

Inequality in the United States

ECON 499: Economics of Inequality

Winter 2018

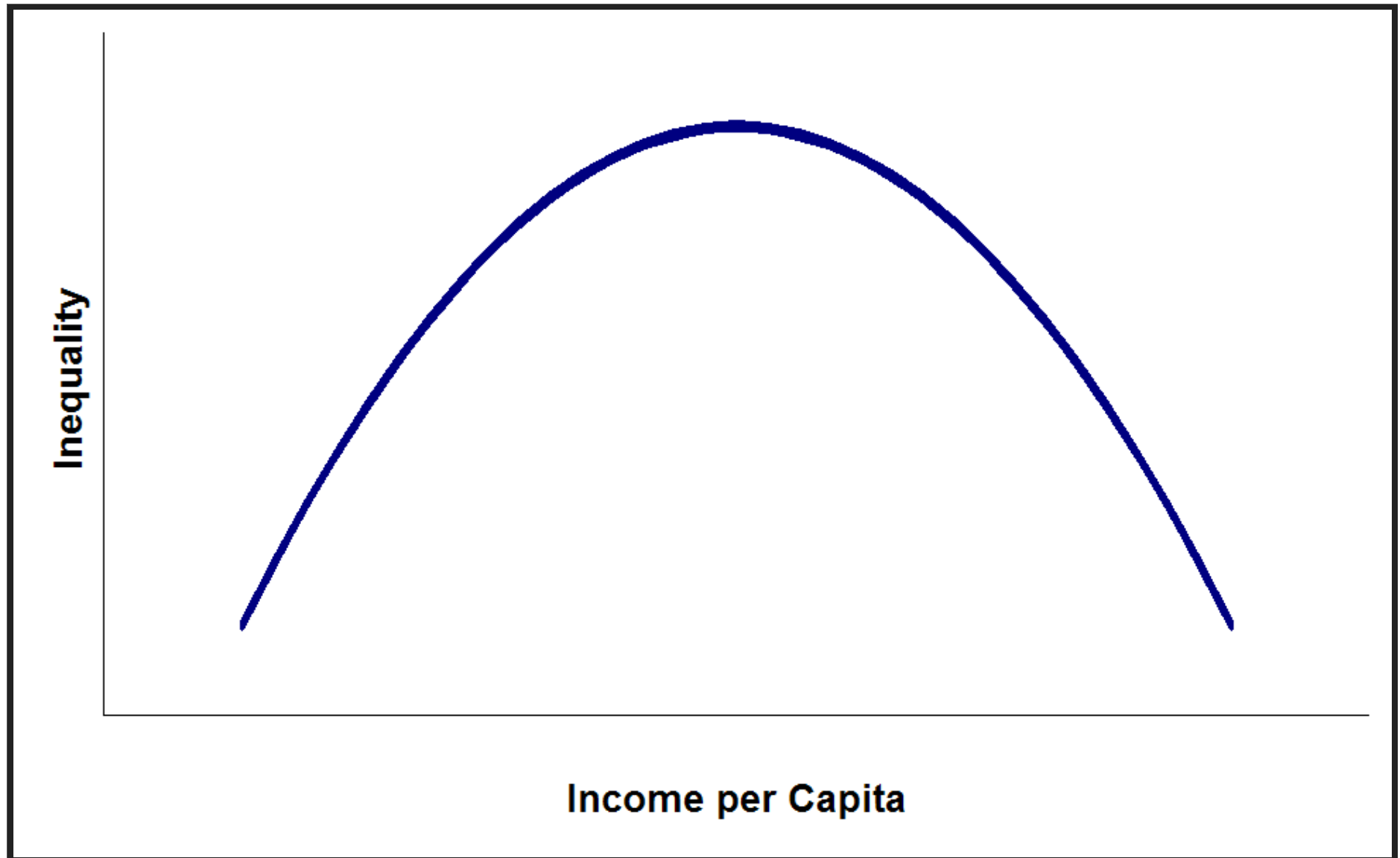
What is inequality?

- We know how to think about inequality theoretically
- How do we measure inequality?
- What can the data tell us?

Kuznets hypothesis

- Poor countries have homogeneous labor, mostly agriculture
- As countries develop, cities become industrial centers
- Creates urban/rural wage gap, increasing inequality
- As development increases, rural workers become educated and move to cities
- Reduces supply of rural workers, increases wages, decreases inequality

Kuznets curve

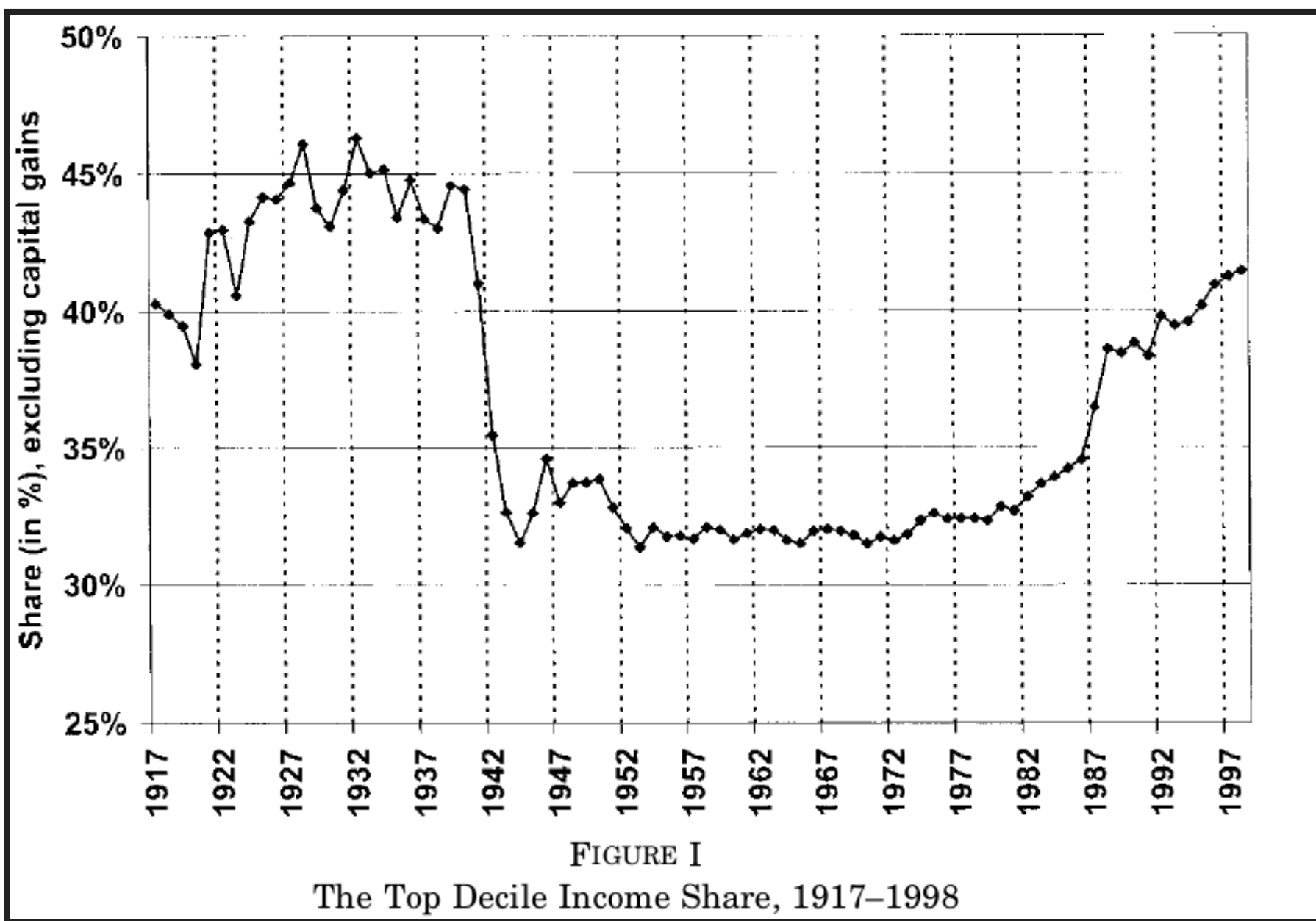


Piketty and Saez, 2003

- "Income inequality in the United States, 1913-1998"
- One of the first papers to estimate long-run evolution of inequality
- Two of the most prominent empirical researchers
- Renewed economists interest in inequality
- Much of these findings are included in Piketty's famous book (which we will talk about later)

Data

- Tax return statistics reported by IRS
- Most people did not pay income tax prior to 1944, so focus on top 10%
- Gross income: Wages, profits, dividends, interest, rents, etc
- Exclude capital gains (people don't sell assets every year, therefore it is "lumpy")
- Calculated before any taxes, deductions, or transfers



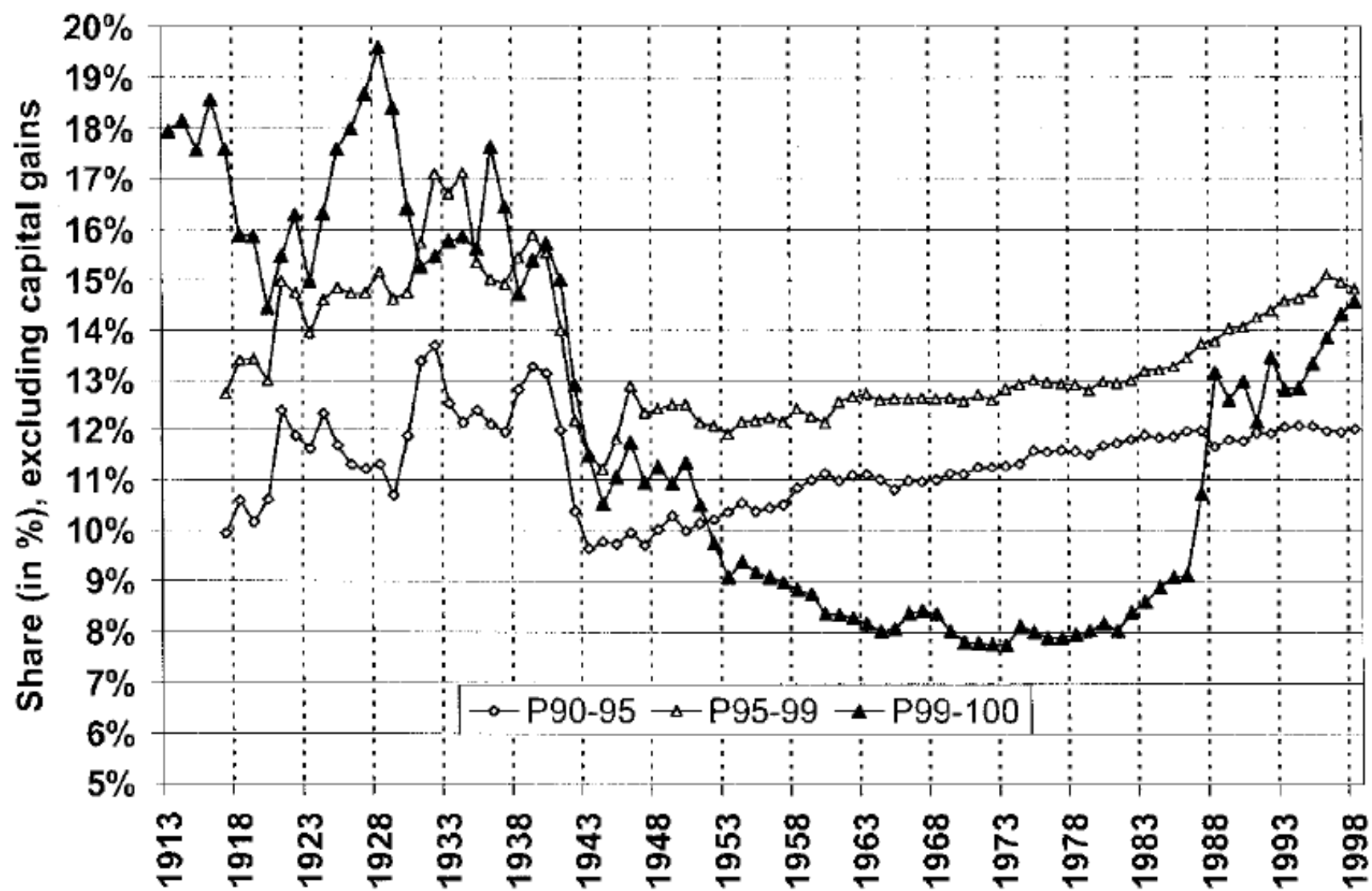


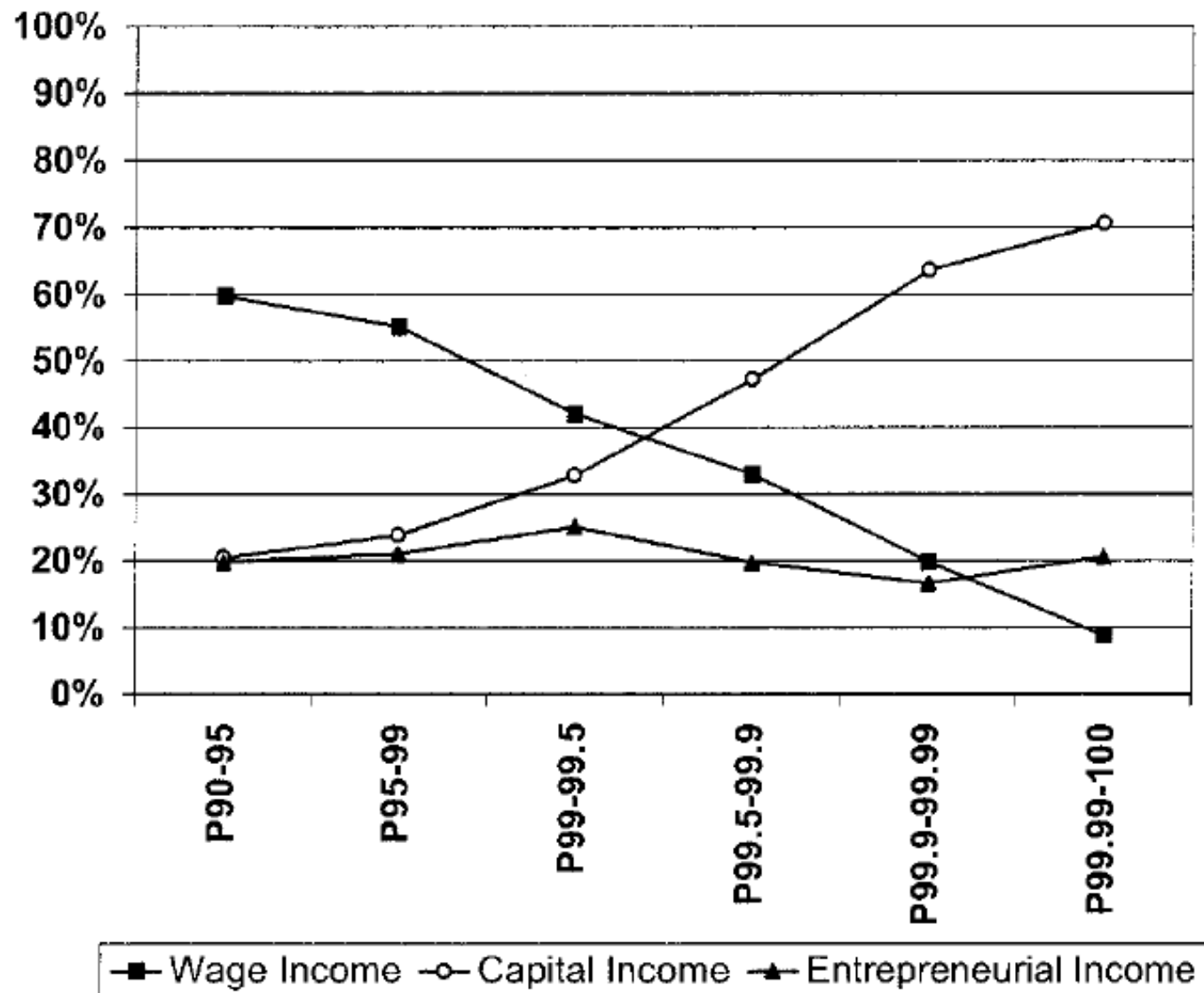
FIGURE II

The Income Shares of P90-95, P95-99, and P99-100, 1913-1998

The fall in top income share

- 1938-1939
- World War II funded primarily through corporate income tax
- Top incomes were mostly earned through capital income

Panel A: 1929



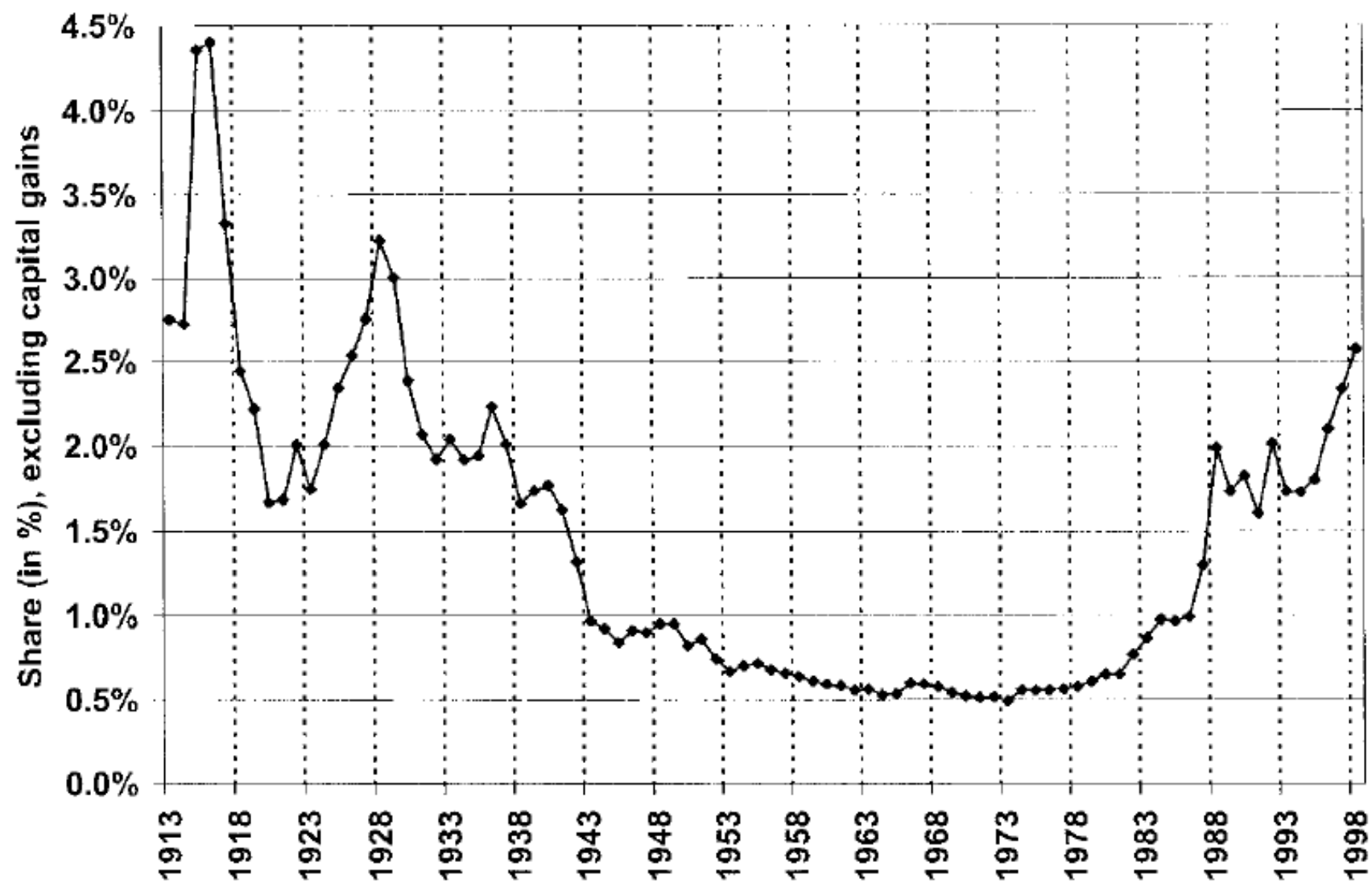
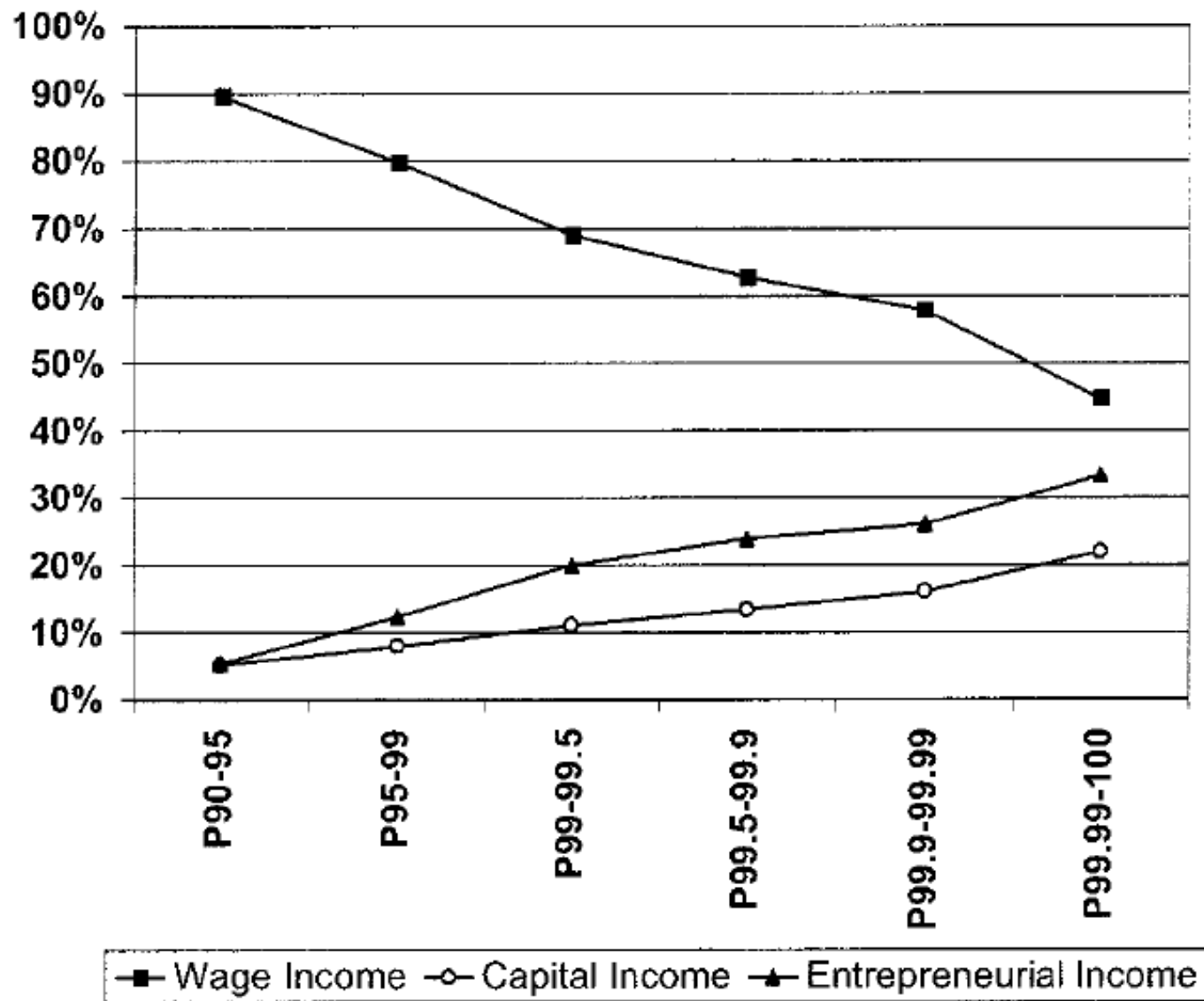


FIGURE III

The Top 0.01 Percent Income Share, 1913–1998

Panel B: 1998



Declining capital incomes

- Capital incomes for the top income earners have declined steadily since WWII
- Capital income is derived from wealth
- After WWII ended, why did capital incomes not recover to previous levels?
- Why are the wealthy not earning as much capital income today?

Progressive taxation: A possible explanation

- Pre WWI taxes are relatively flat, allowed wealth to accumulate
- Great depression and WWII "shocks" decreased the wealth of the top earners
- Progressive taxation and corporate taxes prevented wealth from accumulating to previous levels

The rise in top income after 1970

- Primarily labor income
- Tax Reform Act of 1986: Top marginal tax rate changed from 50% to 28%
- Raised to 39.6% by 1993
- Initial cut coincides with rapid growth of top incomes

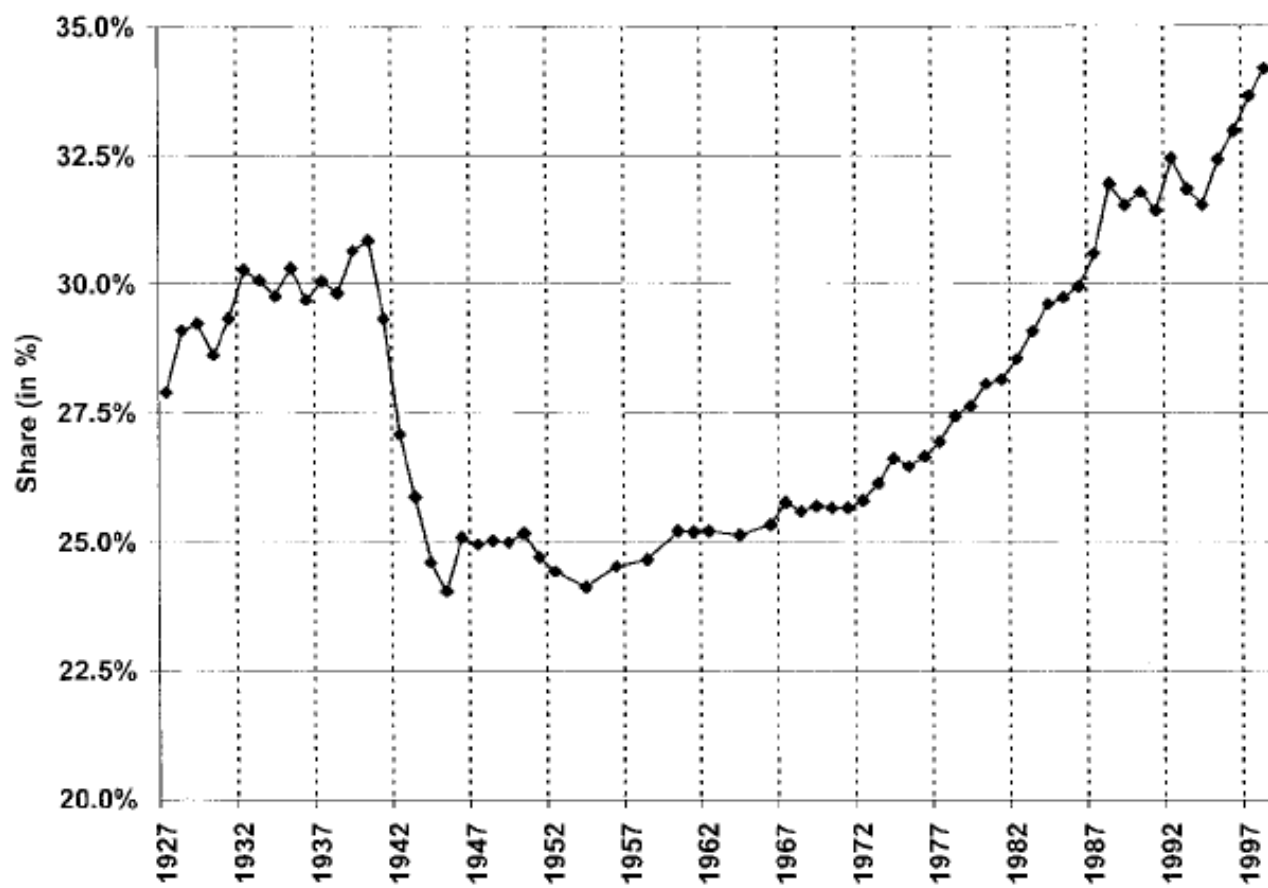


FIGURE VIII
The Top Decile Wage Income Share, 1927–1998

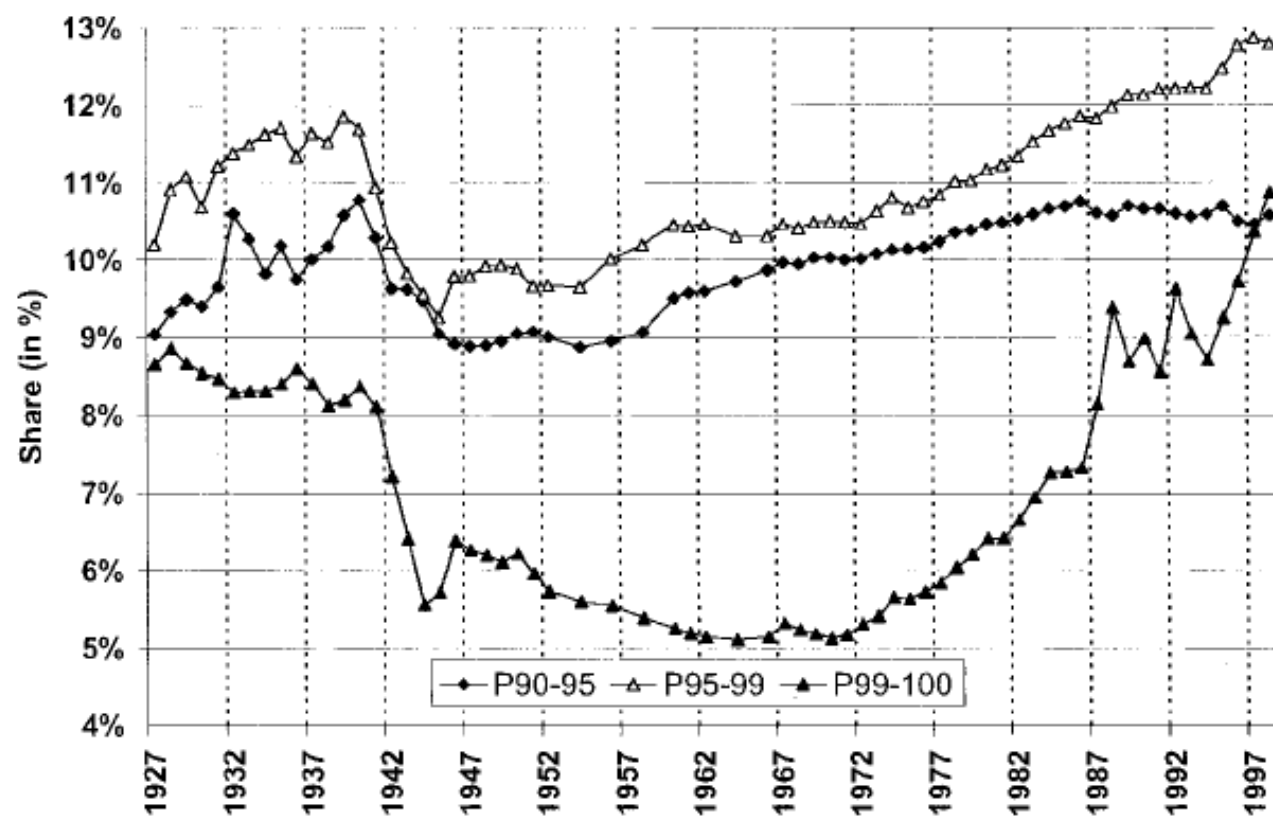


FIGURE IX

Wage Income Shares for P90-95, P95-99, and P99-100, 1927-1998

A mystery?

- It's not clear from the data what is causing the rapid rise in top incomes
- Piketty and Saez speculate that changing social attitudes toward executive pay may be a factor

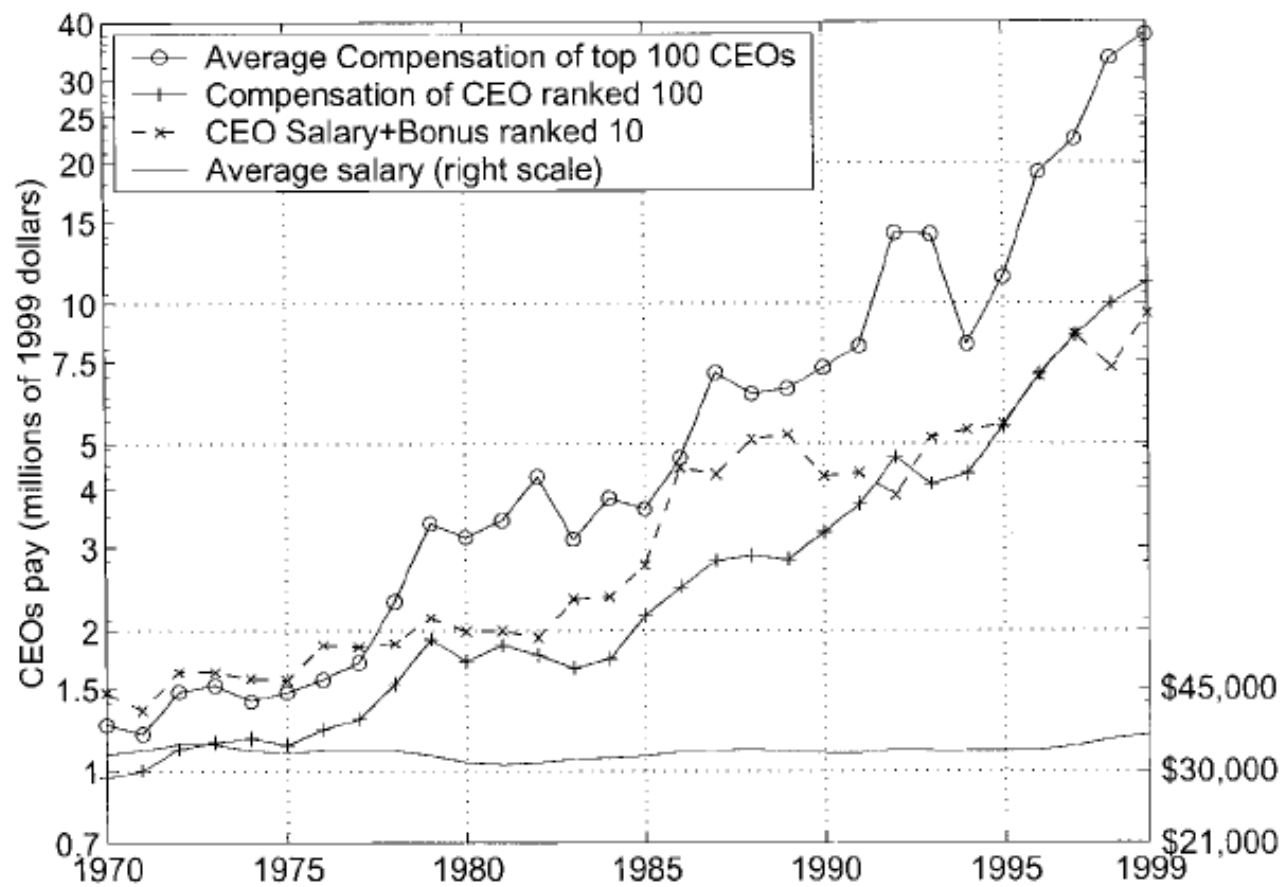


FIGURE XI

CEOs' Pay versus Average Wages, 1970–1999

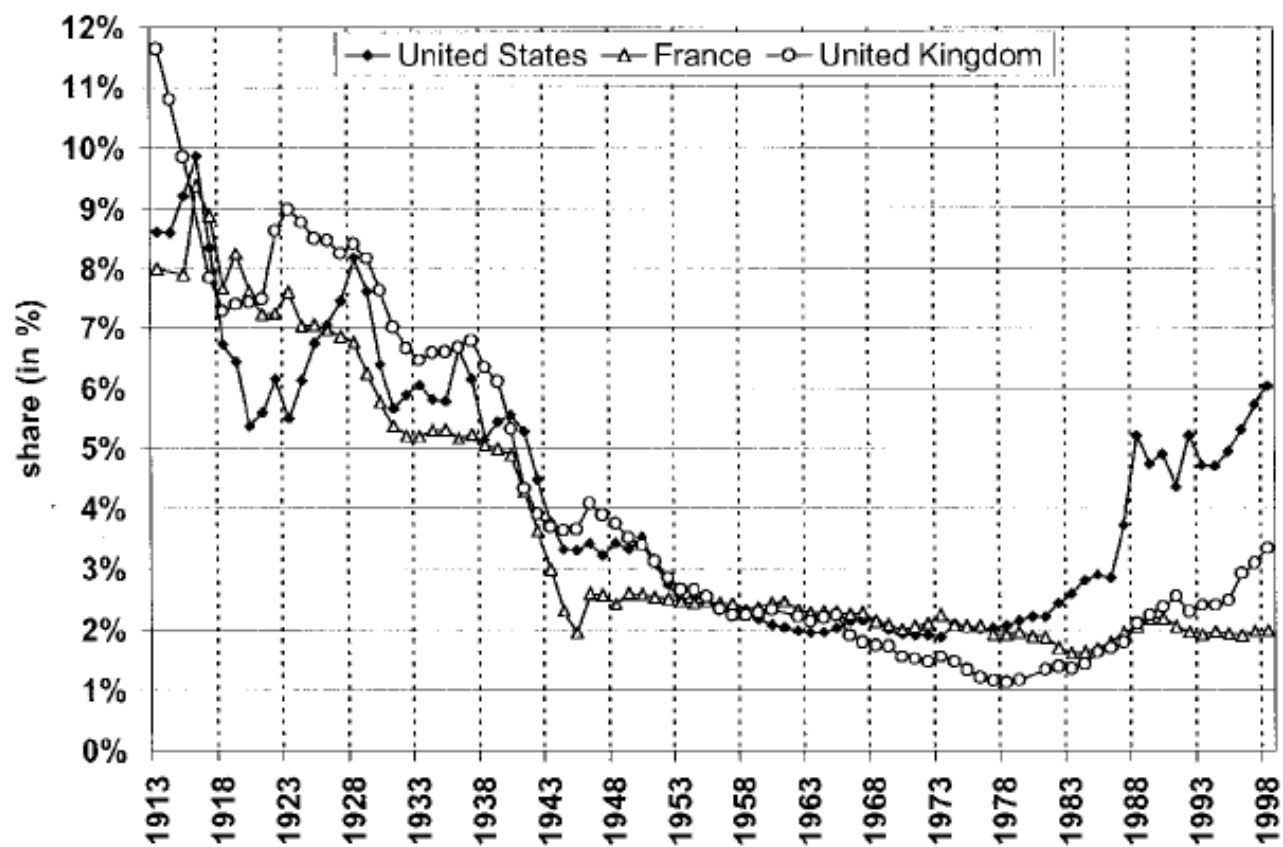


FIGURE XII

Top 0.1 Percent Income Shares in the United States, France, and the United Kingdom, 1913–1998

Critiques of Piketty and Saez

- Only looking at income in the top 10%, ignoring inequality elsewhere in the distribution ("transfer sensitivity" principle)
- The unit of observation is the "tax unit", not weighting observations by number of people, children, etc
- Their definition of income ignores non-market sources

What is income?

- Piketty and Saez:
 - Salaries and wages
 - Capital gains
- Other sources:
 - Benefits
 - Taxes
 - "In kind" transfers

Market vs comprehensive income

- Market income:
 - The pre-tax compensation earned in exchange for selling labor
 - Income from capital: profits, interest, etc
- Comprehensive income:
 - Market income plus "everything else"
 - The total money received that can be used to purchase goods and services

Healthcare

- A large non-market source of income
- People need to consume health services whether or not they have insurance
- Employer-provided insurance isn't included in wages, by allows people to consume more than they otherwise could
- Kaestner and Lubotsky (2016), optional on Canvas

Healthcare facts

- Healthcare expenses were 17% of GDP in 2014
- 70% of expenses paid by public or private insurance (not out-of-pocket)
- 36% of all expenses paid by Federal programs Medicaid and Medicare
- Average Medicaid recipient receives \ \$9,125 per year (family of 3)

Medicare

- Covers nearly all citizens age 65 and older
- Covers some disabled citizens under 65
- Financed by 2.9% payroll tax (+0.9% for high income earners)
- Average beneficiary receives \ \$11,400
- Adults over 65 generally have lower income than those under 65
- Transfer from relatively high incomes to lower incomes
- Reduces inequality (principle of transfers)

Medicaid

- Provides insurance for low income families
- Covers 60 million people
- Reduces inequality

*Table 1***Medicare and Medicaid Participation Rates by Decile of Adjusted Family Income**

<i>Decile of adjusted family income</i>	<i>Medicare participation rate (%)</i>			<i>Medicaid participation rate (%)</i>		
	<i>1995</i>	<i>2004</i>	<i>2012</i>	<i>1995</i>	<i>2004</i>	<i>2012</i>
Bottom decile	7.2	9.8	8.4	44.8	35.7	41.6
2	23.3	23.8	21.6	22.7	23.4	31.6
3	21.4	23.1	24.8	9.2	13.2	17.7
4	18.5	18.4	22.0	4.6	7.6	11.0
5	14.5	13.8	16.9	2.8	3.9	6.5
6	10.7	10.1	13.7	1.5	2.6	3.8
7	8.7	8.7	12.5	0.8	1.5	2.2
8	7.3	6.9	10.5	0.6	1.0	1.5
9	6.2	6.8	9.3	0.6	0.6	0.8
Top decile	6.6	6.5	9.3	0.5	0.4	0.8

Affordable Care Act

- Allows states to expand Medicaid coverage (many don't)
- Offers subsidies to people with less than 400% federal poverty level
- Increased the coverage for low-income workers
- Reduces inequality

Table 2

Health Insurance Coverage Rates of the Nonelderly in 2012 and 2014 by Decile of Adjusted Family Income

<i>Decile of adjusted family income</i>	<i>Fraction uninsured</i>			<i>Fraction on Medicaid</i>			<i>Fraction with private insurance</i>		
	<i>2012</i>	<i>2014</i>	<i>Δ 2014– 2012</i>	<i>2012</i>	<i>2014</i>	<i>Δ 2014– 2012</i>	<i>2012</i>	<i>2014</i>	<i>Δ 2014– 2012</i>
Bottom decile	39.3%	31.1%	–8.2	43.1%	47.6%	4.5	22.7%	26.5%	3.8
2	37.8	28.3	–9.5	34.4	38.9	4.5	34.3	40.0	5.7
3	30.9	23.3	–7.6	21.6	23.9	2.3	54.8	60.4	5.6
4	22.5	16.5	–6.0	15.3	17.1	1.8	69.2	73.6	4.4
5	15.5	11.8	–3.7	12.3	13.1	0.8	79.1	81.8	2.7
6	11.1	8.4	–2.7	9.9	11.1	1.2	85.3	87.0	1.7
7	7.8	6.1	–1.7	8.7	8.9	0.2	89.7	90.8	1.1
8	5.6	4.3	–1.3	7.4	7.7	0.3	92.6	93.4	0.8
9	4.1	3.3	–0.8	6.5	6.7	0.2	94.8	95.1	0.3
Top decile	2.8	2.3	–0.5	5.1	5.2	0.1	96.4	96.6	0.2

Employer provided healthcare

- Most middle and high-income earners receive insurance through their employer
- Employee contributions untaxed – increases income of middle and top earners
- Increases inequality

Figure 1

Average Tax Subsidy for Employer-Provided Health Insurance by Decile of Adjusted Family Income

