

Osher Lifelong Learning Institute, Winter 2020
**What Economists Know About Important
Policy Issues**

Lecture 4: Economic Inequality

February 12, 2020

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National Economic Education Delegation

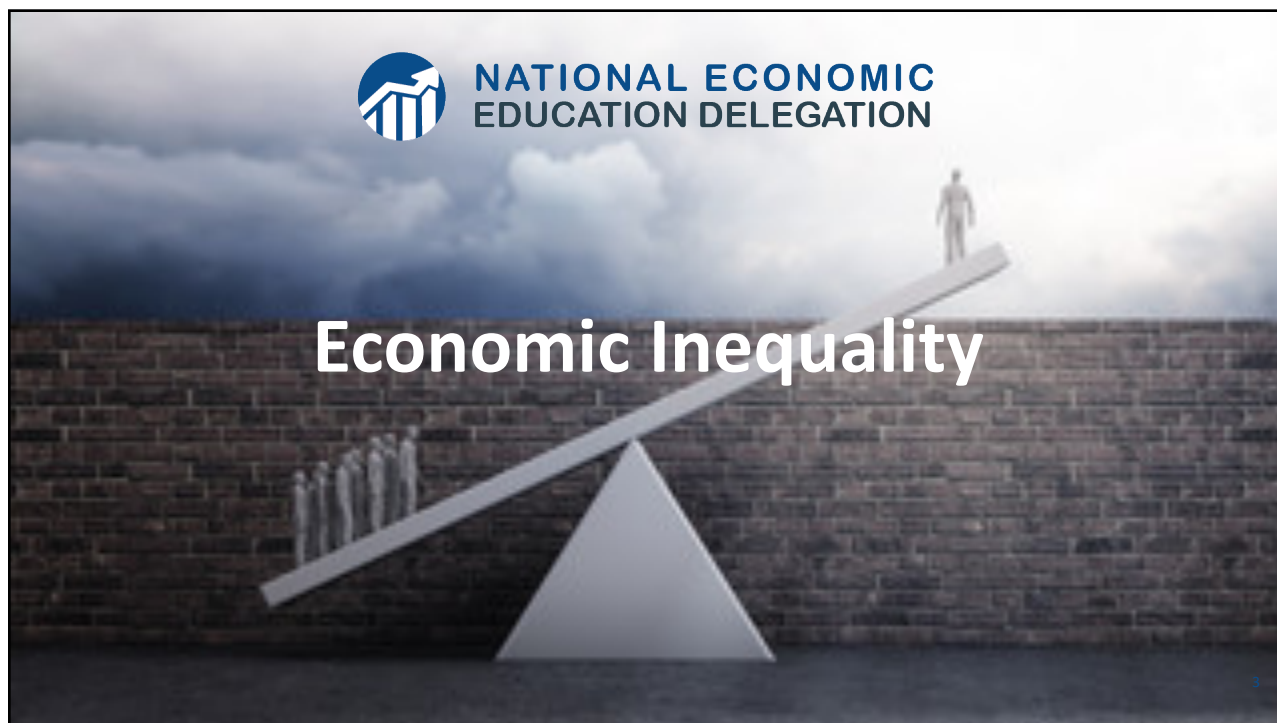
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Course Outline

- **What Economists Know About Important Policy Issues**

- Week 1 (1/22): US Economic Update
- Week 2 (1/29): Government Budgets
- Week 3 (2/5): Climate Change
- **Week 4 (2/12): Income Inequality**
- Week 5 (2/19): Trade and Globalization
- Week 6 (2/26): Housing Policy


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- **This slide deck was authored by:**
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 - Robert Wright, Augustana University
- **Disclaimer**
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Outline

- Definition
- Measurement
- How does it happen?
- Does it matter?
- Is it a problem?
- What to do about it



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Economic Inequality: Income

- **Definition:**
 - The extent to which the distribution of income deviates from complete equality
 - The dispersion of income throughout the economy



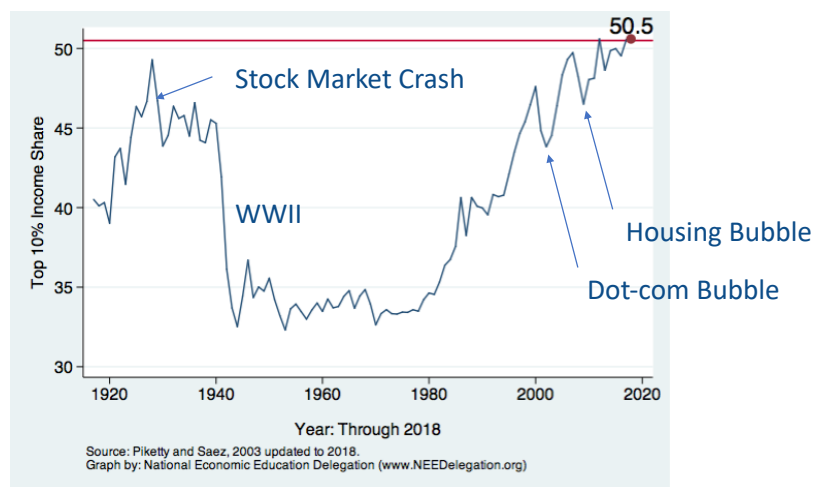
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Different Ways of Thinking About Inequality

- **Income Inequality**
 - Before taxes and transfers
 - After taxes and transfers
- **Wealth Inequality**
- **Consumption Inequality**

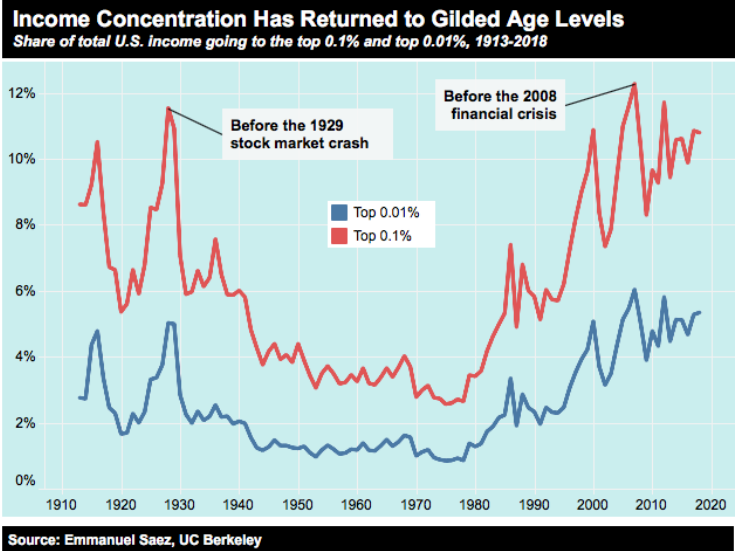
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National Income Inequality: Share of Top 10%



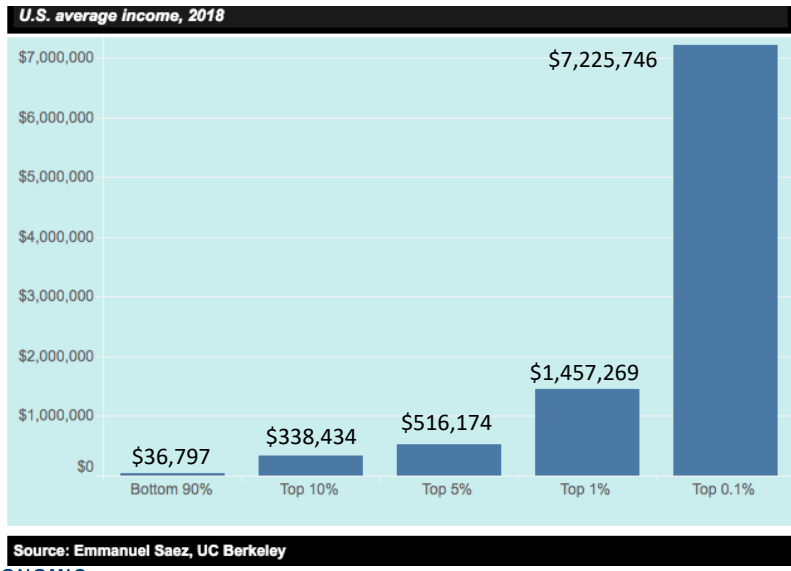
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Concentration at the Very Top



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Incomes Across the Distribution



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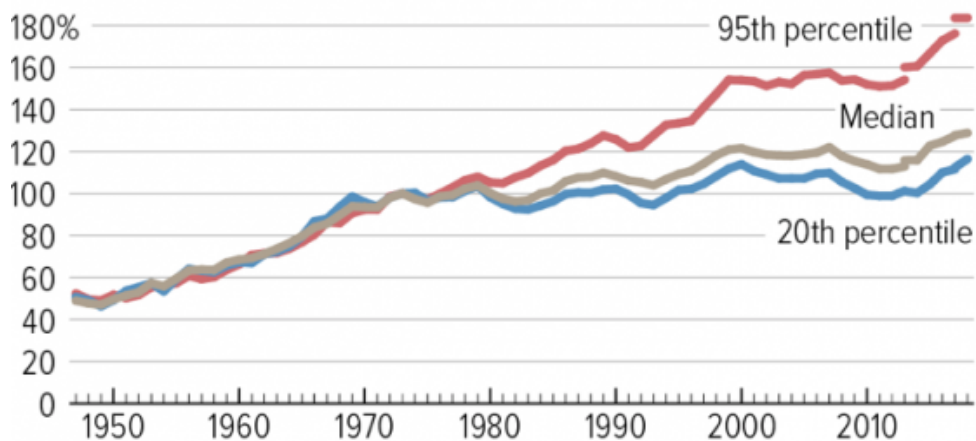
Recent Facts on Income Inequality

- **Beginning in the 1970s, the income gap widened.**
 - Income in the middle and lower parts of the distribution slowed
 - Incomes at the top continued to grow strongly
 - Income shares at the very top of the distribution rose to levels last seen more than 80 years ago

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The Abrupt Increase in Inequality

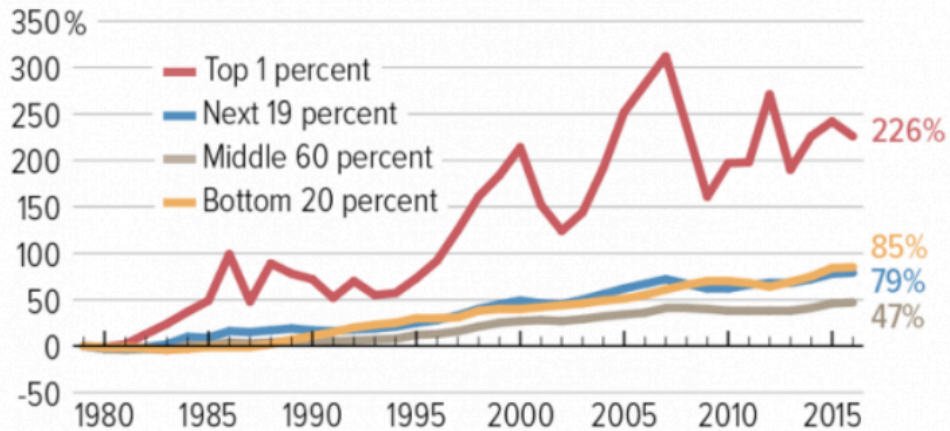
Real family income between 1947 and 2018, as a percentage of 1973 level



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Most of the Action Is at the Very Top

Percent change in income after transfers and taxes since 1979

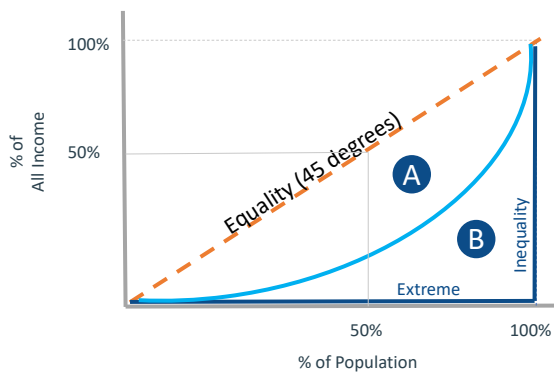


Source: Chad Stone, Danilo Trisi, Arloc Sherman, and Roderick Taylor, "A Guide to Statistics on Historical Trends in Income Inequality," Center on Budget and Policy Priorities, Policy Futures, May 15, 2018, page 11.

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The Gini Coefficient

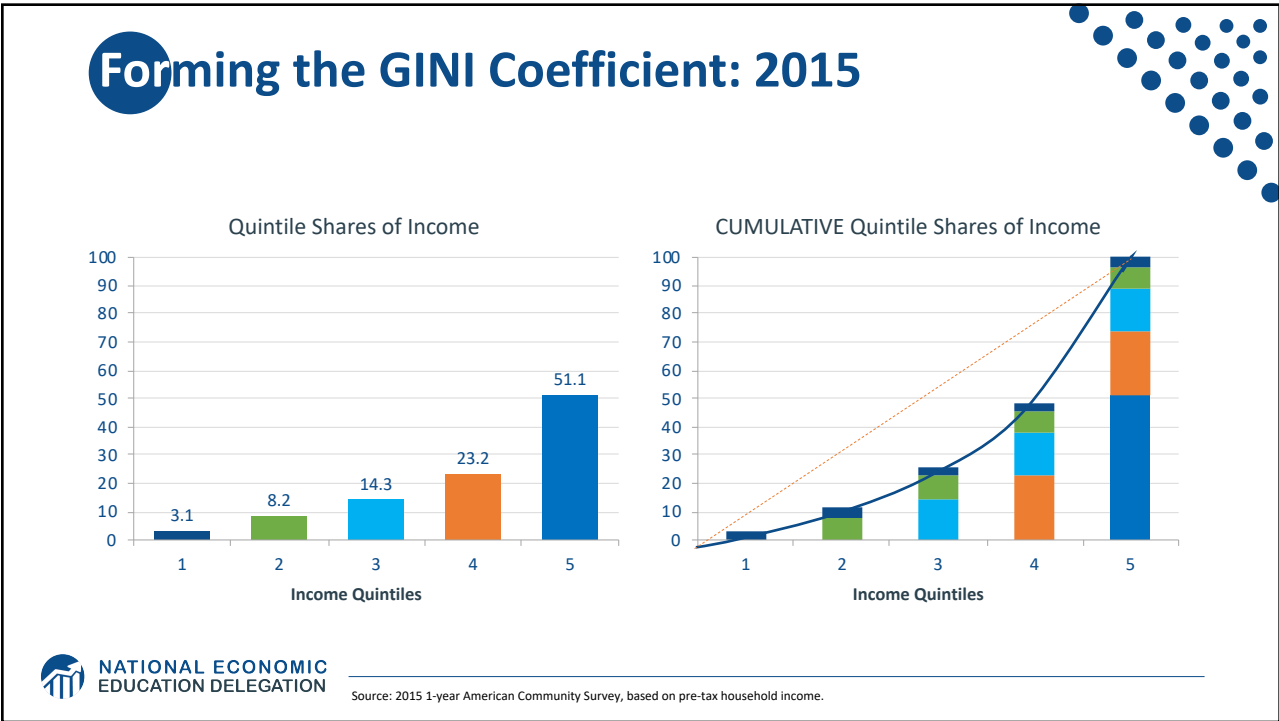


$$\text{Gini} = \frac{A}{A + B} \times 100$$

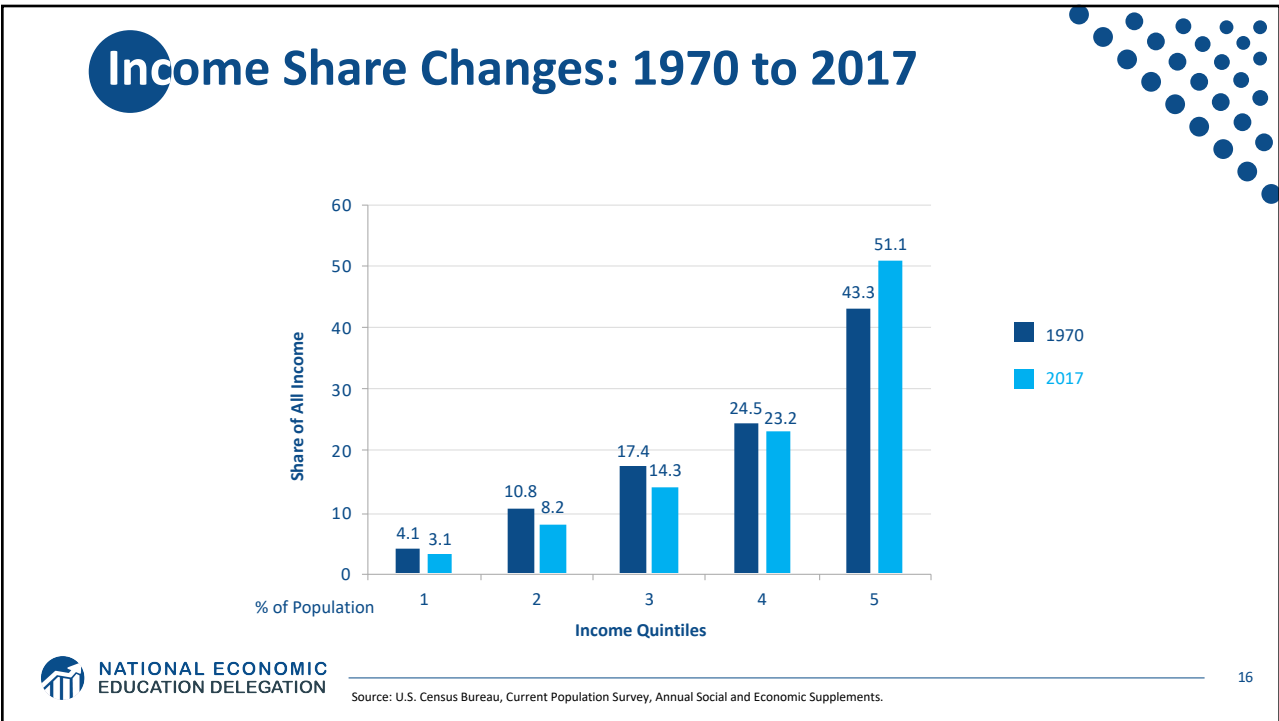
Bigger A: More inequality
Smaller A: Less inequality



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Income Changes from Growing Inequality

Bottom 90% of Households

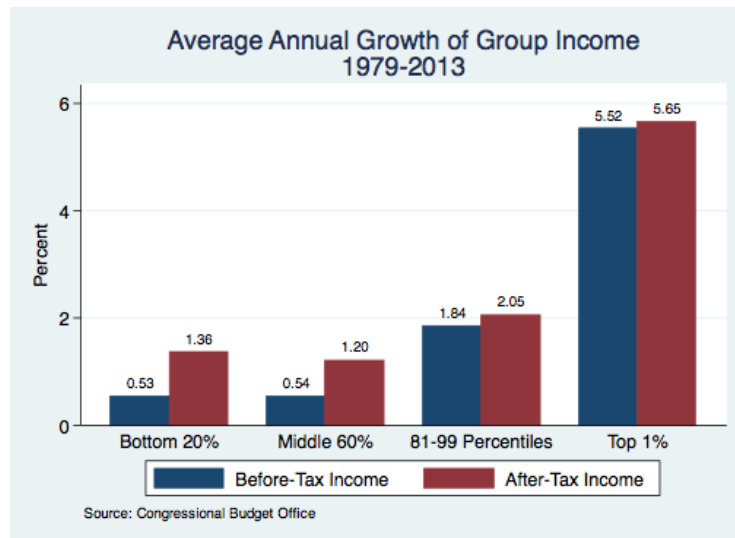
INCOME GROUP	TOTAL LOSS/GAIN IN ANNUAL INCOME*	AVERAGE LOSS/GAIN PER HOUSEHOLD PER YEAR*
TOP 1%	\$673 billion more	\$597,241 more
96-99	\$140 billion more	\$29,895 more
91-95	\$29 billion more	\$4,912 more
81-90	\$43 billion less	\$3,733 less
61-80	\$194 billion less	\$8,598 less
41-60	\$224 billion less	\$10,100 less
21-40	\$189 billion less	\$8,582 less
BOTTOM 20%	\$136 billion less	\$5,623 less

* Compared to what incomes would have been had all income groups seen the same growth rate in 1979-2005 as they did during previous decades. Source: Jacob Hacker, Yale University; Paul Pierson, UC-Berkeley



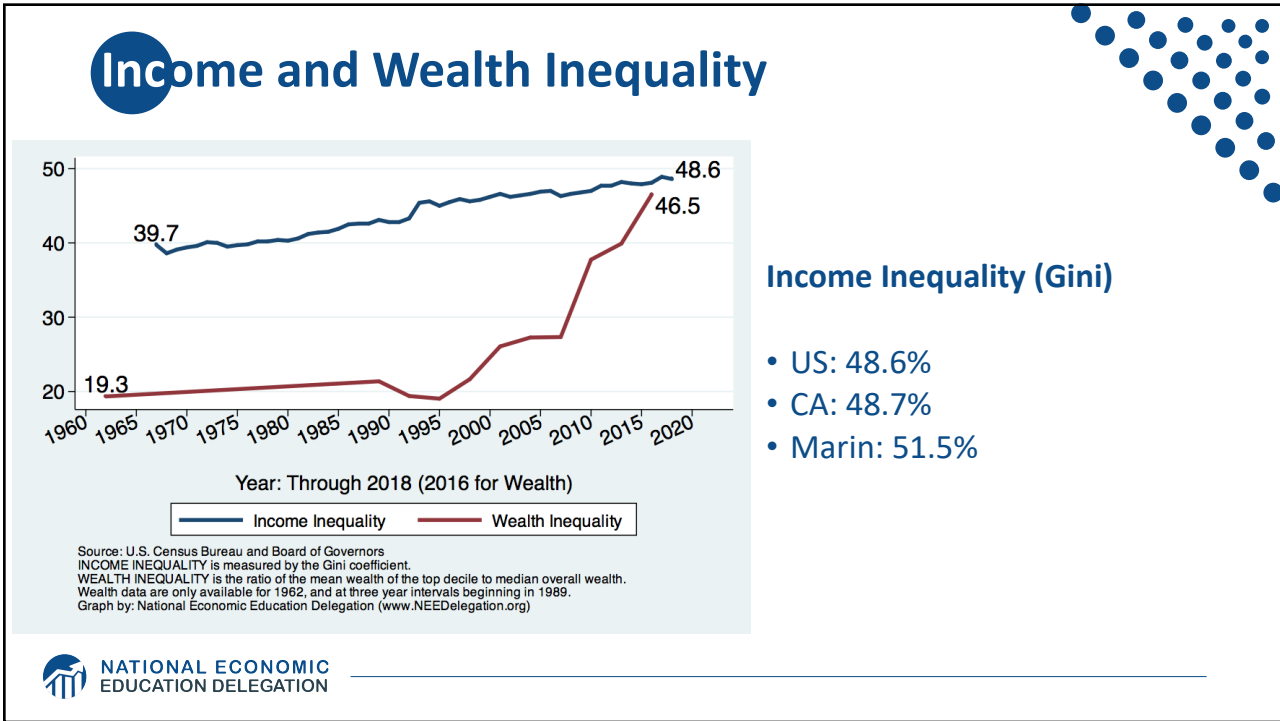
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Growth Has Been Primarily at the Very Top

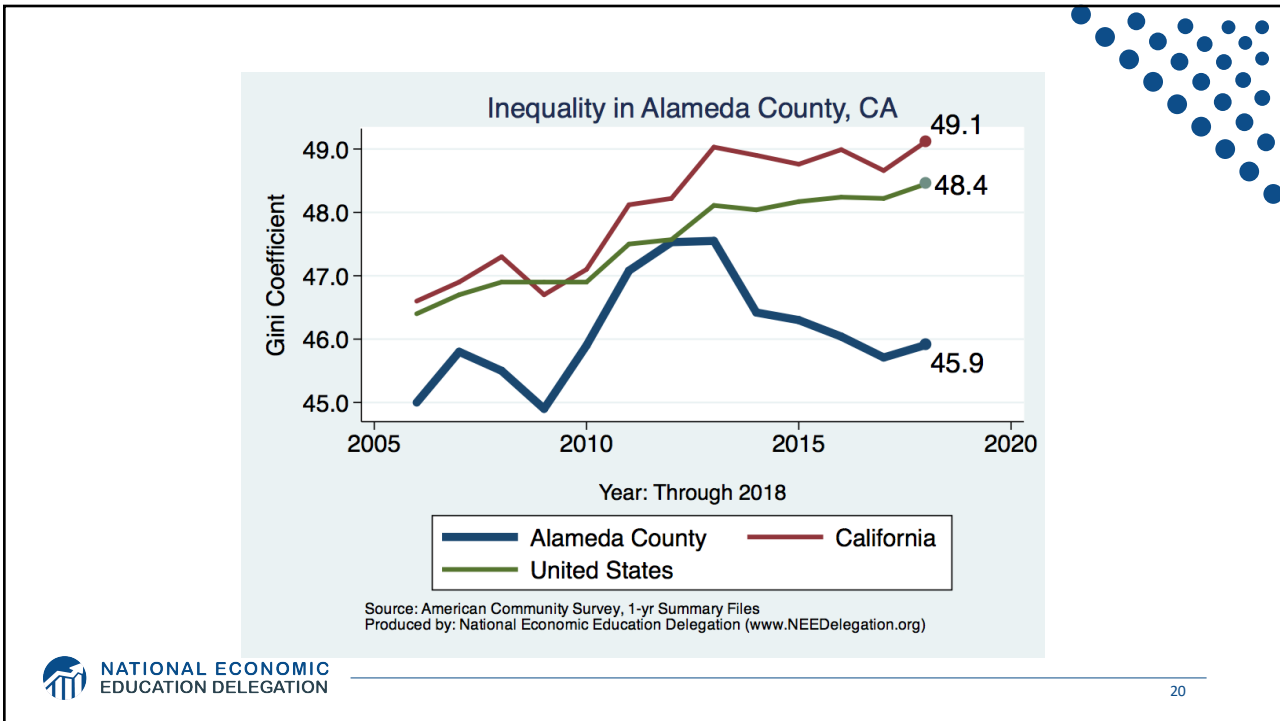


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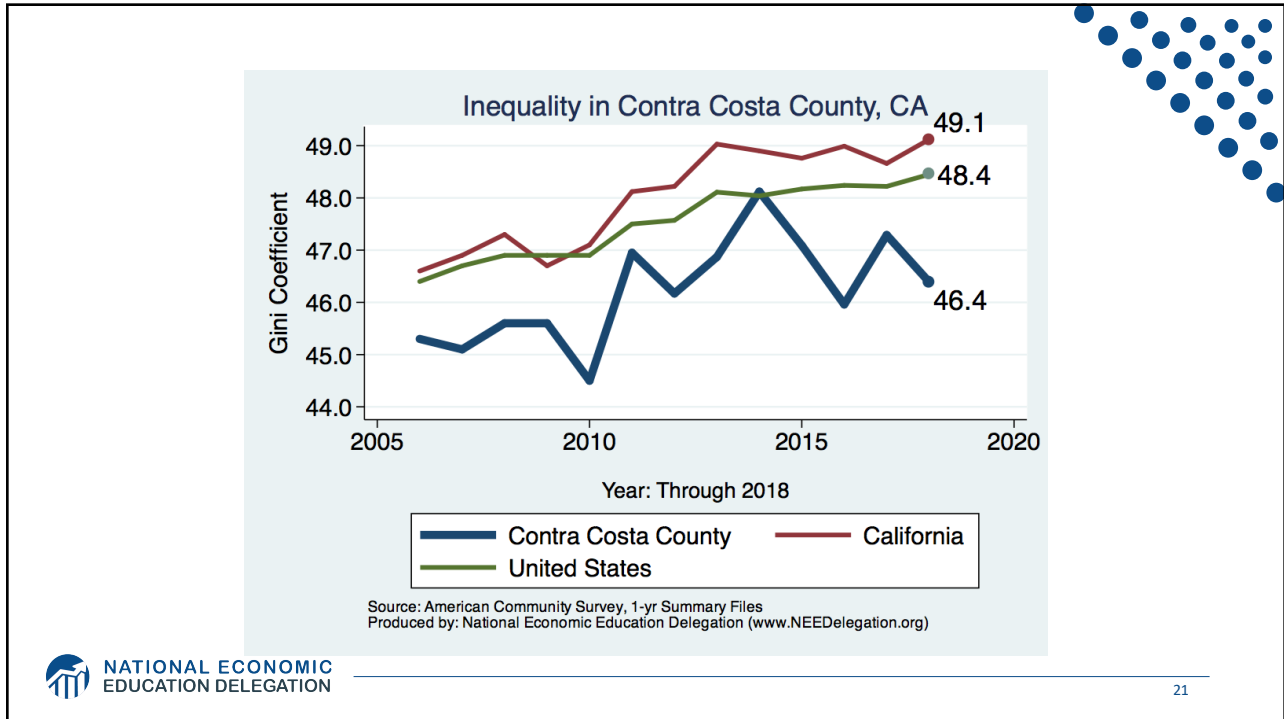
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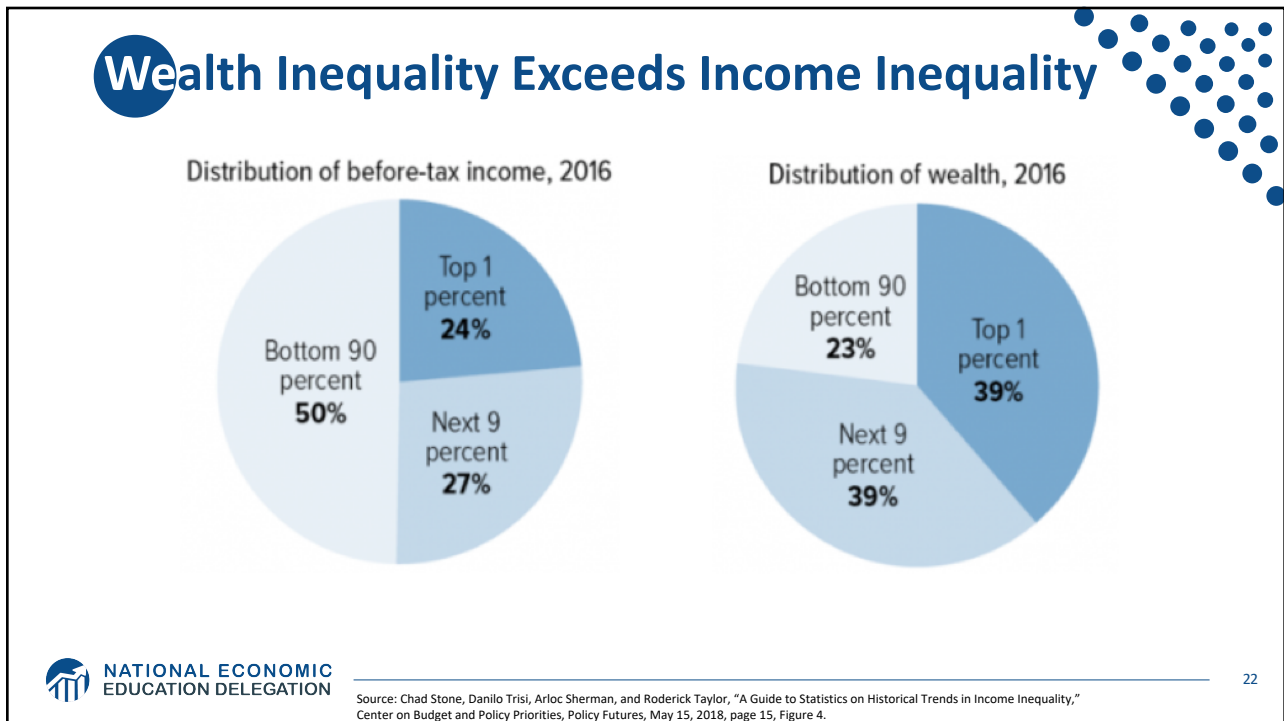
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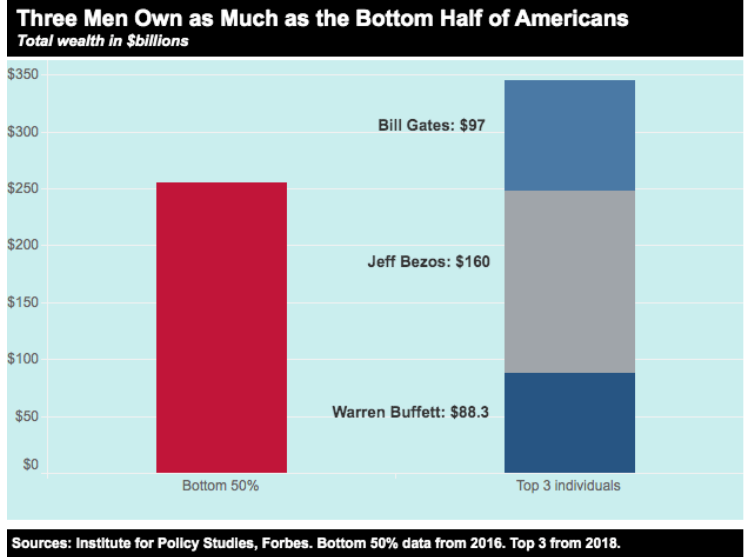


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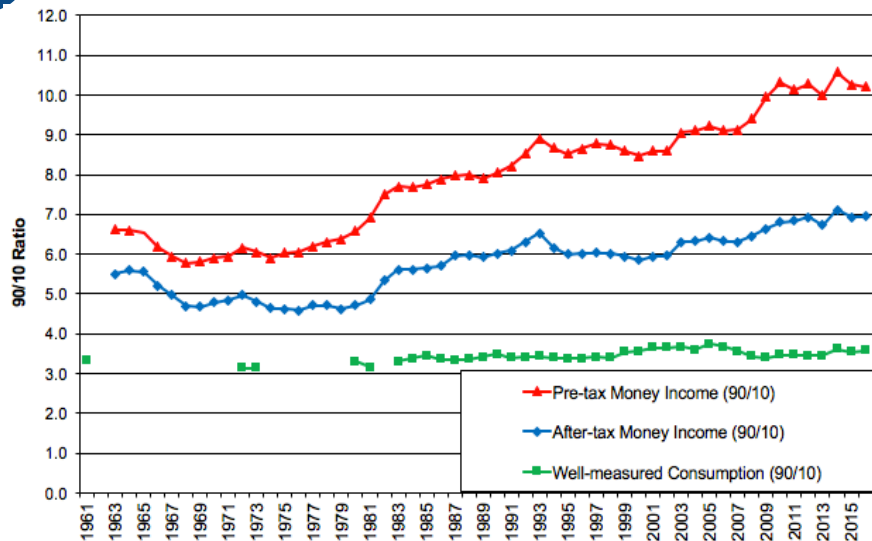
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Wealth is Extremely Concentrated



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A Third Measure of Inequality: Consumption



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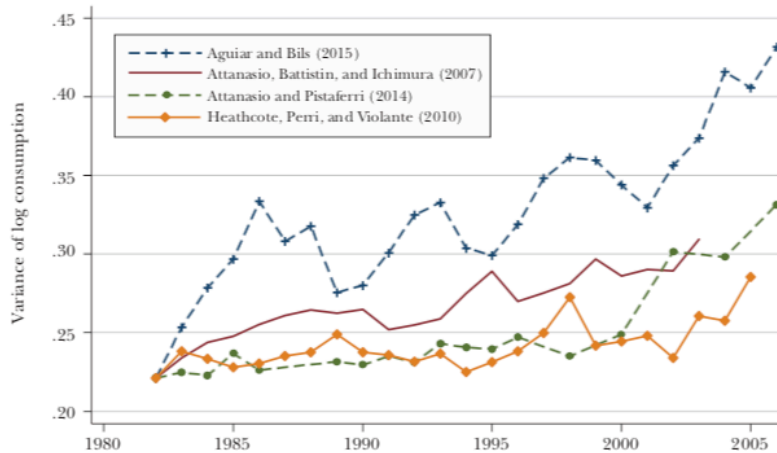
Consumption Inequality

- Consumption is another important metric for judging inequality
- Arguably a better indicator of “well-being”
- Extremely difficult to measure
- Growing evidence that consumption inequality has also increased

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Growing Evidence: Consumption Inequality

The Evolution of Consumption Inequality over Time as Measured by Different Papers



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Case Study: Economic Research

- **Early, controversial result is published.**
- **Flurry of effort to understand the result.**
- **Growing body of evidence.**
- **Consensus reached?**
 - Not always
 - Sometimes data continue to conflict
 - Often merely a preponderance of evidence drives understanding
- **Why has this happened with consumption inequality?**
 - Inadequacy of data and methods



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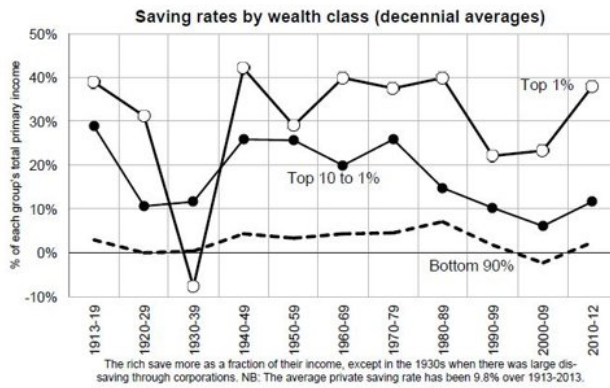
Summary: Consumption Inequality

- **Early research indicated that although income inequality may be increasing, consumption inequality may not be.**
 - How is this possible? Borrowing, or otherwise smoothing consumption.
- **Mounting evidence that it is increasing along with income and wealth inequality.**
- **Consensus reached? No.**



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But High-Income Households Save More



Source: Emmanuel Saez and Gabriel Zucman, *The Distribution of U.S. Wealth, Capital*

- Facilitates the Consumption of: **Wealth**
- Which facilitates the consumption of: **Leisure**



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Where Does Inequality Come From?

• Labor Characteristics

- Demographics
 - o Age distribution
- Personal Choices
 - o Educational attainment
 - o Effort
 - o Priorities
 - o Household composition
- Immigration

• Market Forces

- Technology
- Changing demand patterns
- Competition for labor

• Government Policy

- Market influence
- Redistribution



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Government Policy and Inequality

- **Market Influence: PRE-distribution**

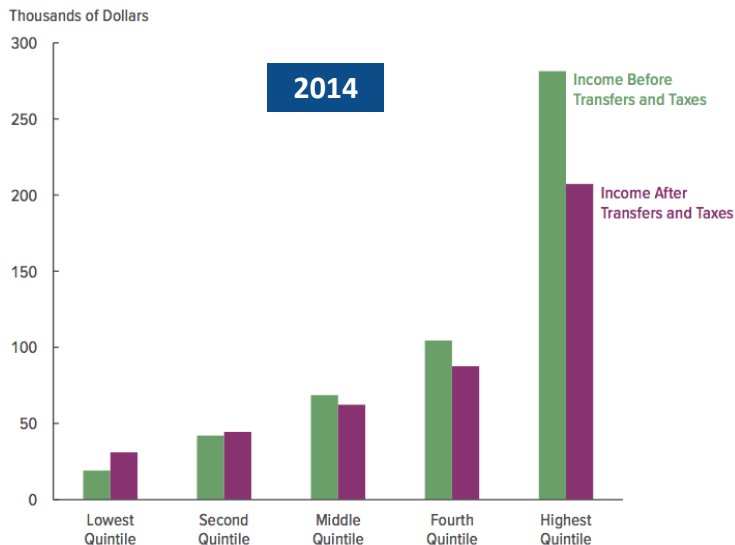
- Characteristics of labor
 - o Access to education
- Effects on labor demand
 - o Market regulation
 - Competition policy
 - o Labor regulations
 - Minimum wage, overtime, health insurance, etc.

- **RE-distribution**

- Tax Rates
- Income support
 - o Direct aid
 - o Food stamps

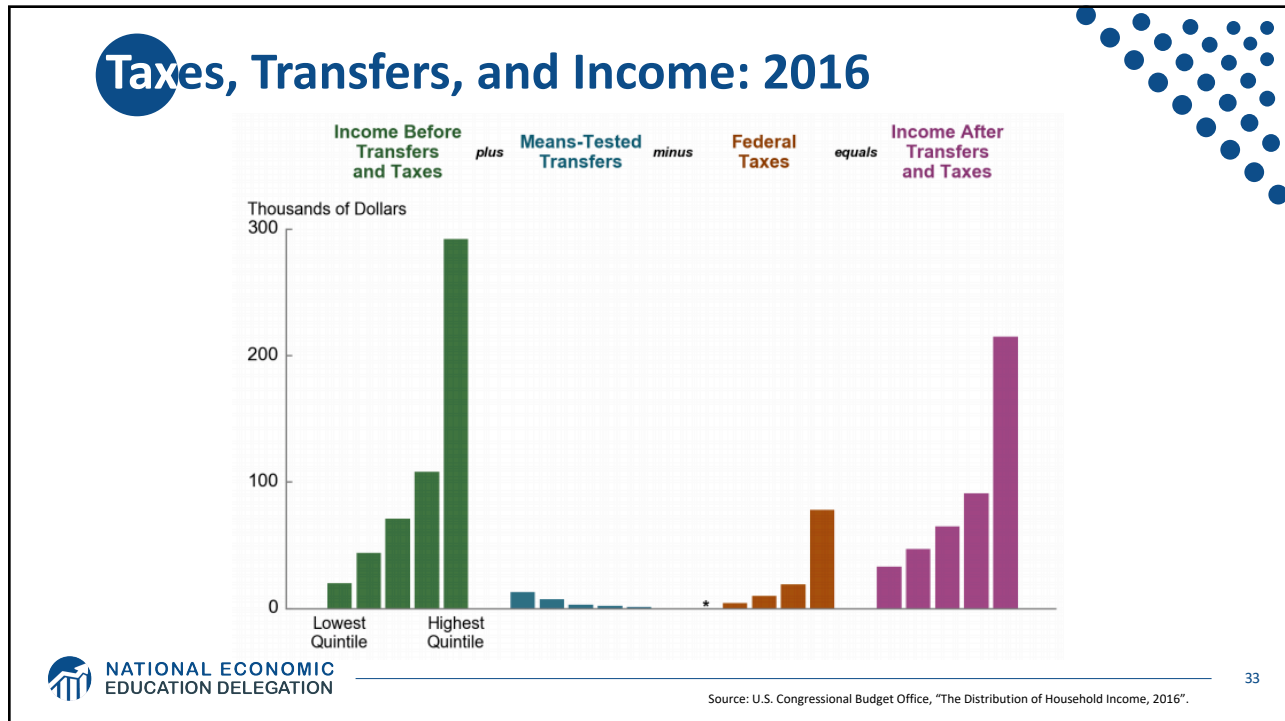
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Tax and Transfer Programs and Inequality

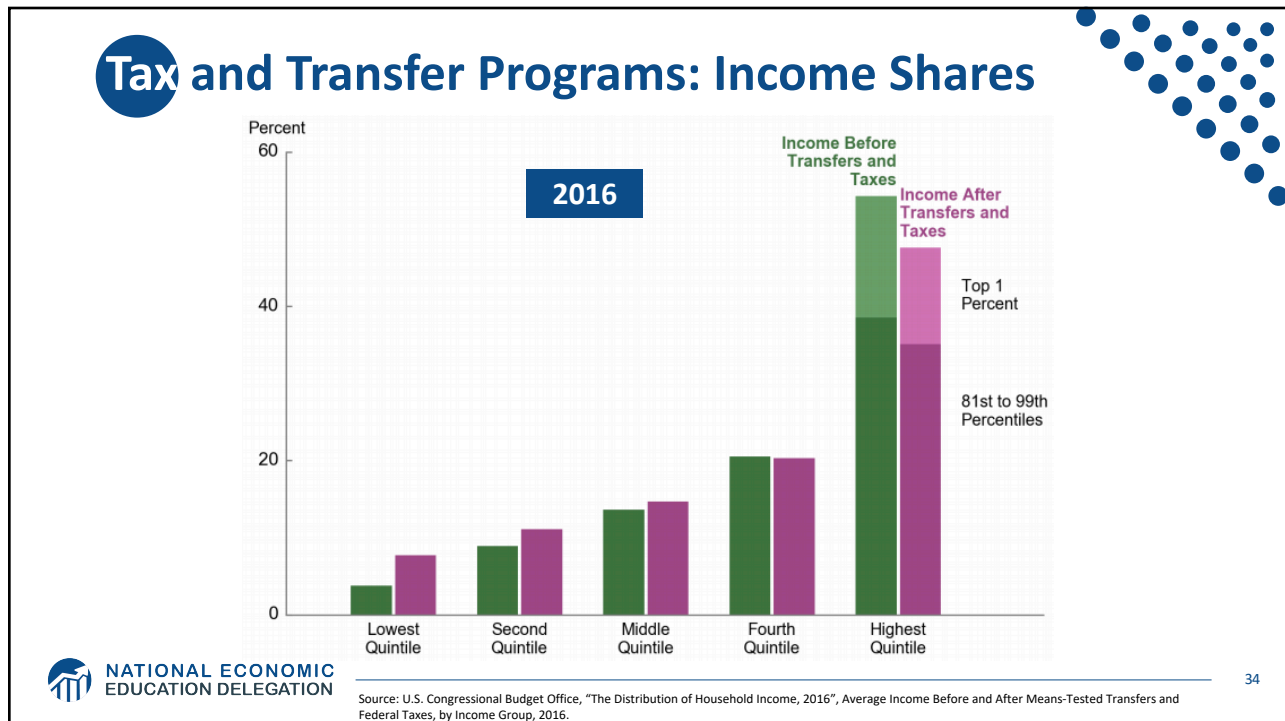


Source: U.S. Congressional Budget Office, "The Distribution of Household Income, 2014", Average Income Before and After Means-Tested Transfers and Federal Taxes, by Income Group, 2014.

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What About Tax Rates?

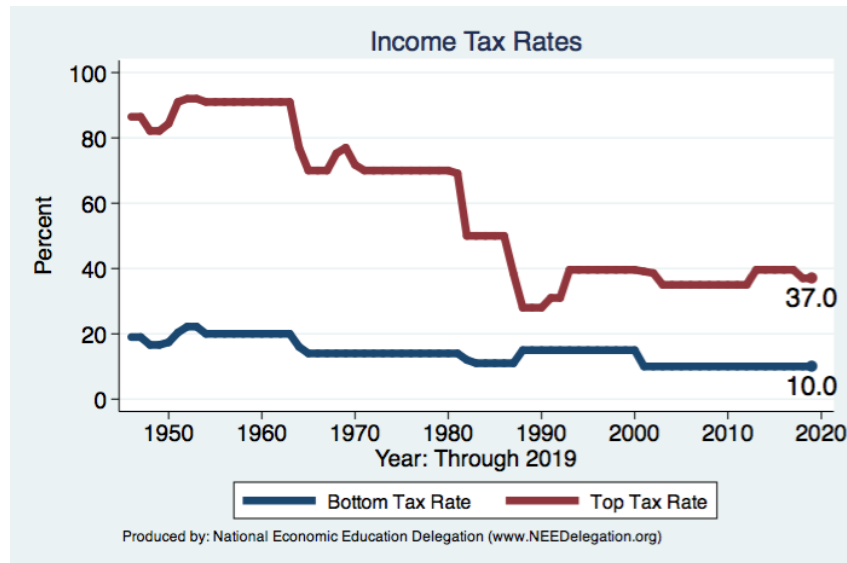
400 TAXPAYERS WITH HIGHEST INCOMES

1992-2014



Source: IRS, Statistics of Income Division, December 2016.

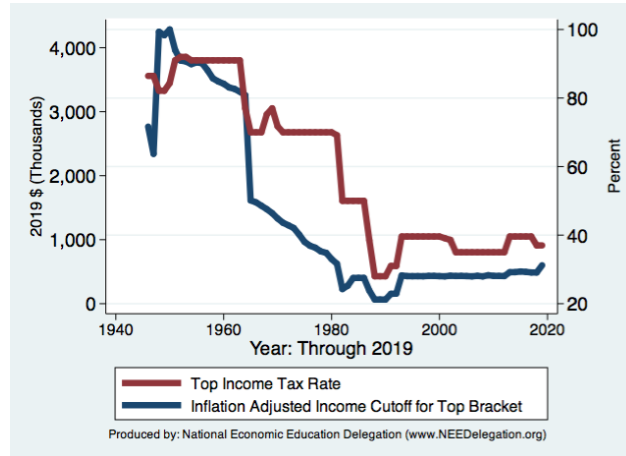
Tax Rates Over Time



Produced by: National Economic Education Delegation (www.NEEDelegation.org)

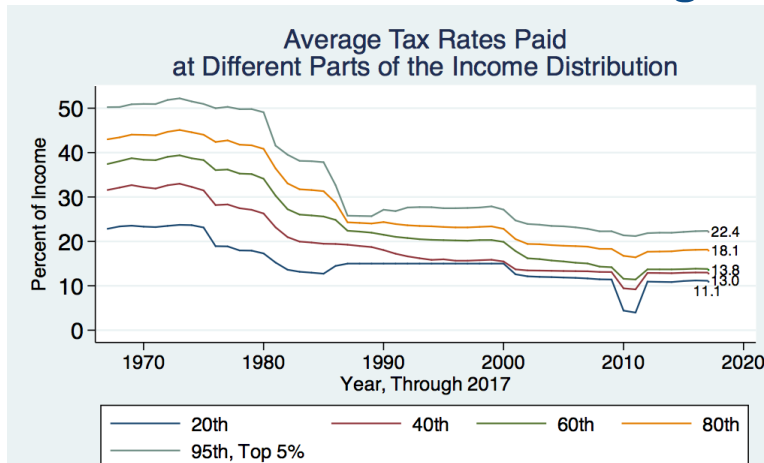


The Top Tax Rate and Income Cutoff



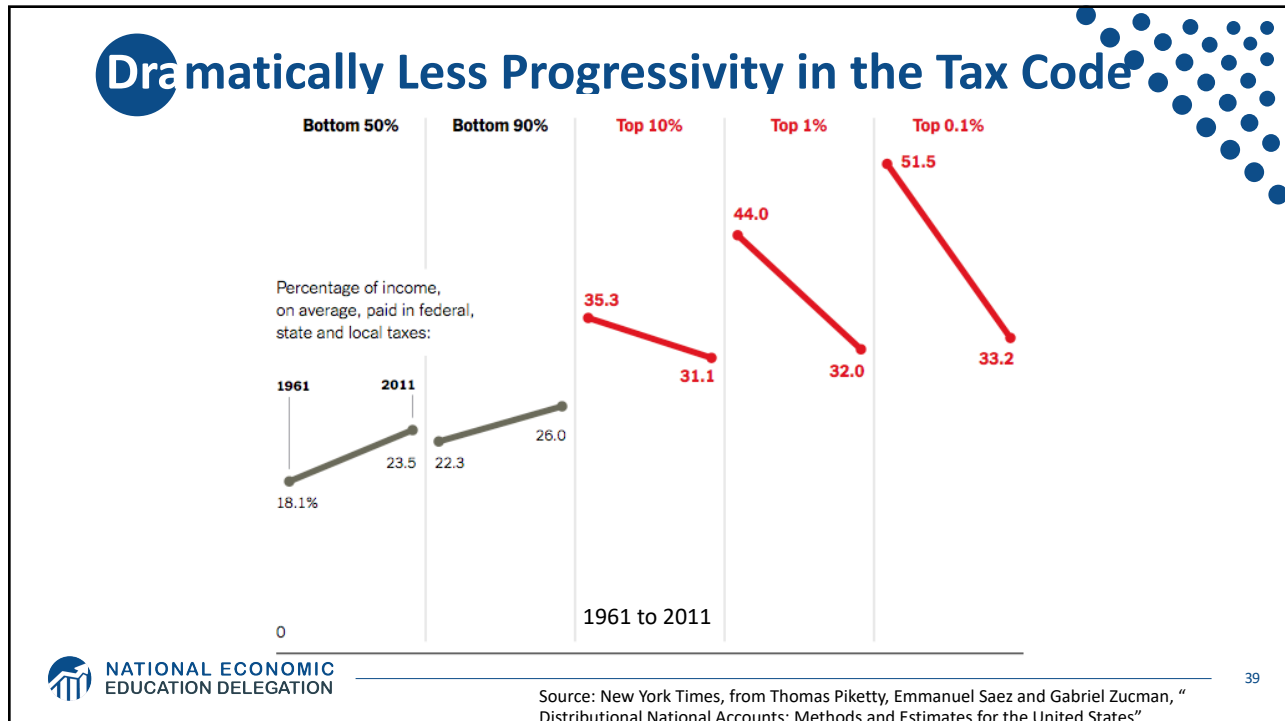
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Average Tax Rates Across Income Categories

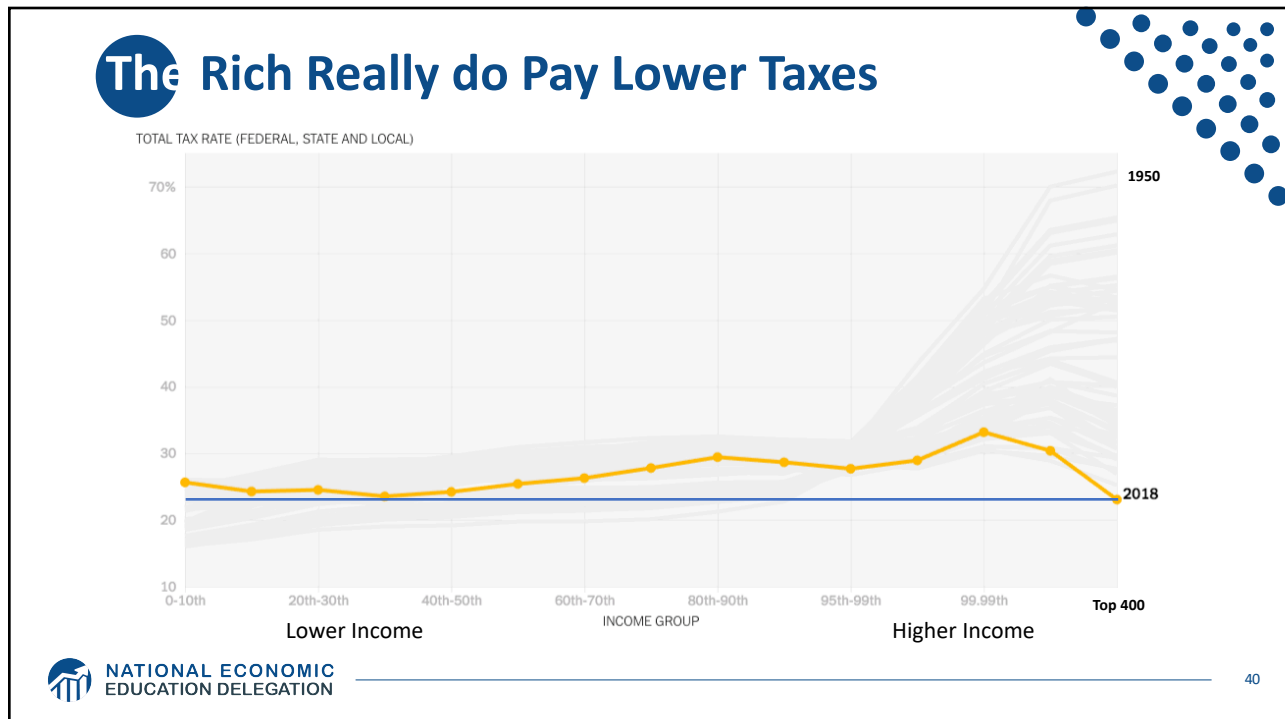


Each line represents that average tax rate for the given percentile of the income distribution in each year. Income cutoffs change over time.
 Source: <https://www.tax-brackets.org/federaltaxtable>, and BLS for historical income levels.
 Produced by: National Economic Education Delegation (www.NEEDelegation.org)

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Market Forces and Inequality

- **Changing demand patterns**
 - Technology
 - Globalization
 - Industry composition
 - PCs instead of typewriters
 - Services instead of goods
 - Professional services instead of personal services
- **Competition in labor markets**
 - Unionization
 - Market concentration



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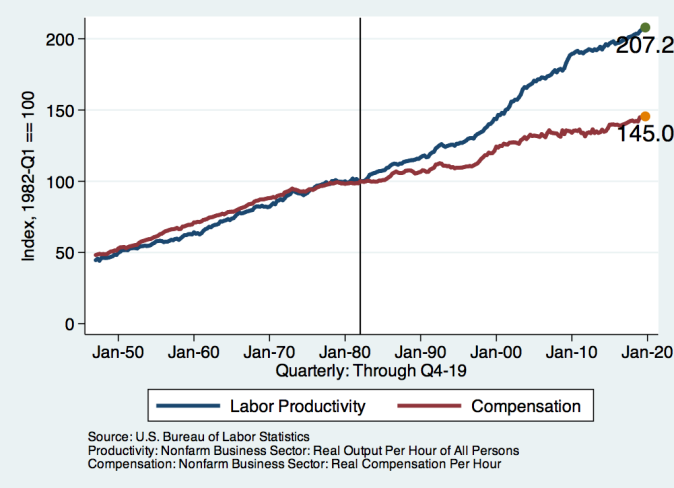
Where Does Inequality Come From? Summary

- **Labor characteristics**
 - What do workers bring to the market?
- **Market forces**
 - How does the market value the labor characteristics?
- **Government policies**
 - PRE-distribution – affecting markets
 - Redistribution – affecting incomes



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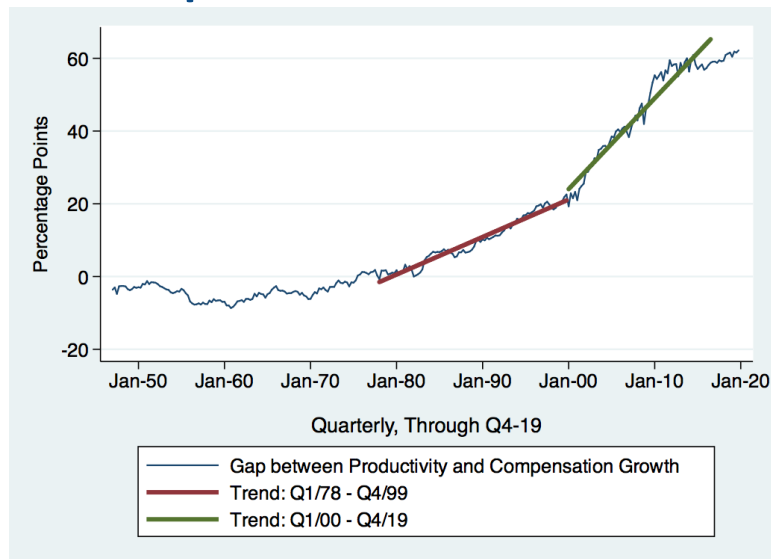
Labor Income is Unhinged from Productivity

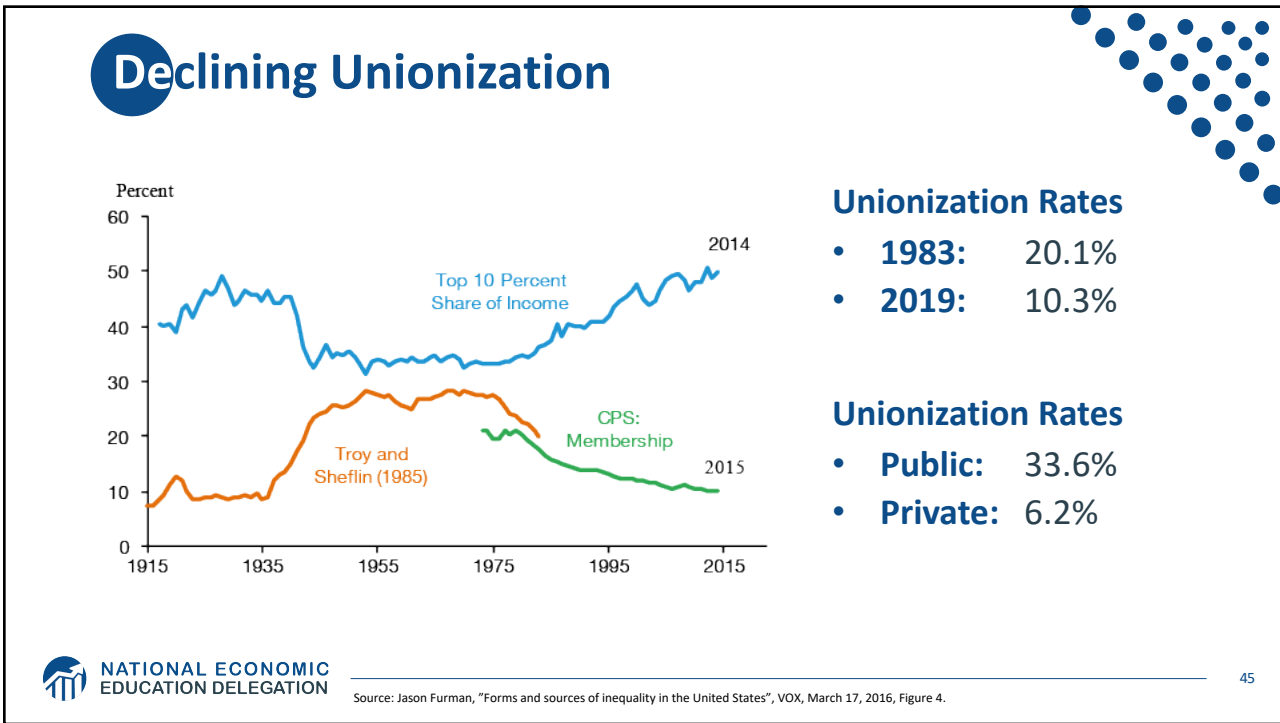


Why?

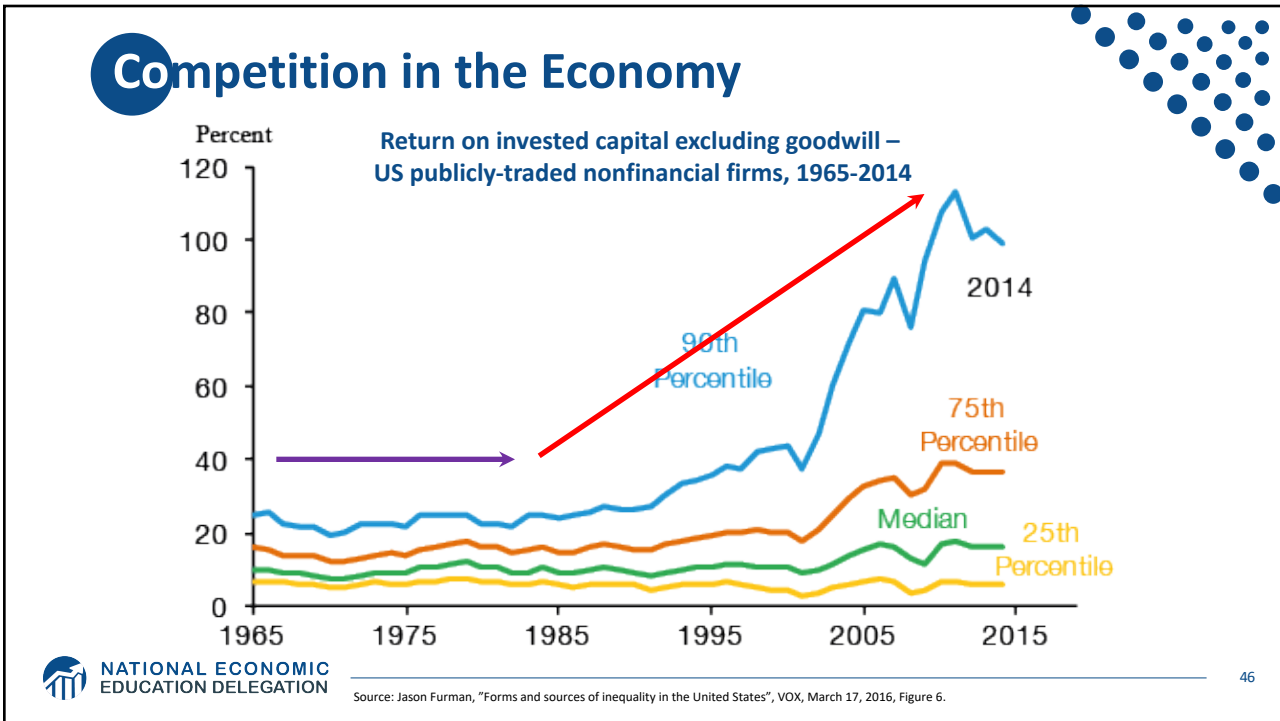
- Declining unionization
- Globalization
- Immigration
- Competition policy
- Cheap technology

Labor Share Gap Acceleration





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Growing Revenue Concentration

Industry	Percentage Point Change in Revenue Share Earned by 50 Largest Firms, 1997-2007
Transportation and Warehousing	12.0
Retail Trade	7.6
Finance and Insurance	7.4
Real Estate Rental and Leasing	6.6
Utilities	5.6
Wholesale Trade	4.6
Educational Services	2.7
Accommodation and Food Services	2.6
Professional, Scientific and Technical Services	2.1
Administrative/Support	0.9
Other Services, Non-Public Admin	-1.5
Arts, Entertainment and Recreation	-2.3
Health Care and Social Assistance	-3.7



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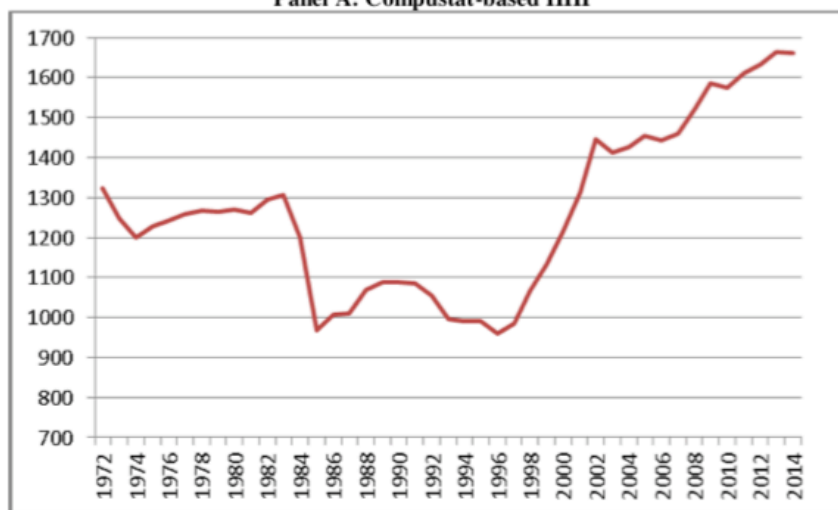
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Source: Furman and Orszag, "A Firm-Level Perspective on the Role of Rents in the Rise in Inequality", 2015.

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Concentration is Continuing

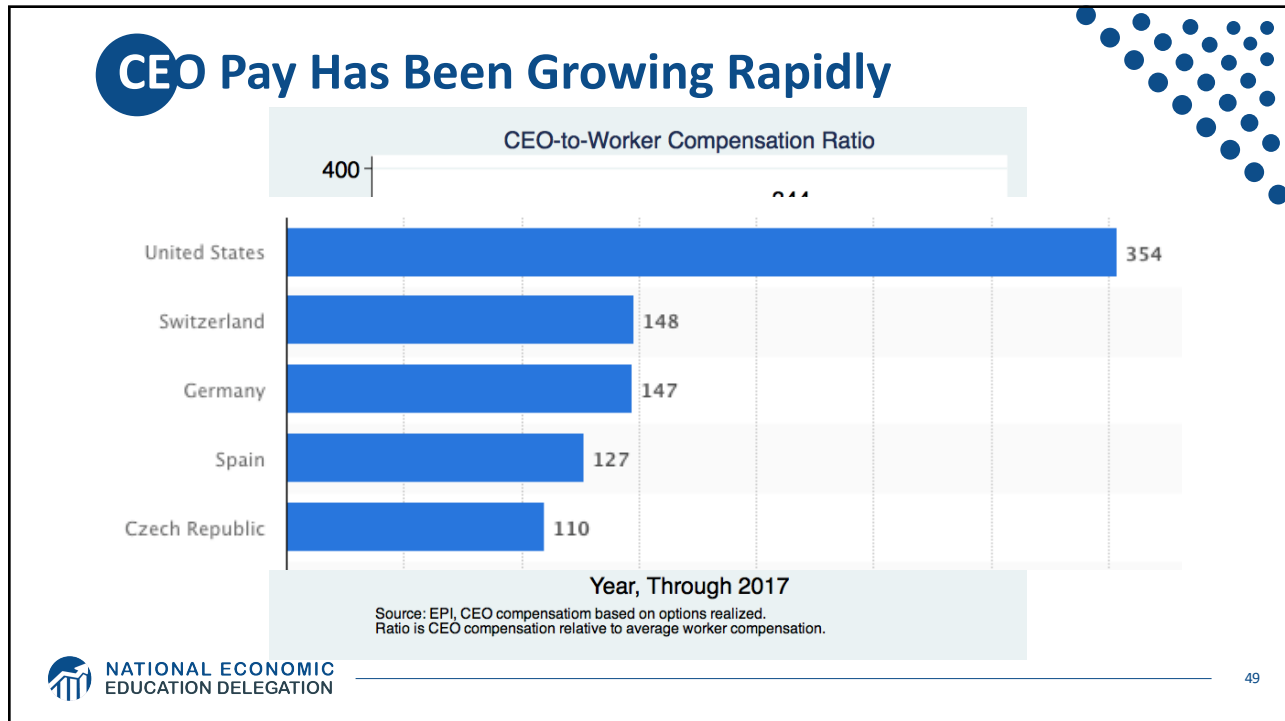
Panel A: Compustat-based HHI



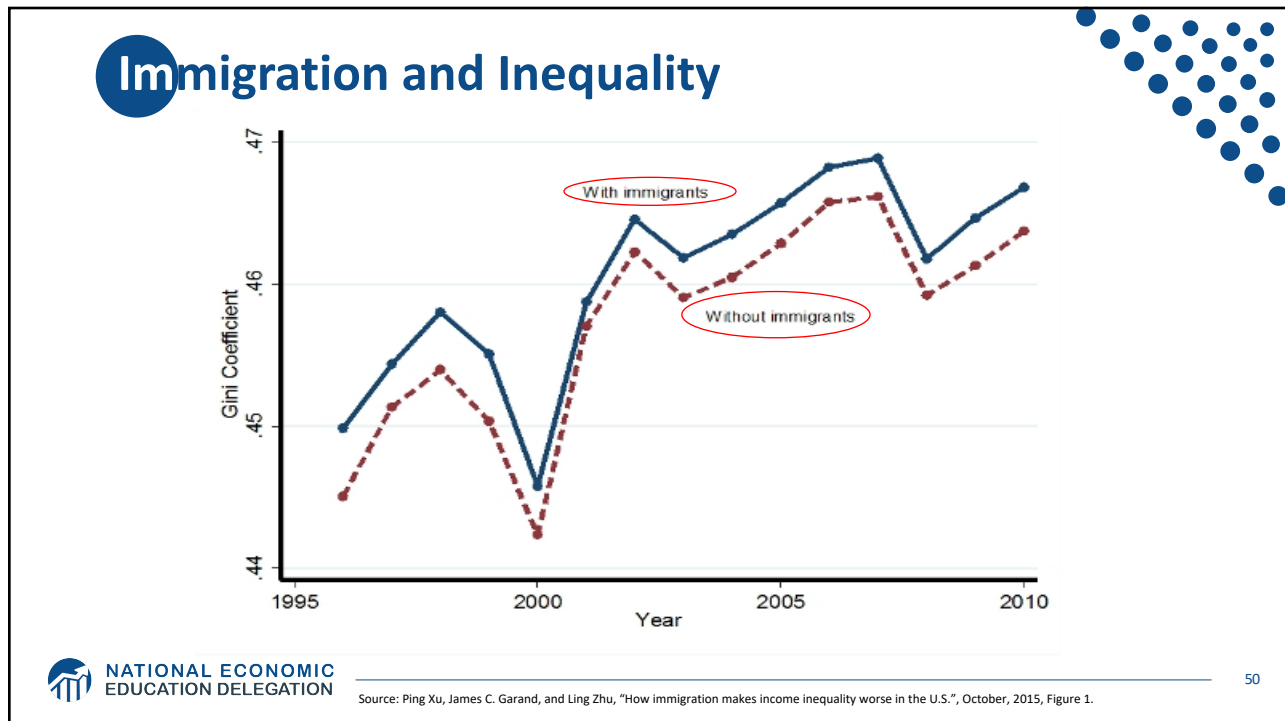
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Immigration and Inequality- Summary

- **Beginning in about 1970, the immigrant share of the U.S. Population increased dramatically.**
 - 5% in 1970 and 14% in 2016
- **Immigration tends to happen most often among:**
 - Low-skilled low-wage workers
 - High-skilled high-wage workers
- **Immigration has likely increased income inequality.**
- **Its effect has likely been small.**
 - ~5% between 1980 and 2000
 - No reason to think it has been bigger since



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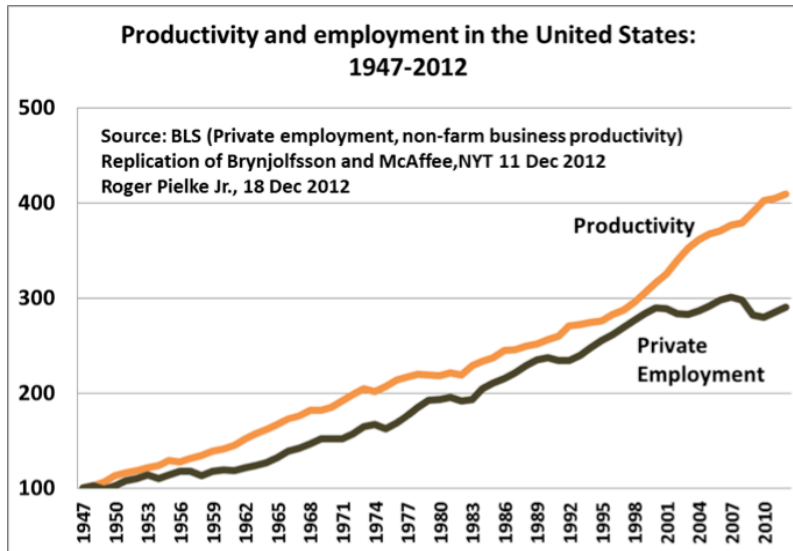
Technological Change and Inequality

- **Much of the technology adopted in the last 30 years has eliminated low-skill or low-wage jobs.**
 - Computers, advanced manufacturing equipment, steel mini-mills, automation
- **There is a “winner take all” aspect of the technology-driven economy.**
 - This likely favors a small group of individuals.
- **Both aspects increase inequality by increasing the rewards to:**
 - Those with significant labor market skills.
 - Owners over workers



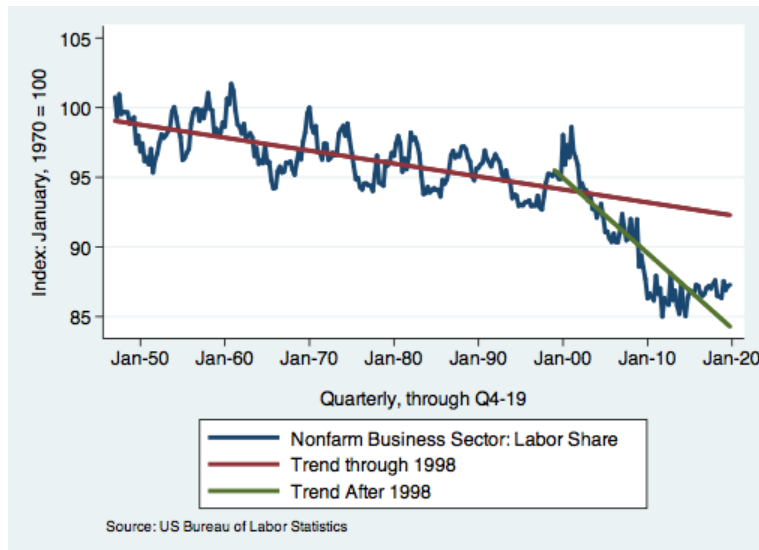
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Technology Benefits Ownership over Labor



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Effects of the Unhinging?



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Technology can Hurt Low Income Workers



Early on, technology was good to low income workers



Until it was bad for them....

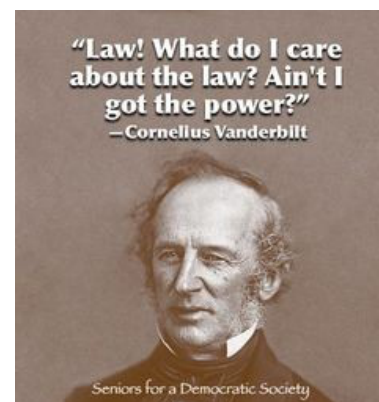
A Modern Example: Uber & Lyft

• Technology:

- Facilitates market power for owners.
- Reduces bargaining power for labor.
- Shifts costs of doing business onto labor.

• Modern day Robber Barons?

- Ruthlessly absorbing as much income as they can.
- Lack of regard for labor.



Globalization

- **What is globalization?**
 - Flow of goods, services, capital, and labor across international borders
- **How does it affect inequality?**
 - Through a differential impact on low-skilled workers and hence their wages
 - For the United States, globalization is thought to lower the wages of low skilled and hence low-wage workers relative to those of high-skilled workers



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Mechanisms for the Effects of Globalization

- **Merchandise trade**
 - Importing goods that are made with low-skilled workers and exporting goods that are made with high-skilled workers
 - Lowers the wages of unskilled relative to skilled
 - making the distribution of income **less equal**
- **Outsourcing**
 - Similar channel as with merchandise trade
- **Trade in services**
 - US imports of middle-skill services: business and some professional services
- **Intuitively: The same as if we were to move the actual workers.**



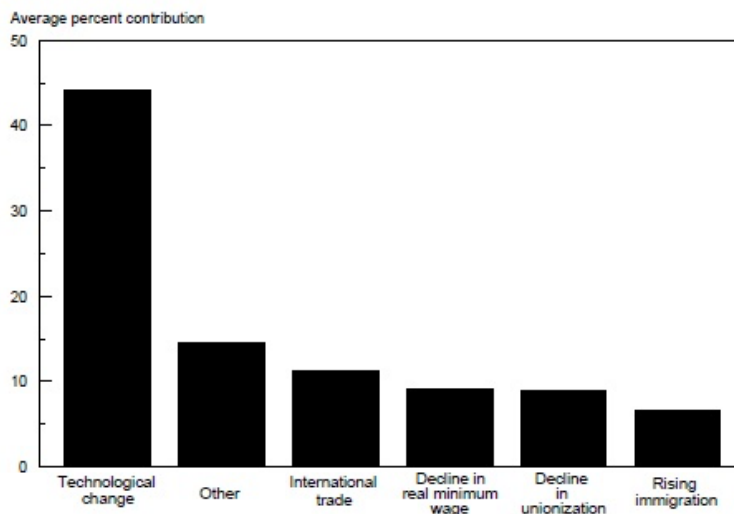
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What is driving increasing inequality?

- **Primary drivers:**
 - Technology
 - Globalization
 - Institutions
- **These drivers can also influence personal choices in ways that affect measured income inequality.**
 - For example, educational choices or labor force participation

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Sources of Inequality Through Late 1990s



Source: Federal Reserve Bank of New York.

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Why Does Inequality Matter?

- **Too little inequality can:**

- Reduce individual motivation
- Slow economic growth

- **Too much inequality can:**

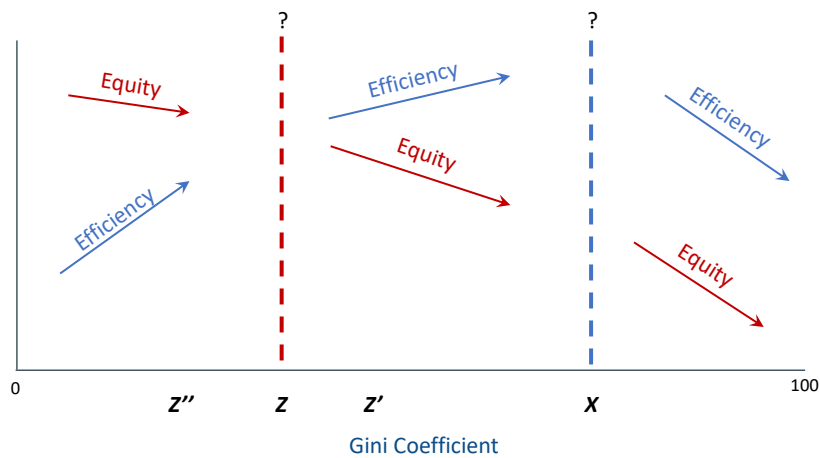
- Reduce individual motivation
- Slow economic growth

- **Too much inequality may also:**

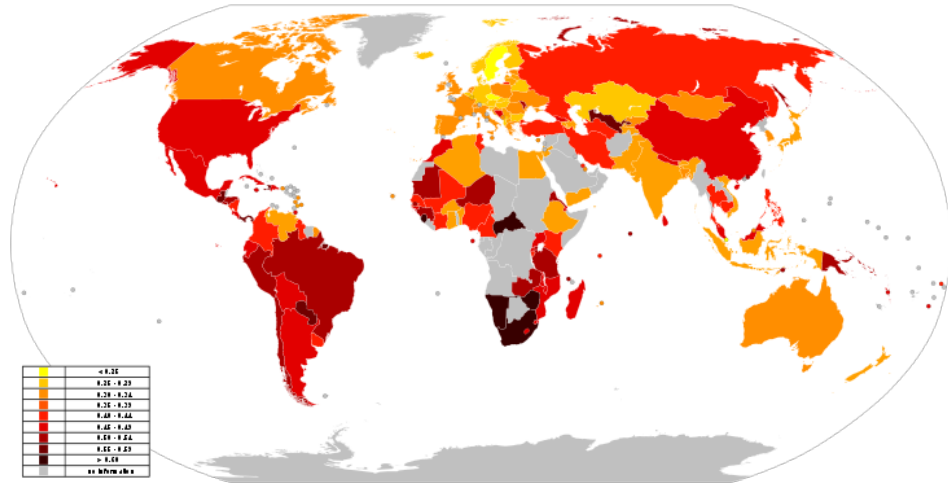
- Divide society
- Distort political environment
- Reduce political participation
- Reduce investments in public goods
 - o Education
 - o Environmental protections



How Much Inequality Is too Much?



An International Perspective

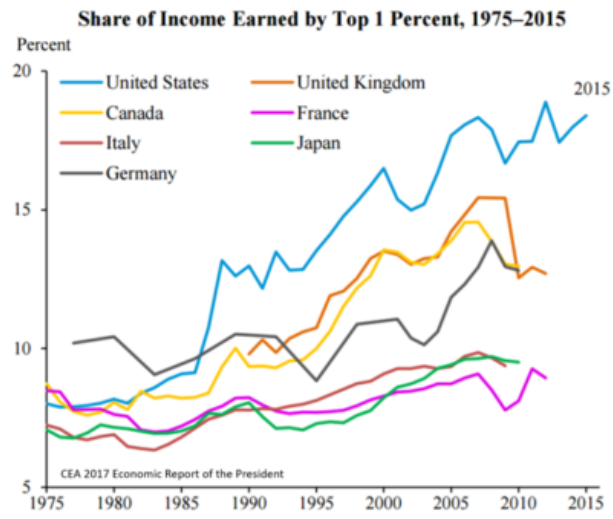


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Source: Data taken from the 2014 CIA World Factbook.

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An International Perspective: Comparables

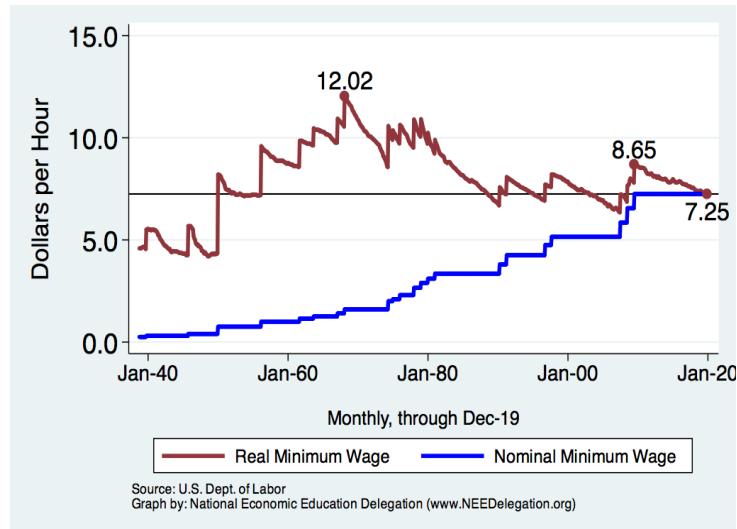


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Source: World Wealth and Income Database.

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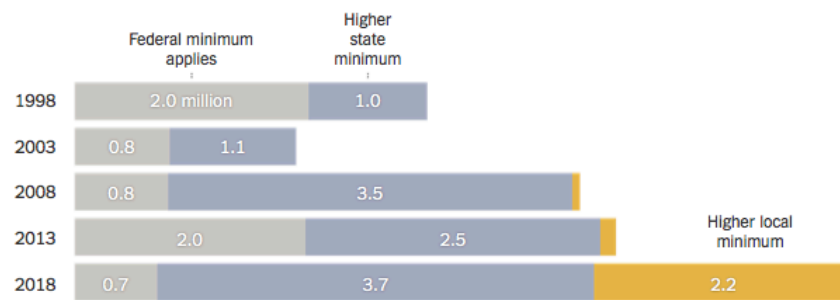
Historical Values of Minimum Wages



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Most Minimum Wage Workers Aren't Bound by the Federal Minimum Anymore

Millions of workers:



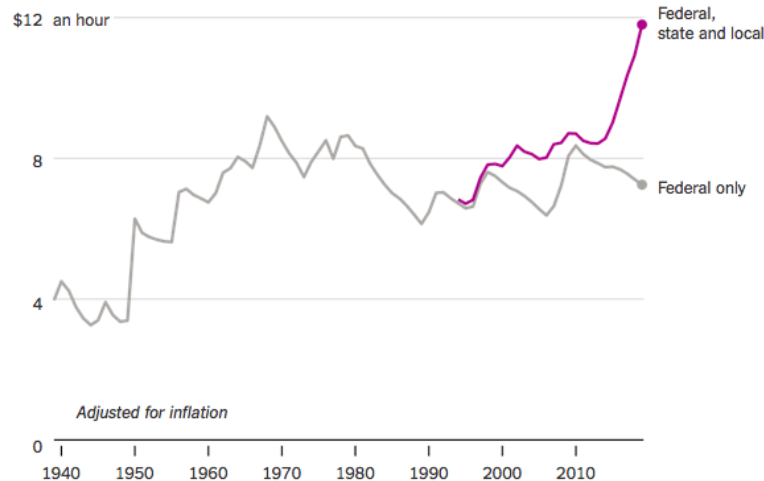
Includes farm workers and tipped incomes

Source: Author's analysis of Current Population Survey; data from the Berkeley Center for Labor Research and Education, as well as Kavya Vaghul and Ben Zipperer (2016).

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States and Local Gov'ts are Raising Min Wages

The average job at the federal, state or local minimum wage pays almost \$12 an hour.



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Addressing Inequality: Immediately Available Policy Solutions (2/2)

• Other

- Reverse trends in market power

• Locally

- Employment services: job training, interview skills, or assistance with day-to-day issues, such as child care
- Cognizance of the potential for technologies to affect worker/employer power dynamics
 - o Uber, Lyft, etc.



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Addressing Inequality: Long Term

- **It's all about access to resources:**

- Education, in particular
 - Improve public education
 - Reduce disparities in quality of public education
 - Improve counseling in low-income schools
 - With respect to college – paths to success and funding
- Investments are needed in early education, not later
 - Universal pre-K
 - Upgrade quality of elementary schools in low-income areas

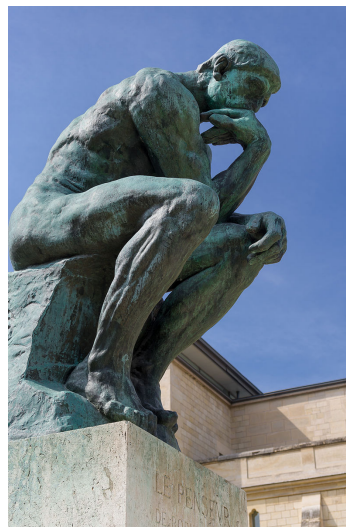


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What to do About Inequality?

- **Nothing?**
- **Redistribution?**
- **PRE-distribution?**
- **Access to resources?**



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Tension in Policy Solutions

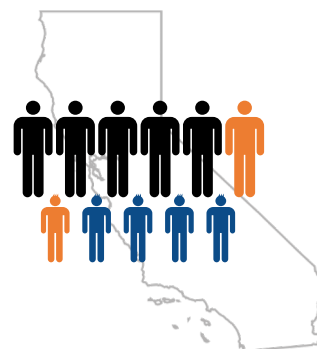
- **Is it possible to increase growth at the same time that you reduce income inequality?**
 - Common refrain among some that government intervention in the economy is always and everywhere bad for growth.
- **Possibly: expanding equality of access promotes the full utilization of resources.**
 - Expanding equality of access requires resources likely from the well-to-do.



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Summary

- **Income inequality is clearly increasing.**
 - The economy is clearly favoring owners of productive resources over labor.
- **The causes appear to be largely driven by:**
 - The market – technology, competition, and trade
 - Changing institutions.
- **Open questions are:**
 - To act or not to act?
 - If so, how?
- **The level of inequality is a policy choice.**



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Thank you!

Any Questions?

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Available NEED Topics Include:

- US Economy
- Economic Inequality
- Climate Change
- US Social Policy
- Trade and Globalization
- Economic Mobility
- Trade Wars
- Housing Policy
- Federal Budgets
- Federal Debt
- 2017 Tax Law
- Autonomous Vehicles

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