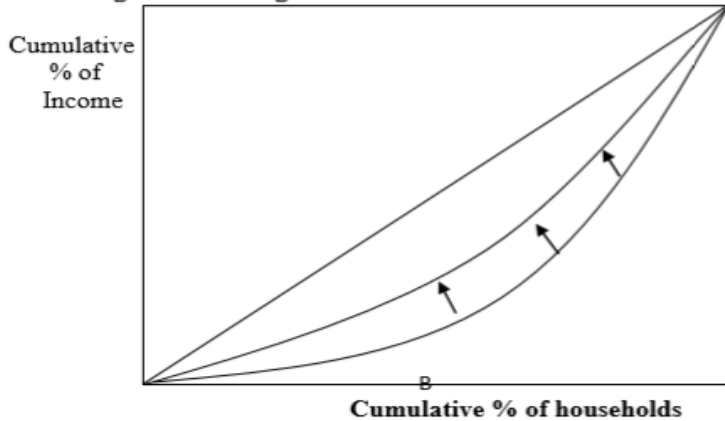
Through the redistributive policy government is able to reduce the gap between rich and poor. The Lorenz curve will shift to the left, toward the absolute equality of income.

#### Tools for redistribution of income

The government can use range of policy measures for redistribution of income:

- (i) **Taxes** –government can use progressive taxes to tax rich more than the poor so the income equalities can reduce.
- (ii) **Transfers**-welfare benefit are transfers the government can provide the poor who cannot provide for themselves
- (iii) **Public Provisions**- provide goods which are free of charge such as hospital, schools etc.
- (iv) **Subsidies**-can subsidize range of goods and services such as medicines, agricultural equipment
- (v) **Regulations**- such as minimum wage rate, affirmative action and equality of opportunities such no discrimination gender, age or ethnicity.

**Figure 5.6: Using Lorenz curve to show the effect of redistributive policy**



### **How government attempts to get equity at the cost of efficiency**

Equity efficiency trade offs occur when redistributive policies results in reduction in economic efficiency.

Such as:

- (i) Increase progressive taxation can result in high income earners with less incentive to work longer hours.
- (ii) Welfare system can result in reduced incentive to work and people can become risk averse and enjoy using welfare benefits only.
- (iii) Tax and subsidy results in loss of allocative efficiency (deadweight loss).

Equity and equality are two strategies we can use in an effort to produce fairness.

**Equality** aims to promote fairness, but it can only work if everyone starts from the same place and needs the same help.

**Equity** appears unfair, but it actively moves everyone closer to success by “leveling the playing field.”

### **Activity – MC (1 mark each)**

1. A curve which shows relationship between the cumulative percentage of households and their cumulative percentage of income is the

- A. 45 degree diagonal curve
- B. wealth-income curve
- C. market income curve
- D. Lorenz curve

2. Equity in income distribution means that

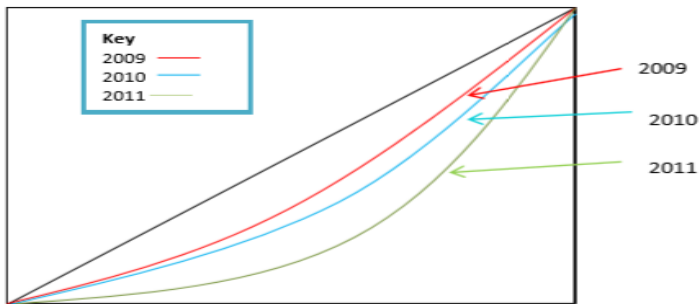
- A. the allocation of resources is such that inefficiency is notable feature
- B. the distribution of income is deemed and regarded as fair
- C. disposable income is the same for everyone
- D. workers get a pay rise

3. A Lorenz Curve can be used to evaluate which of the following economic issues?
- A. The degree of equity in income distribution.
  - B. The allocative and technical efficiency of markets.
  - C. The degree of specialisation and growth within countries.
  - D. The comparative advantage of trading partners and terms of trade.

**SHORT ANSWER QUESTIONS**

1. Study the information given in the graph below and answer the question that follows.

**Lorenz curve: Fiji 2009-2011**



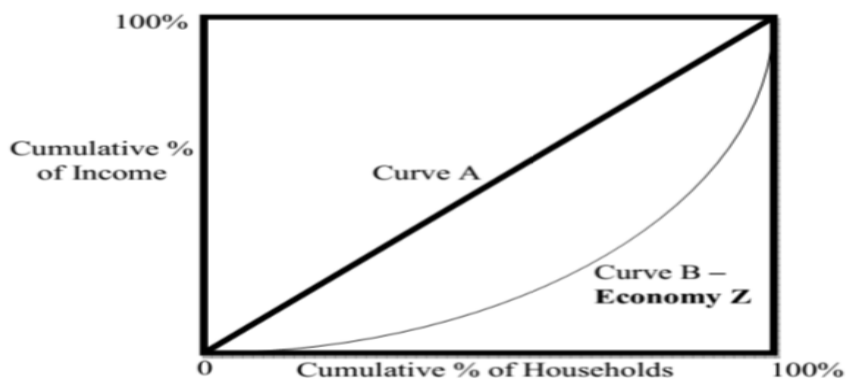
- i. What is the purpose of a Lorenz curve? (1 mark)

- ii. Show the combined effect that a progressive taxation plus social welfare benefit would have on the Lorenz curve? (1 mark)

- iii. Comment on the Lorenz curves for Fiji from 2009-2011 (1 mark)

2.

Lorenz Curve for Economy Z



- (i) What does the above graph reflect on the distribution of income in Economy Z? (1 mark)
- (ii) Name Curve A on the above graph? (1 mark)
- (iii) What do you expect to happen to the Lorenz Curve for Economy Z as a result of replacing a flat taxation rate system with a progressive taxation rate system? (1 mark)
- (iv) The Minister of Finance in Economy Z has announced that in order to improve equity and inequality in income distribution, Economy Z will have to move from a flat taxation rate system to a progressive taxation rate system.
- State how a progressive taxation rate system can bring about improvement in equity and inequality of income distribution. (1 mark)