

Schiller Ch. 2 Inequality

I. Introduction

What does the U.S Constitution have to say about the issues of economic and social equality—all people are to be treated equally (fairly) under the law (p. 18)

II. Why does economic inequality matter?

Caveat: How much inequality is acceptable is a subjective judgment.

A. Costs of inequality

1. Resentment—breed class divisions which undermine democracy
2. Crime
3. Different brands of justice
4. Unequal education opportunity
5. Skews the distribution of political power in favor of the rich, threatening the legitimacy of democracy

B. Benefits of inequality

1. Inequality is fair—those who work hard and are entrepreneurial should have more economic resources than those who are not
2. Inequalities can be a powerful motivation for working, studying, or investing
3. It follows that differential market rewards and hence inequalities are necessary for economic growth

C. Equity versus efficiency

1. Equity is a drag on efficiency—Okun estimates that each dollar of redistribution reduces the size of the pie by 50 cents
2. Similarly, maximizing efficiency reduces equity—periods of dramatic economic growth may increase inequality

III. Inequality of what?

A. Income Concepts: Shortcomings of income as a measure of economic resources

1. Ignores fringe benefits
2. Includes realized capital gains but ignores unrealized capital gains
3. Consumption is often greater than income, particularly for persons receiving non-cash transfers such as poor families and professionals who barter services
4. Gross income exceed the amount of disposable income (taxes cannot be consumed)

B. Unit of Observation: Basic methodological concept

1. Definition of household—one or more persons living under the same roof and sharing cooking facilities

2. Definition of family—people living under one roof related by blood or marriage
3. Which is most appropriate conceptually? Practically?

C. **Trend distortions** when seeking trends in inequality (affects all countries and hence national and international analyses)

1. Composition of households and families has been changing over time
2. Fewer married couples
3. Families are smaller
4. Changing composition of income
5. More non-cash income (in-kind transfers and fringe benefits)

IV. **Alternative Yardsticks**

A. Between Group Averages

1. Differences across racial and ethnic groups
2. Differences across family structures

B. Income shares

1. Definition of the size distribution of income—rank ordering of units of observation by the size of their incomes
2. Categorizing the size distribution of income by quintiles
3. Share of aggregate income received by each quintile

C. The Lorenz Curve—graphic depiction of the relationship between population shares and income shares

1. Graphically depicts the cumulative share of total income received by cumulative percentages of the populations
2. The diagonal line shows perfect equality
3. If inequality exists, the Lorenz curve lies below the diagonal

D. Gini Coefficient

1. single statistic used to summarize the Lorenz curve
2. Calculated as the area between the diagonal and the Lorenz curve divided by the area of the triangle formed by the diagonal.
3. Gini coefficient varies between 0 and 1
4. Gini coefficient equals 0 when perfect equality is attained—each household has the same income
5. Gini coefficient equals 1 when perfect inequality is attained—one household has all the income

E. Normative vs Objective Observations

1. All normative judgments about the degree of inequality are necessarily subjective
2. Still possible to make comparisons through time:

3. Gini coefficient for U.S. household income increased every year between 1967 and 2001.
4. Income inequality has increased by 17 percent between 1967 and 2001.

V. Global Comparisons

A. Within-nation inequality

1. Income inequality is greater in the U.S. than in other industrialized nations.
2. Inequality is generally more severe in developing nations.

B. Inequality Across Nations—world inequalities

1. In 1992, the richest top 10 percent of the world's population received 53 percent of the total world income.
2. World inequality increased substantially between 1920 and 1950. No significant change since 1950.

VI. Income Mobility

A. Stratification versus equality

1. U.S. citizens accept inequality so long as they perceive every one has a plausible chance of “hitting it big.” Americans focus on equality of opportunity, not results.
2. Definition of class stratification—a situation in which people are trapped in a particular income rank. Social, economic, and institutional barriers obstruct interclass movements.

B. Sources of Mobility

1. Age-related mobility—people change their position in the income distribution over their lifetimes as their incomes rise and fall
2. Changes in Family Structure—incomes change when families are formed, grow, shrink and/or are dissolved.
3. Immigration—large influx of immigrants usually pushes other families into higher quintiles. This is faux mobility.
4. Labor-Market Changes
5. Business cycle fluctuations
6. Changing composition of demand and industry
7. Financial market volatility

VII. Mobility Patterns

A. The Mobility Matrix

1. Data needed to measure mobility
 - a. Longitudinal studies—observe the same individuals over a period of time

- b. Cross-sectional studies—a snapshot of a random sample of individuals at one point in time. The random sample changes from year to year.

B. Earnings Mobility

- 1. Intracohort earnings comparisons for 1957-1971 showed 71 percent had experienced earnings mobility—Schiller’s own study

C. Income Mobility

- 1. Earnings is the largest but not sole component of income
- 2. Why earnings is the preferred income concept for mobility studies—tied to individuals, untainted by changes in family structure
- 3. 80 percent of Americans will experience a least one year of poverty, one year of affluence, or both during their lifetimes

D. Social Inequality

- 1. Kaus emphasizes that income inequality is not synonymous with social mobility.

VIII. Summary