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PRINCIPLES OF  
**ECONOMICS**  
*Eighth Edition*



CHAPTER

20

**Income Inequality  
and Poverty**

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# Income Distribution and Poverty

## Showing the Income Distribution with a Lorenz Curve

**Lorenz curve** A curve that shows the distribution of income by arraying incomes from lowest to highest on the horizontal axis and indicating the cumulative fraction of income earned by each fraction of households on the vertical axis.

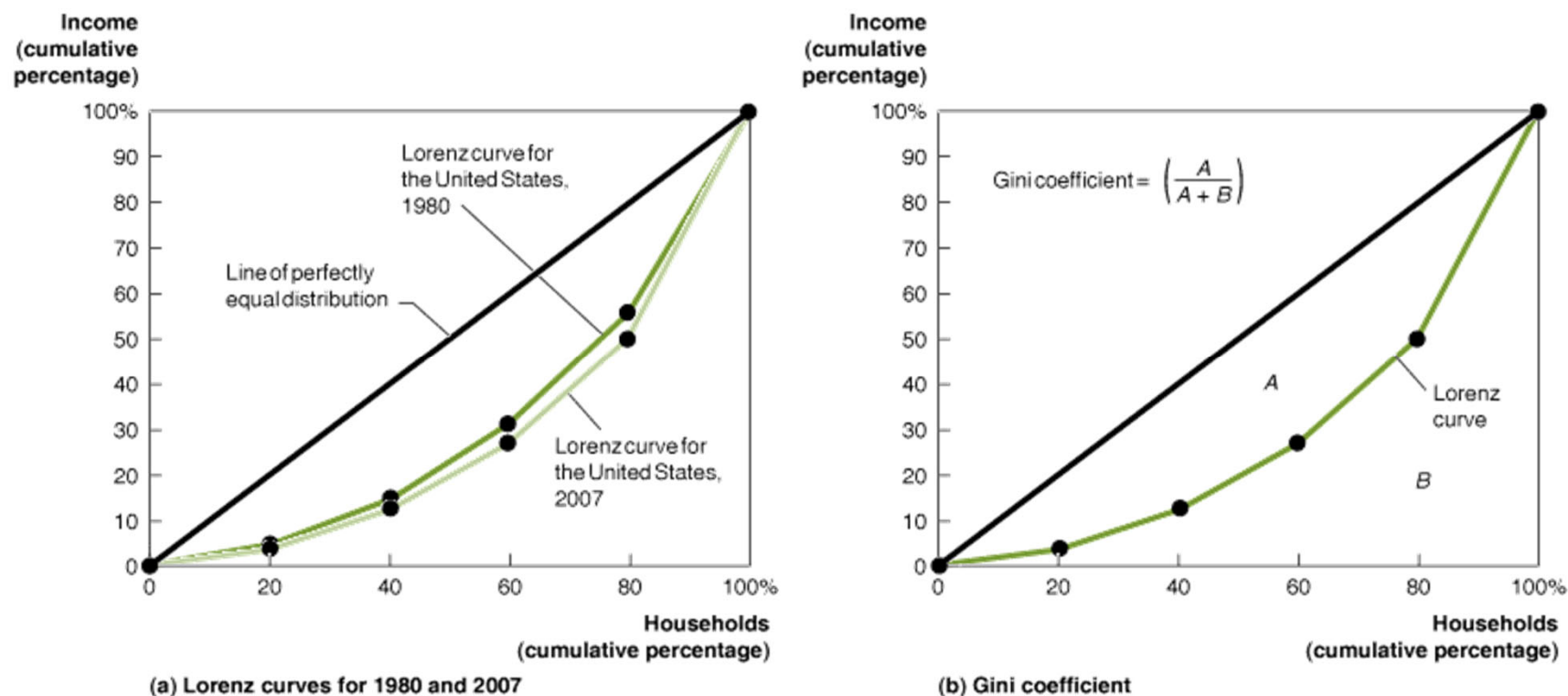
$$\text{Gini coefficient} = \left( \frac{A}{A + B} \right)$$

**18.4 LEARNING OBJECTIVE**

Discuss the distribution of income in the United States and understand the extent of income mobility.

# Income Distribution and Poverty

## Showing the Income Distribution with a Lorenz Curve



**FIGURE 18-6**

### The Lorenz Curve and Gini Coefficient

Because the Lorenz curve for 1980 is closer to the line of perfect equality than the Lorenz curve for 2007, we know that income was more equally distributed in 1980 than in 2007. In panel (b), we show the Gini coefficient. The closer the Gini coefficient is to 1, the more unequal the income distribution.



# Policies to Reduce Poverty

- Poor families more likely to experience
  - Homelessness, drug dependence, health problems, teen pregnancy, illiteracy, unemployment
- Most people believe government should provide a “safety net.”
- We now consider a few such policies...



# 1. Minimum-Wage Laws

- Arguments for:
  - Helps the poor without any cost to government
  - Little impact on employment if demand for unskilled labor is relatively inelastic.
- Arguments against:
  - In the long run, demand for unskilled labor is likely elastic, so minimum wage causes substantial unemployment among the unskilled.
  - Those helped by minimum wage are more likely to be teens from middle-income families than low-income adult workers.





## 2. Welfare

- Welfare: government programs that supplement the incomes of the needy
  - Temporary Assistance for Needy Families (TANF)
  - Supplemental Security Income (SSI)
  - Critics: such programs create incentives to become or remain needy; welfare contributed to the rise of the single-parent family.
  - However, the severity of such incentive problems is unknown.
  - Proponents: inflation-adjusted welfare benefits fell as single-parent families increased.



### 3. Negative Income Tax

- Negative income tax:
  - Tax system that collects revenue from high-income households and gives transfers to low-income households
- The Earned Income Tax Credit (EITC)
  - Is similar to a negative income tax.



## 4. In-Kind Transfers

- In-kind transfers: goods or services provided to the needy
  - Examples: homeless shelters, soup kitchens
  - Supplemental Nutrition Assistance Program (SNAP): Gives low-income families a plastic card that can be used to buy food at stores
  - Medicaid, government-provided healthcare for the poor
- An alternative: cash payments
  - People - buy what they most need; but critics argue could be used for drugs, alcohol





# Anti-Poverty Programs and Work Incentives

- Assistance from anti-poverty programs declines as income rises.
  - The result: Poor families face high effective marginal tax rates (exceeding 100% in some cases!).
  - Such policies therefore discourage the poor from escaping poverty on their own.
- One possible solution: “Workfare,”
  - System requiring people to accept government jobs while collecting benefits.



# Conclusion

- Poverty is one of society's most serious problems.
- Governments can sometimes improve market outcomes.
  - Public policy can help reduce poverty and inequality
- People face trade-offs.
  - Policies designed to improve equity often sacrifice efficiency, so the proper scope of policy is the subject of ongoing controversy