

## Ch. 18: Economic Inequality

- Measuring inequality
- Inequality in income versus wealth
- Sources of inequality
- Income redistribution by government.

## Measuring Economic Inequality

### Market income

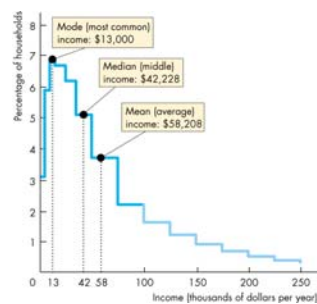
- wages, interest, rent, and profit earned by the household in factor markets, before paying income taxes.

### Money income:

- market income plus cash payments to households by the government.

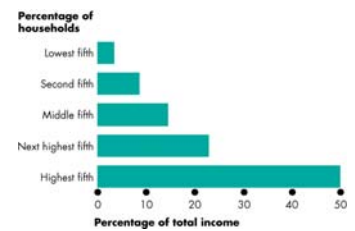
## Measuring Economic Inequality

The distribution of income in the United States is positively skewed (i.e. the mean exceeds the median)



## Measuring Economic Inequality

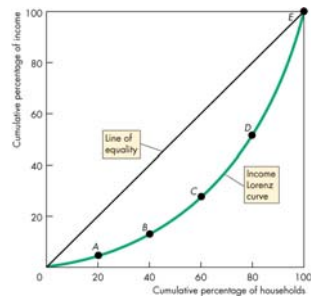
The distribution of income shares for the United States in 2001.



## Measuring Economic Inequality

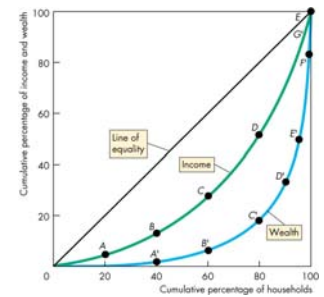
The Lorenz curve shows the cumulative distribution of income.

What would the Lorenz curve look like if one household had 100% of the income?



## Measuring Economic Inequality

The distribution of wealth is even more unequally distributed than income.



## Measuring Economic Inequality

### Wealth Versus Income

Wealth is a stock of assets and income is a flow of earnings that result from a given stock of wealth.

Why is wealth distributed less equally than income?

- wealth measures don't include value of human capital.
  - young will have low earnings, but may have significant amounts of human capital.
  - middle aged will have accumulated wealth and be in their peak years for labor earnings.
  - elderly will have be decumulating wealth and have low labor earnings.

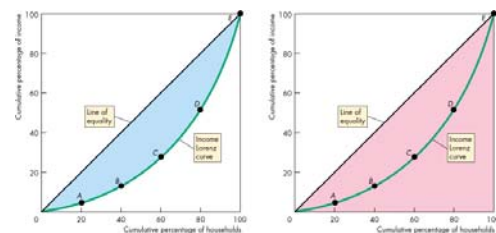
## Measuring Economic Inequality

The Gini Ratio = blue/red

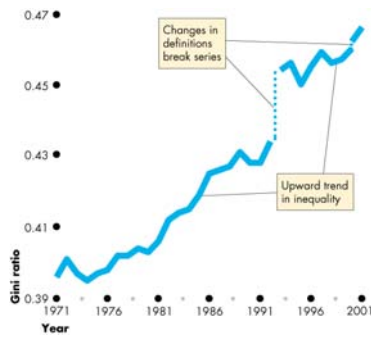
What is range of Gini coefficient?

What does a large Gini ratio imply about inequality?

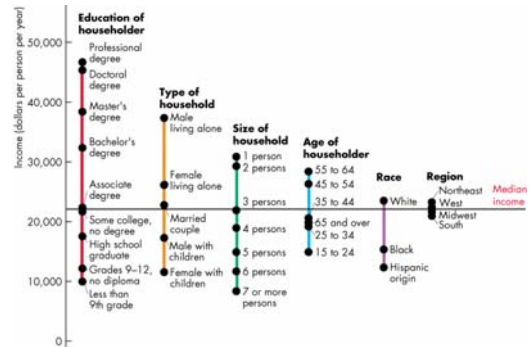
U.S. Gini in 2001 was .45.



## Trends in Inequality



## Measuring Economic Inequality



## Measuring Economic Inequality

### Poverty

a situation in which a household's income is too low to be able to buy the quantities of food, shelter, and clothing that are deemed "necessary".

In 2000:

- the poverty level calculated by the Social Security Administration for a four-person family was \$17,761.
- 11.3 percent of the total population was in poverty.
  - 9.4 percent of white households
  - 21.7 percent of Hispanic households
  - 31.3 percent of black households lived in poverty

## The Sources of Economic Inequality

Inequality arises from unequal labor market outcomes and from unequal ownership of capital.

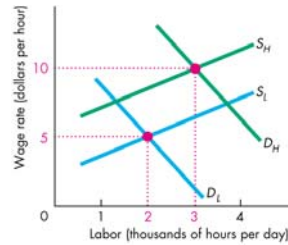
Two significant features of labor markets create income differences among individuals:

- Human capital differences
- Discrimination.

## The Sources of Economic Inequality

The difference in equilibrium wages for high-skilled versus low-skilled labor is the result of

- (a) Higher demand for high skilled (MRP)
- (b) Less supply of high skilled at any given wage (compensating difference)

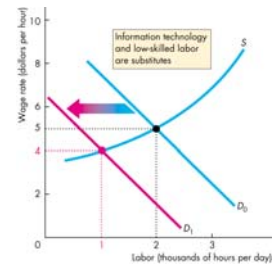


(c) Markets for high-skilled and low-skilled labor

## The Sources of Economic Inequality

Technological change combined with skill differences have widened the gap between low incomes and high incomes.

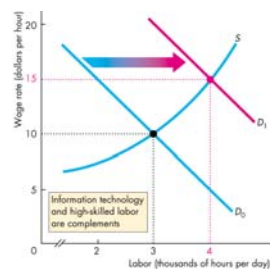
The demand for low-skilled labor has decreased and the wage rate has fallen.



(a) A decrease in demand for low-skilled labor

## The Sources of Economic Inequality

The demand for high-skilled labor has increased and the wage rate has risen.



(b) An increase in demand for high-skilled labor

## The Sources of Economic Inequality

### Discrimination

- Occurs if two equally productive workers are paid different wages.
- Economic studies reveal that differences in human capital alone do not explain gender or race-differences in income.
- Sources of discrimination:
  - Employer
  - Employee
  - Customer
  - Statistical

## The Sources of Economic Inequality

Economists disagree about the extent of discrimination in the labor market.

Firms that practice race or sex discrimination in the labor market would

- pay higher wages for the same marginal revenue product than firms that do not.
- profit margins for the firms practicing discrimination will be lower and the market price of their goods and services would be higher than non-discriminating firms.

## Income Redistribution

The governments in the United States use three main ways to redistribute income to alleviate some degree of economic inequality:

- Income taxes
- Income maintenance programs
- Subsidized services.

## Income Redistribution

### Taxes

A **progressive tax** taxes household at an average rate that rises with income.

A **regressive tax** taxes income at average rates that fall with income, thereby redistributing income away from poorer taxpayers.

A **proportional tax** taxes income at a constant average rate for all income levels.

## Income Redistribution

Are each of the following progressive, proportional, or regressive?

- Sales tax
- Property tax
- Gas tax
- Cigarette taxes
- Payroll tax (e.g. Social Security)

## Income Redistribution

### Income Maintenance Programs

Three major types of programs provide direct payments to individuals:

- Social Security Programs
- Unemployment Compensation
- Welfare Programs

## Income Redistribution

### Subsidized Services

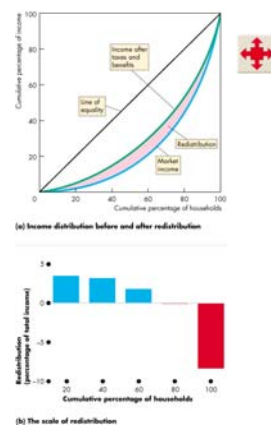
- Education
- Housing
- Food

## Income Redistribution

The influence of government income redistribution efforts in 2001:

The distribution after taxes and benefits is more equal than the distribution of market income.

The three lower income groups gain and the highest income group loses.



## Income Redistribution

### The Equity-Efficiency Tradeoff

Redistributing income leads to an equity-efficiency tradeoff (your text calls it the "Big Trade-off").

Programs to redistribute income are inefficient for three reasons:

1. Uses up resources that could have otherwise been used for producing goods and services.
2. taxes to support redistribution generate a deadweight loss in the markets that are taxed.
3. decreases the incentives for taxpaying workers to provide labor when leisure is a normal good