Poverty

RIDLEY COLLEGE
SINCE 1889

Assessment Objectives

Specific Expectations	
AO2	Explain the difference between absolute and relative poverty
AO2	Explain how poverty is measured using single indicators (international poverty lines, minimum income standards) and composite indicators (multidimensional poverty index)
AO2	Explain difficulties in measuring poverty
AO2	Explain causes of economic inequality and poverty including: inequality of opportunity, different levels of resource ownership, different levels of human capital, discrimination, unequal status and power, government tax and benefits policies, globalization, technological change, market-based supply-side policies.
AO3	Evaluate the impact of income and wealth on: economic growth, standards of living, and social stability
AO2	Distinguish between progressive, proportional and regressive taxes.

Assessment Objectives

Specific Expectations	
AO2	Distinguish between direct taxes (personal income tax, corporate income tax, wealth) and indirect tax.
AO4	Calculate the amount of indirect tax paid from an amount of expenditure, given the indirect tax rate.
AO4	Calculate total and average tax rates from data provided.
AO2	Explain average and marginal tax rates.
AO3	Evaluate the role of different types of taxes in reducing income and wealth inequalities and poverty.
AO3	Explain and evaluate further policies to reduce income and wealth inequalities and poverty including: investment in human capital, transfer payments, targeted spending on goods and services, universal basic income, policies to reduce discrimination, and minimum wage.

Poverty

- **Poverty** refers to the inability of an individual or family to afford an adequate standard of goods and services.
- **Absolute poverty** refers to a situation where a person or family does not have enough income to meet basic human needs.
  - It is defined in relation to a nationally or internationally determined **poverty line**, which determines the minimum income that can sustain a family in terms of its basic needs.
- **Relative poverty** is the condition experience by people in a country whose incomes are considerably lower than the higher income groups in the same country.
  - Compares the income of individuals or households in society with medium incomes.
  - The more unequal the distribution of income, the greater the degree of relative poverty.

Minimum income standards (MIS)

- **Minimum income standards (MIS)** a method to measure poverty consisting of ongoing research on what people in a population believe are the essentials for a minimum acceptable standard of living that allows people to participate in society.
  - It is used to create a basket of goods needed to achieve this minimum.
  - The MIS reveals important information about:
    - The number of people living below the minimum income required to buy the essentials.
    - The relative contribution of each item in the basket to households' abilities to achieve.
  - This information can be helpful to government as a guide to making policies to deal with poverty.

Multidimensional Poverty Index (MPI)

- **Multidimensional poverty index (MPI)** a composite indicator that measures poverty in three dimensions.

    1. **Health** – measured by child mortality, nutrition
    2. **Education** – measured by years of schooling, school attendence
    3. **Living standards** – measured by cooking fuel, sanitation, drinking water, electricity, assets

    - Each country receives an MPI value from 0 to 1, where the higher the MPI value the greater the poverty.
    - In order to be counted as poor, people must be deprived in at least one-third of the indicators listed above.
    - MPI can be broken down by indicator so that for each country it is possible to determine which indicators make the most contributions to poverty.

Multidimensional Poverty Index (MPI)

- The world bank is in the process of developing another MPI based on the following indicators:
  - Income per capita
  - Child school enrolment
  - Adult school attainment
  - Limited-standard drinking water
  - Limited-standard sanitation
  - Electricity
  - Coverage of key health services
  - Malnourishment (child and adult)
  - Incidence of crime
  - Incidence of natural disaster

Difficulties in measuring poverty

- The measurement of poverty is a challenging task for several reasons.

  1. **Measurement problems**

     - Income measures of poverty do not take wealth or savings into consideration.
     - Information provided by households that are surveyed is subjective
     - Surveys do not include homeless people and people in institutions, resulting in underestimates of the extent of poverty.
     - Urban areas have a higher cost of living, so national poverty lines often exclude poor in urban areas who cannot afford necessities.
     - Underestimation results in a smaller proportion of a population with an income below the poverty line.

Causes of economic inequality and poverty

- Economic inequality and poverty have similar overlapping causes.

1. **Inequality of opportunity** – is concerned with inequalities in potential outcomes in standards of living that arise from circumstances the are one's control.
    - Parents' level of education and occupation
    - Parents' level of income
    - Place of birth
    - Gender
    - Race and ethnicity
2. **Different levels of human capital** – human capital refers to the skills, education and good health the people possess.
    - Low levels of education and skills translate into low incomes because there is generally a positive (direct) relationship between skill/educational attainment and income levels.

Causes of economic inequality and poverty

3. **Different levels of resource ownership** – some people inherit, or accumulate through savings from high incomes, financial capital or other forms of property, which gives them an income advantage as well as increased wealth.

4. **Discrimination** – some social groups (racial and ethnic groups, women) often face discrimination in the job market, with the result that they may receive lower wages than others for the same work, or may find greater difficulty findings work.

5. **Unequal status and power** – status refers to one's social or professional position within society.

   - People in positions of power may influence government policies favouring their interests and protecting their income and wealth, rather than policies that favour redistribution.

Causes of economic inequality and poverty

6. **Government tax and benefits policies** – people on low income rely heavily on transfer payments, social services, and merit goods (health care, education, housing) provided by or subsidize by government.
    - Government tax policies play an important role in determining income and wealth distribution.
7. **Technological change** – increased automation has replace human labour
    - Wages of low skilled labour whose jobs are being eliminated do not rise much.
    - New technologies have created demand for higher-level skills, meaning that wages of such workers rise faster than low-skill workers.
    - Technological change leads to the replacement of labour by capital and increases incomes for owners of capital.

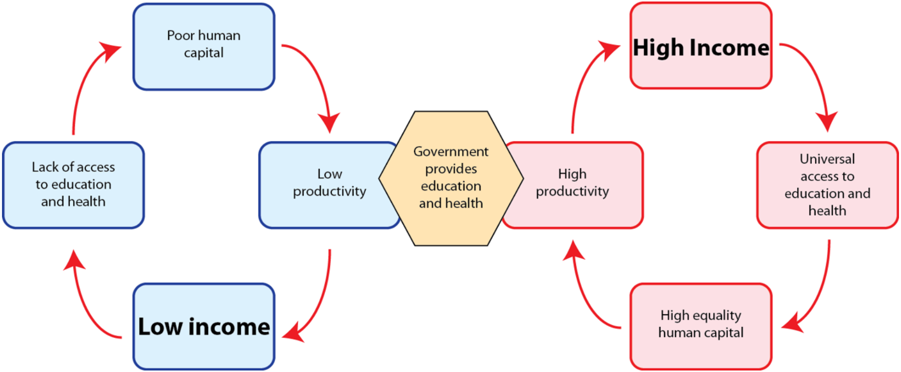
Causes of economic inequality and poverty

8. **Globalization** – refers to economic integration on a global scale, involving increasing interconnectedness throughout the world (trade, finance, investment, people, technology, ideas, knowledge).
   - Foreign direct investment (FDI) by multinational corporations (MNCs) tends to involve greater demand for skilled rather than unskilled workers, increasing the income difference between the two.
   - Developed economies offshore jobs (relocating to other countries with lower labour costs) resulting in lower domestic demand for certain skills.
9. **Market-based supply-side policies** – policies such as discouraging trade unions and reduction of minimum wage have been found to increase inequalities.
10. **High abnormal profits of firm with market power** – some large firms with market power make supernormal profits which transfer income and wealth away from consumers who have to pay higher prices and toward the owners of the firms.

Causes of economic inequality and poverty

11. **Increases in pay of certain occupations** – certain occupations, in particular executives and professionals have benefits from significant increases in pay.
12. **Unemployment** – An unemployed individual receives no income, but may receive some unemployment benefits which tend to be low relative to the income received from work and provided for limited periods.
13. **Geography** – some people live in remote, isolated geographical regions, with limited possibilities for employment.
14. **Age** – older people may receive pensions that are barely enough to cover minimum needs or they may receive no pension at all.

Causes of economic inequality and poverty



Impact on income and wealth inequality

- Income and wealth inequality negatively impacts social outcomes.

  1. **Economic growth** – high levels of inequality has a negative impact on economic growth.

     - Greater income inequality reduces the ability of lower income households to invest in human and physical capital.
     - Countries with higher levels of income inequality have higher levels of inequality of opportunity in education which leads to intergenerational transmission.
     - Wealthy spend a lower fraction of their incomes than lower income groups.
     - Concentration of income and wealth results in political control and the ability of powerful groups to influence government policies for their own benefits.
     - Poor may be unable to access credit, because they have no collateral, meaning fewer investments for people on lower incomes.

Impact on income and wealth inequality

- A more equal distribution of income leads to greater income and economic stability.

2. **Low living standards** – are associated with greater levels of stress, substance abuse, poor levels of health, all leading to poorer job and income-earning prospects.

   - Lack of access to healthcare and education leads to lower human capital, lower productivity, and lower incomes.
   - The inability to access needed health services leads to higher infant, child and maternal mortality.
   - Higher crime rates, drug use, family breakdowns and homelessness.

Policies to reduce income and wealth inequalities

- One of the most important instruments for income and wealth redistribution is taxation.
  - Taxes are the most important source of government revenues and provide funds for public goods, transfer payments, merit goods, and many more.
  - **Direct tax** are taxes paid directly to the government tax authorities by the taxpayer.
    - **Personal income tax (PIT)** are taxes paid by households or individuals on all forms of income including wages, rental income, interest income, and dividends (income from ownership of shares in a company).
    - **Corporate income tax (CIT)** are taxes on the profits of corporations, which are businesses (firms) that have formed a legally body called a "corporation" that is legally seperate from its owners.
    - **Wealth taxes** are taxes on ownership of wealth, most commonly property taxes, based on the value of property owned, and inheritance taxes, based on the value of the property inherited.

Policies to reduce income and wealth inequalities

- **Indirect tax** are taxes levied on spending to buy goods and services. They are paid to the government authorities by suppliers (firms).
  - All indirect taxes are regressive and are inconsistent with the objective of a more equal distribution of income.
  - **Sales tax (General expenditures tax)** are taxes on the spending or sales of goods and services. They are typically a fixed percentage of the retail price of goods and services.
  - "Value added tax" (VAT) differs from sales tax in that it is a tax paid on the value added by each producer in the production process.
  - **Excise taxes** are taxes paid on specific goods and services, such as cigarettes and gasoline.
  - **Tariffs (Customs duties)** are a type of tax applied on imports of foreign goods into a country.

Proportional, progressive, and regressive taxation

- Taxes can be classified as being proportional, progressive, or regressive according to the relationship between income and the fraction of income paid as tax.
    - **Proportional taxation** as income increases, the fraction of income paid as taxes remains constant; there is a constant tax rate.
    - **Progressive taxation** as income increases, the fraction of income paid as taxes increases, there is an increasing tax rate.
        - The more progressive a tax system, the more equal is the after-tax distribution of income compared to the pre-tax distribution of income.
    - **Regressive taxation** as income increases, the fraction of income paid as taxes decreases, there is a decreasing tax rate.
        - Regressive tax systems tend to make the distribution of income less equal.

Other policies to reduce income and wealth inequalities

- There are numerous further redistribution policies that governments can use to address economic inequalities and poverty.

    1. **Investment in human capital** – investment by government in human capital to ensure universal access to education and healthcare.
        - Inequality of opportunity is a major factor leading to income and wealth inequality.
    2. **Transfer payments** are payments made by the government to individuals specifically for the purpose of redistributing income, thus transferring income from those who work and pay taxes towards those that cannot work and need assistance.
        - Groups receiving transfer payments may include "vulnerable groups" such as: older people, sick people, very poor people, children of poor families, unemployed people.

Other policies to reduce income and wealth inequalities

3. **Targeted government spending on goods and services** – governments spend to provide **merit goods**, which are goods that are beneficial for consumers, often with positive consumption externalities, that are underprovided by the market and underconsumed.

   - In the absence of government intervention, two of the most important merit goods that would be underconsumed due to low incomes and poverty would be education and healthcare.
   - Governments may offer subsidize or free education and health care services.

4. **Universal basic income (UBI)** – a method intended to provide everyone in a country with a sum of money that they would receive regardless of any other income they may have; its purpose is to reduce income inequalities and poverty.

   - Financing would come partly from a tax and possibly too from savings from cutting other social service programmes.

Other policies to reduce income and wealth inequalities

5. **Policies to reduce discrimination** – most countries have legislation that forbids discrimination in the workplace. Governments must also ensure that employers are informed about laws on discrimination.

6. **Government intervention in markets** – price controls affect the distribution of income.

   - **Minimum wage legislation**, which sets a legal minimum wage, raises the lowest permissible wage above the equilibrium market level, thereby raising the wage of low-income (usually unskilled) workers.
   - **Food price ceiling** set a maximum for certain food products (prices below the market-determined equilibrium price), making food more affordable.
   - **Rent controls** set maximum rents to support low income people.
   - Price floors for farmers that set legal minimum prices for certain agriculture products, raising their prices above the equilibrium market price in order to support farmers' incomes.