

Inequality

Inequality refers to how unevenly income or wealth is distributed between individuals or households in an economy.

Income vs Wealth Inequality

Income is a flow. It measures the money received over a period of time, including wages, rent, interest and profit.

Wealth is a stock. It measures the value of assets that an individual or household owns, such as property, savings and investments.

Therefore:

- Income inequality → unequal distribution of income.
- Wealth inequality → unequal distribution of assets.

Measuring Income Inequality

The two main measures of income inequality are the Lorenz Curve and the Gini coefficient.

Lorenz Curve

The Lorenz Curve is a graphical representation of the distribution of income within an economy.

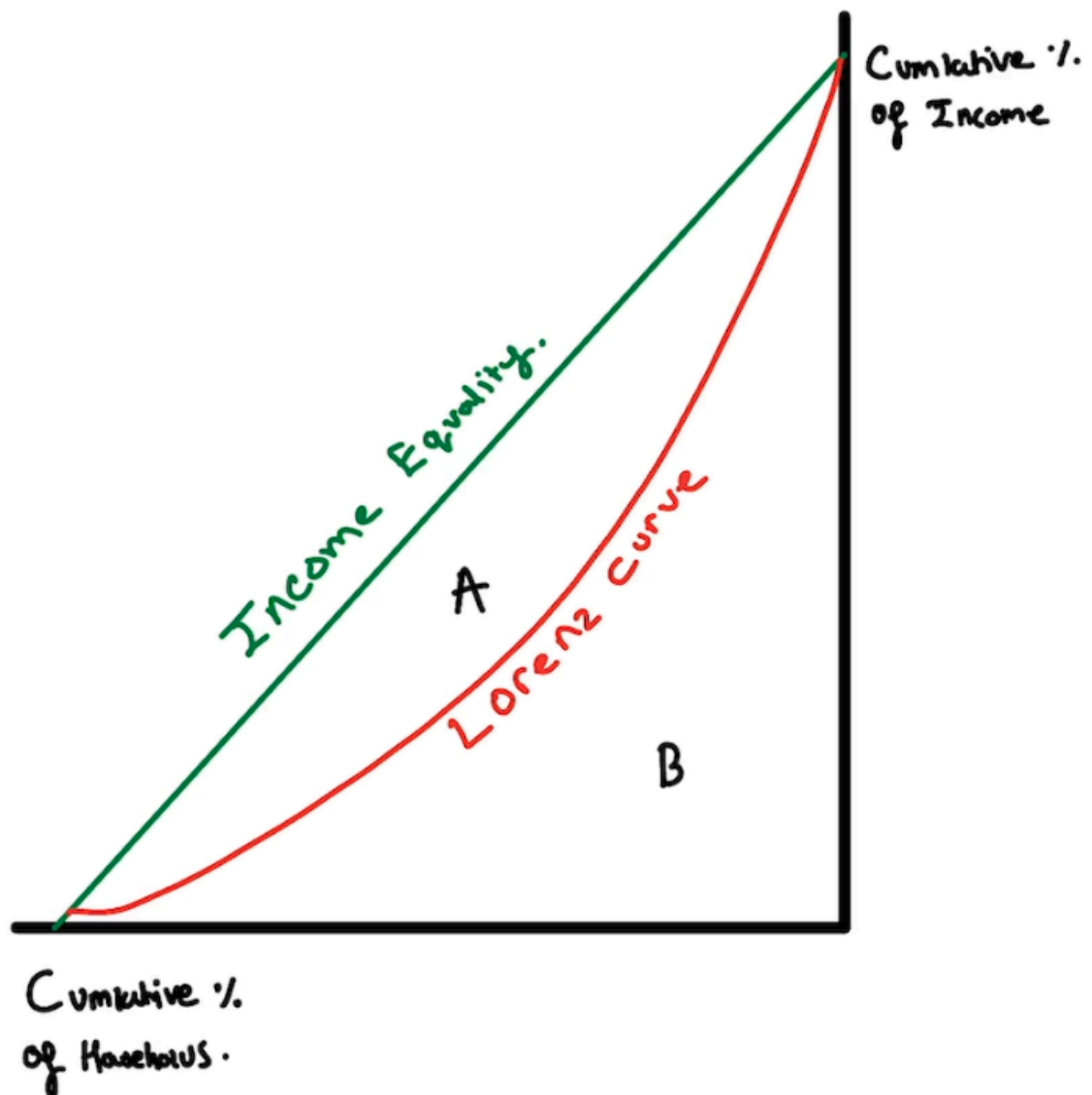
The x-axis shows the cumulative percentage of the population, ranked from lowest to highest income. The y-axis shows the cumulative percentage of income received.

The 45° (Income Equality) line represents perfect equality. For example:

- Bottom 20% of households → 20% of income.
- Bottom 50% → 50% of income.

In reality, the Lorenz Curve usually lies below the line of perfect equality because income is distributed unequally. For example, the bottom 20% may receive only 5% of total income, while higher-income groups receive a disproportionately large share.

Greater distance away from the income equality line → greater income inequality.



Gini Coefficient

The Gini coefficient converts the Lorenz Curve into a numerical measure of income inequality.

$$\text{Gini coefficient} = A / (A + B)$$

Where:

- A = area between the line of perfect equality and the Lorenz Curve.
- B = area underneath the Lorenz Curve.

The coefficient ranges from 0 to 1:

- 0 → perfect equality.
- Closer to 1 → greater inequality.

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The further the Lorenz Curve moves away from the line of equality → area A increases → Gini coefficient increases → income inequality increases.

For example, the UK had a Gini coefficient of around 0.35 in 2022, compared with around 0.25 in the 1970s. This suggests UK income inequality increased substantially over this period, particularly between the 1970s and 1990s.

However, perfect equality is not necessarily desirable. Some inequality can provide incentives to gain skills, work harder, invest and innovate. Policymakers therefore often aim to reduce excessive inequality rather than eliminate inequality completely.

Causes of Income Inequality Within Countries

Education, Training and Skills

Differences in education create differences in human capital and productivity.

More education/training → human capital ↑ → worker productivity ↑ → demand for skilled labour ↑ → wages ↑ → income inequality may increase.

For example UK working-age graduates earn a median salary approximately **£11,500 (42%) higher** than non-graduates.

Technological Progress

Automation/AI ↑ → some routine jobs replaced → demand for some lower-skilled workers ↓ → wages/employment ↓.

At the same time:

Technology ↑ → demand for workers with specialist technological skills ↑ → skilled wages ↑ → income inequality ↑.

Globalisation

Trade barriers ↓ → economies specialise according to comparative advantage → production in competitive industries ↑ → derived demand for workers ↑ → wages ↑.

For example, workers in industries where the UK has a comparative advantage, such as financial services, may benefit from greater international demand.

However:

International competition ↑ → demand for some domestically produced manufactured goods ↓ → derived demand for manufacturing workers ↓ → structural unemployment/wages ↓ → income inequality ↑.

Discrimination

Discrimination can create wage inequality if employers incorrectly perceive particular groups of workers as being less productive.

Perceived productivity ↓ → demand for these workers ↓ → wages ↓ → income inequality ↑.

Causes of Wealth Inequality Within Countries

Income Inequality

Income inequality contributes directly to wealth inequality.

High income → more disposable income available for saving → asset purchases ↑ → wealth accumulates faster.

Low income → larger proportion spent on necessities → ability to save ↓ → asset accumulation ↓.

Therefore, differences in income can become larger differences in wealth over time.

Inheritance

Wealth can be transferred between generations through inheritance.

Wealthy parents → assets passed to children → children begin with greater wealth → ability to generate further income and wealth ↑.

In contrast, households without inherited wealth must primarily accumulate assets by saving employment income. This can cause wealth inequality to persist across generations.

Rising Asset Prices

Increasing house and share prices disproportionately benefit households that already own these assets.

Asset prices ↑ → value of existing assets ↑ → wealth of asset owners ↑.

Those who do not own property or financial assets receive no direct increase in wealth and may find it harder to purchase these assets as prices rise.

For example average UK house prices sit at over **7 times average annual earnings in England** (and over 10 times in London), creating a severe wealth barrier that prevents non-asset-owning households from building property equity.

When the BOE injected £895 billion of money into the economy, this drove up property values disproportionately benefiting the wealthiest 10% of UK households who hold over **40% of all private asset wealth**.