

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

Lecture 5: Economic Inequality

February 26, 2020

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National Economic Education Delegation



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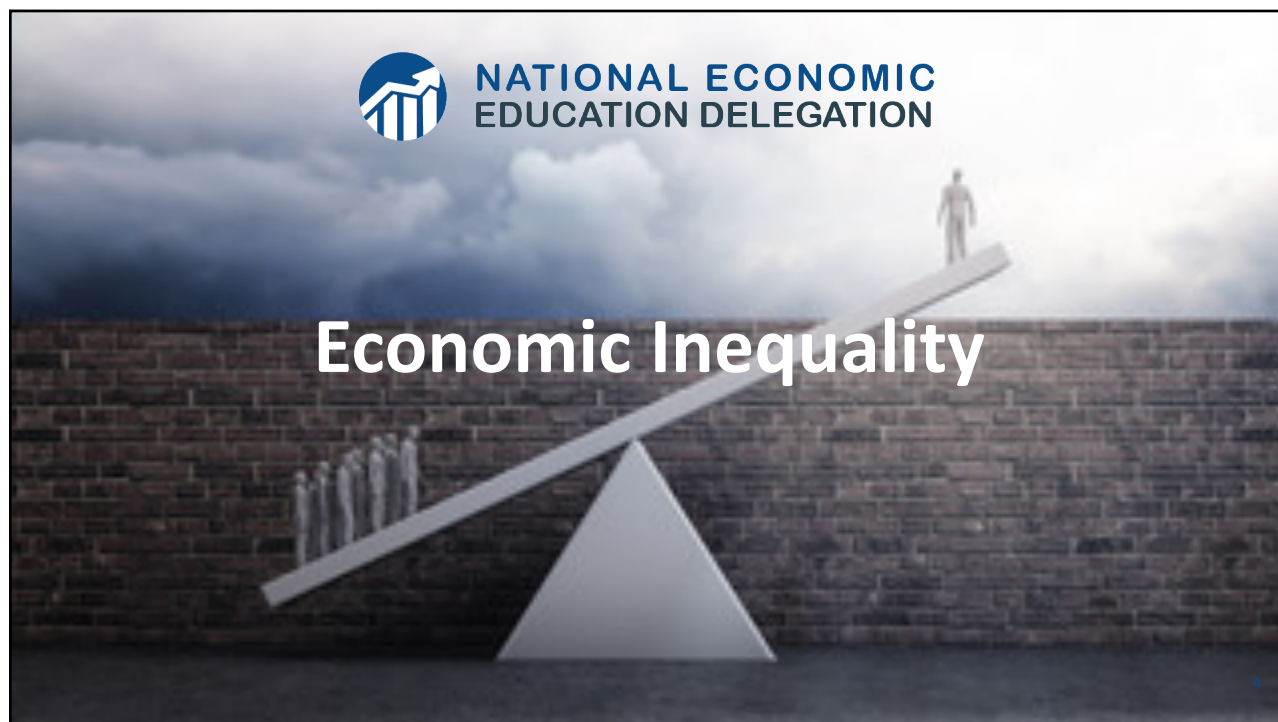
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Course Outline

- **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 (2/19): Trade and Globalization
- **Week 5 (2/26): Income Inequality**

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Credits and Disclaimer

- **This slide deck was authored by:**
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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

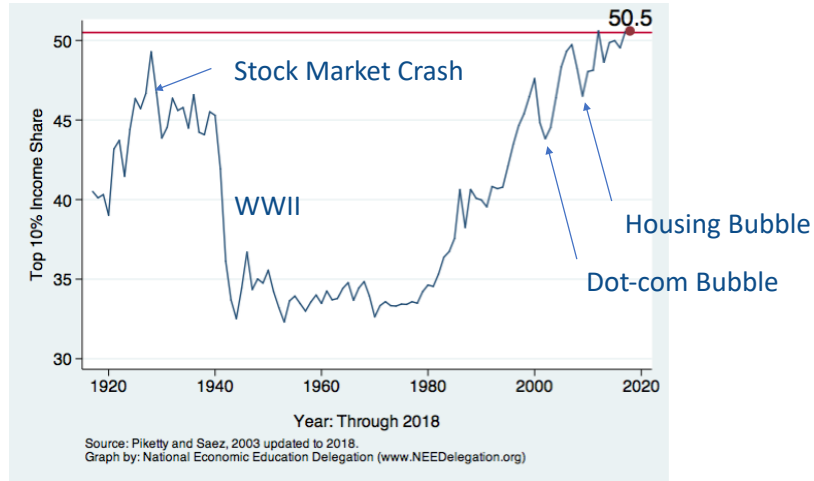


Different Ways of Thinking About Inequality

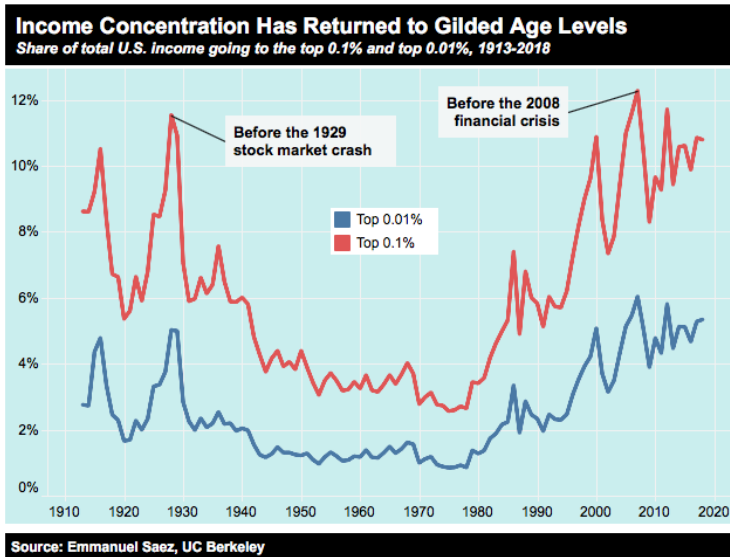
- **Income Inequality**
 - Before taxes and transfers
 - After taxes and transfers
- **Wealth Inequality**
- **Consumption Inequality**



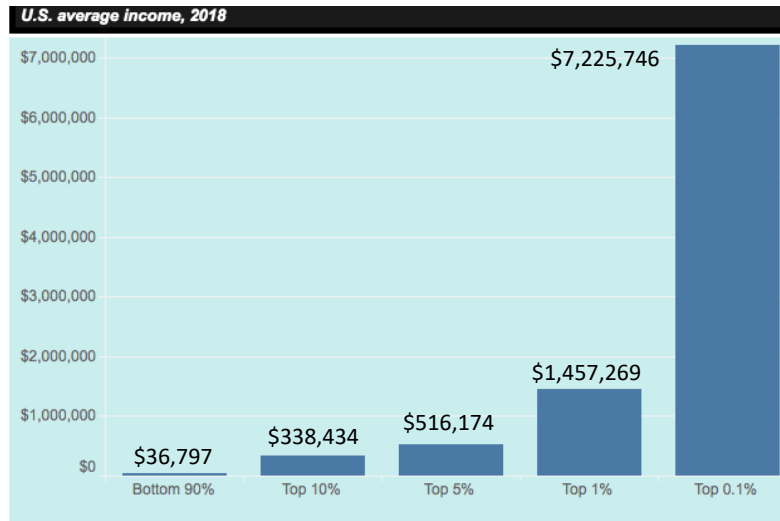
National Income Inequality: Share of Top 10%



Concentration at the Very Top



Incomes Across the Distribution



Source: Emmanuel Saez, UC Berkeley



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Source: <https://inequality.org/facts/income-inequality/>

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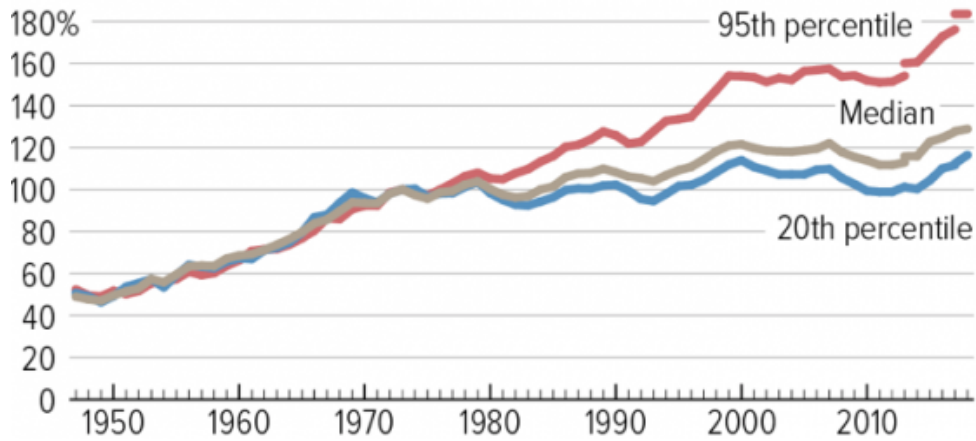
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Source: Chad Stone, Danilo Trisi, Arloc Sherman, and Roderick Taylor, "A Guide to Statistics on Historical Trends in Income Inequality," Center on Budget and Policy Priorities, Policy Futures, May 15, 2018.

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The Abrupt Increase in Inequality

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



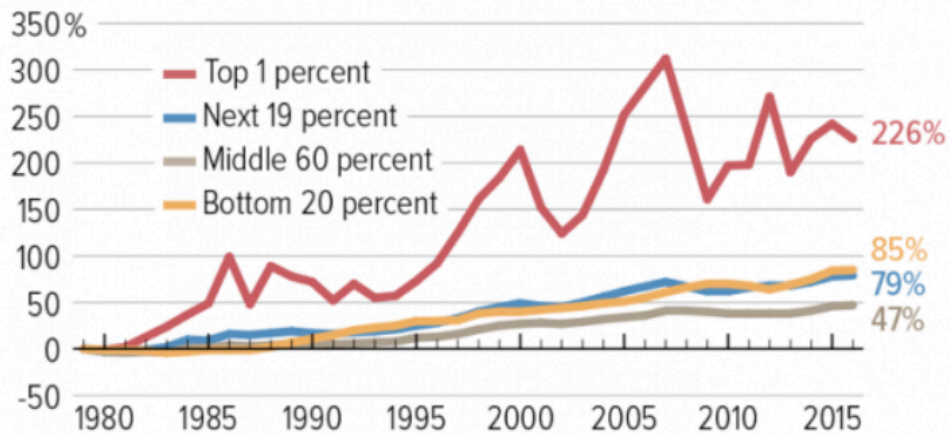
Source: Chad Stone, Danilo Trisi, Arloc Sherman, and Roderick Taylor, "A Guide to Statistics on Historical Trends in Income Inequality," Center on Budget and Policy Priorities, Policy Futures, May 15, 2018, page 10.

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Most of the Action Is at the Very Top

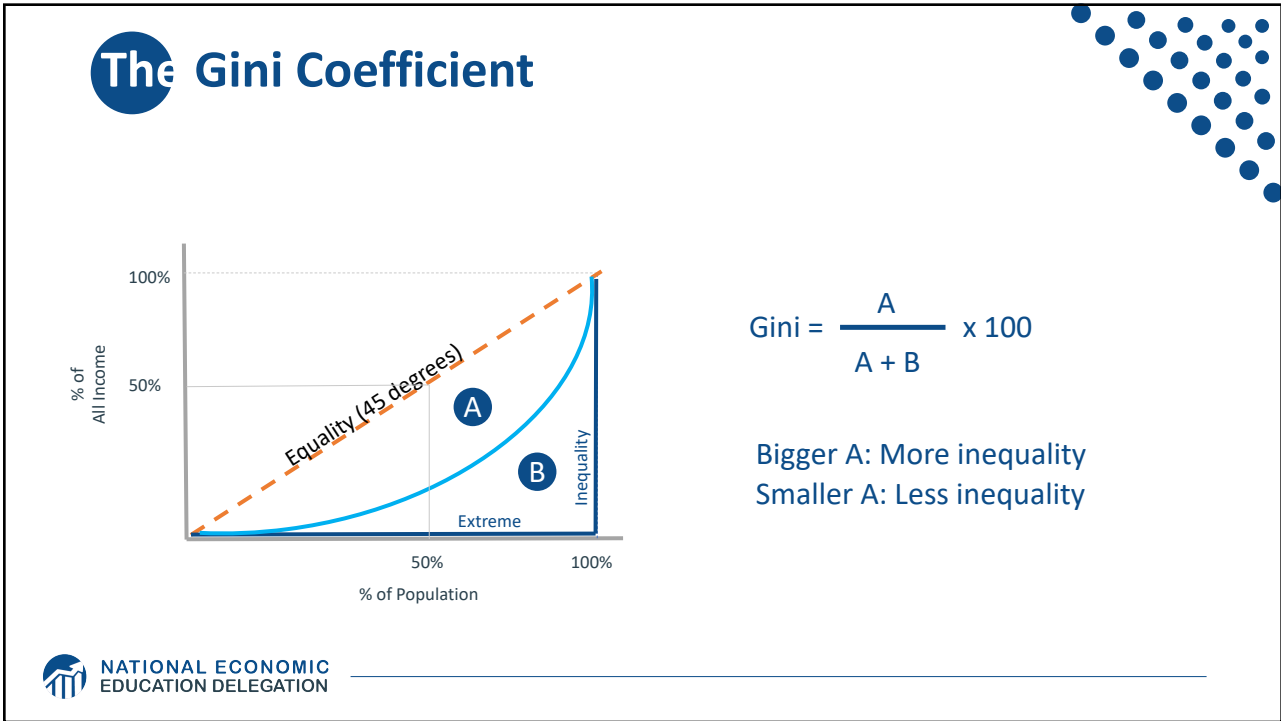
Percent change in income after transfers and taxes since 1979



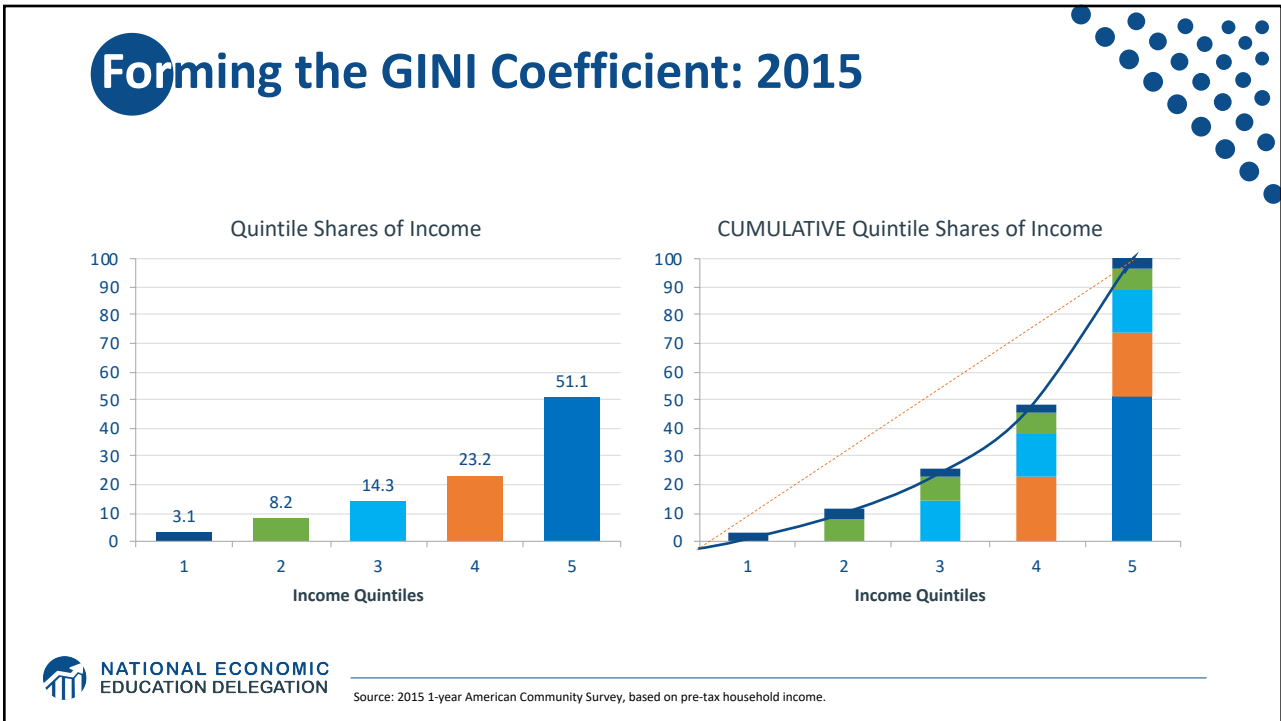
Source: Chad Stone, Danilo Trisi, Arloc Sherman, and Roderick Taylor, "A Guide to Statistics on Historical Trends in Income Inequality," Center on Budget and Policy Priorities, Policy Futures, May 15, 2018, page 11.

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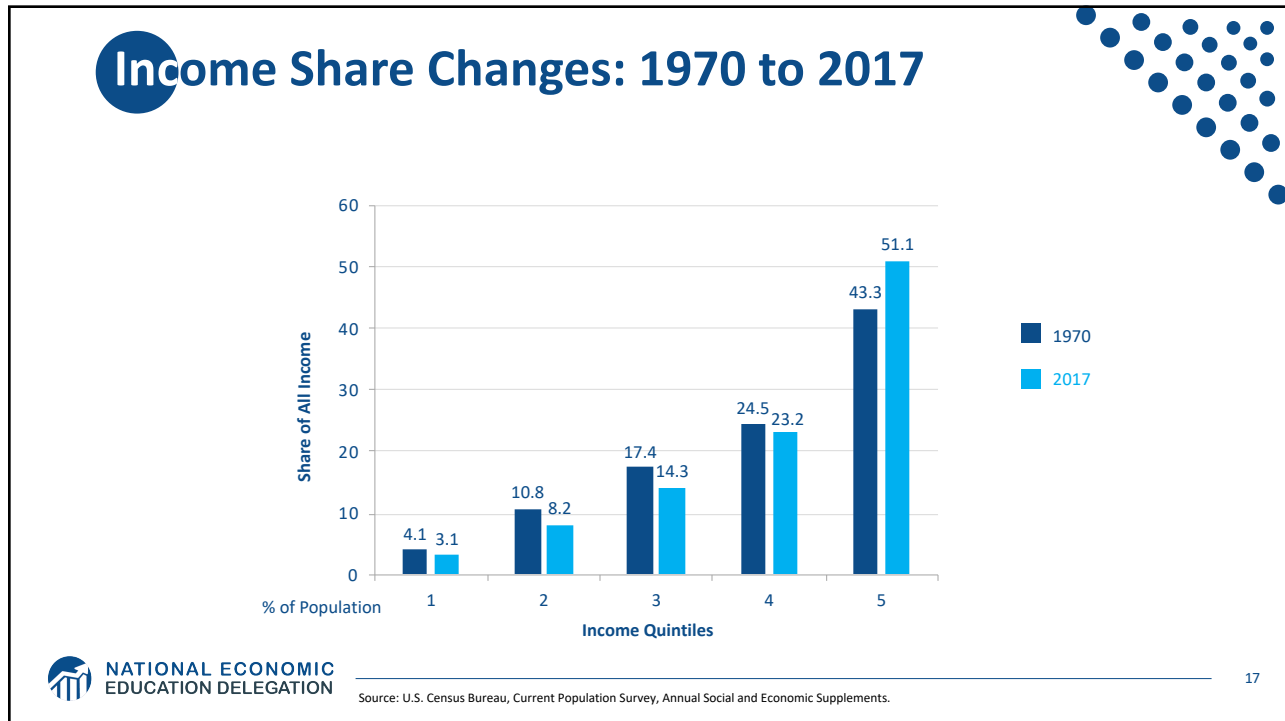
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Income Changes from Growing Inequality

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

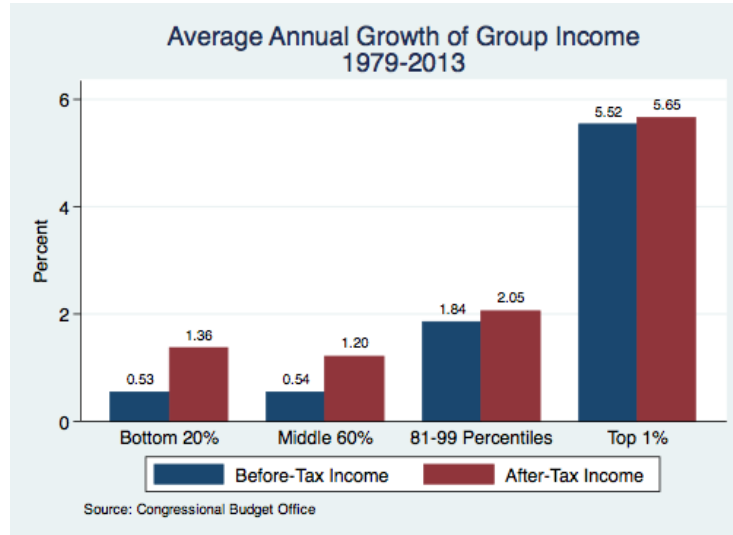
Bottom 90% of Households →

* 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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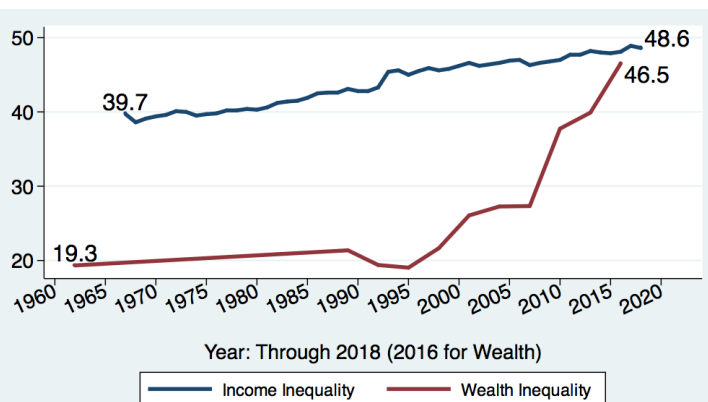
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Growth Has Been Primarily at the Very Top



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Income and Wealth Inequality

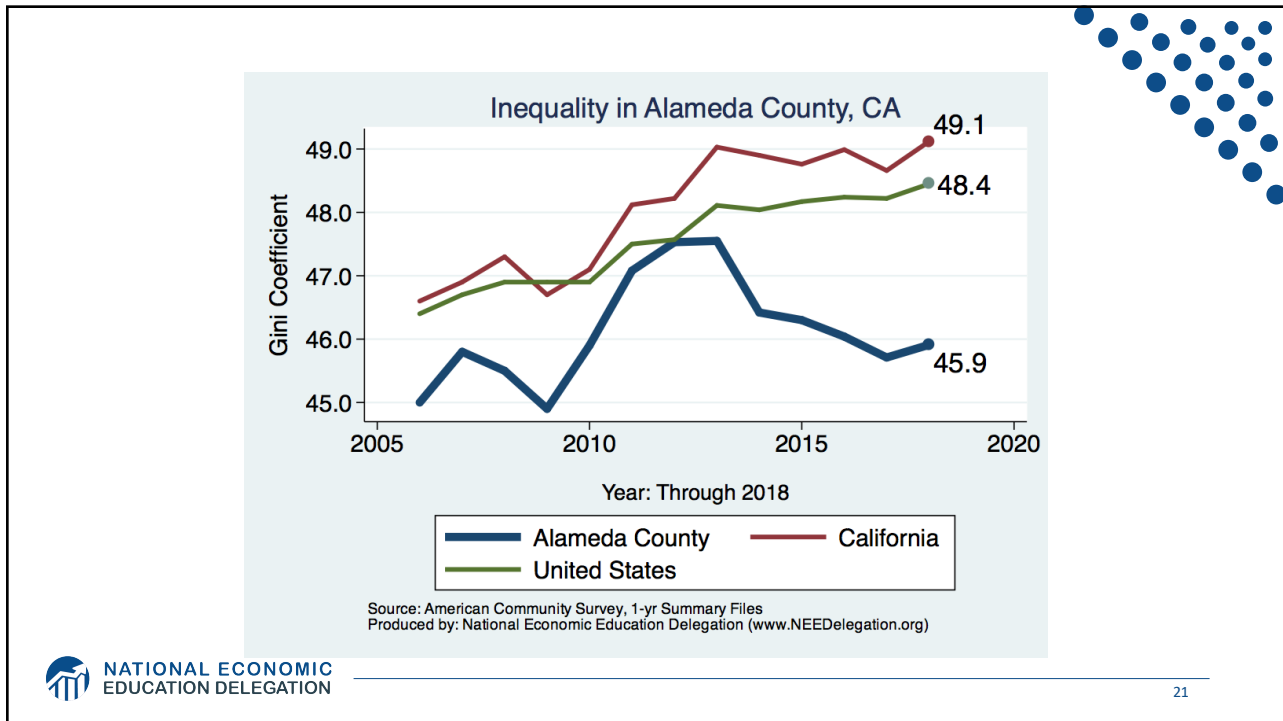


Income Inequality (Gini)

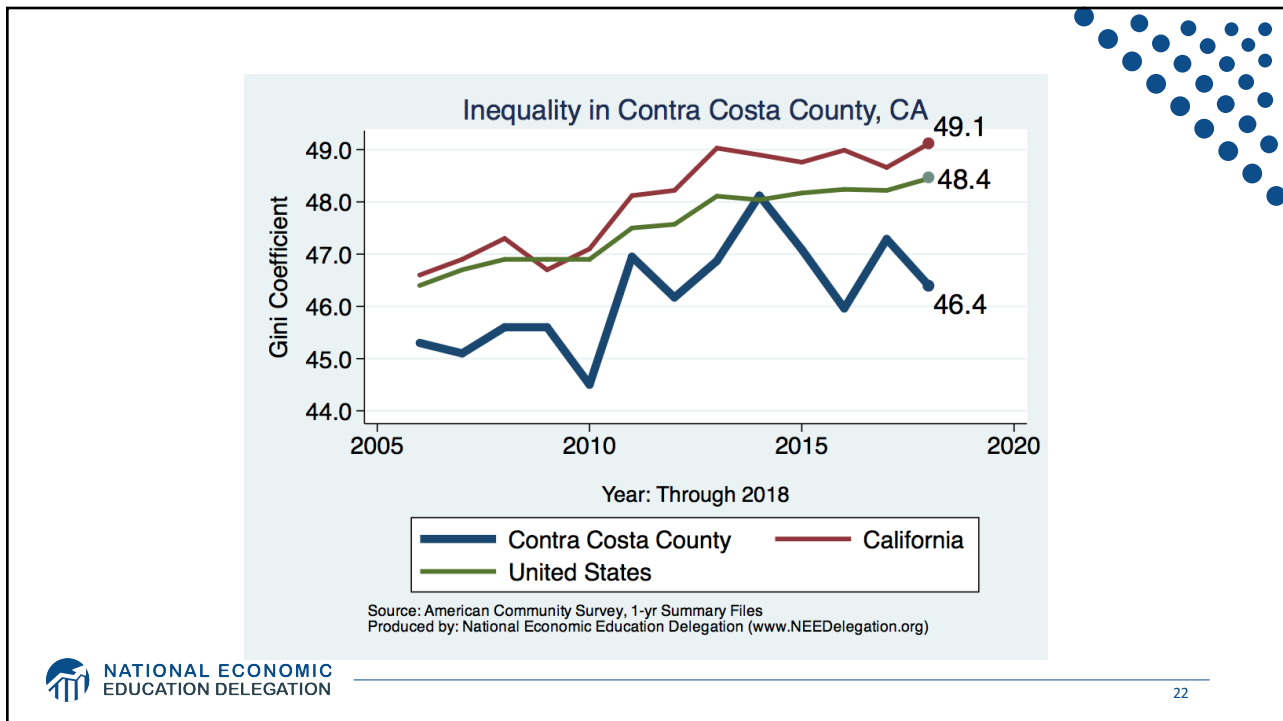
- US: 48.6%
- CA: 48.7%
- Marin: 51.5%

Source: U.S. Census Bureau and Board of Governors
 INCOME INEQUALITY is measured by the Gini coefficient.
 WEALTH INEQUALITY is the ratio of the mean wealth of the top decile to median overall wealth.
 Wealth data are only available for 1962, and at three year intervals beginning in 1989.
 Graph by: National Economic Education Delegation (www.NEEDelegation.org)

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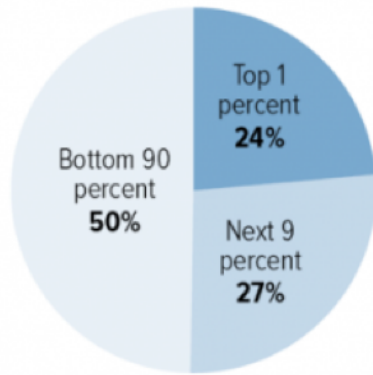
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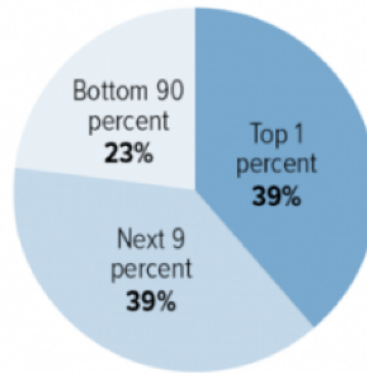
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Wealth Inequality Exceeds Income Inequality

Distribution of before-tax income, 2016



Distribution of wealth, 2016

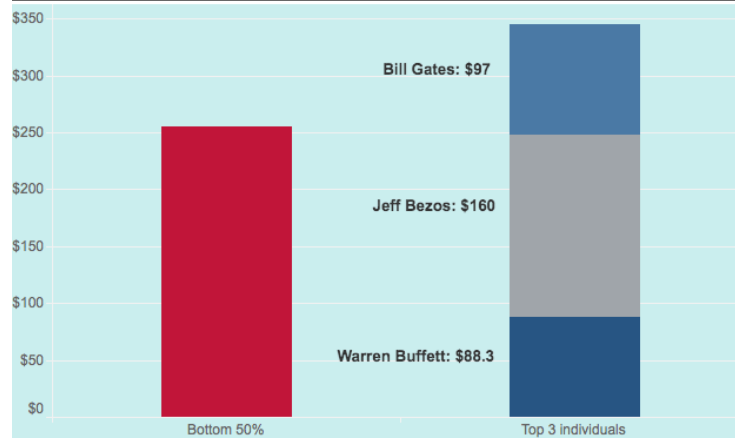


Source: Chad Stone, Danilo Trisi, Arloc Sherman, and Roderick Taylor, "A Guide to Statistics on Historical Trends in Income Inequality," Center on Budget and Policy Priorities, Policy Futures, May 15, 2018, page 15, Figure 4.

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Wealth is Extremely Concentrated

Three Men Own as Much as the Bottom Half of Americans
Total wealth in \$billions

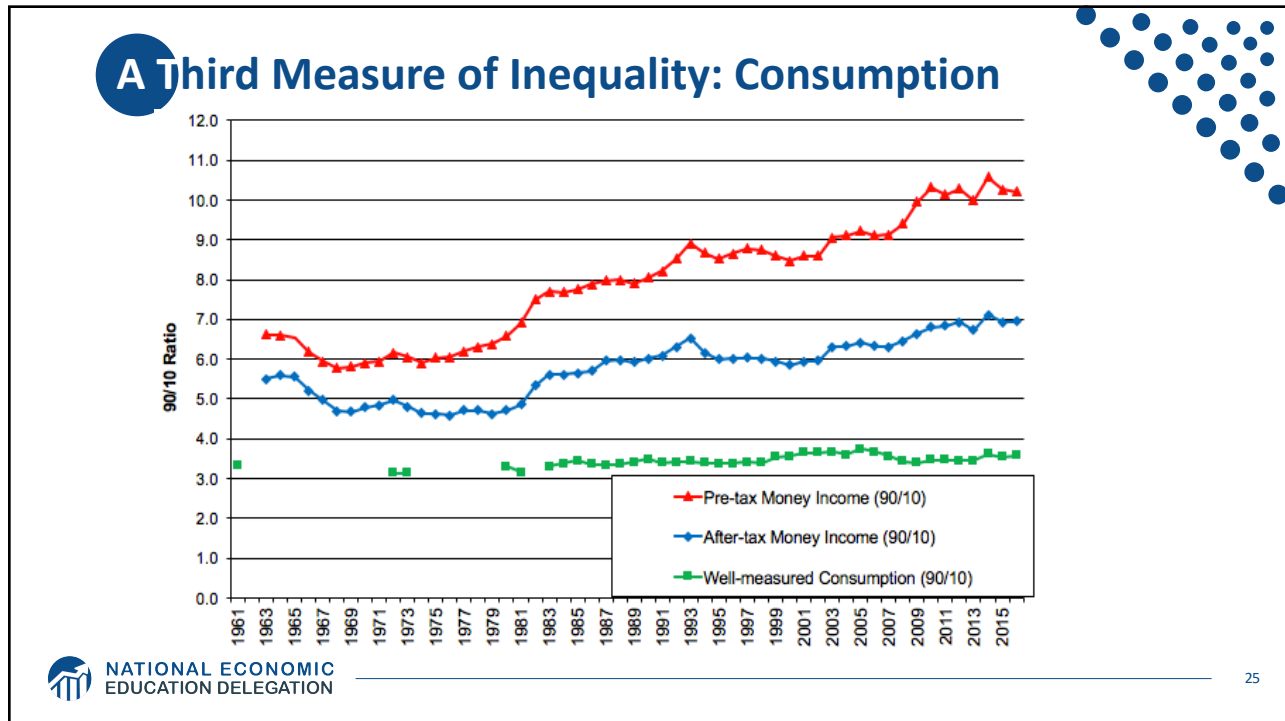


Sources: Institute for Policy Studies, Forbes. Bottom 50% data from 2016. Top 3 from 2018.



Source: <https://inequality.org/facts/wealth-inequality/>

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Consumption Inequality

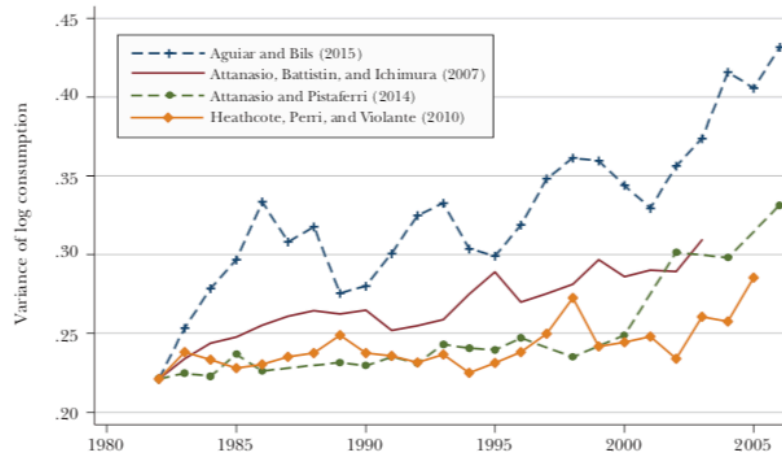
- Consumption is another important metric for judging inequality
- Arguably a better indicator of “well-being”
- Extremely difficult to measure
- Growing evidence that consumption inequality has also increased

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Growing Evidence: Consumption Inequality

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



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Source: Orazio P. Attanasio and Luigi Pistaferri, "Consumption Inequality," Journal of Economic Perspectives, Volume 30, #2, Spring 2016, page 11, Figure 1.

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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.

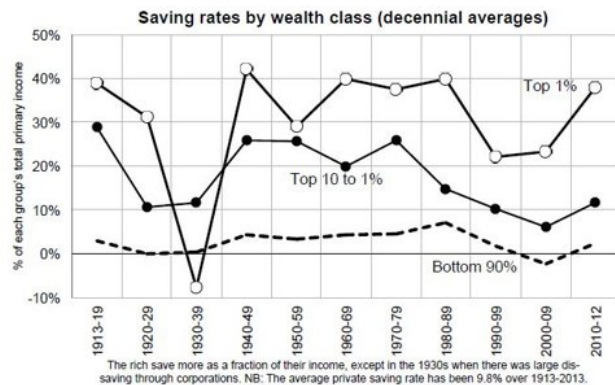


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But High-Income Households Save More



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

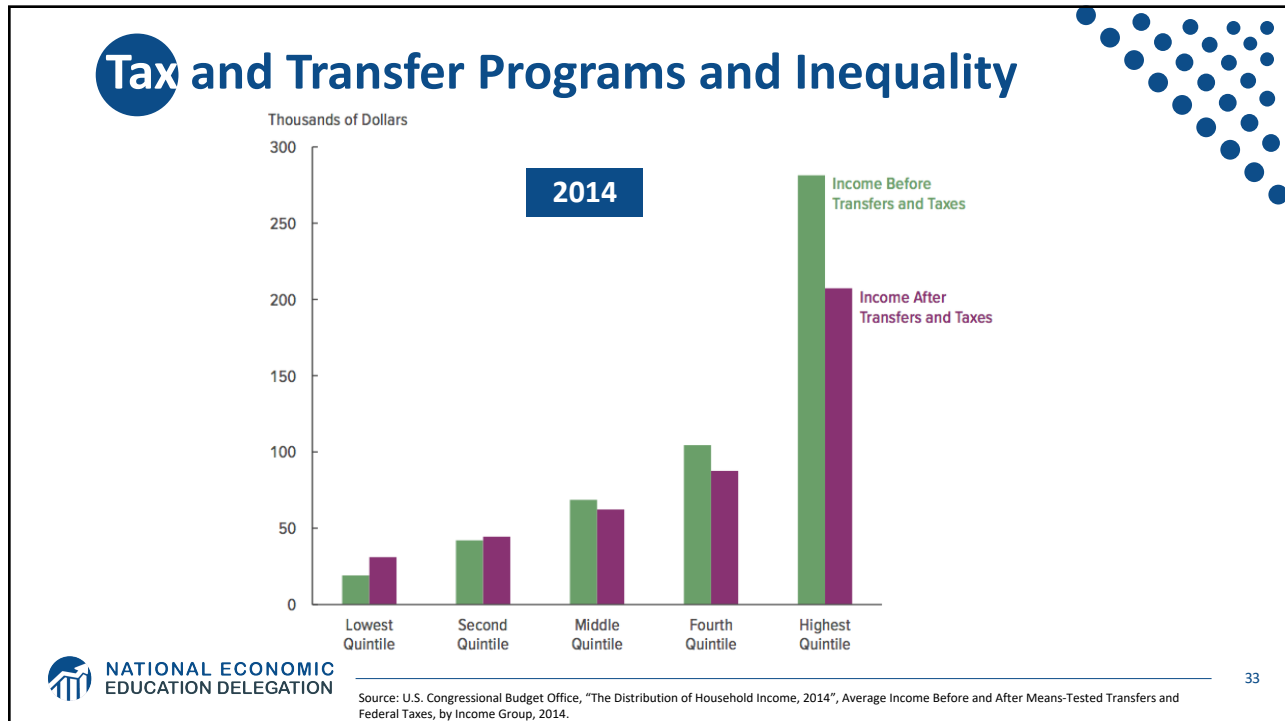
- Tax Rates
- Income support
 - o Direct aid
 - o Food stamps



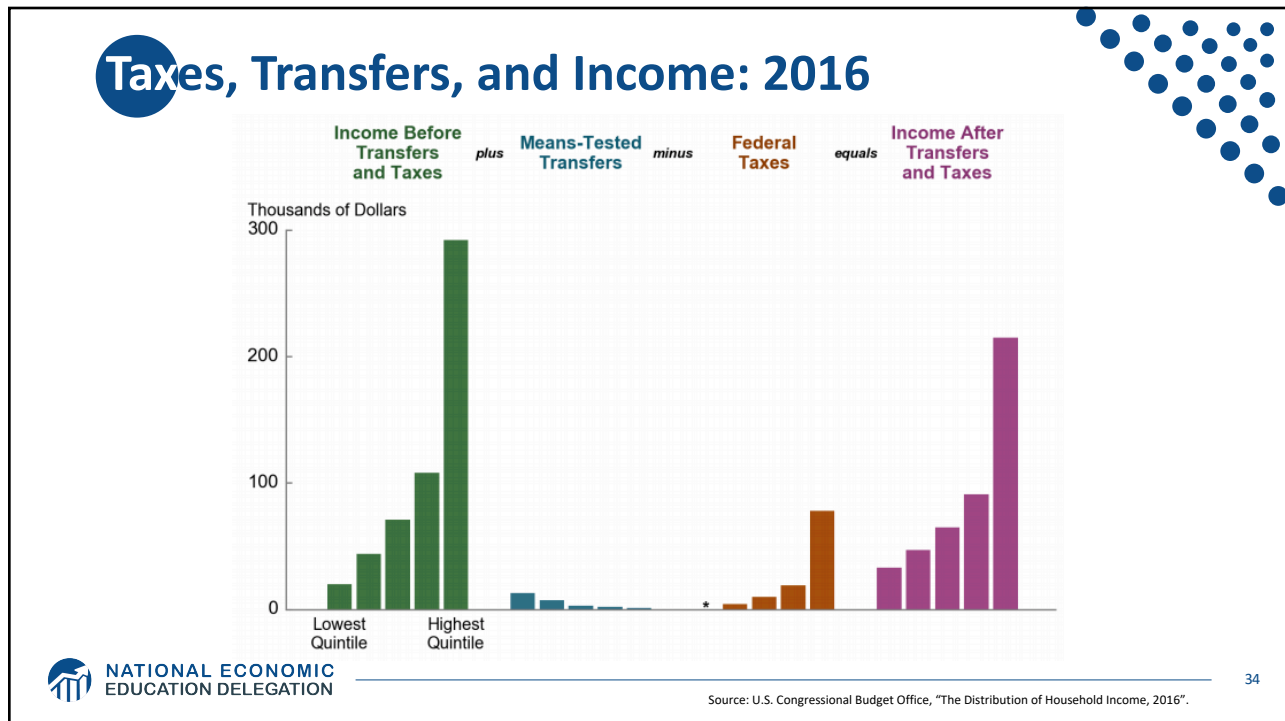
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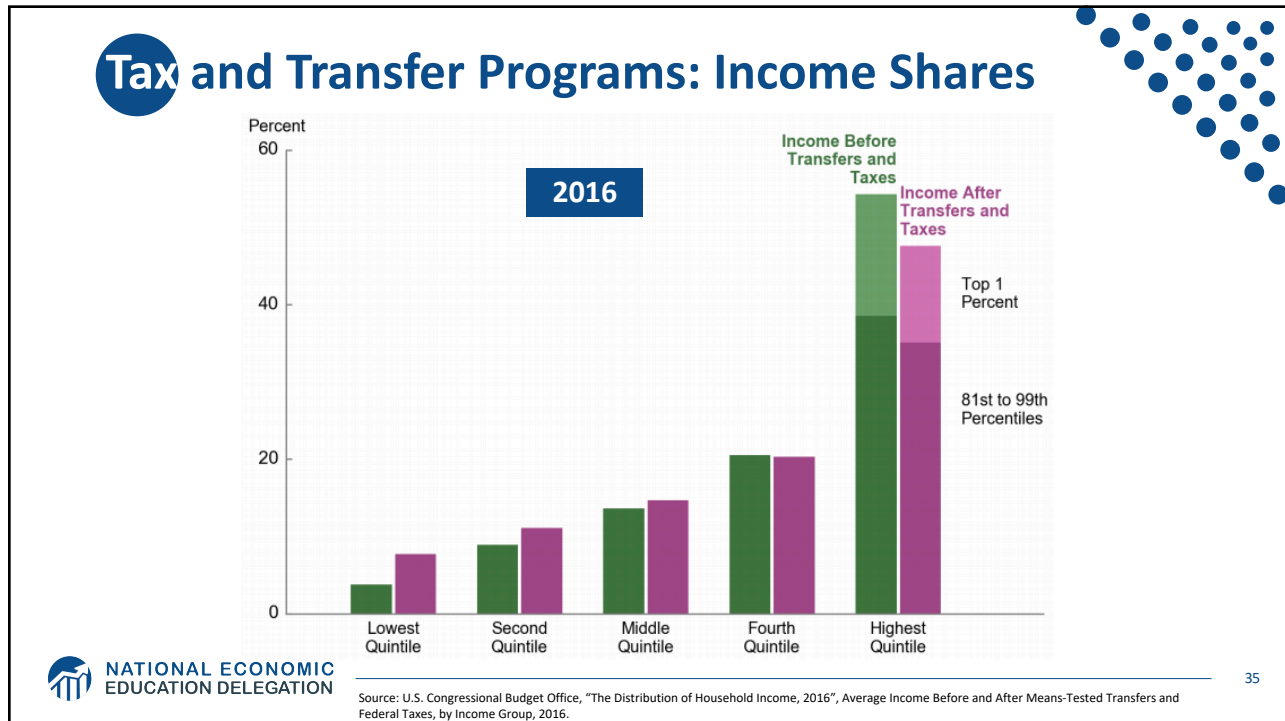
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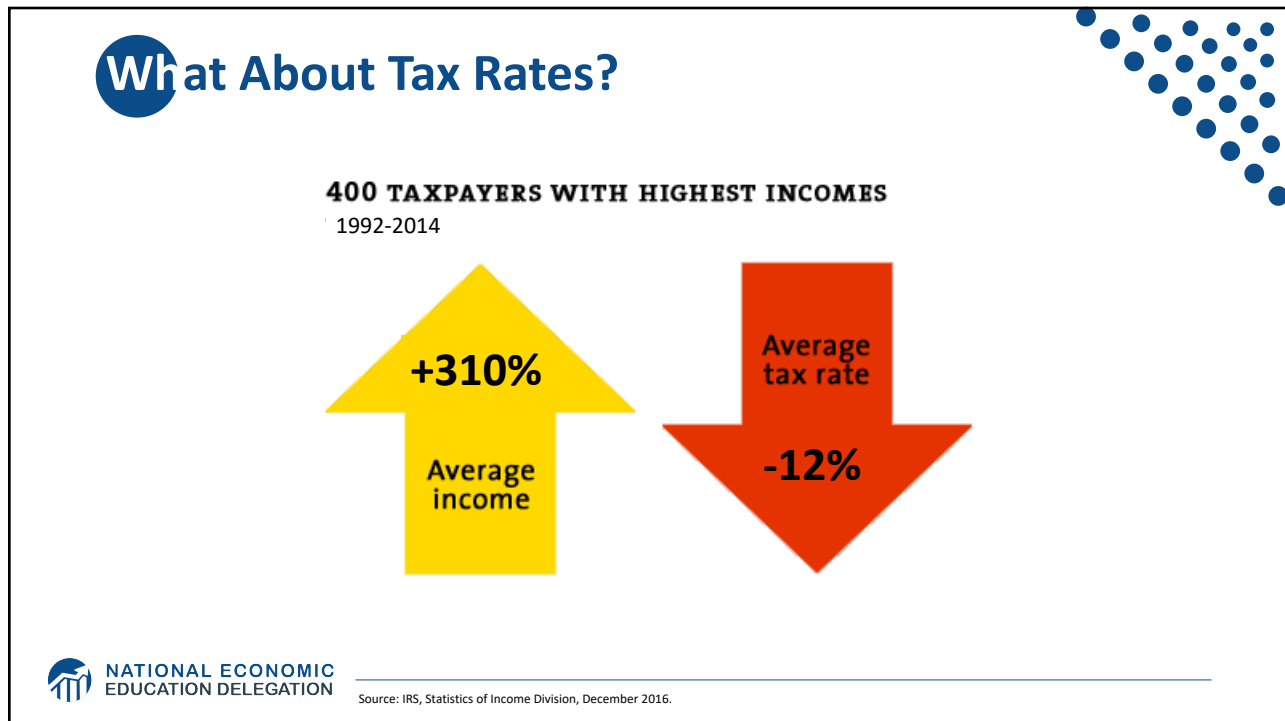
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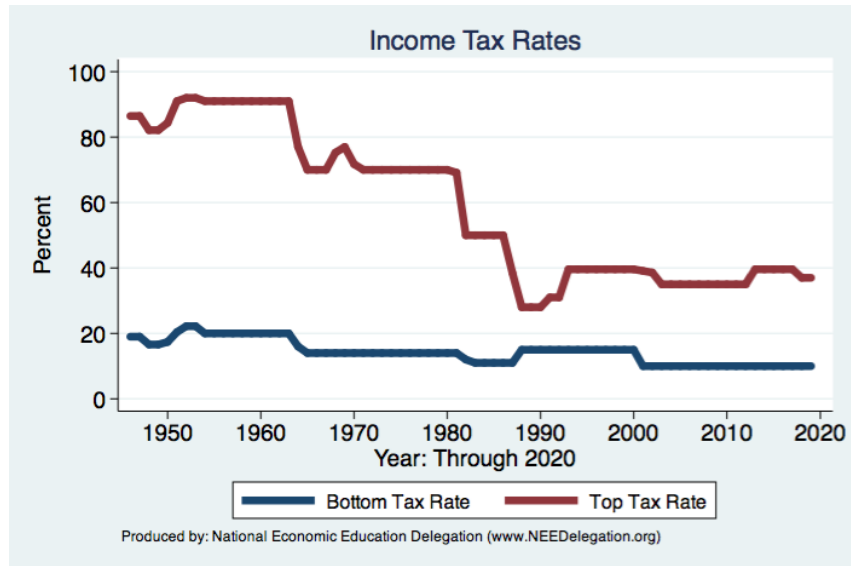


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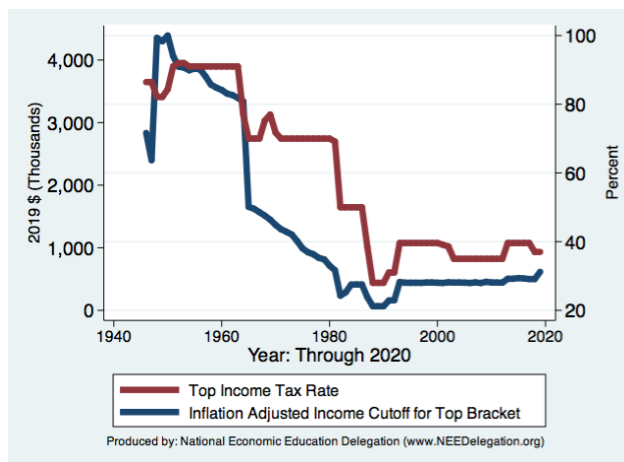
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Tax Rates Over Time



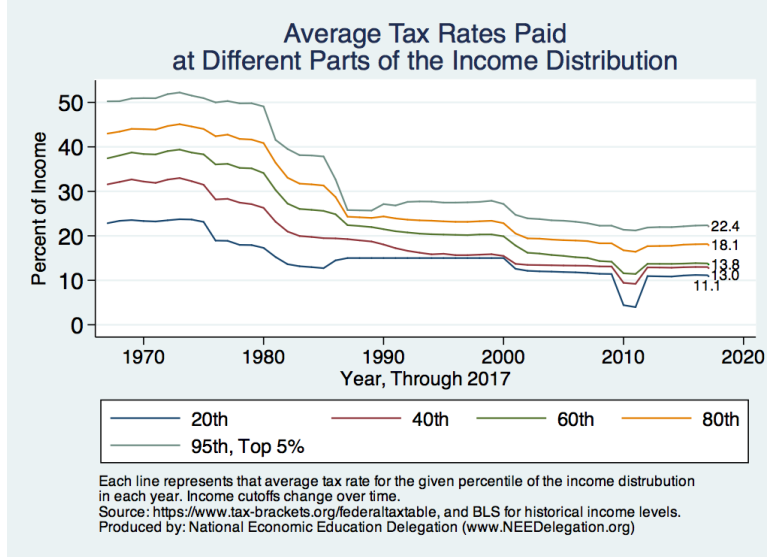
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The Top Tax Rate and Income Cutoff



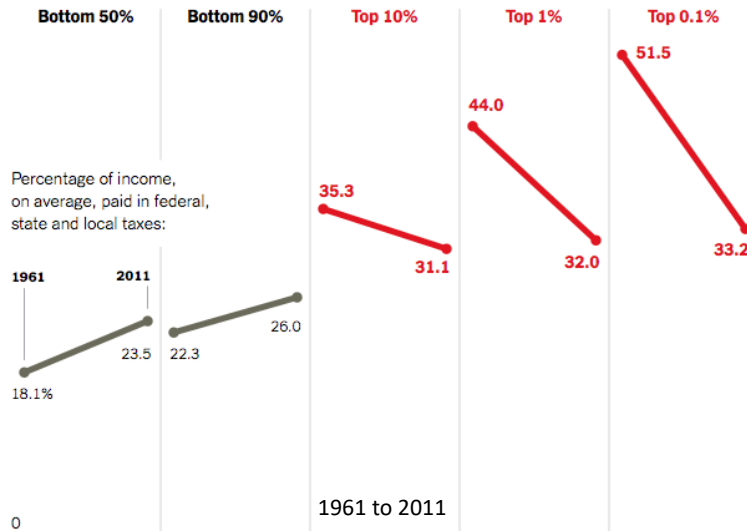
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Average Tax Rates Across Income Categories

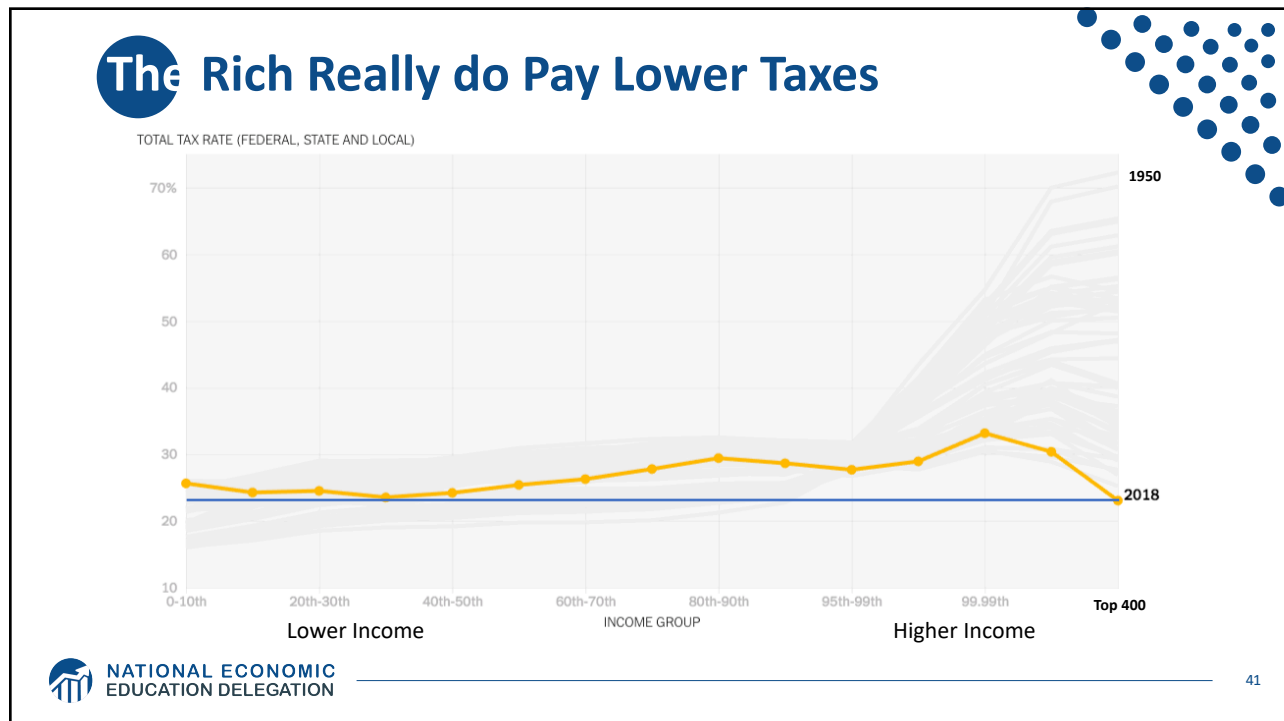


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Dramatically Less Progressivity in the Tax Code



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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

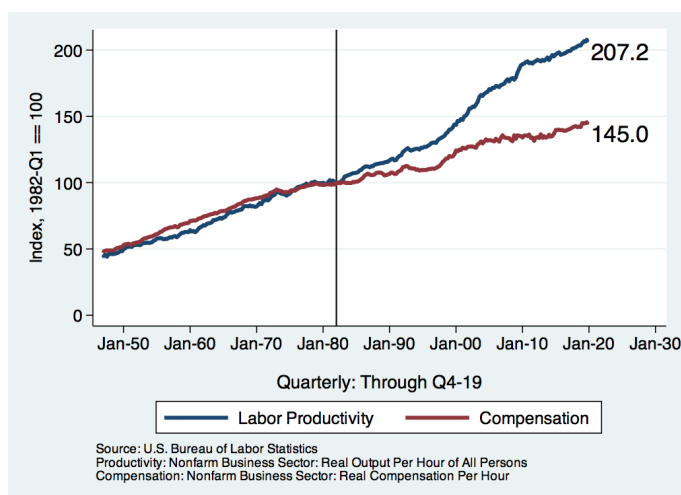


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Labor Income is Unhinged from Productivity



Why?

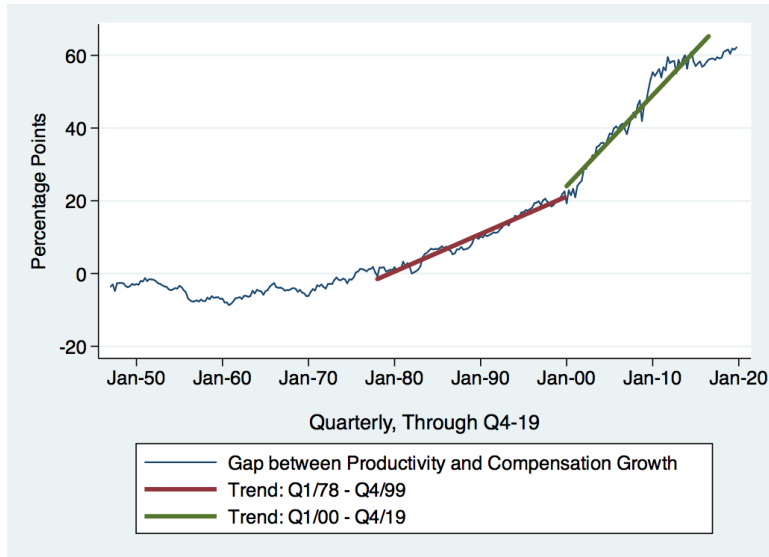
- Declining unionization
- Globalization
- Immigration
- Competition policy
- Cheap technology



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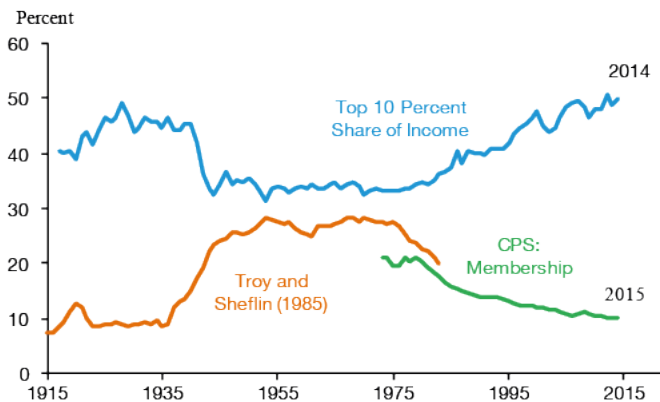
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Labor Share Gap Acceleration



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Declining Unionization



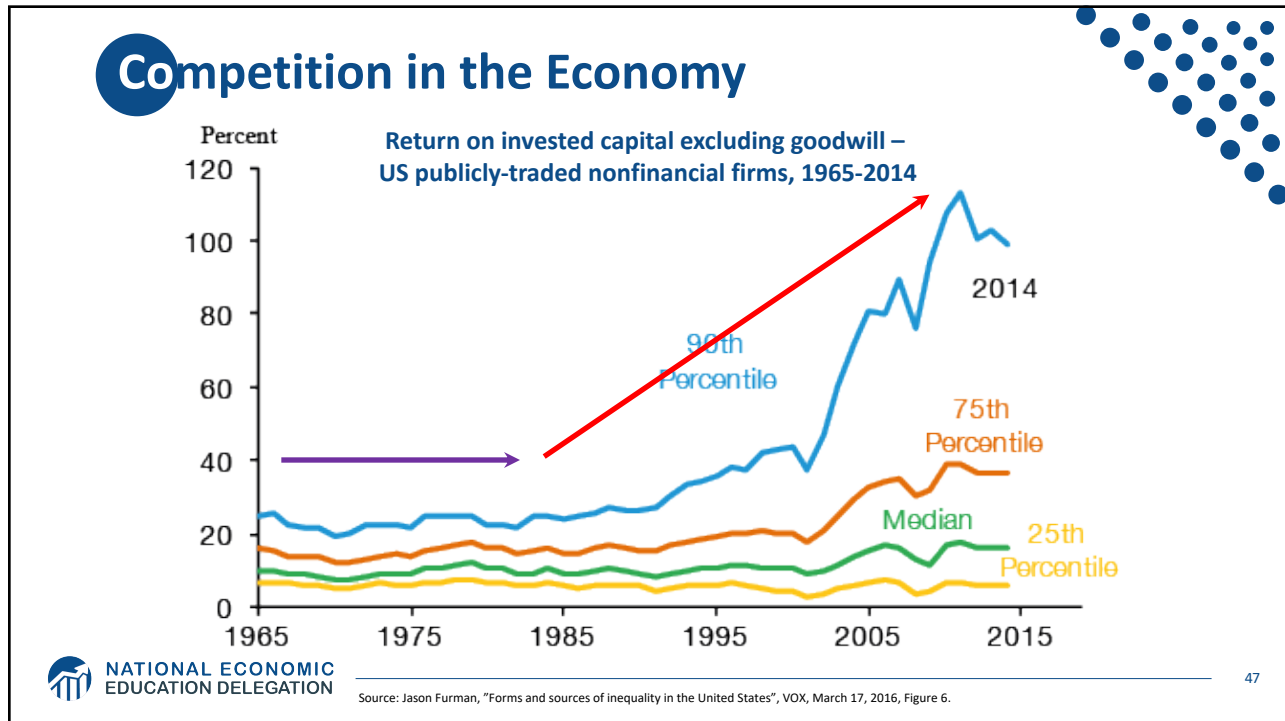
Unionization Rates

- **1983:** 20.1%
- **2019:** 10.3%

Unionization Rates

- **Public:** 33.6%
- **Private:** 6.2%

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Growing Revenue Concentration

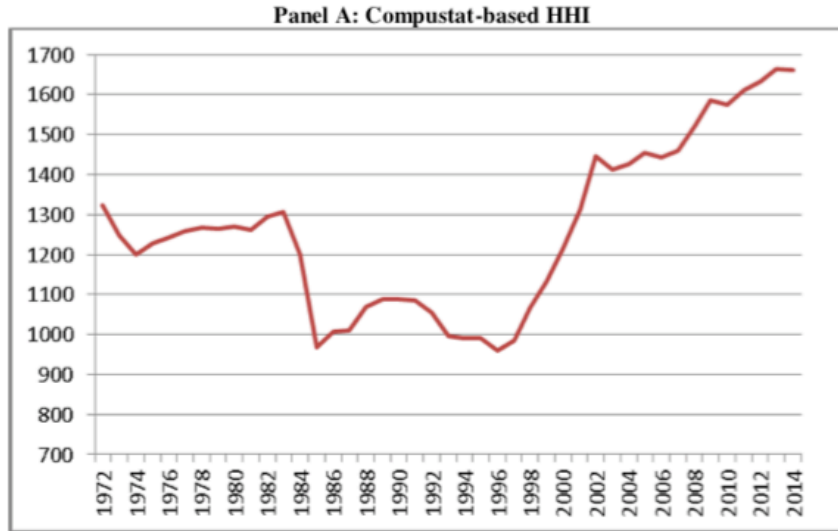
Industry	Percentage Point Change in Revenue Share Earned by 50 Largest Firms, 1997-2007
Transportation and Warehousing	12.0
Retail Trade	7.6
Finance and Insurance	7.4
Real Estate Rental and Leasing	6.6
Utilities	5.6
Wholesale Trade	4.6
Educational Services	2.7
Accommodation and Food Services	2.6
Professional, 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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Source: Furman and Orszag, "A Firm-Level Perspective on the Role of Rents in the Rise in Inequality", 2015.

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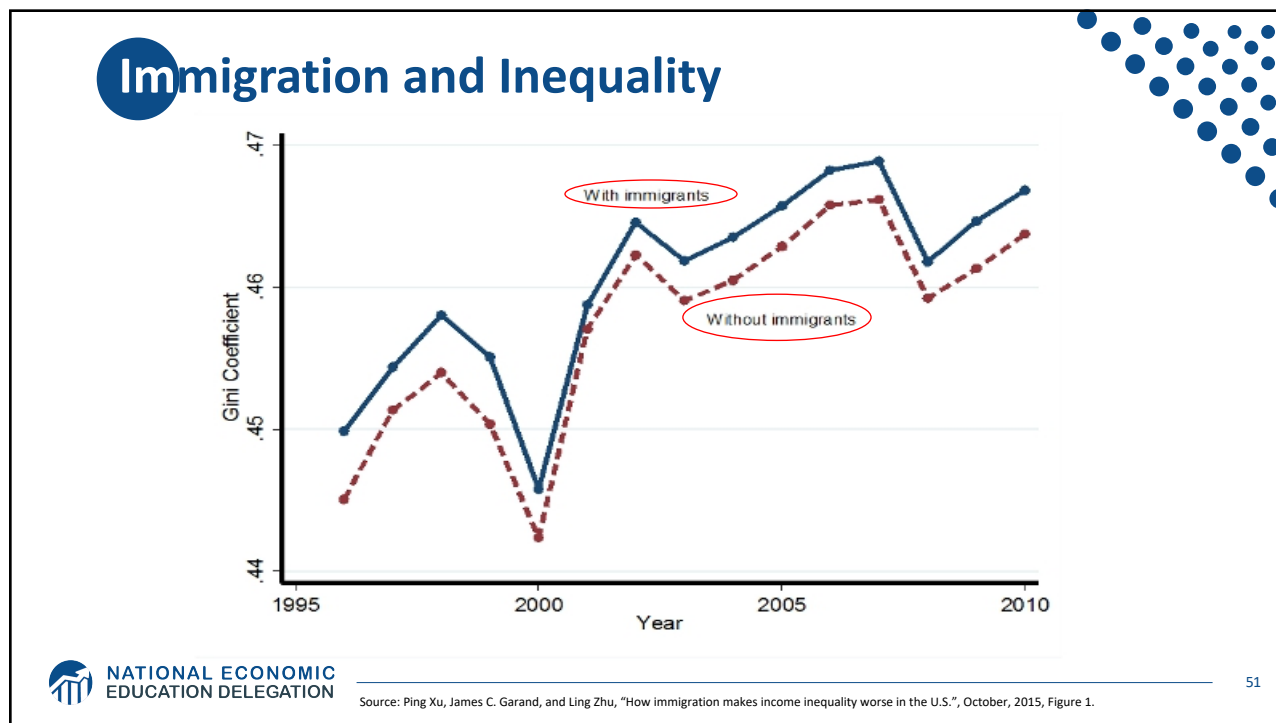
Concentration is Continuing



CEO Pay Has Been Growing Rapidly



Source: EPI, CEO compensation based on options realized. Ratio is CEO compensation relative to average worker compensation.



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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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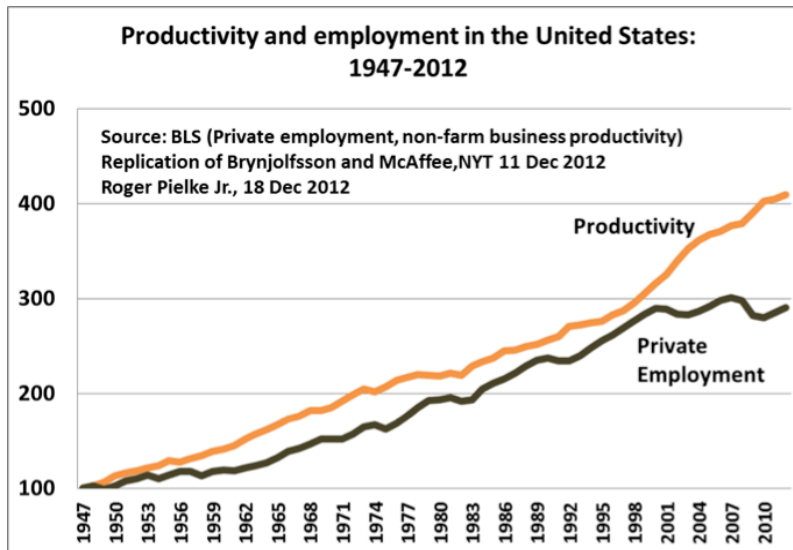
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Technological Change and Inequality

- **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

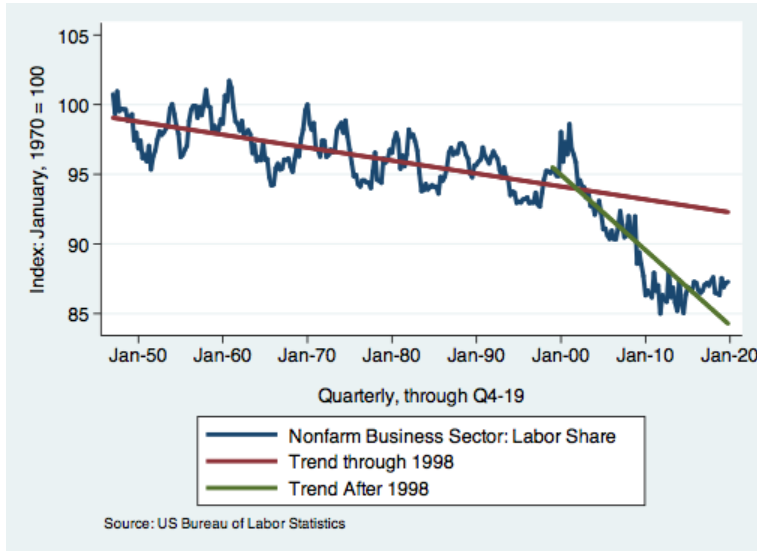
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Technology Benefits Ownership over Labor



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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....

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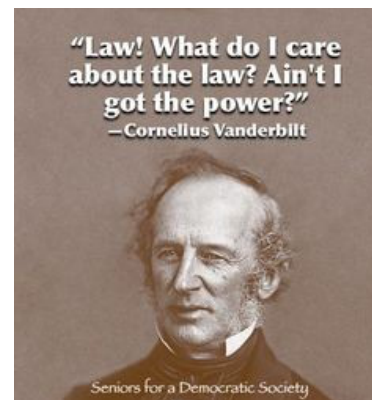
A Modern Example: Uber & Lyft

- **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



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.**

What is driving increasing inequality?

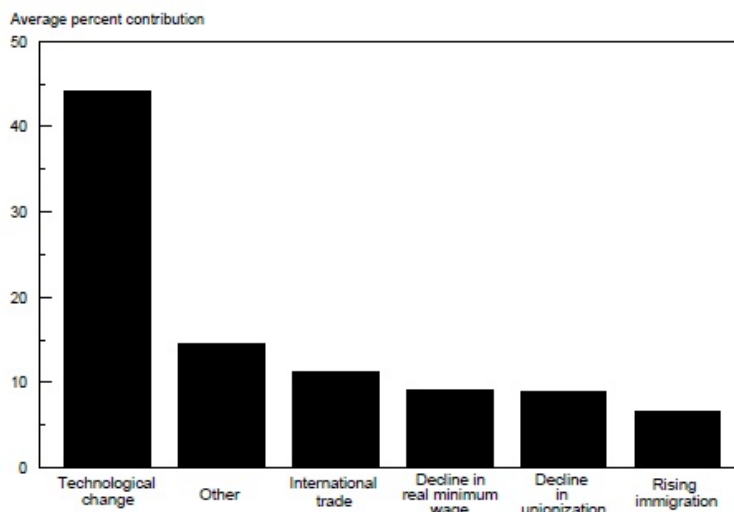
- **Primary drivers:**

- 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

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:**

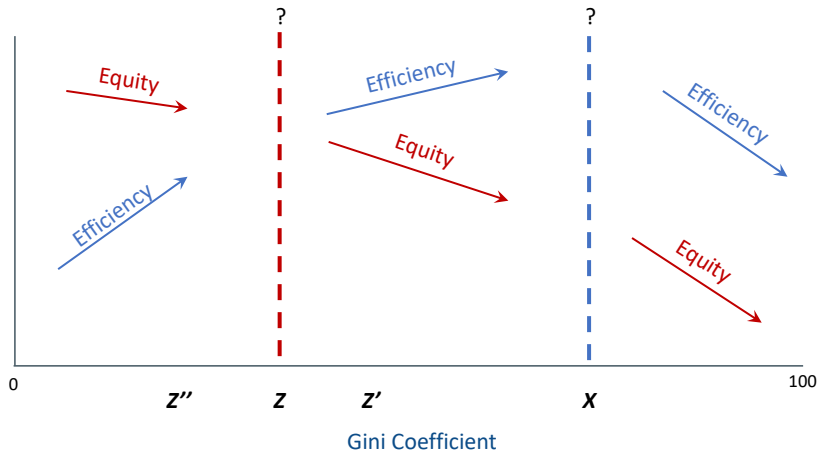
- Divide society
- Distort political environment
- Reduce political participation
- Reduce investments in public goods
 - o Education
 - o Environmental protections



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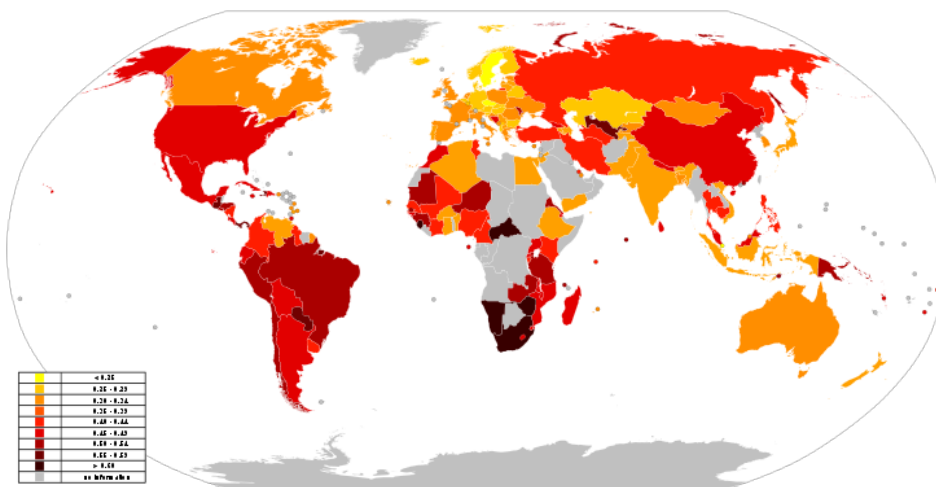
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How Much Inequality Is too Much?



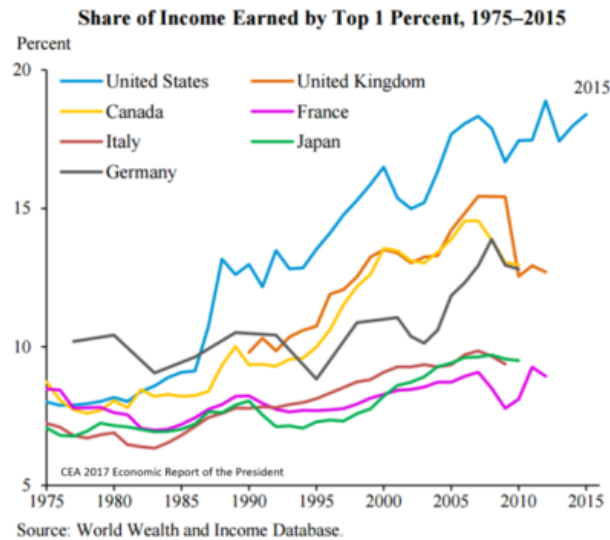
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An International Perspective



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An International Perspective: Comparables



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Addressing Inequality: Is It A Problem?

• Why it might be a problem.

- Economic issues (*Efficiency*)
 - o There is evidence that at some level, increased inequality slows economic growth.
 - o Or, inequality concentrates resources among investors.
- Noneconomic issues (*Equity*)
 - o Values, ethics and morals will drive individual evaluations of the level of inequality.
 - E.g., inequality is primarily a function of market outcomes, so should be left alone.
 - Or, a solid middle class is important for maintaining a civil society, which runs contrary to a high degree of inequality.

• Suppose you think it's a problem. How might it be addressed?

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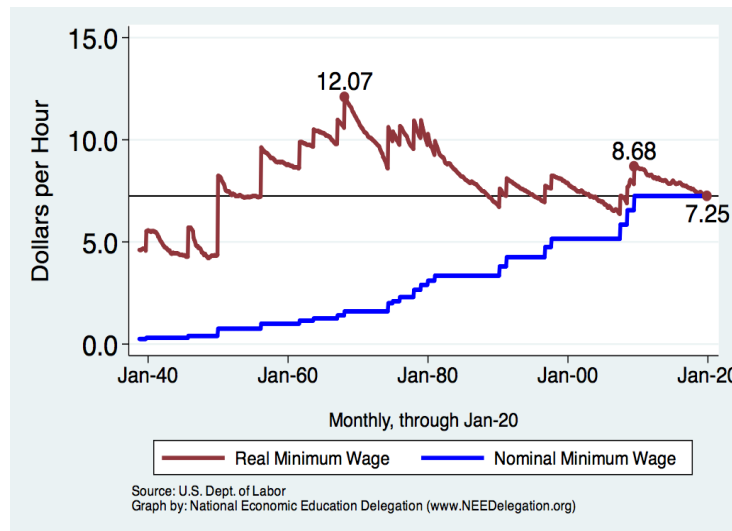
Addressing Inequality: Immediately Available Policy Solutions (1/2)

- **RE-distribution**
 - Tax and transfer programs

- **PRE-distribution**
 - Strengthen labor unions
 - Collective bargaining
 - Other policies that favor labor over business owners
 - Minimum wages

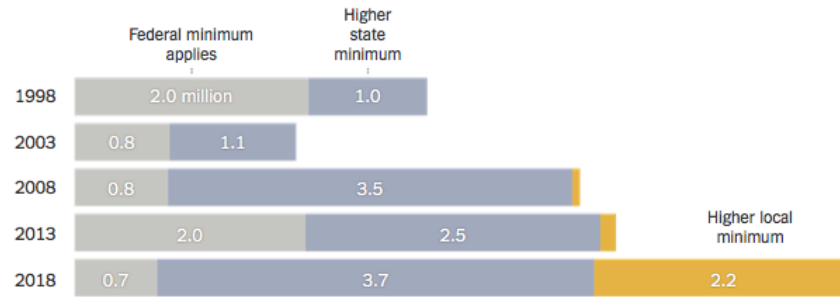


Historical Values of Minimum Wages



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

Millions of workers:

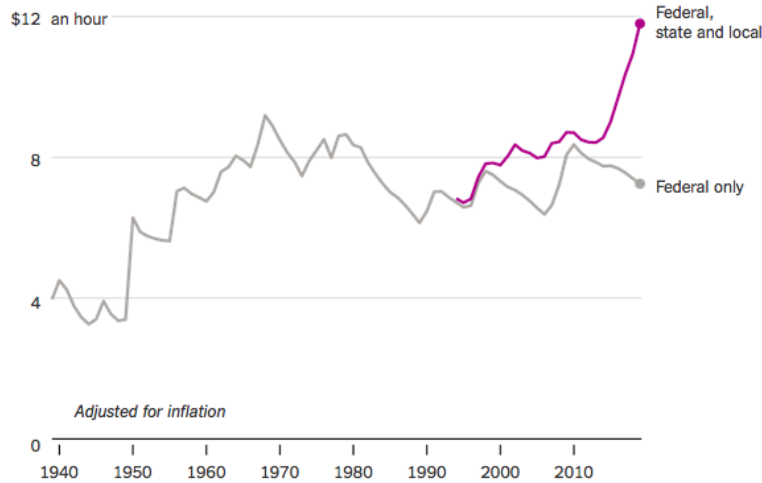


Includes farm workers and tipped incomes

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).

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.



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
 - 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.



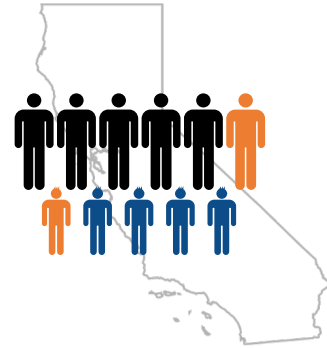
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Summary

- **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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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 (2/19): Trade and Globalization
 - Week 5 (2/26): Income Inequality



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US Economy



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Things to Be Worried About

- **Policy Uncertainty**
 - Trade and immigration policy, especially
- **Business investment**
- **Yield Curve**
- **Government Debt**
- **Income and Wealth Inequality**
- **Ammunition for fighting the next recession**
- **Coronavirus**



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Government Budgets



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Budget Summary: Slide 1

- **Total Spending: \$4.1 Trillion in 2018**
- **There is remarkably little discretion in the budget:**
 - Mandatory: 69%
 - Discretionary 31%
- **Fastest growing parts of the budget: Health Care and Interest**
- **By 2050:**
 - Debt is forecast to grow to 180% of GDP, from 80% today
 - Interest payments are forecast to grow from 8% to 22% of budget



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Budget Summary: Slide 2

- **Categories that get a lot of attention are relatively small...**
 - Foreign Aid: 1% of the budget
 - Income support/welfare: 8.7%
- **Tax expenditures are enormous: 25% of spending**
...and get relatively little attention.



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Federal Debt



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Summary: The Debt

- **The jury is (sort of) out on the debt.**
- **Conventional wisdom is being challenged:**
 - Previously: inflationary and crowd out private investment
 - New assertion: these things don't matter for a country that can borrow in its own currency.
- **Upshot?**
 - This is a policy choice.
 - The cautious approach is to rein in the debt.
 - The cautious approach may lead to slower economic growth.



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Climate Change



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Summary

- **Climate change is real, is caused by human actions, and has impacts we're already feeling.**
- **We need to reduce emissions to balance the costs of action against the costs of inaction.**
- **Scientists and the IPCC recommend that we work to keep warming below 2 degrees celsius.**
 - *Economists believe that this goal is well worth the costs!*
 - *It passes a Cost-Benefit Analysis*



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Summary – *continued*

- **There are many ways to reduce emissions.**
- **Economics-inspired policies can help us do this at the lowest cost.**
- **Taxes and cap and trade are proven effective tools to fight climate change!**
- **Other tools may also be necessary.**



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Bill Nye Explains A Carbon Tax



Trade and Globalization

Conclusions

- Trade and growth are positively related.
- Gains from trade can be widespread (lower prices for consumers).
- Losses from trade can be highly concentrated.
- Tariffs reduce trade overall.
 - Imposing widespread losses to producers (who use imported inputs).
 - And consumers (who buy lower-priced imported goods).
- More direct policies can be more efficient and save gains from trade.
- The trade deficit, per se, is not a source of worry.
 - But activities that cause it, may well be.



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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

