Today’s Topics

• Gordon reading for next Monday
• Essays
• Income Inequality
  – Data
  – Lindert findings Colonial Times to Present
  – Explanations
  – What is “best” distribution?
  – Social Mobility
What does Inequality Look Like in the U.S.?

• Not looking at wage differences by race, sex, or age
• Looking at distribution of income
What does Inequality Look Like in the U.S.?

Example: $30 total
Which distribution has *greater inequality*?

<table>
<thead>
<tr>
<th></th>
<th>Chris</th>
<th>Pat</th>
<th>Jerry</th>
</tr>
</thead>
<tbody>
<tr>
<td>distribution#1</td>
<td>$5</td>
<td>$10</td>
<td>$15</td>
</tr>
<tr>
<td>distribution#2</td>
<td>$5</td>
<td>$6</td>
<td>$19</td>
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Income Shares Growing at the Top, Falling Everywhere Else

Share of household income, 1967 and 2011

<table>
<thead>
<tr>
<th></th>
<th>1967</th>
<th>2011</th>
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<tbody>
<tr>
<td>Bottom 20 Percent</td>
<td>4</td>
<td>3.2</td>
</tr>
<tr>
<td>Second 20 Percent</td>
<td>10.8</td>
<td>8.4</td>
</tr>
<tr>
<td>Middle 20 Percent</td>
<td>17.3</td>
<td>14.3</td>
</tr>
<tr>
<td>Fourth 20 Percent</td>
<td>24.2</td>
<td>23</td>
</tr>
<tr>
<td>Top 20 Percent</td>
<td>43.6</td>
<td>51.1</td>
</tr>
<tr>
<td>Top 5 Percent</td>
<td>17.2</td>
<td>22.3</td>
</tr>
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Source: Census Bureau.
Top income shares. United States, 1913-2012
Sources: The World Top Incomes Database. http://topincomes.g-mond.parisschoolofeconomics.eu/
Piketty & Saez (2007)

Top 0.1% income share
The Roaring 2000s

After a brief dip in the early 2000s because of a decline in the stock market, the share of the nation’s income that goes to those at the top has begun to climb again, hitting a level not seen since the 1920s.

Sources: Thomas Piketty, Paris School of Economics, and Emmanuel Saez, University of California, Berkeley, from I.R.S. data
Kuznets Curve

Income inequality tends to rise then fall as a country develops
U.S. History of Income inequality (from Lindert)
The U.S. has seen a recent rise in inequality
• Lindert looks at “Pre-fisc” which is income distribution BEFORE the government redistributes with transfer programs like welfare and foodstamps.
4 periods of changing inequality

• Colonial
• Industrialization
• Post-Great Depression
• Since 1975
Explanations for Inequality Changes

1. Population growth
   Baby boomers entered the labor force in 1970s, and young workers earn less. Also more immigrants.

2. Changes in skills level of workers
   More people getting an education may decrease inequality.

3. Biases in technological change
   Robots seem to replace low skilled workers, not highly skilled.
Explanations for Inequality Changes

4. Product demand shifts
   With globalization, U.S. exports high tech that rewards high income workers and agriculture exports falling

5. Labor market institution changes
   Unions are weaker

6. Government fiscal redistribution
   Government taxes rich which may level playing field for future generations
Last thoughts on Income/Wealth Inequality?
Is Income Inequality a Problem?

Distribution vs. Efficiency
(how pie sliced) vs. (size of pie)

Doesn’t any change in inequality make some people worse off?

Jerry doesn’t want to go from distribution #2 to #1, but Pat does
Is Income Inequality a Problem?

Doesn’t any **change** in inequality make some people worse off?

Jerry doesn’t want to go from distribution #2 to #1, but Pat does

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What’s the “best” income distribution? Depends on what makes “society” happiest

Social Welfare Function:
A function that combines the utility functions of all individuals into an overall social utility function.

\[ SWF = \text{Function} \left[ U_1, U_2, \ldots, U_N \right] \]

where \( U_1 \) is the utility of person 1, etc.
Utilitarian SWF \( = U_1 + U_2 + \ldots + U_N \)

- total sum of utility matters
- Government should help everyone

Rawlsian SWF \( = \min (U_1, U_2, \ldots, U_N) \)

- Only the least well off person matters
- Government should help those at the bottom

Egalitarian \( SWF = \frac{1}{U_{\text{richest}} - U_{\text{poorest}}} \)

- Better off with no extreme differences
- Government should take from the rich and give to the poor
Decreasing marginal utility of income

- As your income rises, each additional dollar gives you a smaller amount of happiness.
- This implies that for in general, a redistribution of dollars from rich to poor increases social welfare.
- This is true of all three of the above SWFs, as long as it is costless to redistribute dollars.
How easy is it to move up the income ladder?

• THE TRUTH ABOUT SOCIAL MOBILITY
• Gregg Clark

• https://www.thersa.org/discover/videos/event-videos/2014/03/the-truth-about-social-mobility-/