



Income Inequality and Economic Policy

Chapter 12

In this Chapter

- Income versus wealth inequality;
- The elephant chart and the losers of globalization;
- Multidimensional poverty;
- Free trade and income inequality;
- Fossil fuel subsidies and social welfare;
- Universal basic income and its possible impact in the world.



Chapter 1 2.1

Income Inequality and Wealth
Inequality

Wealth Vs. Income Inequality

Wealth inequality

- ❑ Often mis-cited;
- ❑ Not as concerning to many economists;
- ❑ Affected by changes in income inequality;
- ❑ Likely changes slower than income inequality.

Income inequality

- ❑ Measured by the Gini Coefficient;
- ❑ Concerning for economists;
- ❑ Affected by tax structure, economic growth, public policy.

Gini Coefficient

Can vary from 0 to 1, with 0 being perfect income equality, when every individual earns the same amount, and 1, extreme inequality, where one individual gets all income from society. In reality, countries fall in the 0.2 to 0.7 interval.



Income Inequality in Developed and Developing Countries

Developed Countries

- ❑ Problematic because slower growth can lead to growing inequality, and upward distribution of economic gains
- ❑ Many developed countries have policies designed to lower gini coefficients
- ❑ Norway—low Gini score for developed country
- ❑ USA—high Gini score for a developed country

Developing Countries

- ❑ Development often leads to worse income inequality at first.
- ❑ Terrible income inequality in developing countries is often tied to poor institutions and rampant corruption.
- ❑ Ukraine—low gini score for middle-income country
- ❑ Honduras—high Gini score for a middle-income country

Income Inequality In Developed Countries

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Income Inequality in Developing Countries

- ❑ Development often leads to worse income inequality, so developing countries (theoretically) should be less worried about income inequality during developmental periods
- ❑ Terrible income inequality in developing countries is often tied to poor institutions and rampant corruption.
- ❑ Ukraine—low gini score for poorer country
- ❑ Honduras—high Gini score for poorer country



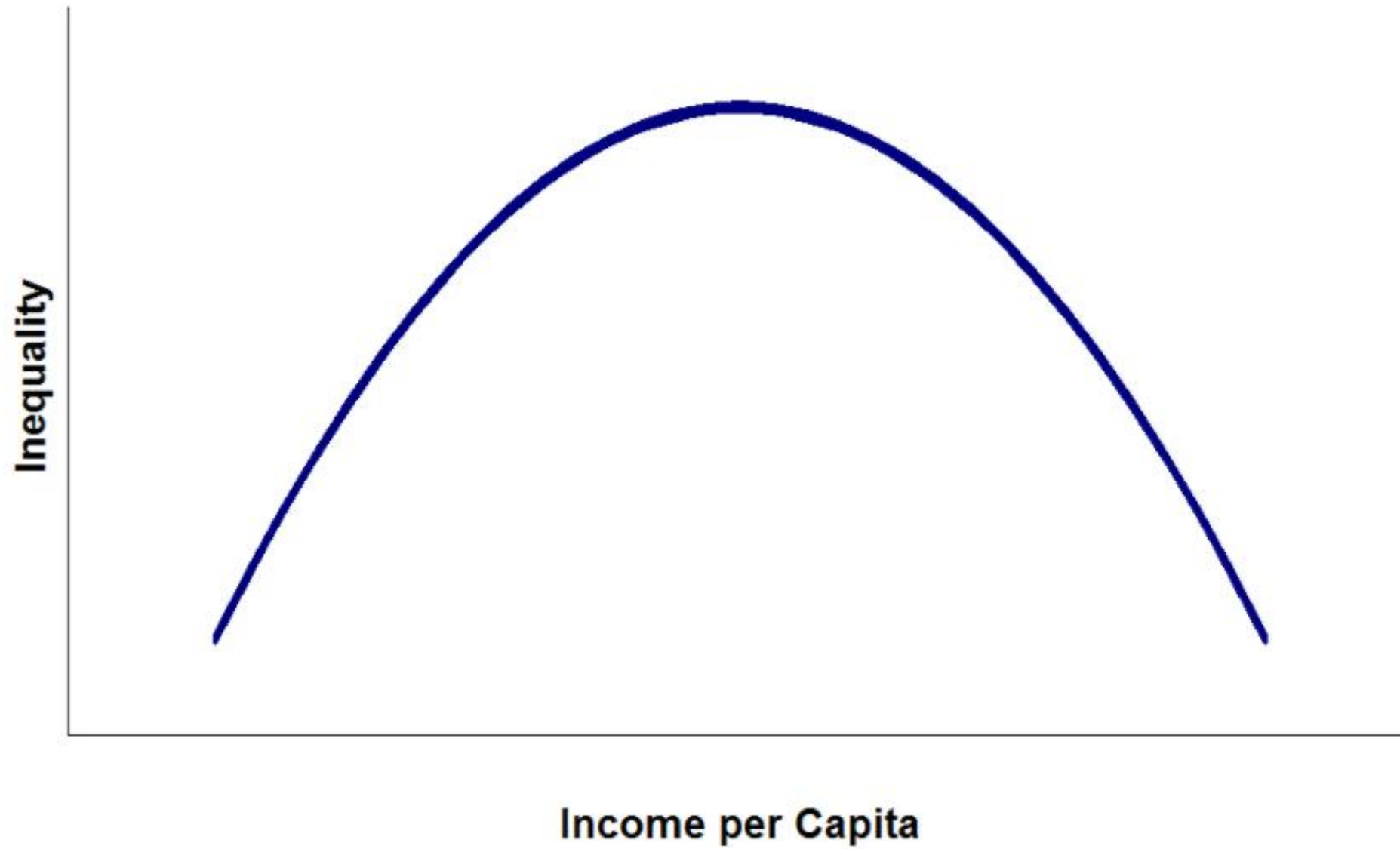
Kuznets Curve

The Kuznets Curve is a hypothetical representation of the idea that as countries develop, economic inequality first increases, then decreases.

Hypothetical is an important qualifier, because it does not always hold true.



Kuznets Curve



Countries by Gini Coefficient

Top 10 Best and Worst Countries in terms of Income Inequality, 2010s (average)

Country	Income Equal	Country	Income Unequal
Ukraine	0.25	Guinea-Bissau	0.51
Slovenia	0.25	Rwanda	0.51
Norway	0.26	Panama	0.52
Czech Republic	0.26	Brazil	0.53
Slovak Republic	0.27	Colombia	0.54
Iceland	0.27	Lesotho	0.54
Sweden	0.27	Honduras	0.55
Belarus	0.27	Zambia	0.56
Kazakhstan	0.27	Haiti	0.61
Finland	0.28	South Africa	0.63

Globalization and Income Inequality

- ❑ Globalization is a boon to global economic growth, but it has winners and losers
- ❑ In developed countries, high-skilled, high income workers benefit from globalization. Lower-skilled laborers tend to lose out as they are more easily replaced by workers from elsewhere.
- ❑ In developing countries, the effect is reversed.
- ❑ Globalization can lower global income inequality while worsening it in developed countries



Chapter 1 2.2

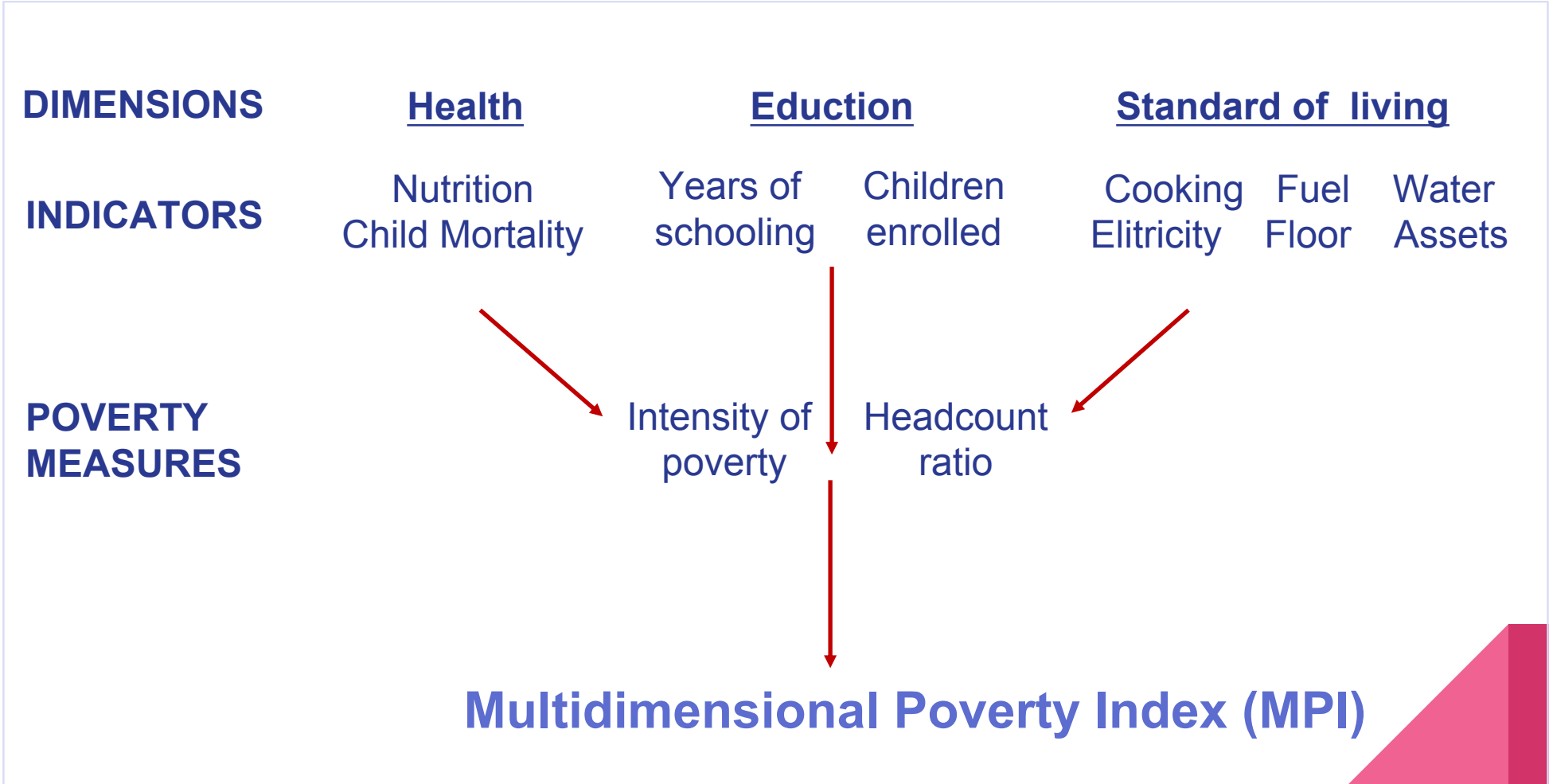
Multidimensional
Inequality and poverty
around the world

Multidimensional Inequality

- ❑ Though income is the primary economic measure of inequality, income inequality is not the only policy measure of inequality
- ❑ There are other indices to check for the wellbeing of individuals and the corresponding inequality between these wellbeing
 - Multidimensional Poverty index
 - Human Development Index

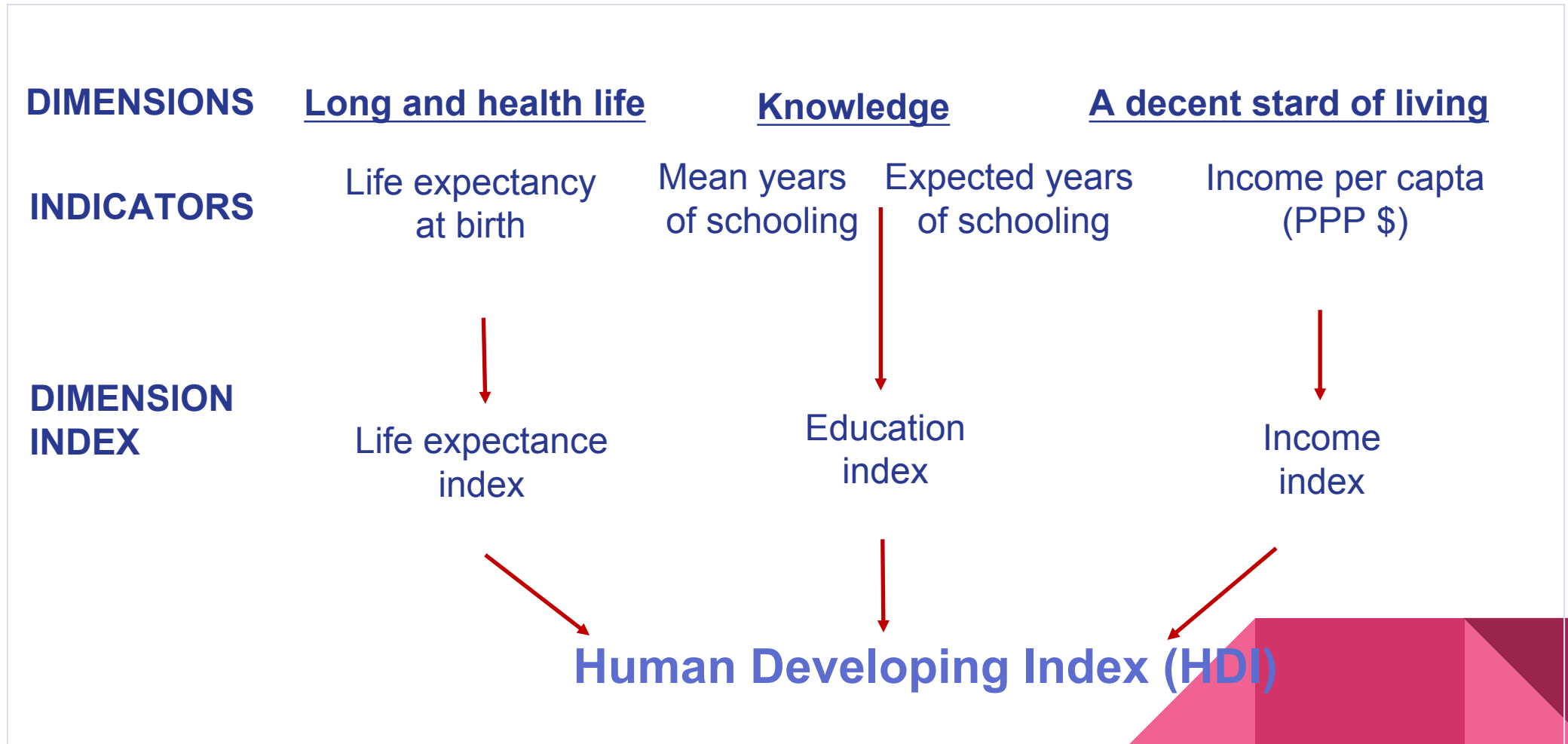


Multidimensional Poverty Index



Source: UNDP (2017).

Human Development Index



Source: UNDP (2017).

Important Global Trends

Extreme Poverty has been halved, globally

Income inequality has increased faster than consumption inequality—(leads to wealthy individuals accumulating more savings, and worsening wealth inequality)

- ❑ Pressing problem for poor countries: *Poverty*
- ❑ Pressing problem for middle income countries: *Poverty and income inequality*
- ❑ Pressing problem for developed countries: *income inequality*



Multidimensional poverty in Africa.

		Population in multidimensional poverty		Population living below income poverty line (%)	
	Survey	Headcount	Intensity of deprivation	National poverty line	PPP \$1.25 a day
Country		(thousands)	(%)	2004–2014	2002–2012
Congo	2014	50,312	50.8	63.6	87.7
Madagascar	2009	15,774	54.6	75.3	87.7
Liberia	2013	3,010	50.8	63.8	83.8
Burundi	2010	7,553	54.0	66.9	81.3
Zambia	2014	8,173	48.6	60.5	74.3
Malawi	2010	10,012	49.8	50.7	72.2
Rwanda	2010	7,669	49.7	44.9	63.0
Central African Rep.	2010	3,320	55.6	62.0	62.8
Nigeria	2013	88,425	54.8	46.0	62.0
Mozambique	2011	17,246	55.6	54.7	60.7
Sierra Leone	2013	4,724	53.0	52.9	56.6
Lesotho	2009	984	45.9	57.1	56.2
Togo	2014	3,394	49.9	58.7	52.5

Chapter 1 2.3

Distributional Effects of
Monetary and Fiscal
Policies.

Distributional Effects of Monetary Policy

- ❑ Most economic policies have effects on inequality, if only secondarily.
- ❑ Improper monetary policy leading to inflation disproportionately harms poorer people.
 - The end of hyperinflation in latin american countries led to significant drops in income inequality across the region.



Distributional Effects of Fiscal Policy

- ❑ Fiscal policy has more direct effects on inequality
- ❑ Tax code and tax bracket structuring can be progressive, flat, or regressive
- ❑ Austerity measures (which often cut social safety nets) have significant effects on worsening income inequality
- ❑ Evidence suggests that spending adjustments have more direct effects on equality than taxation measures



Case Study: Brazil's Bolsa Familia

- ❑ Conditional Cash Transfer;
- ❑ Launched in 2004;
- ❑ Transferred an average of \$50 a month to 13.7 million families;
- ❑ Cost less than 1 % of GDP;
- ❑ Aimed at bringing Brazilian people out of poverty.



Bolsa Familia's requirements and disbursements.

Extreme poverty: family per capita income of U\$34 per month.

Poverty: per capita income of U\$68 per month.

Basic benefit: U\$33 per month.

Variable benefit based on pregnant women, children below 15 years of age (conditional on schooling enrollment and 80% classes frequency): U\$15 to U\$32 per month.

Teenagers up to 17 years: U\$15 to U\$32 per month.

No family may receive more than U\$100 per month

Source: Brazilian Ministry of Social Development (2017).



Bolsa Familia Results

- ❑ Instrumental in taking millions out of poverty.
- ❑ Helped bring Brazil's Gini Coefficient from .596 in 2001 to .519 in 2012.
- ❑ Should be phased out as Brazilian economy matures, but because of its public popularity, it will be tough to remove.

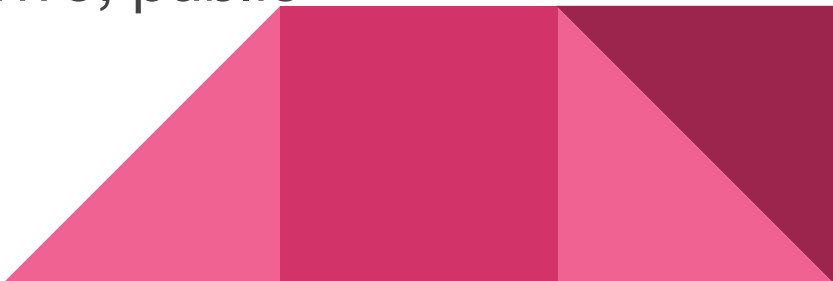


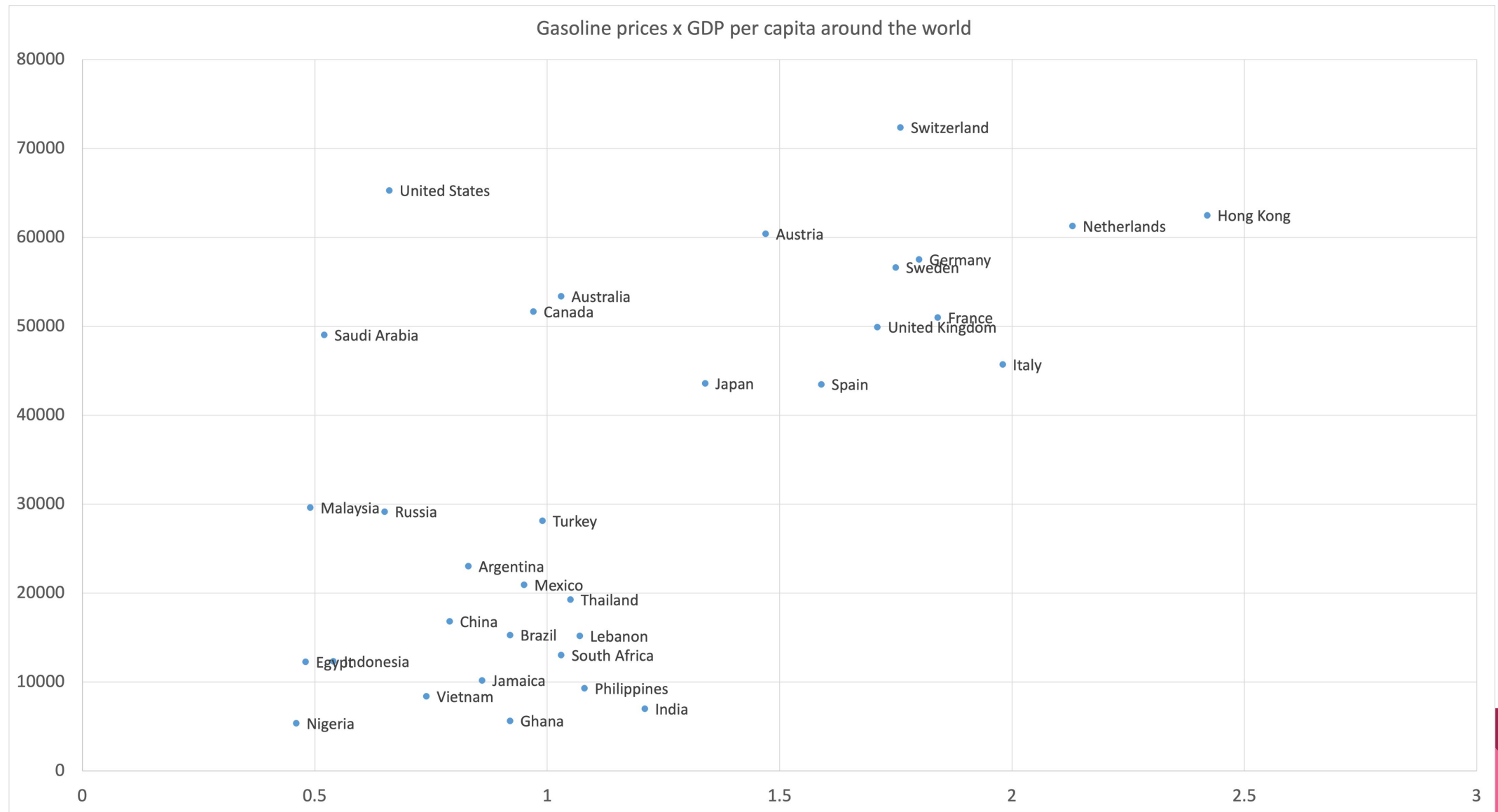
Taxes, Climate Change and Income Inequality

- ❑ Proposed taxes to address climate change and energy consumption include carbon taxes, gasoline taxes, and more.
- ❑ Such taxes ought to be pigouvian, but that is difficult to attain.



Taxes, Climate Change and Inequality

- ❑ One source of inequality in developing countries is energy subsidies
 - These mainly benefit the wealthy individuals who consume more energy sources.
 - ❑ Energy prices in developed countries are dependent upon relationship between government and citizens:
 - U.S. gas prices are low, as places in the USA are spread out, and most american families own cars. Public transportation in the united states is underdeveloped as a result.
 - European energy prices are higher; less people drive; public transportation is better
- 



Gasoline Taxes: Progressive or Regressive?

The distributive effects of a gasoline tax depends on the development of the country

- ❑ Gasoline taxes in developed countries with many car drivers like the United States are likely regressive.
 - This is because unless public transportation is available, lower income Americans must spend a larger percentage of their income on gasoline for transportation



Gasoline Taxes: Progressive or Regressive?

- ❑ Gasoline taxes in developing countries can be progressive, because those with automobiles in developed countries often are upper-middle to upper class



Pigouvian Taxes

- ❑ Taxes levied on a market that generates negative externalities set equal to the social cost of those negative externalities
- ❑ Could be used to address pollution
- ❑ Great in theory; difficult to calibrate properly



Chapter 1 2.4

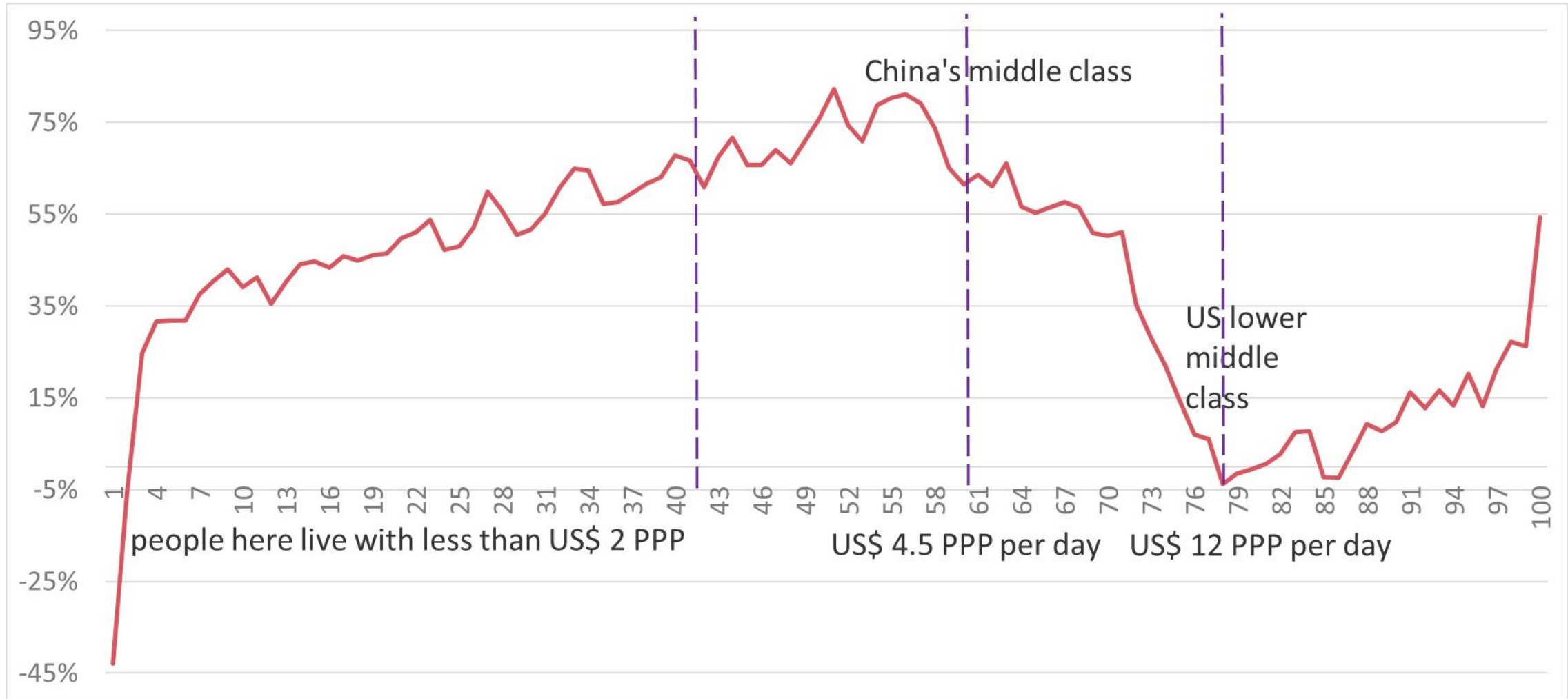
Trade Inequality and Politics

The Elephant Chart

- ❑ Created by Branko Milanovic in 2013.
- ❑ Compares real income growth of global population in 1988 and 2008.
- ❑ Population is divided by income percentile (from the poorest 10% to the richest 10%).
- ❑ Demonstrates that nearly all percentiles of people saw their real income increase substantially over the 20 years, with the exception of the 80th percentile of global income, whose income stagnated over the two decades.



The Elephant Chart



Source: Resolution Foundation (2017), after Christoph Lakner and Branko Milanovic (2013).

Why the American Middle Class has Stagnated

Combination of Trade, technology, and global productivity gains

- ❑ ***Productivity gap*** between average american worker and global workers has ***shrunk***
- ❑ Companies can more easily move production overseas, to cheaper labor



The Decline of the Global Middle Class?

- ❑ The American middle class was simply the first, not the only population to experience this stagnation
- ❑ Wage stagnation in the U.S.A. and the EU has led to various populist, anti-immigration and protectionist movements
- ❑ As its economic growth slows, China is currently worried about middle-class wage stagnation and discontent in the near future
- ❑ Middle-class frustrations played a role in the Arab Spring



Chapter 1 2.5

Inequality and Macroeconomics Redux

Economics and Inequality

- ❑ Major economic decision makers chase economic growth, low inflation and low unemployment before they address inequality.
- ❑ Nonetheless, ***economic policies are not distributively neutral.***
- ❑ Income distribution is multidimensional:
 - Arises from labor market interactions,
 - Affected by: inflation, past wealth (endowments), rate of human capital accumulation, saving profiles, taxation, demographics, rate of innovation, amount of insurance against shocks and more.



Economics and Inequality

- ❑ Inequality is different from inflation and unemployment:
 - Not all rises in inequality are necessarily bad.
- ❑ Gini Coefficients change gradually:
 - It can take decades for national inequality to change dramatically.



Good Read: “Capital in the 21 st Century”

- ❑ Thomas Piketty—*Capital in the 21st Century*.
- ❑ Thesis: the main driver of inequality is that the return on capital exceeds economic growth.
- ❑ This trend creates ever widening inequality, further destabilizing democracy and the social contract.
- ❑ These trends aren’t inevitable or irreversible.
- ❑ Smart public policy can curb worsening inequality.

