ECONOMICS 201 WEEK 9 INEQUALITY & POVERTY

DEFINITIONS

INCOME INEQUALITY

WEALTH INEQUALITY

POVERTY

INEQUALITY

Overview

- Between World War II and the 1970s, there was strong economic growth in the US.
  - Real incomes roughly doubled between the late 1940s and the early 1970s.
  - Households at all levels saw incomes increase, and the gap between upper and lower incomes remained approximately the same.
- Beginning in the 1970s, economic growth slowed, and income inequality increased.

DEFINITIONS

How unequal is the American economy now?

- **The answer depends on how inequality is measured.**
  - By income
    - What counts as “income.”
  - By wealth
    - What counts as “wealth.”

DEFINITIONS

- **Income is defined generally as money received *during a defined period of time*. e.g. Income per year, income per month, income per day.**
- **Wealth is defined as the net value of what is owned *at a certain period of time. Net worth = Assets – Liabilities***
  - *Assets = all real estate or possessions that have a market value.*
  - *Liabilities = total amount of all debts.*
  - *Example: Your house could be sold for $200,000. You have a mortgage of $125,000 which would have to paid off. Thus the net value of your house to you is $75,000.*

MEASURING INEQUALITY

The most common measure of inequality is "income inequality."

- It is easier to measure. i.e. how much money was received is an **actual number**. But, how much you think your house is worth is an **estimate**.
- Data is more readily available on income. The US Census Bureau issues a report on income and poverty in every September.

WHAT IS INCLUDED IN INCOME INEQUALITY STATISTICS?

Includes before tax "cash" or money income such as:

1. Earnings
2. Unemployment compensation
3. Workers' compensation
4. Social security
5. Supplemental security income
6. Public assistance
7. Veterans' payments
8. Survivor benefits
9. Disability benefits
10. Pension or retirement income
11. Interest
12. Dividends
13. Rents, royalties, and estates and trusts
14. Educational assistance
15. Alimony
16. Child support
17. Financial assistance from outside of the household
18. Other income

WHAT IS NOT INCLUDED IN INCOME INEQUALITY STATISTICS?

1. The Census Bureau only measures money income. Thus, it, excludes any non-cash benefits received from government and/or employers such as food stamps, vouchers, educational assistance, transportation, health care, etc.
   - Some economists and policy makers argue that this limitation tends to **underestimate** the total income available to poor households.
   - In essence, critics charge that this limitation makes income inequality statistics look **worse** than they actually are.

WHAT IS NOT INCLUDED IN INCOME INEQUALITY STATISTICS?

2. The Census Bureau data also excludes income from capital gains. Capital gains and losses are proceeds from the **sale of assets**.

   - Assets may be ***real assets*** such as houses, property, or other tangible goods.
     - Example: A person who bought a house for $100,000 and sold it for $180,000 had a capital gain of $80,000.
   - Assets may also be ***financial assets*** such as stocks, bonds, and other securities.
     - Buying and selling financial assets is done primarily in order to obtain capital gains, i.e. "buy low, sell high!"

WHAT IS <u>**NOT**</u> INCLUDED IN INCOME INEQUALITY STATISTICS?

- Households with higher incomes and wealth are much more likely to have capital gains. The collapse of housing prices has greatly reduced the possibility of capital gains for middle and lower income households.
  - Some economists and policy makers argue that this limitation tends to **underestimate** the total income available to wealthy households.
  - In essence, critics charge that this limitation makes income inequality statistics look **better** than they actually are.

INCOME INEQUALITY

Bottom Line:

Income Inequality is a politically controversial issue.

- Arguments over the data and measurement of inequality is really a ***debate over policy*.**
- If inequality is not as bad as we think, then there is less urgency to do something about it.
- On the other hand, if inequality is even worse than we think, then there is more support for changes in taxes and other policies to remedy the situation.

US INCOME DISTRIBUTION
MONEY INCOME, 2013

Percentile	Share of Aggregate Income
Lowest Quintile	3.2
Second Quintile	8.4
Middle Quintile	14.4
Fourth Quintile	23.0
Highest Quintile	51.0
Top 5%	22.2

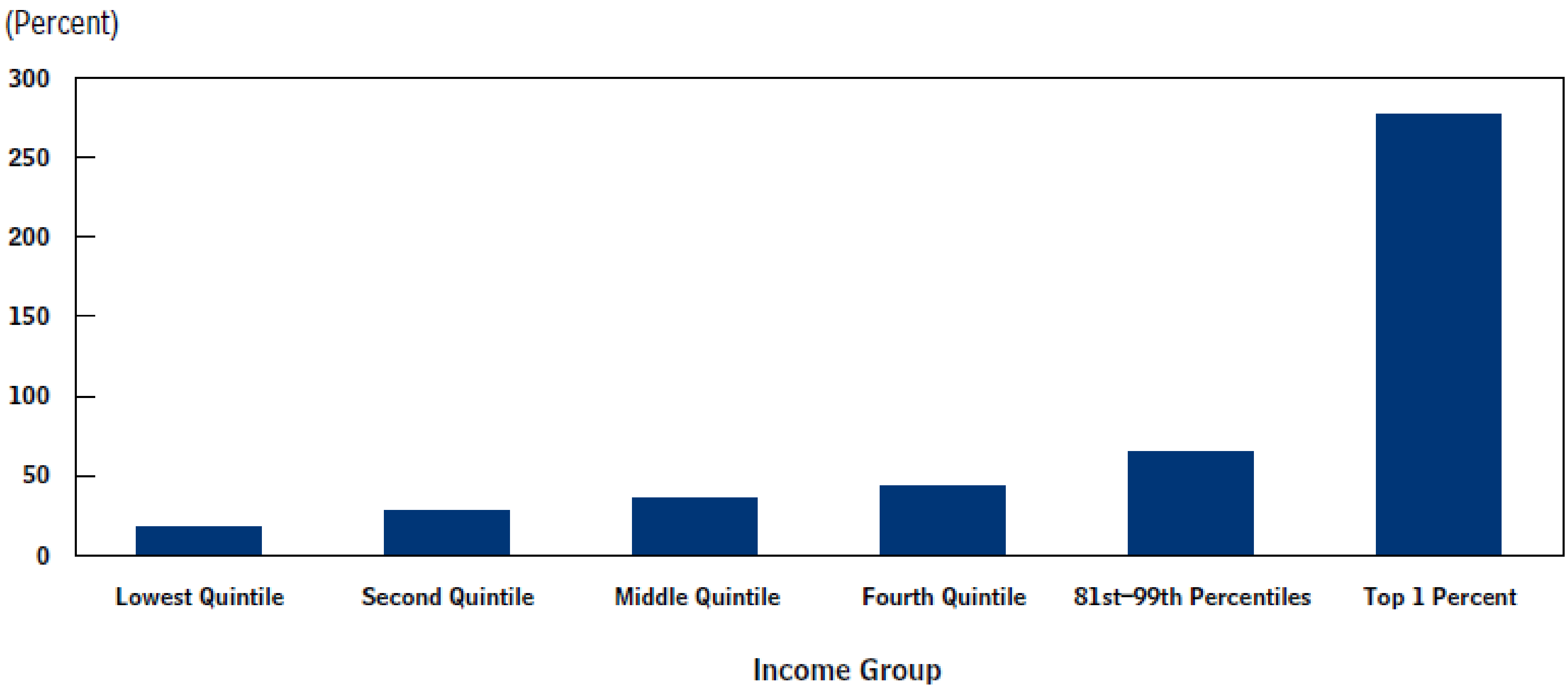
Quintile = 20%

US Bureau of Census, September 2014

CBO REPORT ON INCOME INEQUALITY

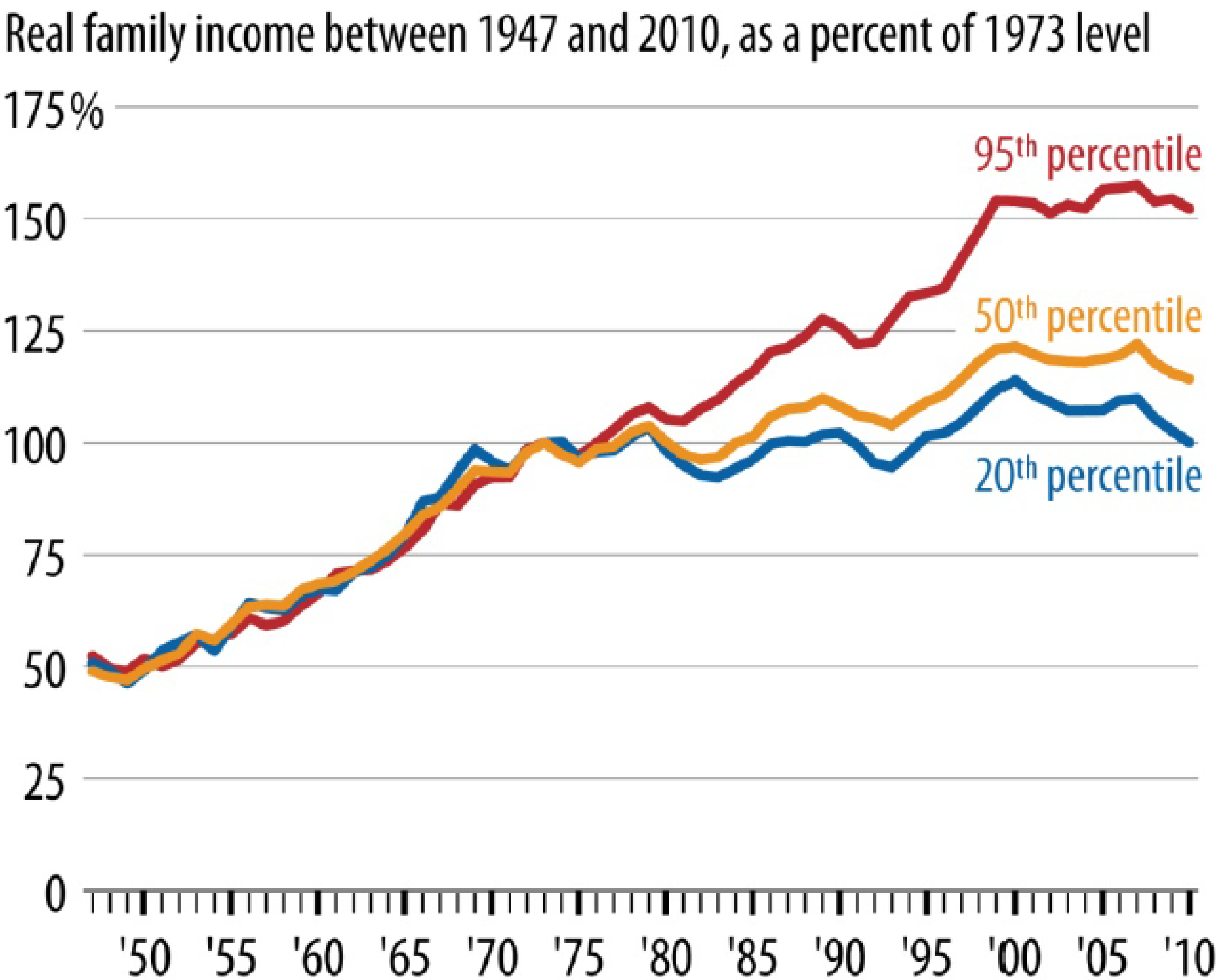
Summary Figure 1.

Growth in Real After-Tax Income from 1979 to 2007



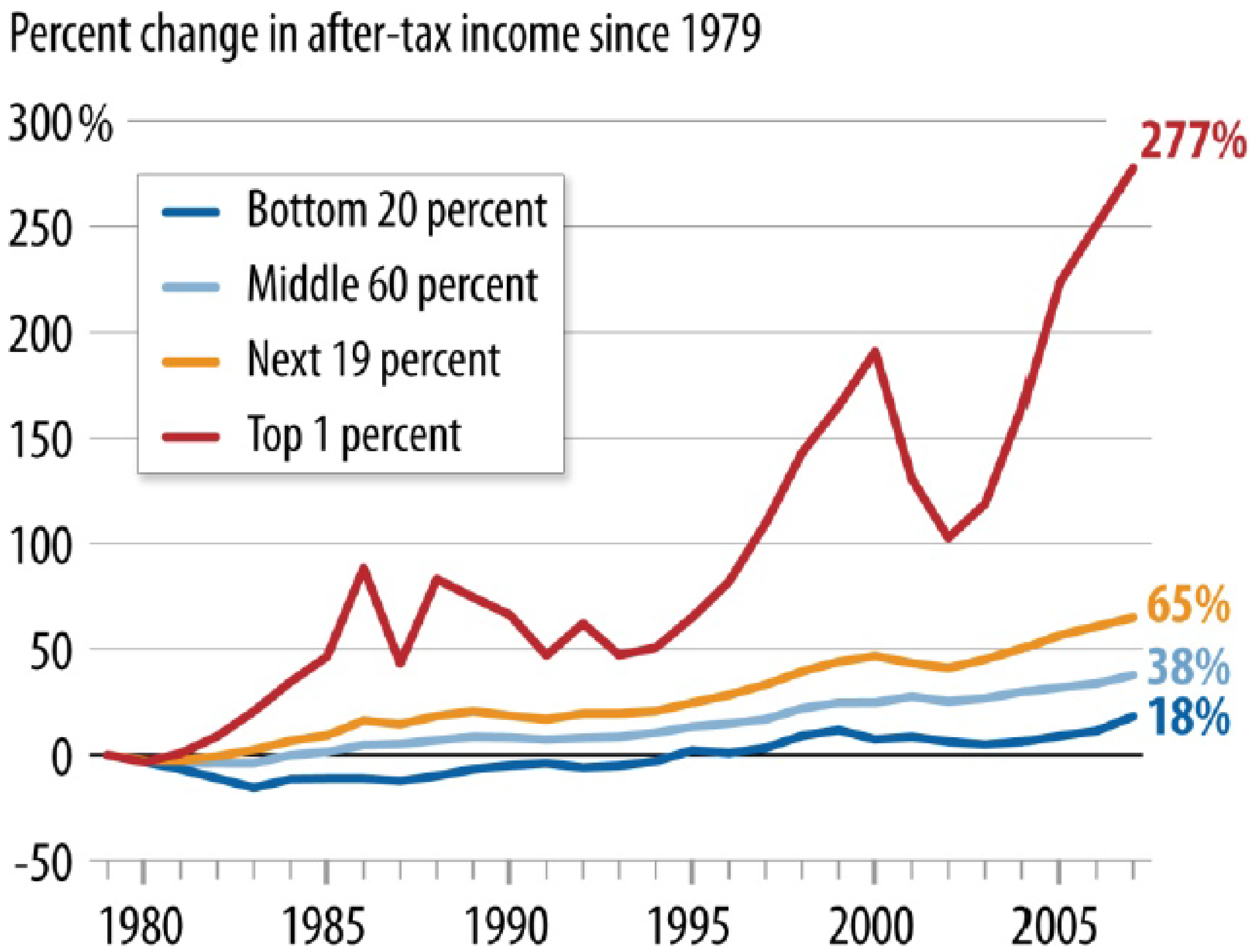
Source: Congressional Budget Office.

Income Gains Widely Shared in Early Postwar Decades — But Not Since Then



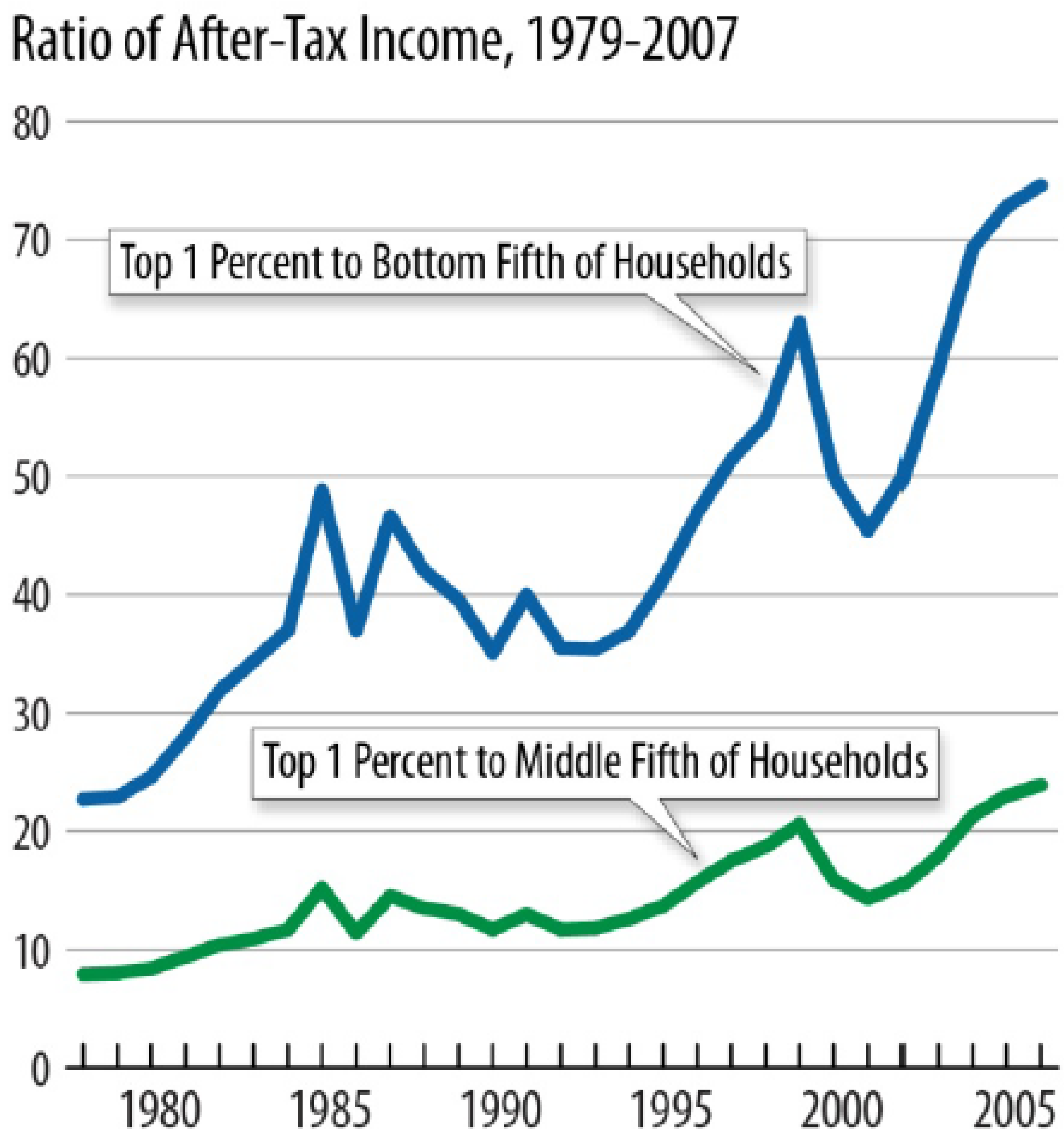
Source: CBPP calculations from U.S. Census Bureau data

Income Gains at the Top Dwarf Those of Low- and Middle-Income Households



Source: Congressional Budget Office

Ratio of Top Incomes to those of Middle and Bottom Households have more than tripled since 1979.

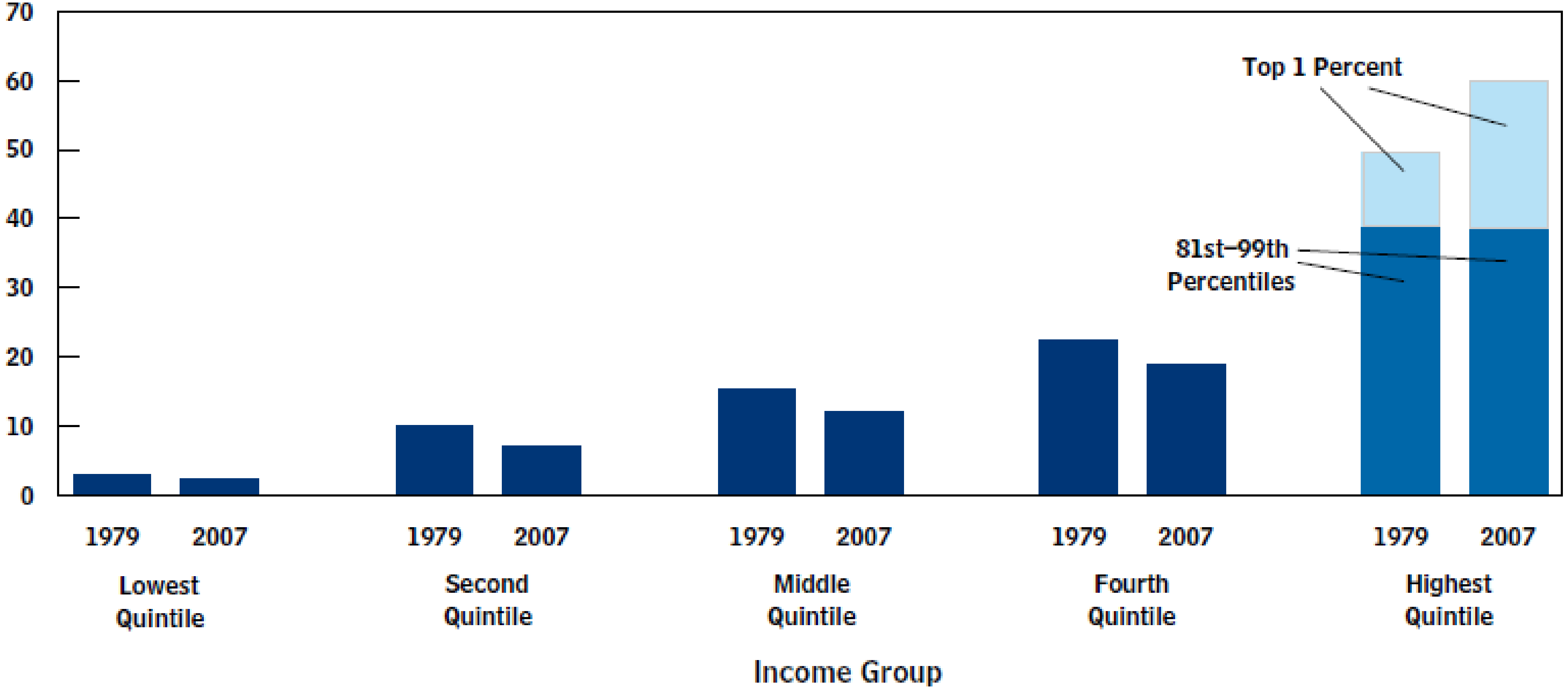


Source: Congressional Budget Office, *Effective Federal Tax Rates: 1979-2007*, June 2010.

CBO REPORT ON INCOME INEQUALITY

Shares of Market Income, 1979 and 2007

(Percent)



Source: Congressional Budget Office.

CAUSES OF INCOME INEQUALITY

What has caused the increase in income inequality in the US?

- There are 2 basic views.
- The first is that growing inequality is due to technological changes and higher rewards going to more highly skilled and educated persons.
  - This view regards the increase in income inequality as inevitable and even desirable and contributes to greater in productivity.
  - Here's a link describing this point of view http://www.pbs.org/newshour/bb/business/july-dec11/makingsense_10-26.html

CAUSES OF INCOME INEQUALITY

What has caused the increase in income inequality in the US?

- The second view that growing inequality is due to the expansion of the finance and banking sectors in the US economy, and the differential rewards in income and tax treatment given to this sector.
    - This view regards the increase in income inequality as <u>not</u> inevitable and reflecting underlying differences in political and economic power or influence.
    - Here's a link describing this point of view. http://billmoyers.com/segment/jacob-hacker-paul-pierson-on-engineered-inequality/

WHAT DO YOU THINK?

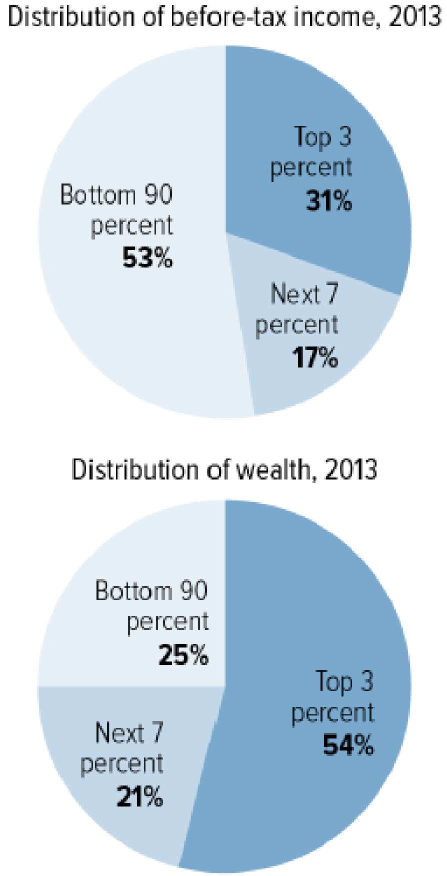
These two views are diametrically opposed.

Which view makes the most sense to you?

WEALTH INEQUALITY

Wealth is much more concentrated at the top than income.

- According to the Survey of Consumer Finances, the top 3% of the *wealth* distribution owned 54% of household wealth in 2013.
- In contrast, the top 3% of the *income* distribution received 31% of income.
- *Note: The top 3% in each distribution is not necessarily the same people.*



Note: Percentages may not add to 100 percent due to rounding.

Source: Survey of Consumer Finances 2014

WEALTH INEQUALITY

Top 10%

- Families in the top 10% held 76% of household wealth in 2013.
- The average wealth for the top 10% was $4 million.

51 to 90th percentiles

- Average wealth = $316,000

26 to 50th percentiles

- Average Wealth = $36,000

Below 25th percentile

- Wealth was negative.
- Average of $13,000 in debt.

WEALTH INEQUALITY

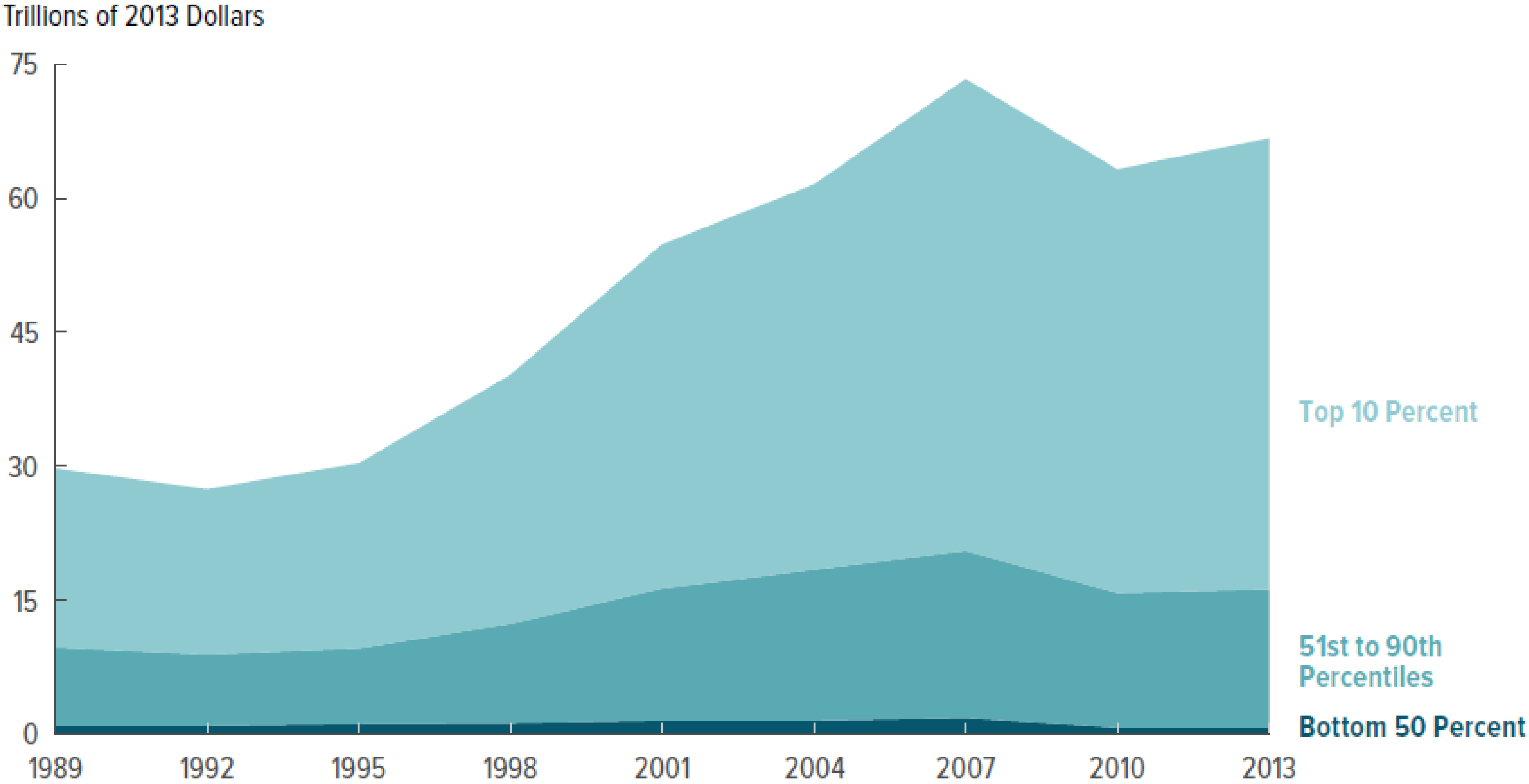
The distribution of wealth is a highly skewed distribution.

This means that there is a big difference between the *mean* and the *median*.

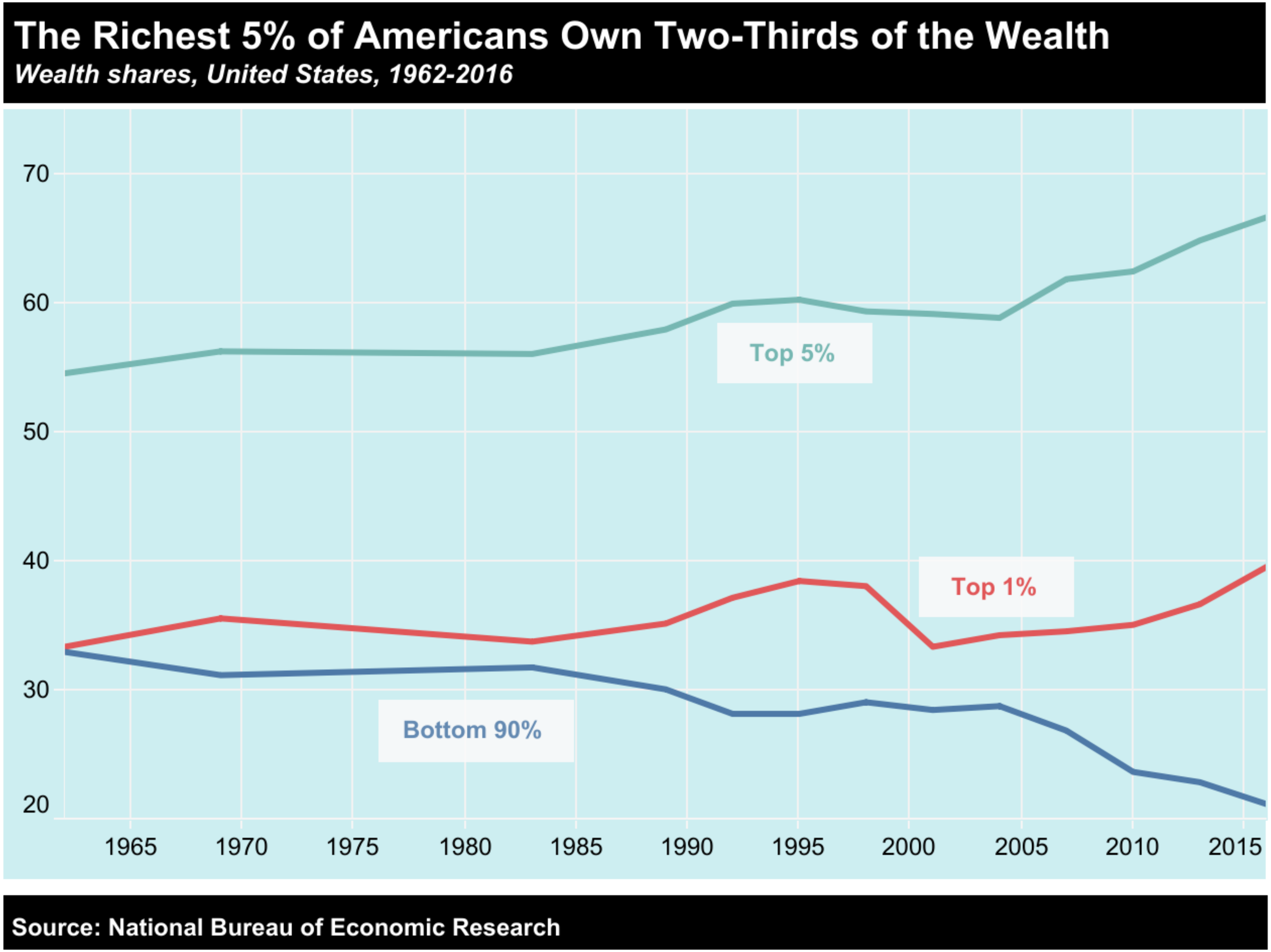
In 2016,

- The median net worth of families was $97,300.
- The mean net worth was $692,100.

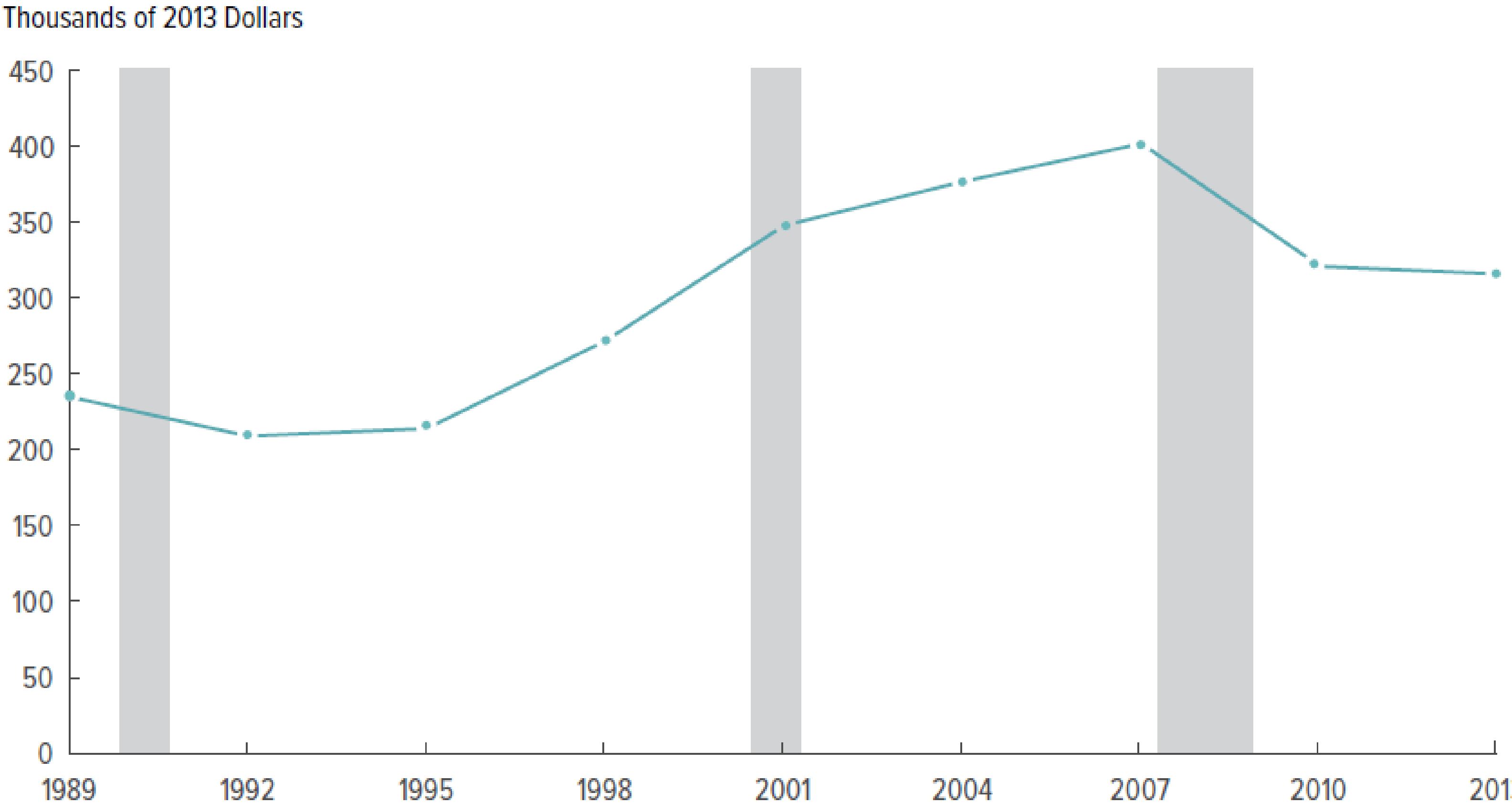
Holdings of Family Wealth, by Wealth Group



Source: Congressional Budget Office, using data from the Survey of Consumer Finances, supplemented with data from *Forbes* magazine's list of the nation's 400 wealthiest people.


The Richest 5% of Americans Own Two-Thirds of the Wealth
Wealth shares, United States, 1962-2016
70
60
50
40
30
20
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
Top 5%
Top 1%
Bottom 90%
Source: National Bureau of Economic Research

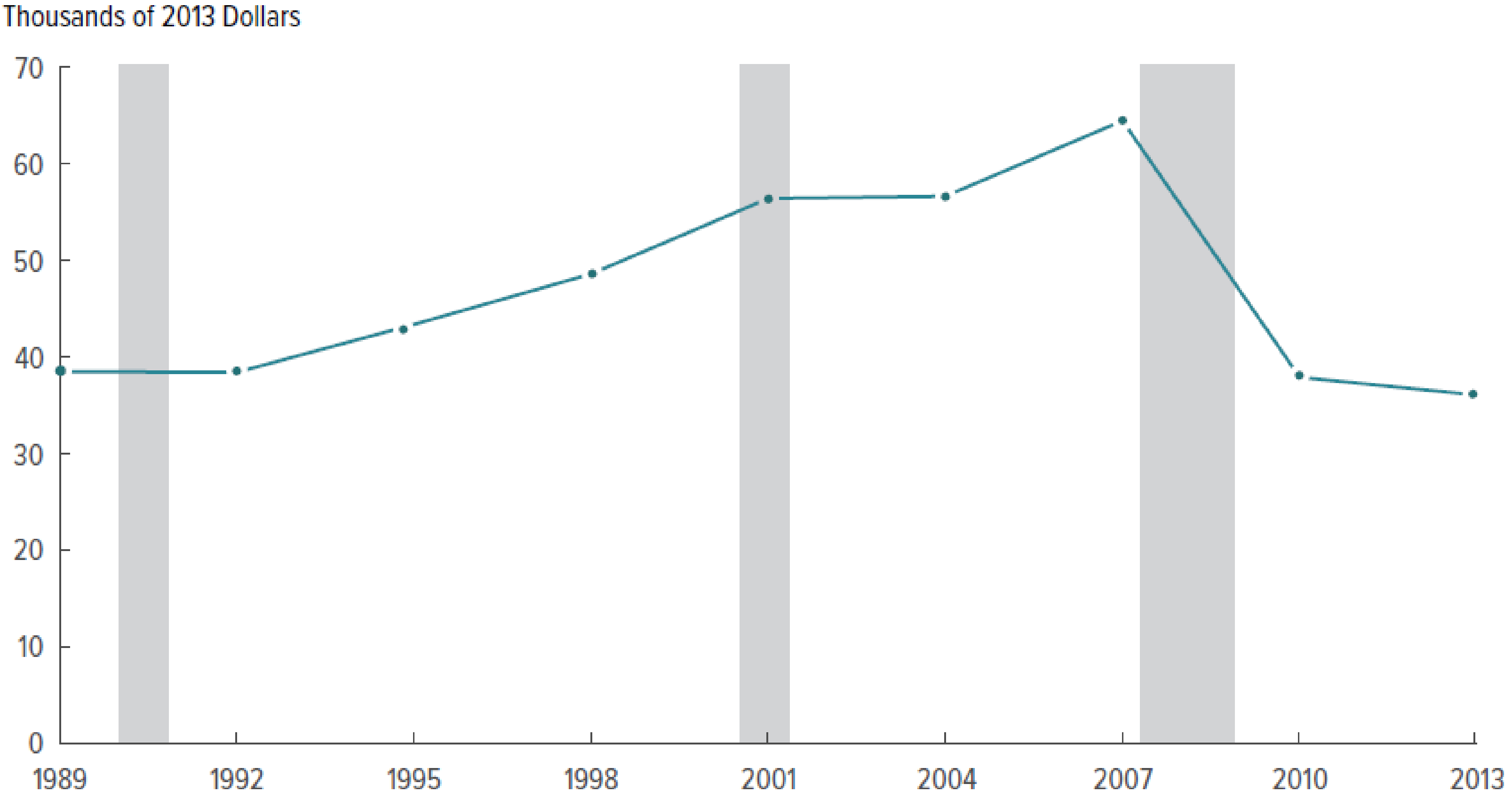
Average Wealth for Families in the 51st to 90th Percentiles of the Wealth Distribution



Source: Congressional Budget Office, using data from the Survey of Consumer Finances.

The Survey of Consumer Finances is conducted every three years.

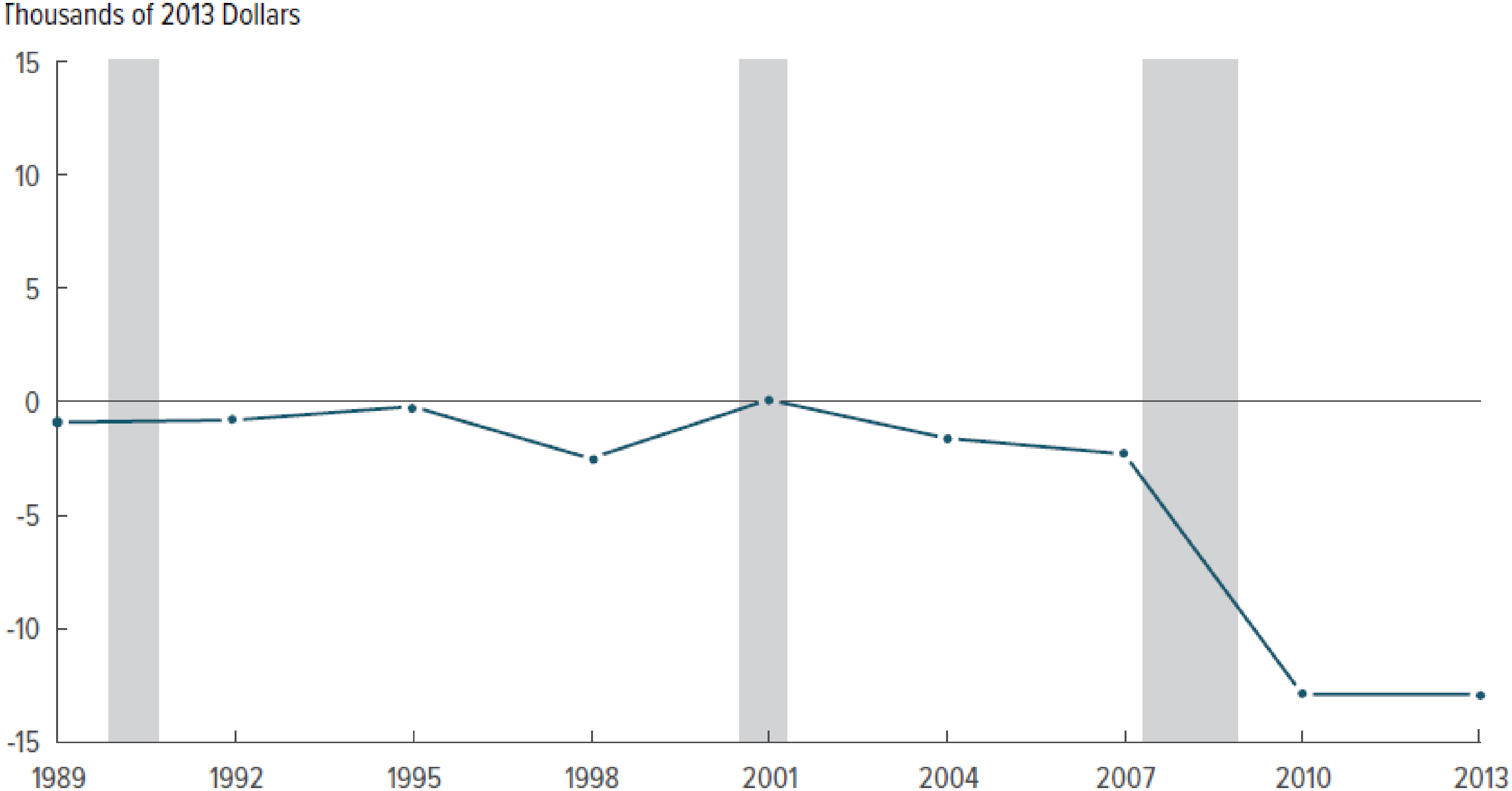
Average Wealth for Families in the 26th to 50th Percentiles of the Wealth Distribution



Source: Congressional Budget Office, using data from the Survey of Consumer Finances.

The Survey of Consumer Finances is conducted every three years.

Average Wealth for Families in the Bottom 25 Percent of the Wealth Distribution



Source: Congressional Budget Office, using data from the Survey of Consumer Finances.

The Survey of Consumer Finances is conducted every three years.