

INCOME INEQUALITY AND REDISTRIBUTION

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CHAPTER 2 (LPD 7): INCOME REDISTRIBUTION

1. BASICS: WHY REDUCE INCOME INEQUALITY?
2. GOVERNMENT INSTRUMENTS TO REDUCE INCOME INEQUALITY: ***BEFORE*** *ENTERING THE LABOUR MARKET*
3. GOVERNMENT INSTRUMENTS TO REDUCE INCOME INEQUALITY: ***AFTER*** *ENTERING THE LABOUR MARKET*
4. EFFECTIVENESS OF INCOME REDISTRIBUTION POLICY

CHAPTER 2 (LPD 7): INCOME REDISTRIBUTION

5. GINI COEFFICIENT AND LORENZ CURVE BEFORE AND AFTER INCOME REDISTRIBUTION

1. BASICS: WHY REDUCE INCOME INEQUALITY?

1.1 CASE-STUDY

Read the following news headlines

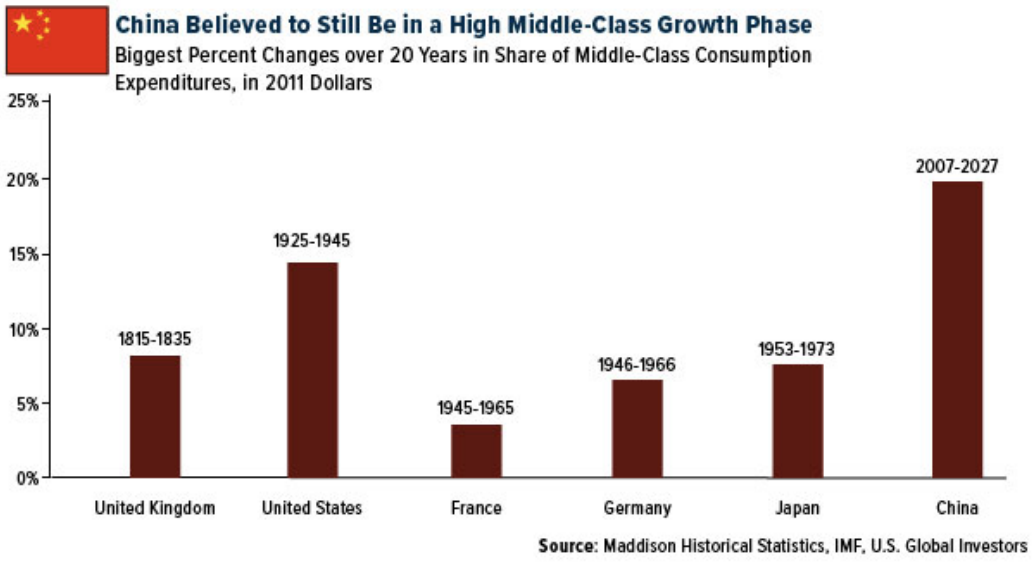
(1) IN BELGIUM, NEARLY ONE IN FIVE CHILDREN LIVES IN POVERTY



(2) "STOP THE ULTRA RICH" PARADE TAKES PLACE IN BRUSSELS



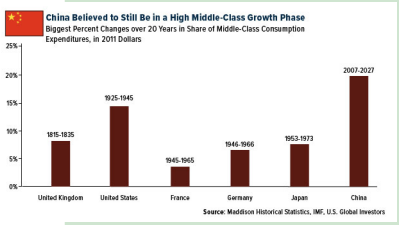
(3) CHINA HAS THE LARGEST MIDDLE-CLASS CONSUMER MARKET IN THE WORLD



(4) FINLAND IS NAMED THE HAPPIEST COUNTRY IN THE WORLD FOR THE NINTH YEAR IN A ROW



Answer the following questions:

Question	Answer
 Is it a fair situation? Y/N Explain why.	
 What explains this social unrest?	
 What are the effects of a growing middle-class?	
 Why are people so happy in Finland?	

1.2 REASONS TO REDUCE INCOME INEQUALITY

There are 4 good reasons why economic inequality must be reduced:

1. Social justice:

- Significant income inequality can be seen as unjust
- Especially when it arises from circumstances over which people have little control

2. Social stability and cohesion:

- Extreme income inequality can lead to tensions, distrust in institutions and social unrest
- It can even lead to an unbalanced distribution of power (the rich gaining too much influence over politics and policy)

3. Economic efficiency:

- Inequality can slow down economic growth, because people on low incomes have less access to education, which means that talent remains untapped
- It also leads to lower consumption (consumption = engine of economic growth!) and lower social contributions and taxes (not good for public finances)

4. Health and well-being:

- Societies with high inequality are less healthy, have higher crime rates and lower life expectancies
- Inequality leads to a weaker well-being of the population

Conclusion: by redistributing income, the government can guarantee 1) a fairer society, 2) a stronger trust between citizens and the government, 3) a higher economic growth and 4) fulfillment of basic needs that stimulates well-being.

2. GOVERNMENT INSTRUMENTS TO REDUCE INCOME INEQUALITY: BEFORE ENTERING THE LABOUR MARKET

2.1 CASE-STUDY

Read the following news headlines

(1) HEAVY INVESTMENTS IN EDUCATION IN MEXICO CONTRIBUTE IN AN IMPORTANT WAY TO REDUCING INCOME INEQUALITY





(2) CANADA SHOWS HOW THE ART OF INCLUSION CAN HELP BUILD A BETTER SOCIETY



CAREER INTEGRATION PROGRAM CANADA

How Newcomers Can Succeed in Their First Canadian Job

(3) AFRICAN COUNTRIES COMMIT TO STRENGTHEN WOMEN'S RIGHTS ON THE LABOUR MARKET AMID RISING GENDER DISCRIMINATION







Answer the following questions (explain the headlines with regard to reducing income inequality):

Question	Answer
Explain the headline 	
Explain the headline 	
Explain the headline 	

2.2 INSTRUMENTS TO REDUCE INCOME INEQUALITY: BEFORE ENTERING THE LABOUR MARKET

There are 3 government measures that are put in place before people enter the labour market and that reduce income inequality:

1. The role of compulsory education:

- By making education compulsory for children, their basic level of knowledge and skills increases, which improves their chances of finding better and better-paid jobs
- Children from low-income families are given more opportunities to climb the social and economic ladder >>> reduces inequality between generations

Other example: Finland
Finland has a uniform and completely free high-quality public education system
Extra support is given to pupils who fall behind

2. The role of integration programmes (for foreign-language newcomers):

- Language is crucial for finding work and actively participating in society, therefore language education reduces disadvantages in the labour market
- Integration programmes give newcomers insight into rules, rights and obligations, enabling them to participate more quickly in social and economic life

Other example: Australia

Australia uses a highly structured, merit-based points system that matches skilled migrants directly with labour shortages

Its strong school incorporation programs ensure that children of immigrants adapt rapidly and achieve high educational outcomes

Integration Australia

3. The role of legislation:

- The government can enact laws and regulations that enforce equal treatment; it has a preventive and corrective effect

  >>> examples: fight discrimination on the labour market based on the basis of gender, religion, sexual orientation, …

- Everyone has a fairer chance and the economic position of women is improved

Other example: Iceland

Iceland implemented the Act on Equal Treatment in the Labour Market, banning workplace discrimination across numerous categories like race, religion, disability, and age, following its pioneering equal pay certification law

These three forms of government intervention create more equal opportunities for people entering the labour market

3. GOVERNMENT INSTRUMENTS TO REDUCE INCOME INEQUALITY: AFTER ENTERING THE LABOUR MARKET

3.1 CASE-STUDY

Read the following news headlines

(1) THE RICHEST 1% OF HOUSEHOLDS IN THE US OWNS 32% OF ALL WEALTH.
AS INEQUALITY GROWS, MORE STATES IN THE US LOOK TO TAX THE RICH



(2) VIETNAM'S LARGEST CITY INTRODUCES FREE HEALTH INSURANCE FOR RESIDENTS AGED 60 AND ABOVE



(3) RIGA'S PUBLIC TRANSPORT WILL BE FREE AS OF SEPTEMBER 2026



Answer the following questions (explain the headlines with regard to reducing income inequality):

Question	Answer
Explain the headline 	
Explain the headline 	
Explain the headline 	

3.2 INSTRUMENTS TO REDUCE INCOME INEQUALITY: AFTER ENTERING THE LABOUR MARKET

There are 3 types of government intervention that are put in place after people enter the labour market and that reduce income inequality:

1. The role of taxes:

- Income taxes are taxes that citizens pay on their wages/salaries, income from wealth (property, investments, …) or other sources of income
- This is an important source of income for the government to finance public and semi-public goods and services

INCOME FROM LABOUR	INCOME FROM INVESTMENTS	INCOME FROM PROPERTY	MISCELLANEOUS INCOME
salary, wage	interest, dividend	rent	

INCOME TAX

Income inequality is reduced through a progressive tax system

Definition: a tax system in which the tax rate increases as income increases

Example: Low income family A has an income of €24.000
High income family B has an income of €120.000

Flat rate tax system	Progressive tax system
Tax rate = 35%, regardless of income	Tax rate depends on income Low incomes: 25% Middle incomes: 35% High incomes: 50%
Income inequality before taxes = 5 120.000 : 24.000	Income inequality before taxes = 5 120.000 : 24.000
Income inequality after taxes = 5 (120.000 – 42.000) : (24.000 – 8.400)	Income inequality after taxes = 3,33 (120.000 – 60.000) : (24.000 – 6.000)



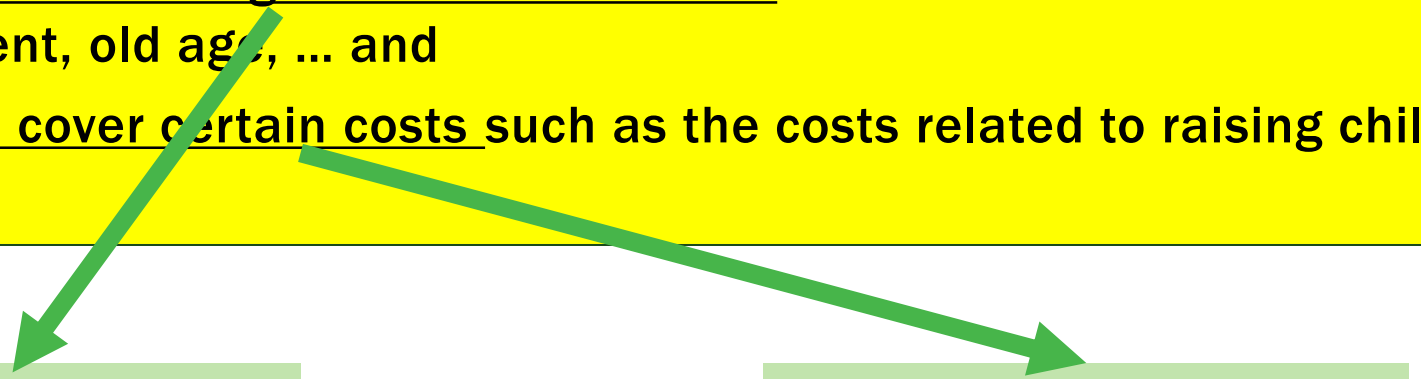
Progressive income taxes ensure a reduction in income inequality because higher incomes contribute relatively more, while lower incomes retain relatively more of their income

The additional tax revenues can also be used to combat poverty and finance semi-public goods and services that increase equal opportunities
(see further)

2. The role of the social security system:

The social security system is a system of social security benefits

- that protects citizens against loss of income due to circumstances such as illness, unemployment, old age, … and
- that helps to cover certain costs such as the costs related to raising children, going on holiday, …



REPLACEMENT income

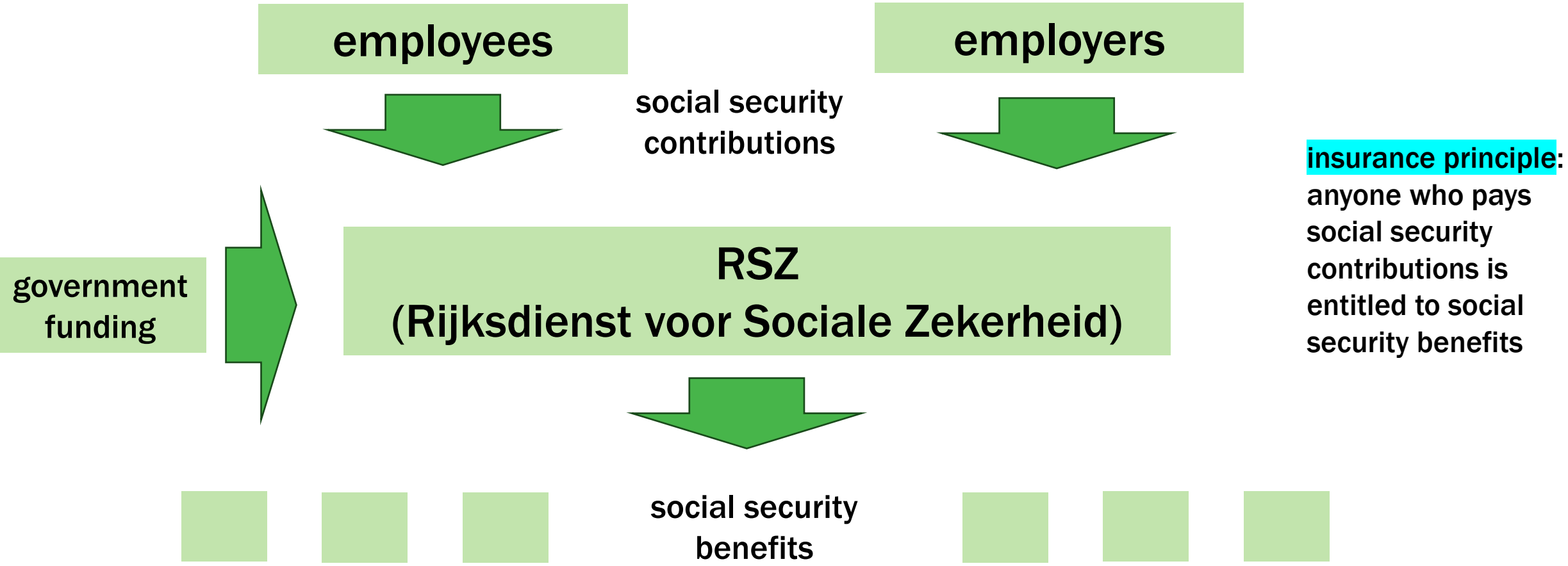
unemployment benefit, sickness and disability benefit, pension

SUPPLEMENTARY income

child benefit (“Groeipakket”), holiday pay

The system has a redistributive effect through the role of social security benefits

It acts as a "safety net" and enables people to recover from difficult financial situations and it keeps income differences within limits



insurance principle: anyone who pays social security contributions is entitled to social security benefits



The social security system ensures a reduction in income inequality because higher incomes contribute more through higher contributions (based on income), while benefits mainly go to people with lower incomes and/or greater needs

= solidarity principe

By providing a guaranteed financial floor, the system lifts millions of older adults above the poverty line who would otherwise have little to no income (see further)

3. The role of semi-public goods and services:

The government provides semi-public goods and services that have a redistributive effect, such as public transport and social housing

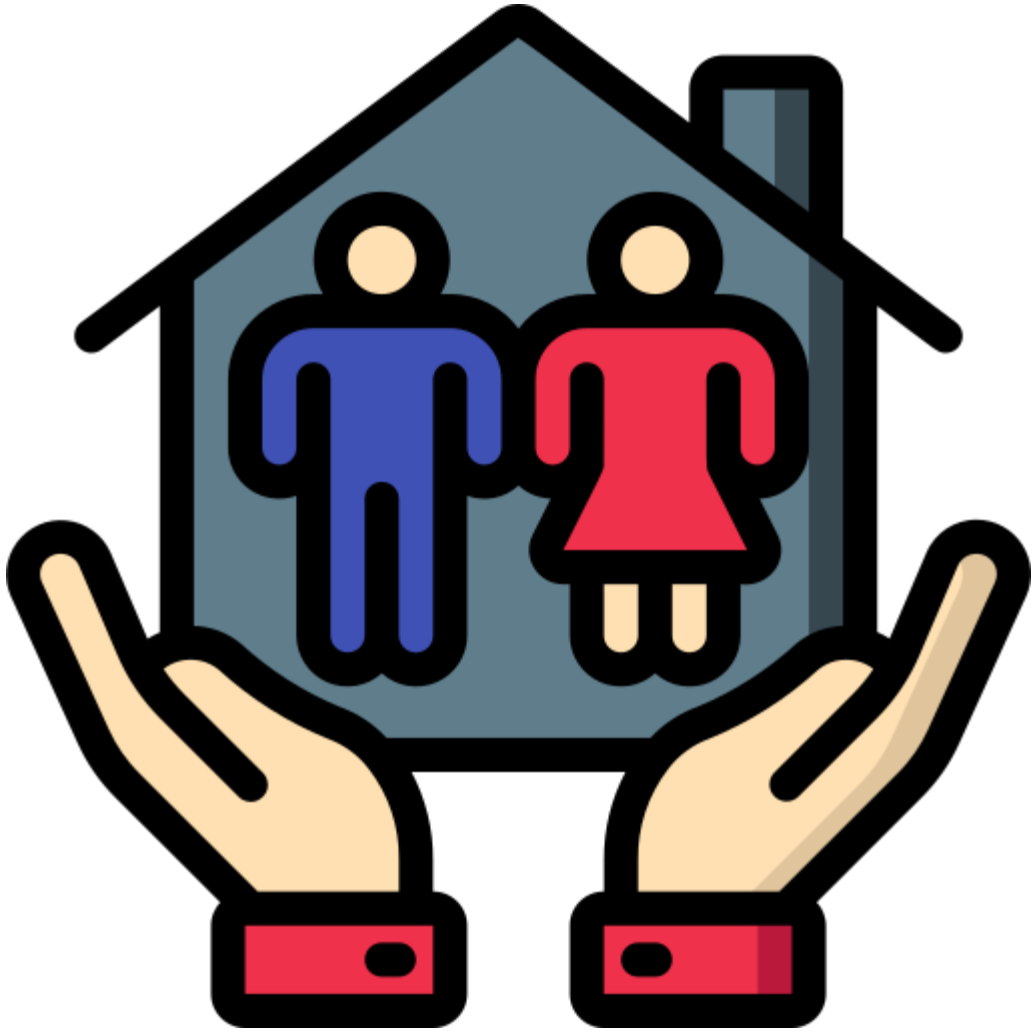
Semi-public goods and services are both excludable and rivalrous (like private goods and services), but they are provided by the government for the sake of social justice (income redistribution)

EXCLUDABLE

If you don't buy a ticket, you won't be allowed on the bus. If your income is too high, you won't be eligible for social housing

RIVALROUS

If a bus is full, no one else can get on. If a social housing flat is occupied, another family cannot live there



Semi-public goods ensure a reduction in income inequality because

- cheap (or even free) public transport enables everyone to go to school or work and gives people on low incomes (who cannot afford a car) access to the same opportunities. It also increases labour mobility

- cheap social housing lowers the cost of living for low incomes, which leaves them with more disposable income (private market rents take up a huge portion of low-income budgets and often lead to debt or even homelessness)

Both reduce structural barriers that perpetuate poverty and narrow the gap between rich and poor

4. EFFECTIVENESS OF INCOME REDISTRIBUTION POLICY

4.1 CASE-STUDY

Read the following news headlines

(1) MANY EU COUNTRIES FAIL TO FIGHT TAX EVASION





(2) RICH COUNTRIES SPEND 60 TIMES AS MUCH ON HEALTHCARE PER PERSON AS POOR COUNTRIES





(3) REJECTION OF PASSENGER RAIL PRIVATIZATION GROWS IN BRAZIL





Answer the following questions (explain the headlines with regard to reducing income inequality):

Question	Answer
Explain the headline 	
Explain the headline 	
Explain the headline 	

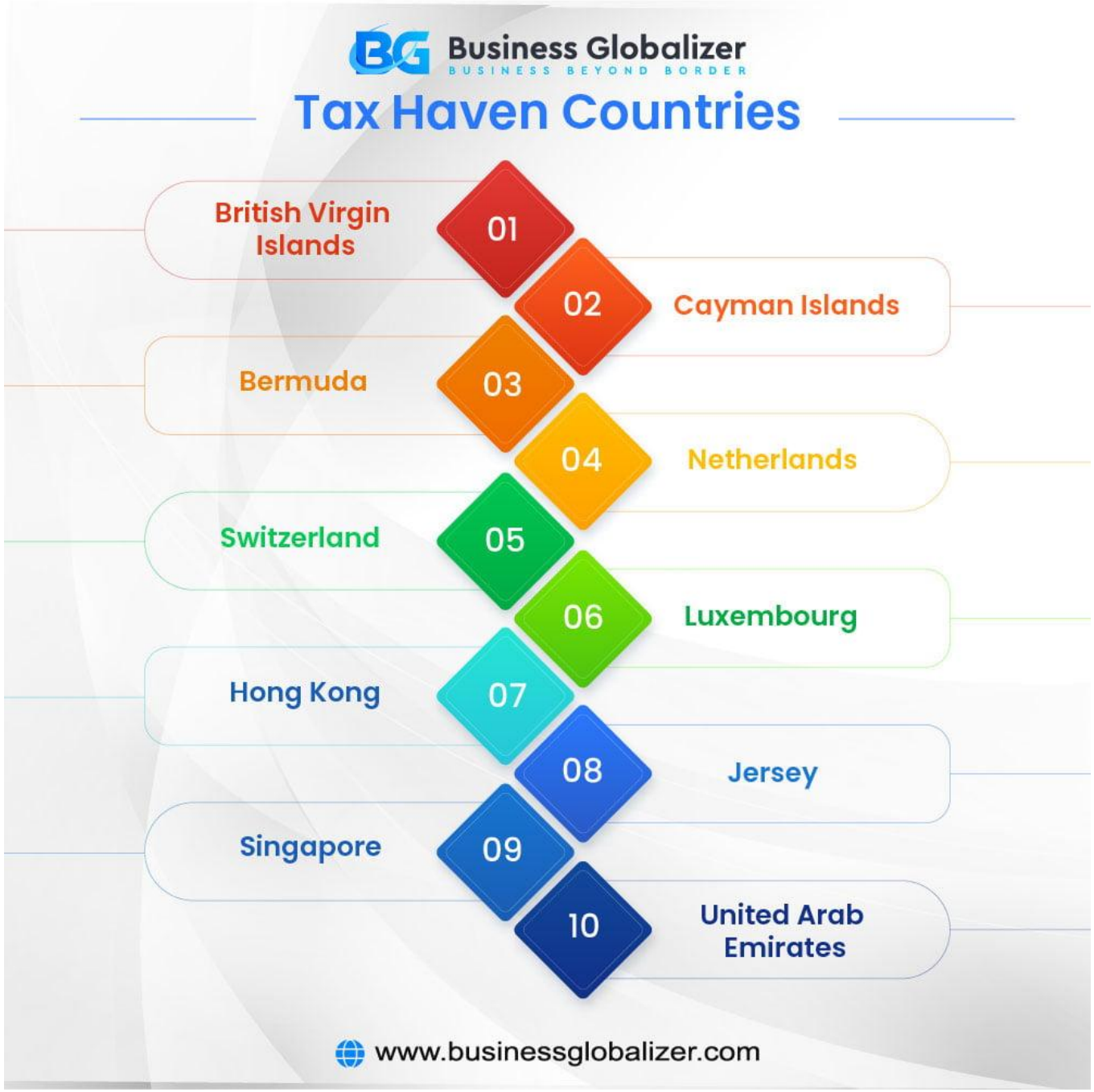
4.2 HOW EFFECTIVE IS INCOME REDISTRIBUTION POLICY?

When taking a critical look at the income redistribution policies of the government, we can identify three phenomena that weaken the redistribution impact of the government:

1. The role of tax avoidance and tax evasion:

Both tax avoidance (using tax legislation and "loopholes" to pay as little tax as possible) and tax evasion (fraud) make income redistribution less effective because

- higher incomes have the resources to hire expensive accountants and tax experts
- large fortunes can be more easily shifted to tax havens or hidden through complex constructions



If high incomes and fortunes systematically avoid or evade taxes, they contribute less than anticipated

weaker income redistribution

2. The role of the “Matthew effect”

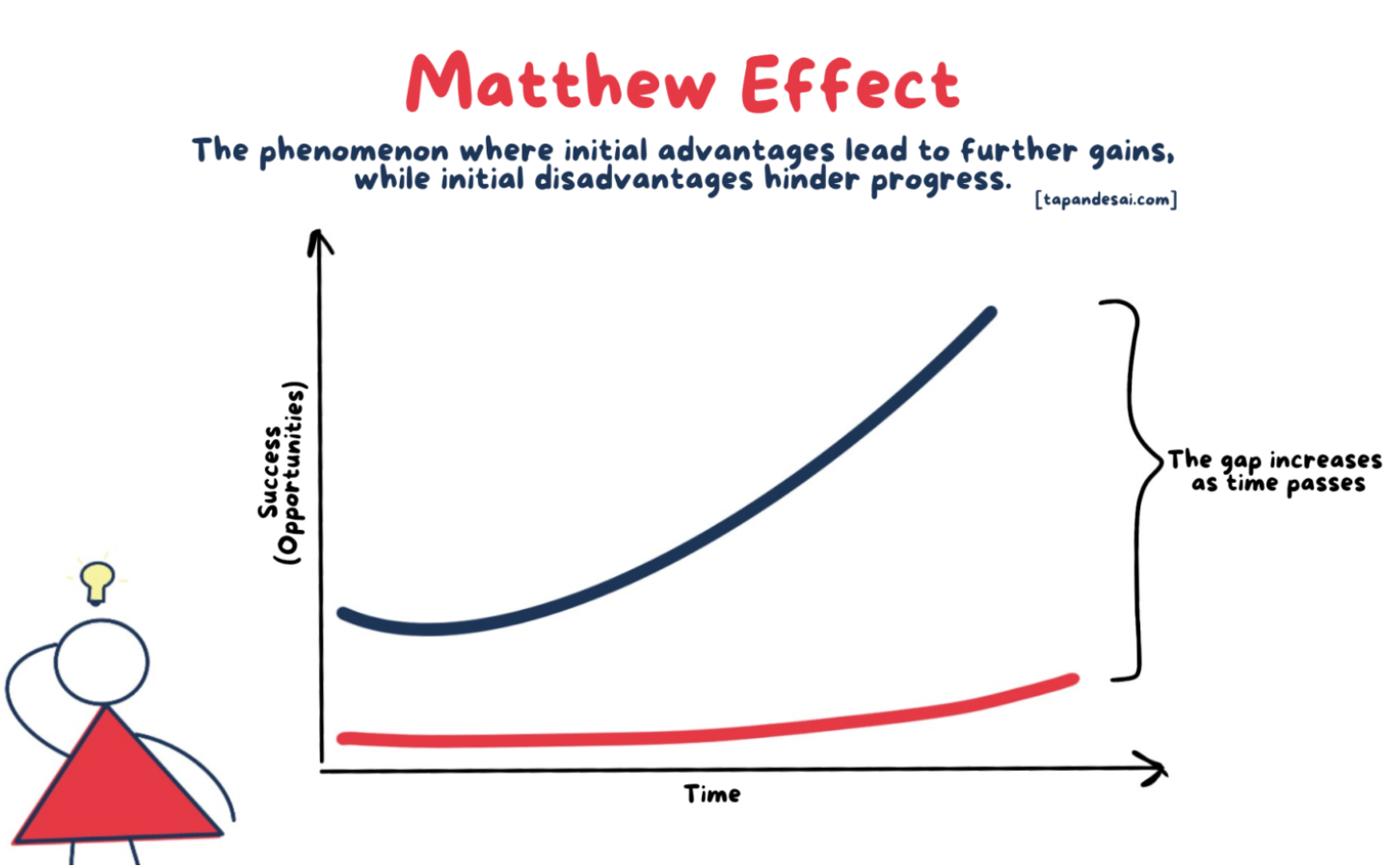
The Matthew effect refers to the biblical principle: “To those who have, more will be given; to those who have nothing, even what they have will be taken away”

In social security this means that the benefits of social measures often go to people who are already better off, rather than to the most vulnerable groups

Example 1: child benefit: all families receive the same amount, including wealthy families who do not really need it

Example 2: health care: higher incomes make more use of expensive specialist care

Example 3: pension: high incomes make more use of pension funds which enables them to have an extra pension (on top of the legal pension)



If high incomes receive money from the social security system that they do not really need (or need less), then the gap between rich and poor remains greater than if the benefits went exclusively to the low incomes

weaker income redistribution

3. The role of privatization

Governments may decide to privatize semi-public goods for various reasons

Practice shows that privatization often leads to higher prices because private companies want to make a profit, whereas the good or service was previously provided at cost price

Example:

The privatization of British Rail in the United Kingdom is a good example of rail privatization that faced severe criticism for resulting in much higher ticket prices for passengers

The ongoing process to bring Britain's railways back into public ownership under Great British Railways reflects the conclusion that the privatized model failed to deliver affordable and reliable value for money





If privatization of semi-public goods and services leads to higher prices, it will be more difficult for low incomes to pay for basic service (transport, but also energy for example); semi-public goods then lose their role as "equalizers" in society

weaker income redistribution

5. GINI COEFFICIENT AND LORENZ CURVE BEFORE AND AFTER INCOME REDISTRIBUTION

Income inequality can be measured and visualized through the concepts of GINI coefficient and LORENZ curve

These examples show the effects of income redistribution through taxes and social transfers

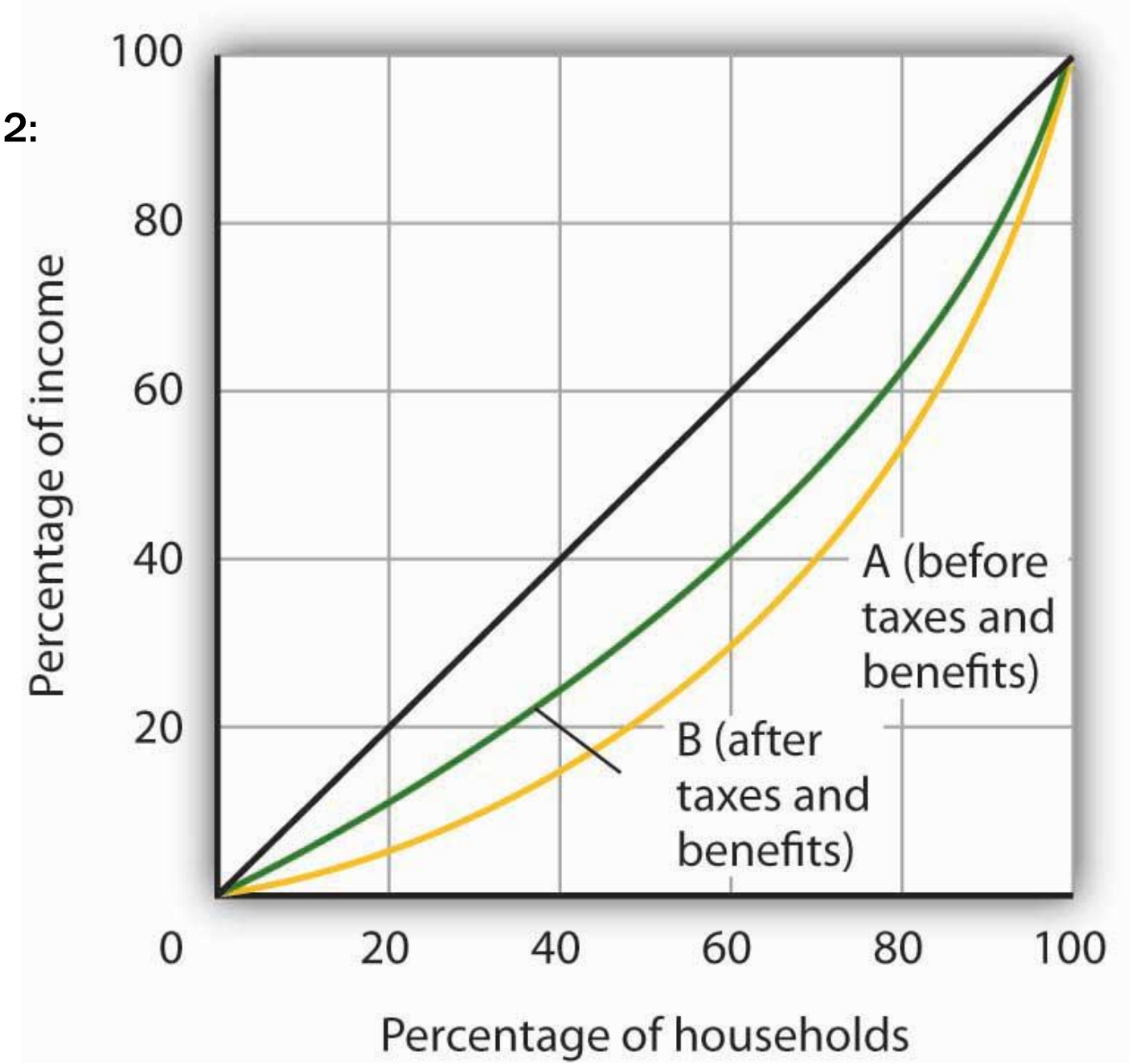
Example 1:

Country	GINI coefficient before income redistribution	GINI coefficient after income redistribution
Germany	0,42	0,31
Colombia	0,54	0,51

STRONG redistribution effect because of effective tax system and well-developed social security system

WEAK redistribution effect because of less effective tax and social security systems (very large informal economy!)

Example 2:



The US Lorenz curve B (after taxes and social tranfers) lies closer to the equal income line than Lorenz curve A