

Income Inequality and Poverty

Chapter 20

The Distribution of Income

“A person’s earnings depend on the supply and demand for that person’s labor, which in turn depend on natural ability, human capital, compensating differentials, discrimination, and so on.”

The Measurement of Inequality

- ◆ **How much inequality is there in our society?**
- ◆ **How many people live in poverty?**
- ◆ **What problems arise in measuring the amount of inequality?**
- ◆ **How often do people move among income classes?**

The Distribution of Income in the United States: 1998

Annual Family Income	Percent of Families
Under \$15,000	11.7%
\$15,000-\$24,999	12.3
\$25,000-\$34,999	12.7
\$35,000-\$49,999	16.8
\$50,000-\$74,999	21.5
\$75,000-\$99,999	11.7
\$100,000 and over	13.3

U.S. Income Inequality

◆ Imagine that you. . .

. . . lined up all of the families in the economy according to their annual income.

. . . divided the families into five equal groups (bottom fifth, second fifth, etc.)

. . . computed the share of total income that each group of families received.

Income Inequality in the United States

Year	Bottom Fifth	Second Fifth	Middle Fifth	Fourth Fifth	Top Fifth	Top 5%
1998	4.2%	9.9%	15.7%	23.0%	47.3%	20.7%
1990	4.6	10.8	16.6	23.8	44.3	17.4
1980	5.2	11.5	17.5	24.3	41.5	15.3
1970	5.5	12.2	17.6	23.8	40.9	15.6
1960	4.8	12.2	17.8	24.0	41.3	15.9
1950	4.5	12.0	17.4	23.4	42.7	17.3
1935	4.1	9.2	14.1	20.9	51.7	26.5

U.S. Income Inequality

If income were equally distributed across all families, each one-fifth of families would receive one-fifth (20 percent) of total income.



U.S. Income Inequality

- ◆ From 1935-1970, the distribution of income gradually became more equal.
- ◆ In more recent years, this trend has reversed itself.



Reasons for Recent Increase in Income Inequality

- ◆ **The following have tended to reduce the demand for unskilled labor and raise the demand for skilled labor:**
 - ◆ **Increases in international trade with low-wage countries**
 - ◆ **Changes in technology**

Reasons for Recent Increase in Income Inequality

- ◆ **The wages of unskilled workers have fallen relative to the wages of skilled workers.**
- ◆ **This has resulted in increased inequality in family incomes.**

The Women's Movement and the Income Distribution

The percentage of women who hold jobs has risen from about 32 percent in the 1950s to about 54 percent in the 1990s.

Income Equality Around the World

Country	Bottom Fifth	Second Fifth	Middle Fifth	Fourth Fifth	Top Fifth
Germany	9.0%	13.5%	17.5%	22.9%	37.1%
Canada	7.5	12.9	17.2	23.0	39.3
Russia	7.4	12.6	17.7	24.2	38.2
United Kingdom	7.1	12.8	17.2	23.1	39.8
China	5.5	9.8	14.9	22.3	47.5
United States	4.8	10.5	16.0	23.5	45.2
Chile	3.5	6.6	10.9	18.1	61.0
Brazil	2.5	5.7	9.9	17.7	64.2

The Poverty Rate

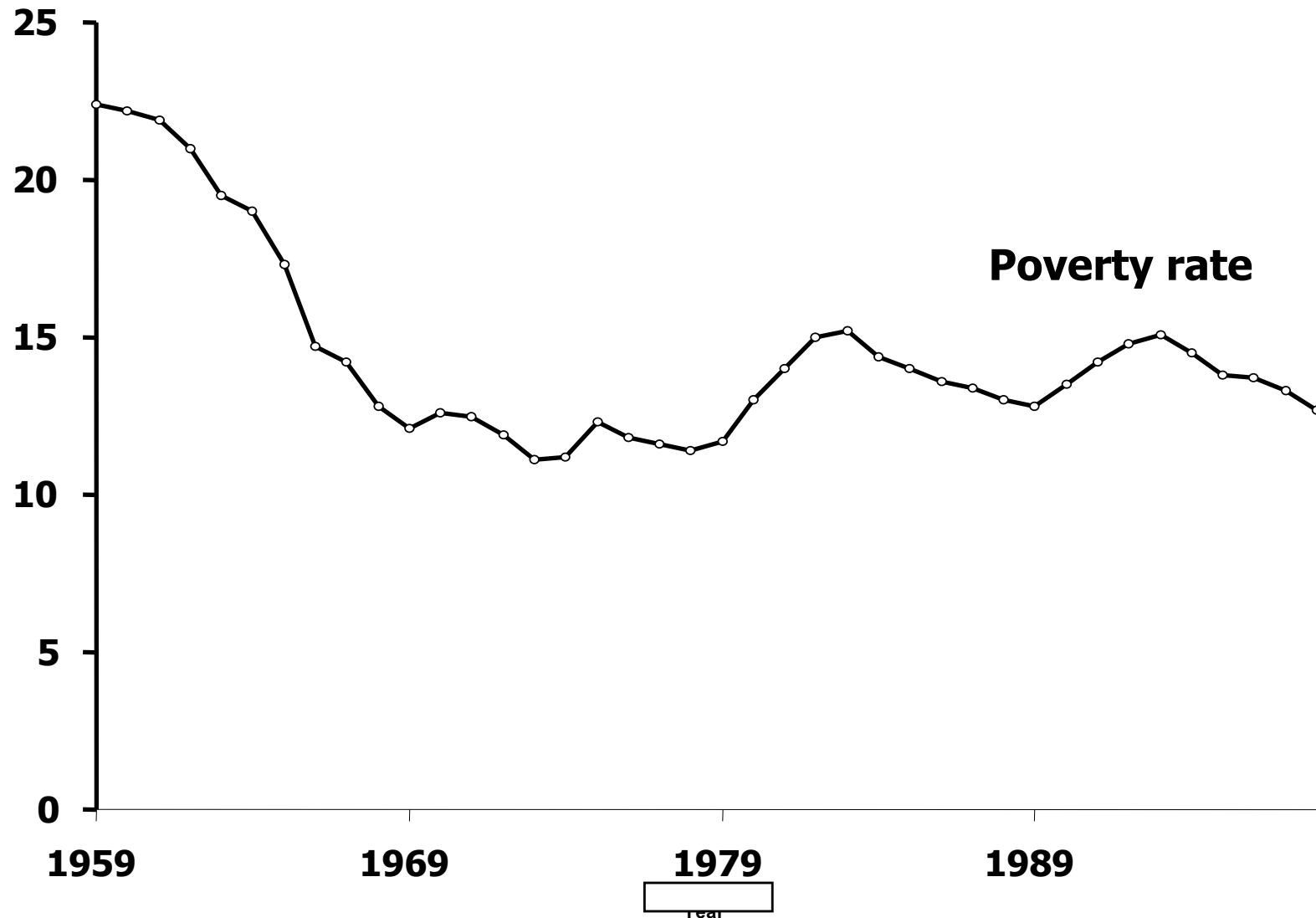
The poverty rate is the percentage of the population whose family income falls below an absolute level called the poverty line.

The Poverty Line

The poverty line is set by the federal government at roughly three times the cost of providing an adequate diet.

The Poverty Rate

Percent of
Population
below the
Poverty Line



The Poverty Line and Income Inequality

- ◆ **As economic growth pushes the entire income distribution upward, more families are pushed above the poverty line because the poverty line is an absolute rather than a relative standard.**
- ◆ **Despite continued economic growth in average income, the poverty rate has not declined.**
- ◆ **Although economic growth has raised the income of the typical family, the increase in inequality has prevented the poorest families from sharing in this greater economic prosperity.**

Who Is Poor?

Group	Poverty Rate
All persons	12.7%
White, not Hispanic	8.2
Black	26.1
Hispanic	25.6
Asian, Pacific Islander	12.5
Children (under age 18)	18.9
Elderly (over age 64)	10.5
Female household, no husband present	33.1

Three Facts About Poverty

- ◆ **Poverty is correlated with race.**
- ◆ **Poverty is correlated with age.**
- ◆ **Poverty is correlated with family composition.**

Problems in Measuring Inequality

- ◆ **Data on income distribution and the poverty rate give an incomplete picture of inequality in living standards because of the following:**
 - ◆ **In-kind transfers**
 - ◆ **The economic life cycle**
 - ◆ **Transitory versus permanent income**

In-Kind Transfers

Transfers to the poor given in the form of goods and services rather than cash are called in-kind transfers.

In-Kind Transfers

- ◆ **Measurements of the distribution of income and the poverty rate are based on families' money income.**
- ◆ **The failure to include in-kind transfers as part of income greatly affects the measured poverty rate.**

The Economic Life Cycle

- ◆ **The regular pattern of income variation over a person's life is called the life cycle.**
 - ◆ **A young worker has a low income at the beginning of his or her career.**
 - ◆ **Income rises as the worker gains maturity and experience.**
 - ◆ **Income peaks at about age 50.**
 - ◆ **Income falls sharply at retirement, around age 65.**

Transitory versus Permanent Income

- ◆ **Incomes vary because of random and transitory forces.**
 - ◆ **Acts of nature that reduce income**
 - ◆ **Temporary layoffs due to illness or economic conditions, etc.**

Transitory versus Permanent Income

- ◆ **A family's ability to buy goods and services depends largely on its permanent income, which is its normal, or average, income.**
- ◆ **Permanent income excludes transitory changes in income.**

Economic Mobility

- ◆ **The movement of people among income classes is called economic mobility.**
- ◆ **Economic mobility is substantial in the U.S. economy.**

Sources of Economic Mobility

- ◆ **Movements up and down the income ladder can be due to:**
 - ◆ **Good or bad luck.**
 - ◆ **Hard work or laziness.**
 - ◆ **Persistence of economic success from generation to generation.**

Political Philosophy of Redistributing Income

**What should the government do
about economic inequality?**

- ◆ **Economic analysis alone cannot
give us the answer.**
- ◆ **The question is a normative one
facing policymakers.**

Three Political Philosophies

- ◆ **Utilitarianism**
- ◆ **Liberalism**
- ◆ **Libertarianism**

Utilitarianism

- ◆ **Utilitarianism is the view that government should redistribute income to maximize the total utility of everyone in society.**
- ◆ **The founders of utilitarianism are the English philosophers Jeremy Bentham and John Stuart Mill.**

Utilitarianism

- ◆ **The utilitarian case for redistributing income is based on the assumption of diminishing marginal utility.**
 - ◆ **An extra dollar of income to a poor person provides that person with more utility, or well-being, than does an extra dollar to a rich person.**

Liberalism

- ◆ **Liberalism is the view that income should be redistributed in such a way so that the poorest in society always receive an adequate level of income as a form of social insurance.**
- ◆ **This view was originally developed by the philosopher John Rawls.**

Liberalism

- ◆ Public policy should be based on the maximin criterion, which seeks to maximize the utility or well-being of the worst-off person in society.
- ◆ That is, rather than maximizing the sum of everyone's utility, one should *maximize the minimum utility*.

Libertarianism

- ◆ **Libertarianism is the view that government should enforce individual rights to ensure that everyone has the same opportunity to use his or her talents to achieve success, but should not redistribute income.**
- ◆ **Libertarians argue that equality of opportunity is more important than equality of income.**

Policies to Reduce Poverty

- ◆ **Minimum-wage laws**
- ◆ **Welfare**
- ◆ **Negative income tax**
- ◆ **In-kind transfers**