



## 2.12 The market's inability to achieve equity (HL only)

# Learning objectives

2.12 The market's inability to achieve equity (HL only)	Depth	Diagrams and calculations
<ul style="list-style-type: none"><li>• <b>Workings of free market economy may result in an unequal distribution of income and wealth</b></li></ul>	<b>AO2</b>	<b>Diagram: showing the circular flow model to illustrate why the free market results in inequalities</b>

# Real world example - data analysis

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**Source 1:** [Household Income Distribution in the U.S. Visualized as 100 Homes](#)

**Source 2:** [The Wealth Inequality Problem in One Chart](#)

## Data Analysis Questions

1. What do you notice from the data?
2. What questions do you wonder about the data?
3. Research information that may help you answer your questions from Q2.
4. What conclusions can you make from Q1, Q2, and Q3?

# Key terms

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**A free-market economy** is an economy where consumers and producers decide the allocation of resources without government intervention.

**Income** refers to the money received by households in exchange for factors of production provided to firms in the resource market.

**Wealth** refers to the total value of assets that households own e.g., property, savings, stock.

**Equality** is the state of being equal; a positive concept which can be tested with available data.

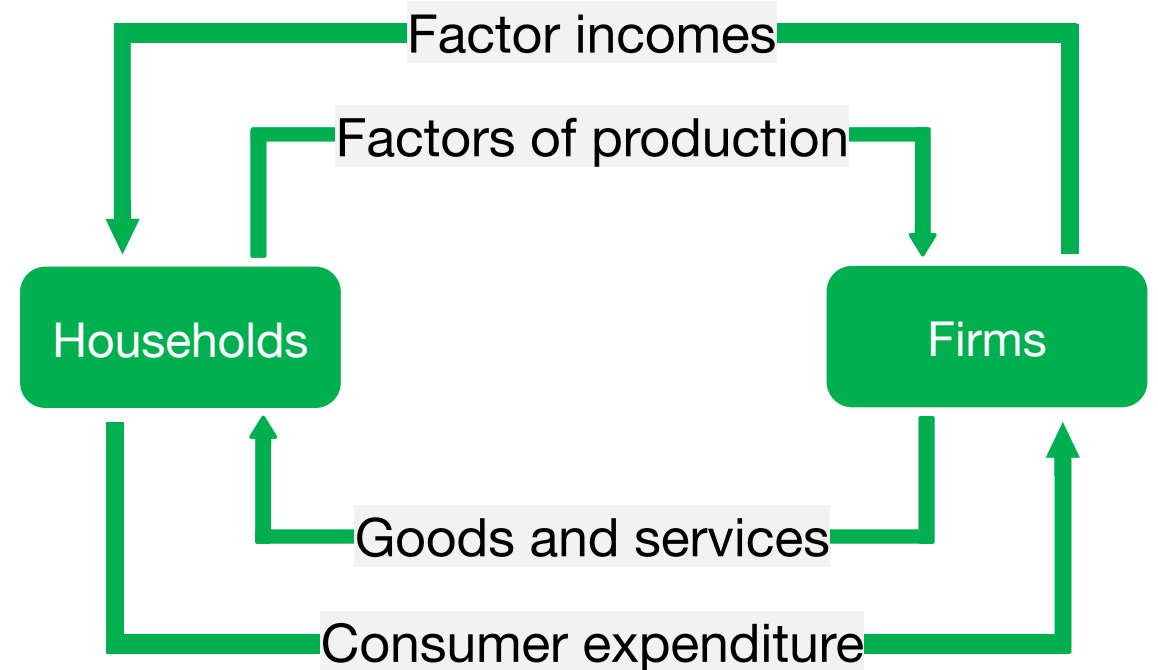
**Equity** is the idea of being fair or just; a normative concept dependent on value judgements.



# Circular flow of income review

The **circular flow of income model** shows the interaction between households and firms.

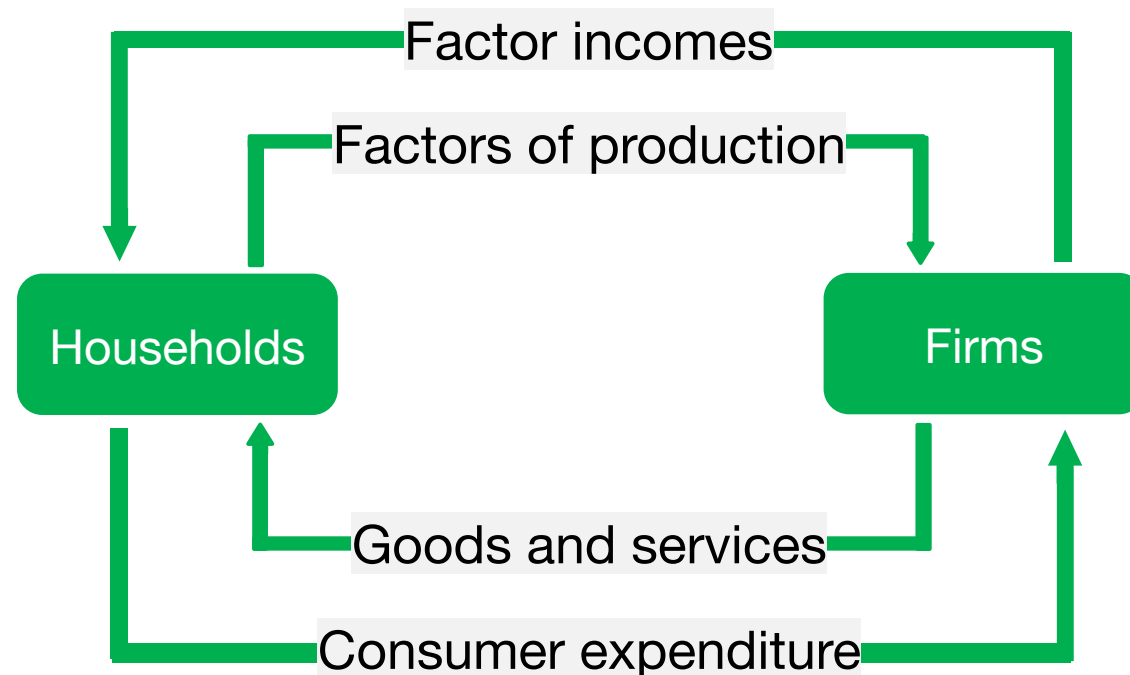
- Households provide resources to businesses.
- Businesses provide income to households.
- Businesses use the resources to produce goods and services for households.
- Households provide expenditure to businesses.
- Cycle repeats.



# Circular flow of income and income distribution

Household incomes depends on the factors of production traded in the resource market.

Factor of production	Factor income
Capital	Interest
Entrepreneurship	Profit
Land	Rent
Labour	Wages



# Income inequality

There are many reasons behind the unequal distribution of income in a free-market economy.

Factor of production	Factor income
Capital	Interest
Entrepreneurship	Profit
Land	Rent
Labour	Wages

One of which is the **unequal distribution of resources** amongst households. Most households depend on providing labour for wages, while a smaller proportion of households may own capital, businesses, and land which provides multiple income streams, resulting in higher income.

# Unequal distribution of resources

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There are different reasons why a small portion of households own capital, businesses, and land.

- Inheritance of resources.
- Risk tolerance for entrepreneurship.
- Differences in wages resulting in difference in savings available for investing in capital, businesses, and land.





# Unequal income distribution & the free market economy

Other factors that contribute towards unequal income generation can be explained via the workings of free market economy.



## Labour and wages

Most households depend on providing labour in exchange for wages.

What factors could affect the level of wages workers might receive from employment?

# Labour and wages

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Factors that affect the **demand and supply of labour** in the labour market impact wages:

- Occupation and industry
- Experience
- Qualifications and skills
- Hours worked
- Location

These factors contribute towards the unequal distribution of wages in the labour market.



## Entrepreneurship and profits

A small portion of households may run a business for potential profits.

What factors could affect the level of profits entrepreneurs might receive?

# Entrepreneurship and profits

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Factors which affect the **revenues** and **costs** of a business impact the profits and losses.

- Market structure and level of competitiveness of the industry
- Market demand and supply factors
- Size of the business i.e., economies of scale
- Research and development

These factors contribute towards the unequal distribution of profits across industries.





## Land and rent

A small portion of households own land and property which can be rented out.

What factors could affect the level of rent landowners might receive?



# Land and rent

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Factors that affect the **demand and supply of land** in the property rental market impact rent.

- Size of property
- Location of property
- Business confidence
- Business cycle stages

These factors contribute towards the unequal distribution of rent in the property rental market.



## Real world example

**Article:** [Technology Isn't Destroying Jobs, But Is Increasing Inequality](#)

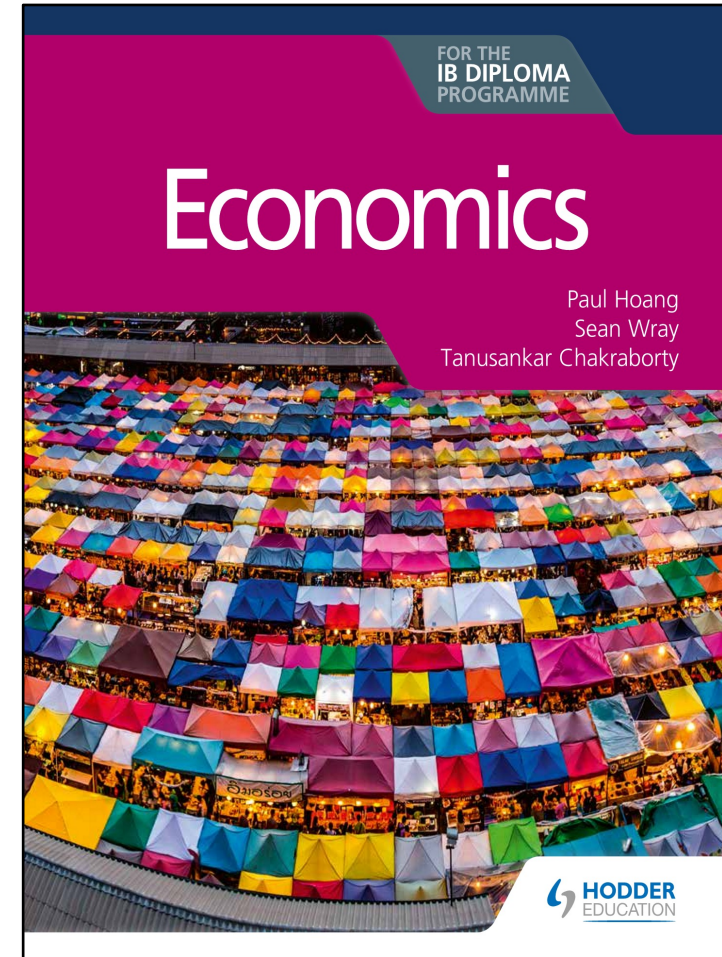
Explain how technology may impact income inequality in a free-market economy.

# Over to you...

Hoang, Wray, & Chakraborty (2020)

Economics for the IB Diploma Programme

- Page 223
- Paper 1 Exam Practice Question 15.1 (HL only)
- [10 marks]





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