<p style="text-align: center">Reading 10
The Politics of Income and Wealth Inequality</p>

I. Some Descriptive Statistics on Income Inequality

The first step in discussing income and wealth inequality is a look at the facts.[1] But, for the subject of the distribution of income and wealth, the facts are far from settled. You might think that the data is open, clear, and without question, but that is not the case. One solution to this is to look at trends and consider any consensus among experts. You will never completely free the subject of controversy, but it is possible to see where the bulk of the evidence is pointing. In other words, do not expect the numbers on income distribution are calculated with extreme precision. So, look more at whether these same imprecise numbers are substantially rising or falling. Bias in the data is hard to eliminate, but the trend of poorly measured numbers is considerably smaller if the bias in measurement is stable.

In addition to the basic problems of poor measurement, the distribution of wealth is much harder to measure accurately than the distribution of income. This is because income is being paid for services (wages/salaries, rent, interest and profits) every day and there is lots of data on this. The transactions are much more visible and we have income tax records that help greatly to explain the personal and functional distribution of this income. Wealth is not always being traded so frequently and is subject to tremendous changes in valuations due to bubbles and crashes. Human capital, a form of wealth is typically ignored, but this forms an important source of wealth for workers. You cannot improve the productivity of a machine once it is built, but you can greatly improve the productivity of a worker many times over (assuming he or she wants to improve).

For any country, we can quantify degree of deviation from perfect equality in the distribution of income by looking at the (i) the gini coefficient, or we can look at the deviation between the two extremes of poor and rich using (ii) the ratio of the percentages of income earned by the top 20% to the bottom 20%. [2]

gini – The data from the IMF (as shown in Figure 1) indicates that many areas of the world have experienced rising gini coefficients from 1990 to 2012. A rising gini coefficient implies a worsening income distribution. Not every area of the world has worsened though. Both Africa and Latin America have had declining income inequality, although there are some exceptions to this. The US, UK, Australia, Russia, and China have all seen rising levels of inequality. But, Mexico, Brazil, Norway, and Ireland, as well as large parts of Latin America and Africa (excluding South Africa), have had falling inequality. According to Figure 1, advanced economies have seen increases in their gini coefficients from between 0% to 5% 1990 to 2012. It is interesting also how that Indonesia and the Philippines have experienced a rise in inequality according to Figure 1. The
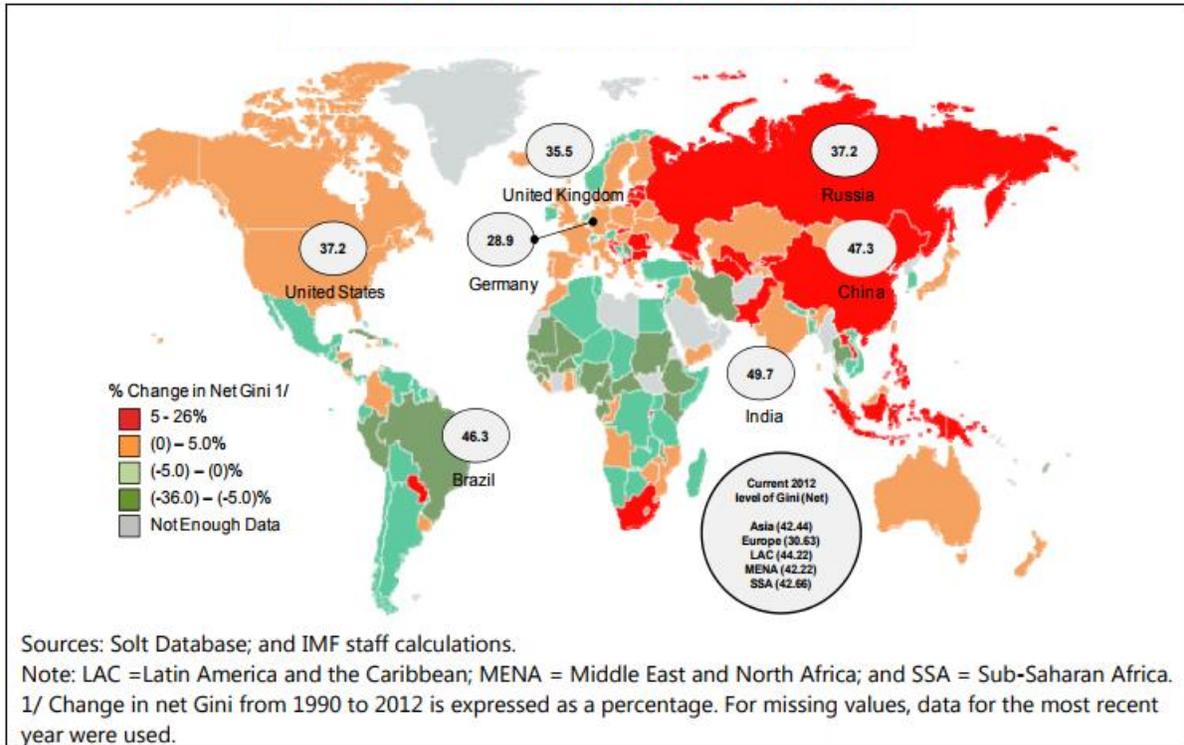
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[1] Of course, one must be convinced that the issue of income and wealth inequality is sufficiently important to consider at all. Not everyone agrees on this – at least with respect to the current distribution.

[2] To see a video on these two quantitative measures, check out Jason Welker's videos here. He does a beautiful job explaining things and has a perfect voice to narrate.

story of movements in inequality is very rich and diverse, spanning multiple countries and multiple income levels.

Figure 1 Change in the Net Gini Index 1990 - 2012

Sources: Solt Database; and IMF staff calculations.
Note: LAC =Latin America and the Caribbean; MENA = Middle East and North Africa; and SSA = Sub-Saharan Africa.
1/ Change in net Gini from 1990 to 2012 is expressed as a percentage. For missing values, data for the most recent year were used.

Source: IMF Staff Discussion Note June 2015 A net gini coefficient is one that uses income including after taxes and transfers.

top 20%/bottom 20% –

II. What is Causing Changes in Income Distributions?

The IMF seems to be somewhat lost when it comes to *why* inequality is changing. In some countries things are worsening, while in other countries things are getting more equal. There is no clear global pattern to what is happening. The reason we hear so much about the distribution of income worsening is that it is occurring in the US.[3]

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[3] Here is a little conservative politics, which you may ignore if you lean progressive. When one considers inequality by state, the most egregious states are deep blue (Democratic Party) states including Connecticut, New York, New Jersey, Massachusetts, California, Vermont, and Washington. Red (Republican Party) states that have high inequality are Wyoming and Florida. Washington DC is not a state, but has a very unequal distribution of income and is also deep blue. Note that each state has within its power to equalize incomes in its own state, but refuses to take that step, insisting instead that the Federal government address the problem. This is a good example of federalism at work. If any state tried to equalize its income within its borders by itself, the wealthy would simply move to another

Obviously for advanced economies such as the US the digital age has given some groups in society tremendous earning power. The rise in inequality in the US corresponds suspiciously to the stupendous dot.com boom, investment and consumption in IT, and a significant premium on skilled labor. The sudden boost of technology and its rapid adoption globally has made millions of people rich, while leaving the rest of humanity growing at much slower rates. Perhaps no time in history has IQ, coupled with educational opportunities and a strong work ethic, produced such a boost to skilled labor's income position in society. In addition, the regulation-based economy has made any individuals or firms (including legal and lobbying) dealing with government important. It is not a coincidence that Washington DC has become one of the areas in the US with greatest inequality (see EPI).

The IMF has made the following conjecture

> Technological progress and the resulting rise in the skill premium (positives for growth and productivity) and the decline of some labor market institutions have contributed to inequality in both advanced economies and EMDCs. Globalization has played a smaller but reinforcing role. Interestingly, we find that rising skill premium is associated with widening income disparities in advanced countries, while financial deepening is associated with rising inequality in EMDCs, suggesting scope for policies that promote financial inclusion.

> Policies that focus on the poor and the middle class can mitigate inequality. Irrespective of the level of economic development, better access to education and health care and well-targeted social policies, while ensuring that labor market institutions do not excessively penalize the poor, can help raise the income share for the poor and the middle class.

III. What do Experts Say about Income Inequality

In this section, rather than having you read something here, I would like you to listen to Gregory Mankiw and Jared Bernstein politely and humorously discuss income inequality in the US. The debate is about an hour. Mankiw begins to talk around 8 minutes into the video. Mankiw is a famous Harvard economist who has a bestselling Principles text, which is also used at our school. Be sure to take down the reasons Mankiw gives for income inequality and listen closely to his discussion of these.

Questions:

#1. What is the difference between the distribution of income and the distribution of wealth?

#2. Why do people care about the distribution of income?

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state. There is strong competition among the states in the US. This is happening in California, where many firms and individuals have already moved to Texas and Utah.

#3.   Why not let the government decide the level of income for everyone?

#4.   The Northern European countries have gini coefficients that are among the lowest in the world. Can you explain how they accomplish this?

#5.   US inequality is rising. What does the IMF think will help ameliorate this?

#6.   Greg Mankiw has five possible reasons for the rise in US inequality (i) the race between education and technology, (ii) globalization and trade, (iii) immigration, (iv) superstar phenomenon, and (5) assortative mating. Choose one and explain it.

#7.   Is income inequality something that can be solved by politics?

#8.   Which parts of the world are enjoying greater inequality and why do you think this is occurring?