In this chapter, look for the answers to these questions:

- How much inequality and poverty exist in our society?
- What are the problems measuring inequality?
- What are some of the leading philosophies on the proper role of government in altering the distribution of income?
- What policies are used to fight poverty? What are the problems with these policies?

Introduction
From the previous two chapters:

- Equilibrium wages equal

- Differences in equilibrium wages result from differences in
  - worker characteristics: education, experience, talent, effort
  - job characteristics: extent to which a job is pleasant and safe

- Some earnings differences due to discrimination.
Introduction

Even in the absence of discrimination, the income distribution in a market economy may not be equitable or otherwise desirable.

In this chapter, we examine indicators of inequality and poverty, philosophies about income redistribution, and policies designed to help the poor.

The U.S. Income Distribution: 2006

<table>
<thead>
<tr>
<th>Group</th>
<th>Annual household income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bottom fifth</td>
<td>Under $20,035</td>
</tr>
<tr>
<td>Second fifth</td>
<td>$20,035 – $37,774</td>
</tr>
<tr>
<td>Middle fifth</td>
<td>$37,774 – $60,000</td>
</tr>
<tr>
<td>Fourth fifth</td>
<td>$60,000 – $97,032</td>
</tr>
<tr>
<td>Top fifth</td>
<td>$97,032 and over</td>
</tr>
<tr>
<td>Top 5 percent</td>
<td>$174,012 and over</td>
</tr>
</tbody>
</table>

U.S. Inequality Over Time

Income share of the top 20% divided by income share of the bottom 20%
Inequality Around the World

Income share of the top 10% divided by income share of the bottom 10%

INCOME INEQUALITY AND POVERTY

Poverty

- Poverty line:
- Poverty rate:

Poverty in 2006 in the U.S.:
- Median family income = $58,526
- Poverty line for family of four = $20,614
- Poverty rate = 12.3%

U.S. Poverty Over Time

Percent of the population below poverty line

INCOME INEQUALITY AND POVERTY
**U.S. Poverty Rate by Group, 2006**

<table>
<thead>
<tr>
<th>Group</th>
<th>Poverty Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>All persons</td>
<td>12.3%</td>
</tr>
<tr>
<td>White, not Hispanic</td>
<td>8.2</td>
</tr>
<tr>
<td>Black</td>
<td>24.3</td>
</tr>
<tr>
<td>Hispanic</td>
<td>20.6</td>
</tr>
<tr>
<td>Asian</td>
<td>10.3</td>
</tr>
<tr>
<td>Children</td>
<td>17.4</td>
</tr>
<tr>
<td>Elderly</td>
<td>9.4</td>
</tr>
<tr>
<td>Married-couple families</td>
<td>4.9</td>
</tr>
<tr>
<td>Female household, no spouse present</td>
<td>28.3</td>
</tr>
</tbody>
</table>

**Problems Measuring Inequality**

1. **In-kind transfers:**
   - Omitted from measures of inequality and poverty, biasing them upward

2. **The Life Cycle:**
   - People can borrow and save to offset life-cycle changes in income (e.g., saving for retirement).
   - Life-cycle income variation causes inequality in income but not inequality in living standards.

3. **Transitory vs. Permanent Income:**
   - People can borrow and save to smooth out *transitory* income fluctuations.
   - A better measure of inequality in living standards would be based not on current income, but on

4. **Economic mobility:**
   - Many people move among income classes.
   - The poverty and inequality measures discussed above do not distinguish between the temporarily poor and the persistently poor.
The Political Philosophy of Redistributing Income

We consider three philosophies:
- Utilitarianism
- Liberalism
- Libertarianism

Utilitarianism
- Utility:
- Utilitarianism:
  - Founders: Jeremy Bentham, John Stuart Mill
  - Because of diminishing marginal utility, redistributing income from rich to poor
  - Yet, utilitarians do not advocate equalizing incomes – would reduce total income of everyone due to incentive effects and efficiency losses.

Liberalism
- Liberalism:
  - Founder: John Rawls
  - Maximin criterion:
    - Calls for more redistribution than utilitarianism (though still not complete equalization of incomes).
    - Income redistribution is a form of social insurance.
Libertarianism

- **Libertarianism:**
  - Advocate: Robert Nozick
  - Instead of focusing on outcomes, libertarians focus on
    - Govt should enforce
  - If the income distribution is achieved fairly, gov't

Policies to Reduce Poverty

- Poor families more likely to experience
  - Homelessness
  - Drug dependence
  - Health problems
  - Teen pregnancy
  - Illiteracy
  - Unemployment
- Most people believe gov't should provide a "safety net."
- We now consider a few such policies...

1. Minimum-Wage Laws

- Arguments for:

- Arguments against:
2. Welfare

- Welfare:
  - Temporary Assistance for Needy Families (TANF)
  - Supplemental Security Income (SSI)
  - Critics argue that such programs

- However, the severity of such incentive problems is unknown.
- Proponents note that inflation-adjusted welfare benefits fell as single-parent families increased.

3. Negative Income Tax

- Negative income tax:

- Example: Taxes owed =
  - If earnings = $90,000, taxes owed = $20,000
  - If earnings = $60,000, taxes owed = $10,000
  - If earnings = $30,000, taxes owed =
  - If earnings = $15,000, taxes "owed" =

- The Earned Income Tax Credit (EITC) is similar to a negative income tax.

4. In-Kind Transfers

- In-kind transfers are goods or services provided to the needy. Examples:
  - Homeless shelters
  - Soup kitchens
  - Food stamps, govt vouchers redeemable for food at grocery stores
  - Medicaid, govt-provided healthcare for the poor
  - An alternative: cash payments
Anti-Poverty Programs and Work Incentives

Assistance from anti-poverty programs declines as income rises.

The result:

Such policies therefore discourage the poor from escaping poverty on their own.

One possible solution:

CONCLUSION

Poverty is one of society’s most serious problems.

One of the Ten Principles from Chapter 1:

Governments can sometimes improve market outcomes.

Public policy can help reduce poverty and inequality.

Another principle: People face trade-offs.

so the proper scope of policy is the subject of ongoing controversy.