Chapter 15: Economic Inequality.

<table>
<thead>
<tr>
<th></th>
<th>Families</th>
<th>Income</th>
<th>Wealth</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>percentage</td>
<td>cumulative percentage</td>
<td>percentage</td>
</tr>
<tr>
<td>lowest 20</td>
<td>20</td>
<td>3.7</td>
<td>3.7</td>
</tr>
<tr>
<td>second 20</td>
<td>40</td>
<td>9.1</td>
<td>12.8</td>
</tr>
<tr>
<td>third 20</td>
<td>60</td>
<td>15.2</td>
<td>28</td>
</tr>
<tr>
<td>fourth 20</td>
<td>80</td>
<td>23.3</td>
<td>51.3</td>
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<tr>
<td>fifth 20</td>
<td>100</td>
<td>48.7</td>
<td>100</td>
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</tbody>
</table>

I. income versus wealth.

II. how is each measured.

A. why is wealth distributed more unequally?
   1. differences in savings rates and rate of return on saving.
   2. differences in inheritance
   3. differences in age

A. Lorenz curve: plot the above points for the income distribution (at each possible percentile)
   1. the closer the Lorenz curve becomes to the 45 degree line (line of equality), the more equal the distribution of income (or wealth).
   2. Gini coefficient: area between Lorenz curve and 45 degree line divided by total area below 45 degree line. (1=perfect inequality; 0=perfect equality).
   3. Inequality has risen over time: since 1970, the percentage of income earned by the top fifth has risen while the percentage earned by each of the bottom four-fifths has fallen.

B. Poverty: defined as 3x the minimum cost of a nutritionally sound diet.
   4. in 1995,
i. the poverty level for a four-person family was $15,569.
ii. 39.5 million Americans were in families that had incomes below the poverty level.
iii. 12% of white families; 31% of Hispanic; and 33% of black families were below the poverty level.
iv. 40% of families headed by a single female are in poverty
v. poverty rates vary by state:
   a. Ohio: 11.5%
   b. New Mexico: 25.3% (highest)
   c. New Hampshire: 5.3% (lowest)
   d.

C. Problems with measuring economic inequality.

vi. wealth vs income.
   a. even if income was constant over one’s life, wealth with vary with age.
      1) median wealth by age of household head:
         i) <35: 9,200
         ii) 35-44: 69,200
         iii) 45-54: 114,000
         iv) 55-64: 110,500
         v) 65-74: 88,400
         vi) 75 and over: 83,200
   b. wealth measures don’t capture income generated from human capital.
   c. income varies over time (perhaps should measure life-time income?)
      1) 21% of all people poor for 2 or more months of 1992.
      2) 4.8% of all people poor for all 24 months of 1992-93
      3) median duration of a poverty spell: 4.9 months.
   d. what should be included in income? (health insurance benefits, food stamps, before or after-tax income?)
      1) dropping government money transfers and health insurance would cause poverty rate to rise from 13.8 to 21.1 in 1995.
      2) adding non-cash transfers and subtracting taxes drops the poverty rate to 9.4%.
      3) including government non-cash transfers, value of medicaid, etc. causes poverty rate to drop to 9.4 in 1995.

I. What causes inequality?
A. labor earnings differ due to differences in education etc.

B. family background.
   i. high degree of correlation between parental and child incomes
      a. poor neighborhoods don’t have as much money to finance schools.
      b. Ohio supreme court and court rule that Ohio financing system is unconstitutional.
      c. more educated parents may emphasize education more.
   i. inheritance.

A. discrimination.
   1. some groups may be discriminated against in labor market, loan market, in selling their goods, etc.

I. Government programs to fight poverty and/or reduce inequality.

A. Social Security.
   1. social insurance program: must pay taxes to be eligible.
      i. OASDI: (1997) PAID OUT $368 billion;
      ii. medicare (1997): $194 billion
      iii. highly redistributive; has done a wonderful job of reducing poverty among the elderly over the past 30 years.
      iv. financed by tax of 7.65% by employer and employee on max of approximately $70k of earnings.

A. unemployment insurance
   1. financed by a payroll tax.
   2. fraction of earnings replaced for a limited period of time.
   3. differs across states.

B. welfare programs.
   1. AFDC previously, now TANF.
   2. food stamps
   3. school lunch programs
   4. medicaid

V. Problems with welfare programs: reduced incentive to work.