INCOME INEQUALITY AND POVERTY

I. FACTS ABOUT INCOME INEQUALITY

a. Average household income in the U.S. is among the highest in the world: 2006- $66,570
b. DISTRIBUTION BY INCOME CATEGORY
    i. One way to look at INCOME INEQUALITY is to look at percentages of households in a series of income categories
    ii. Review table 11.1 on page 259
c. DISTRIBUTION BY QUINTILES (FIFTHS)
    i. Second way is to look at total number of individuals, households or families into quintiles or fifths of numerically equal groups; examine the personal income received by each quintile
    ii. Review figure 11.1 on page 260
d. THE LORENZ CURVE AND THE GINI RATIO
    i. Display graphically the distribution of personal income by quintiles through a LORENZ CURVE
        1. The graph on figure 11.1 on page 260 visually depicts the relative income inequality of the U.S.. The straight line is a perfectly equal distribution of income.
        2. Points a-e on the graph depicts the actual distribution of income and the gold portion of the graph shows the relative amount of income inequality.

        3. The farther the Lorenz curve sags away from the linear line of perfect equality, the GREATER the income inequality
    ii. Can also numerically represent income inequality by the GINI RATIO: review figure 11.1 on page 260
        1. Gini Ratio= area between the Lorenz Curve and diagonal (gold area) / total area below the diagonal (gold + gray area)
        2. For figure 11.1 the Gini Ratio is .470
        3. Easier to compare than graphical Lorenz Curve
        4. The HIGHER the Gini Ratio, the GREATER the income inequality
        5. Compare countries on page 261
e. INCOME MOBILITY: THE TIME DIMENSION
    i. The income accounting period of one year is too short to be very meaningful.
    ii. The movement of individuals or households to move from income quintile to another over time is called INCOME MOBILITY.
        1. For most income receivers, income starts at a low level in younger years and moves through the quintiles at middle and then declines.
    iii. As we change from immediacy to longer time periods, there is considerable movement of income receivers over income classes

iv. Income is MORE EQUALLY DISTRIBUTED over a 5,10, and 20 year period versus a single year.

f. EFFECT OF GOVERNMENT REDISTRIBUTION

i. Does not take into account effects of personal income and payroll taxes, nor does it take into account government provided in-kind or NONCASH TRANSFERS such as medical care, housing subsidies, subsidized school lunches, or food stamps.

1. Much like income due to the ability to "purchase" goods and services.

ii. Which contributes greater to redistribution…government taxes or government transers??? Transfers. Why? U.S. tax system is only slightly progressive

iii. Transfer payments have been important in alleviating poverty.

II. CAUSES OF INCOME INEQUALITY

a. Market system is permissive of a high degree of income inequality due to rewarding individuals on the basis of the contribution they or they resources they own in producing society's output.

b. ABILITY – People have different physical, mental and aesthetic talents.

c. EDUCATION AND TRAINING – People must develop and refine their capabilities through education and training. Differences in training and education contribute to income inequality.

i. On the job training also contributes; experience in the position yields greater skils

d. DISCRIMINATION
   i. A cause in income inequality.
   ii. Economists cannot account for differences in income equality due to education, occupations, hours of work; unexplained residual is due to discrimination.
   iii. Economists do not see discrimination as a dominant factor in income inequality.

e. PREFERENCES AND RISKS
   i. Differences due to preferences for market work relative to leisure, work in the household, and types of occupations.
   ii. Willingness to assume risk, both in the job and the entrepreneur.

f. UNEQUAL DISTRIBUTION OF WEALTH
   i. Income is FLOW; wealth is a STOCK, representing a particular moment of both financial and real assets an individual has accumulated over time.
   ii. The ownership of wealth in the U.S. is MORE unequal than the distribution of income.
      1. The wealthiest 10% of families owned 70% of total wealth. 2004
      2. The wealthiest 1% of families owned 33% of total wealth.
      3. The bottom 90% owned 30% of total wealth.
      4. Inequality in wealth leads to inequality in rent, interest, and

dividends; thus inequality in income.

g. MARKET POWER
    i. Ability to "rig the market" on one's own behalf; example; unions and professional groups limit supply of labor
h. LUCK, CONNECTIONS AND MISFORTUNE
    i. Being at the right place at the right time; discovery of oil on a ranch;
    ii. Being at the wrong place at the wrong time; prolonged illness, serious accident

III. INCOME INEQUALITY OVER TIME
a. Over time, economic growth in the U.S. has had increased income in ABSOLUTE terms over time. The RELATIVE distribution of income can be more or less equal.
b. RISING INCOME INEQUALITY SINCE 1970
    i. Review table 11.2 on page 266; distribution of income in quintiles has become more unequal since 1970.
c. CAUSES OF GROWING INEQUALITY
    i. GREATER DEMAND FOR HIGHLY SKILLED WORKERS- higher demand for highly educated workers.
        1. Because highly skilled workers remain relatively scarce, their wages have been bid up.
        2. Growth of "superstar" player.
    ii. DEMOGRAPHIC CHANGES
        1. Entrance of large numbers of unskilled baby boomers into the labor force; younger people earn less than older people.

iii. INTERNATIONAL TRADE, IMMIGRATION AND DECLINE IN UNIONISM
    1. Stronger international competition from imports.
    2. Transfer of jobs to lower-wage workers in developing countries
    3. Upsurge in immigration with unskilled workers.
    4. Both rich and poor are experiencing rises in real income.
    5. Income growth has been fastest in highest quintile.
    6. Income inequality not just U.S. phenomenon.

iv. APPLYING THE ANALYSIS: LAUGHING AT SHREK
    1. The distribution of CONSUMPTION INEQUALITY is less than income inequality.
    2. Products consumed by both the rich and poor are closer together than any time in history.
        a. Cell phones, ipods, HDTV's, cars

IV. EQUALITY VERSUS EFFICIENCY
- a. THE CASE FOR EQUALITY: MAXIMIZING TOTAL UTILITY
    - i. Argument for an equal distribution of income is that income equality MAXIMIZES the TOTAL CONSUMER SATISFACTION (UTILITY) from any particular level of output and income.
        1. Review figure 11.3 on page 269

2. Money incomes are subject to the LAW OF DIMINISHING MARGINAL UTILITY: the more the income, the less marginal utility on the last dollar spent. Ex. Low income – heat, rent, electricity
3. Pro-equality; the optimal distribution is equal distribution so marginal utility of last dollar is same among all people.
4. On 11.3, the transfer of $2500, Anderson GAINED utility represented by blue area, and Brooks LOST utility represented by red area. Blue area is greater than red area so greater combined total utility versus income inequality.

b. THE CASE FOR INEQUALITY: INCENTIVES AND EFFICIENCY
   i. Crack in the case for equality is that there is NO fixed amount of output; not a 0 sum game.
   ii. Tax and transfer process diminishes the income rewards. Lacks incentives to earn higher incomes.
   iii. Taxes are a reduction in the rewards from increased productive effort; Transfers is a reward for diminished effort.
   iv. INEQUALITY IS ESSENTIAL TO MAINTAIN INCENTIVES TO PRODUCE OUTPUT AND INCOME.

c. THE EQUALITY-EFFICIENCY TRADE OFF
   i. EQUALITY-EFFICIENCY TRADE-OFF: greater income equality (achieved through redistribution of income) comes

at the opportunity cost of reduced production and income. Same is true in reverse.

V. THE ECONOMICS OF POVERTY
   a. DEFINITION OF POVERTY- POVERTY is a condition in which a person or family does not have the means to satisfy basic needs for food, clothing, shelter and transportation.
      i. Federal Gov't has established POVERTY THRESHOLDS
         1. 2006; individual at $9800; family of 4 at $20,000; family of 6 at $26,800
         2. POVERTY RATE- the % of the population living in poverty; in 2006 it was 12.3%
   b. INCIDENCE OF POVERTY
      i. Poor are heterogeneous.
      ii. Figure 11.4 on page 272 show the disproportion of poverty rates.
      iii. High poverty rates of children is distressing since poverty breeds poverty.
      iv. As many as ½ of people in poverty are poor for only 1-2 years before climbing out of poverty.
   c. POVERTY TRENDS
      i. Review figure 11.5 on page 273
      ii. In 2006, African Americans and Hispanics had double the rates of poverty versus whites.
   d. MEASUREMENT ISSUES
      i. Living in metropolitan areas will be more costly than living in rural areas.
      ii. When CONSUMPTION is considered rather than INCOME, some of the poverty in the U.S. disappears.

iii. In-kind benefits are not considered in poverty issues.

VI. THE U.S. INCOME-MAINTENANCE SYSTEM

a. Economists agree there are poverty issues in the U.S.. Helping those with low incomes is a widely accepted goal of U.S. public policy.

b. There are two types of ENTITLEMENT PROGRAMS: all eligible persons are assured (entitled) the benefits set forth in the government programs.

    i. SOCIAL INSURANCE PROGRAMS: partially replace earnings that have been lost due to retirement, disability, or temporary unemployment

        1. SOCIAL SECURITY AND MEDICARE: replaces earnings when workers retire, become disabled or die.

            a. Covers over 90% of workforce.

            b. Social Security covers to first $102K of income.

            c. Medicare; hospital insurance for elderly or disabled; unlimited income, not $102K

        2. UNEMPLOYMENT COMPENSATION- all 50 states sponsor these unemployment insurance programs

            a. Financed by small payroll tax, paid by employees, that varies.

    ii. PUBLIC ASSISTANCE PROGRAMS – WELFARE

1. Unable to earn income due to permanent disabilities or have low income with dependent children. Includes a "means test."
    a. SUPPLEMENTARY SECURITY INCOME (SSI)-establish uniform, nationwide minimum income for aged, blind, disabled.
    b. TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF) – low income families; replaced the Aid for Families with Dependent Children (AFDC)-assistance for 2 years.
        i. Ended food stamp eligibility for able-bodied persons 18-50
        ii. Set lifetime limit of 5 years
        iii. Tightened definition of "disabled children"
        iv. 5 year waiting period for immigrants.

c. FOOD STAMP PROGRAM – low income for nutritionally adequate diet.
d. MEDICAID- medical expenses for participants of SSI and TANF
e. EARNED INCOME TAX CREDIT –tax credit for low income families.