Econ 121 A/B
Principles of Economics
Spring 2024

Inequality

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ST. OLAF COLLEGE
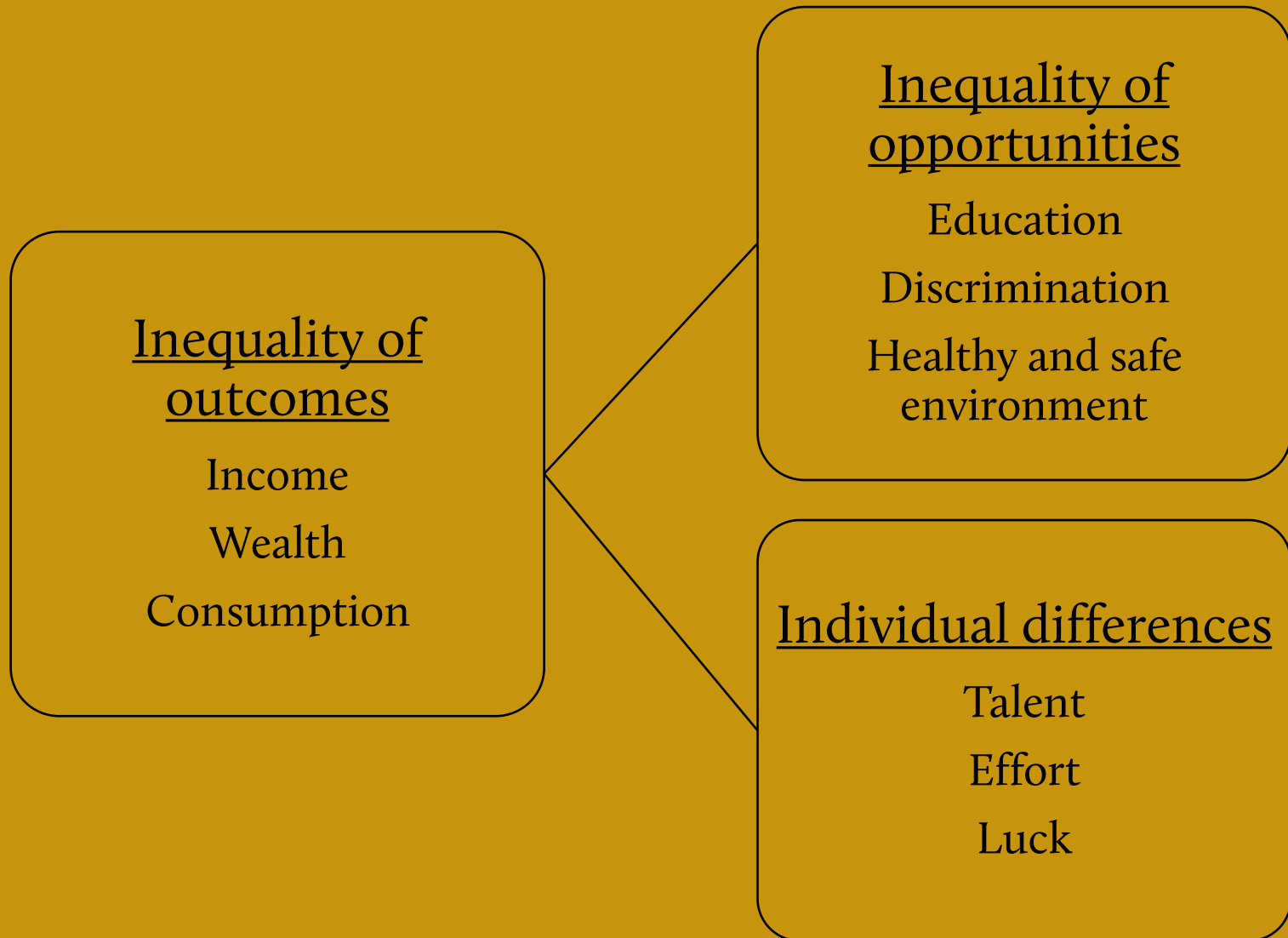
Learning Objectives

- Discuss what drives economic inequality among individuals and households.

- Understand the measurements for inequality.

- Evaluate policies to address inequality.

Economic inequality

Inequality of outcomes

Income

Wealth

Consumption

Inequality of opportunities

Education

Discrimination

Healthy and safe environment

Individual differences

Talent

Effort

Luck

What is the type of inequality in this case?

- Antonio earns more money working in finance than his college roommate Lorenzo does as a prosecutor for the federal government.
- In many countries, girls still lack the same access to education that boys have.

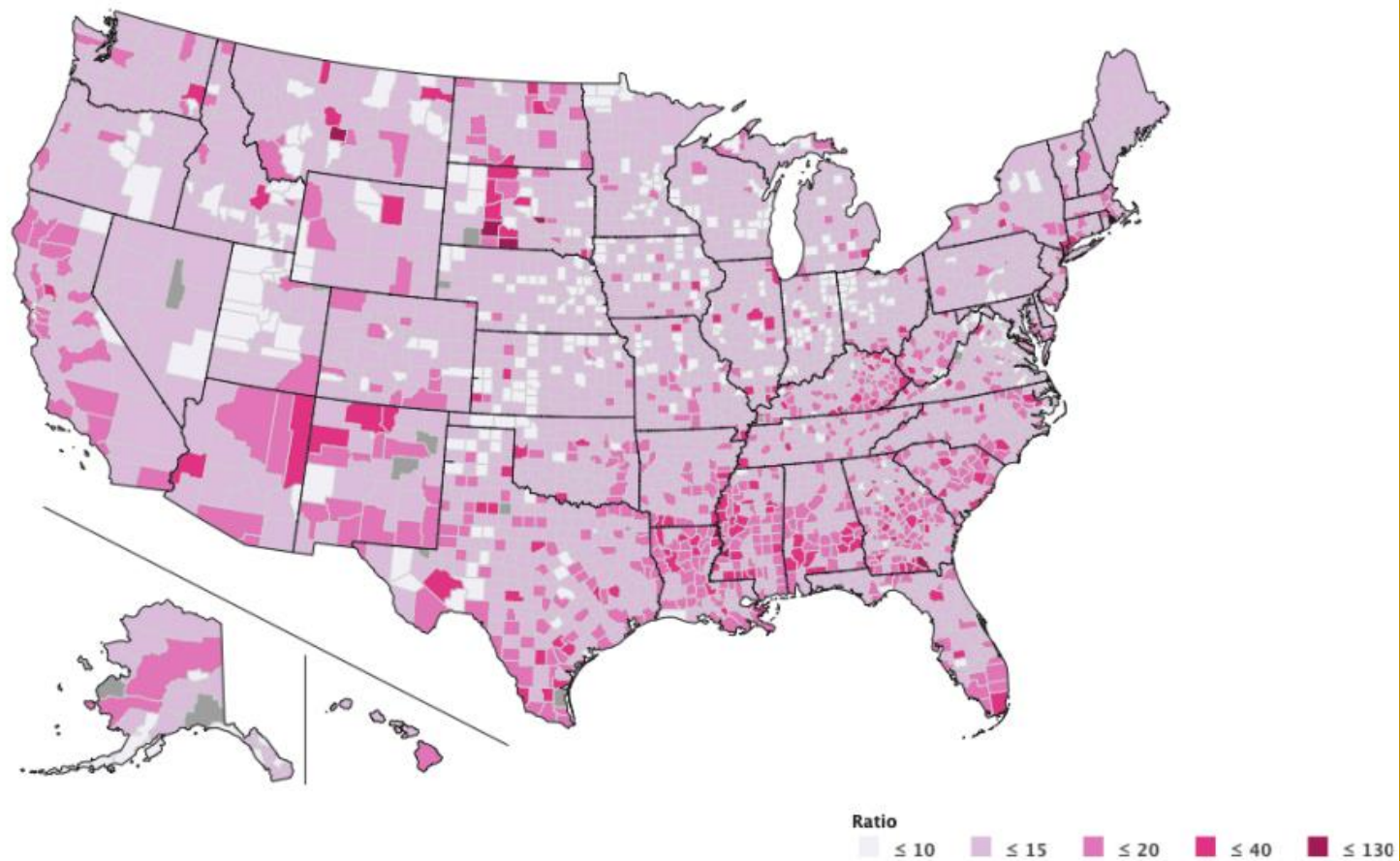# What is the type of inequality in this case?

- Anita has an easy time finding a good-paying job after college because her parents have many connections and can help her land her first job. Anita's roommate, Sonia, has no such family connections and has to work a part-time job after graduating until she finds something better.

- In a company, employees that work together on a team project and have the same position in the firm are paid a bonus according to their individual performance in that project.

Measuring income inequality

- Quintiles – US Census
  - The ratio of the average income for the highest quintile of earners divided by the average income of the lowest quintile of earners.

Figure 1
Income Inequality by County

FRED 📈 2020 Income Inequality by County (Ratio)

Ratio
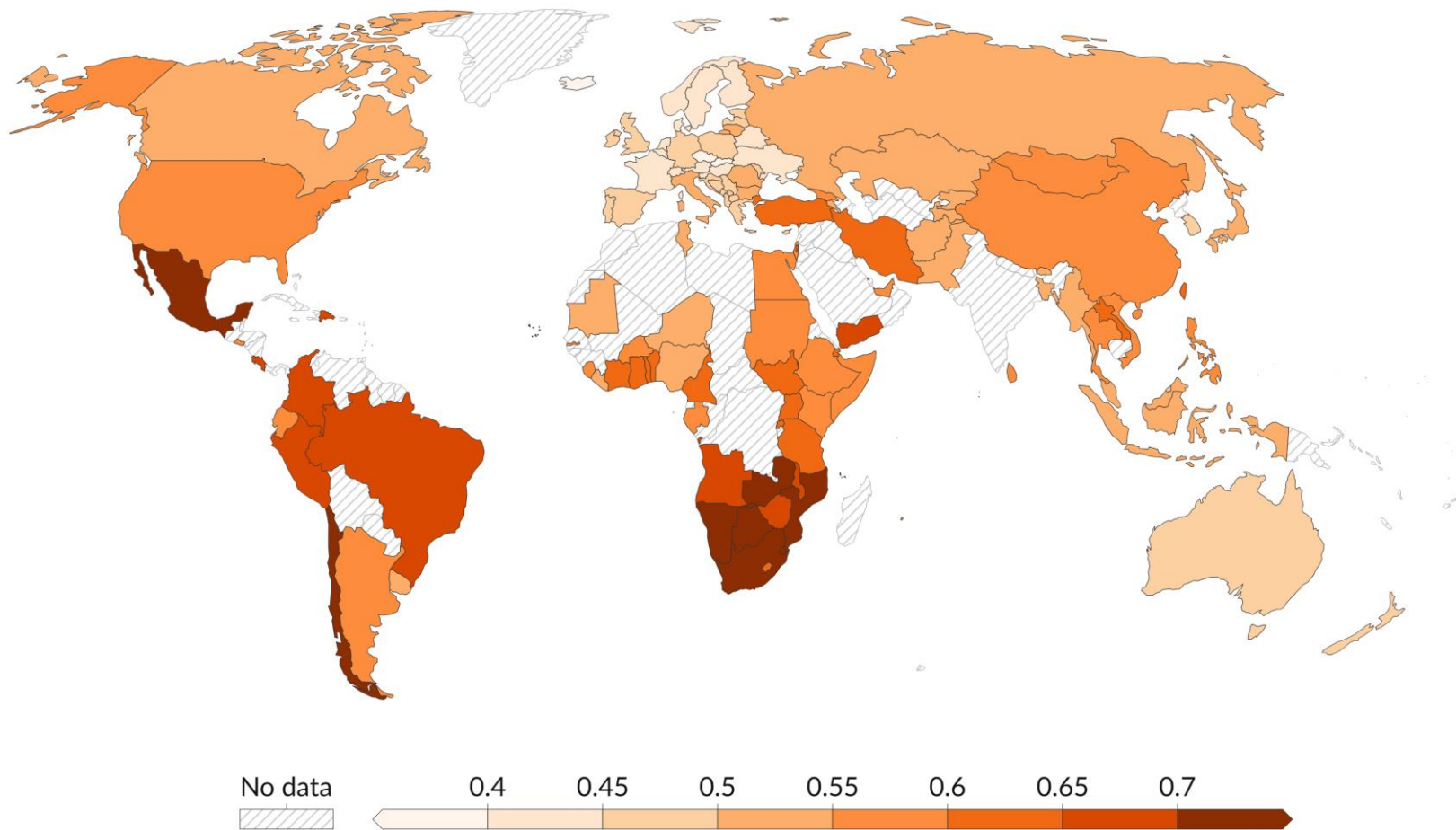≤ 10   ≤ 15   ≤ 20   ≤ 40   ≤ 130

Measuring income inequality

- Quintiles – US Census
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- Gini Index – World Bank
  - Gini = (½) average difference between all the pairs of individuals / average income

Gini coefficient, 2019

The Gini coefficient measures inequality on a scale from 0 to 1. Higher values indicate higher inequality. Inequality is measured here in terms of income before taxes and benefits.
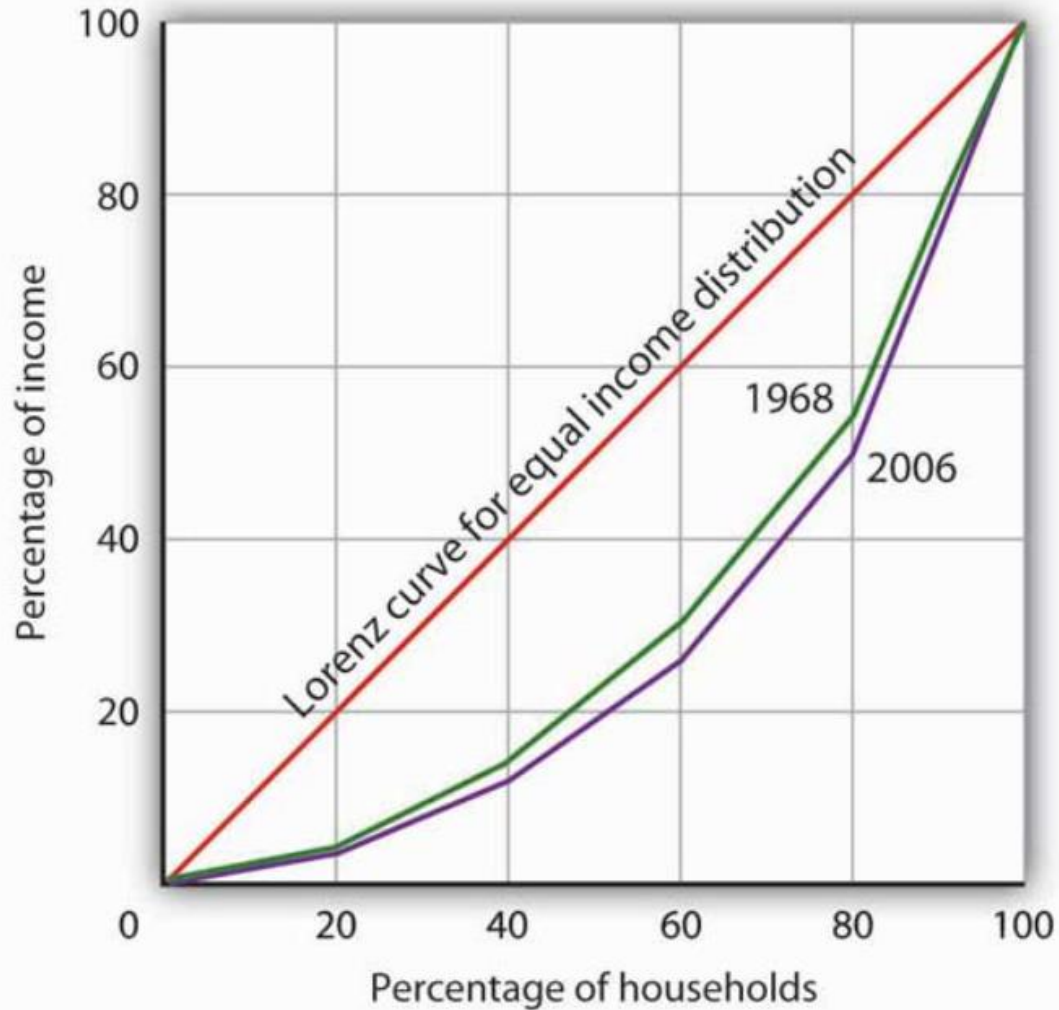

Our World in Data

No data   0.4   0.45   0.5   0.55   0.6   0.65   0.7
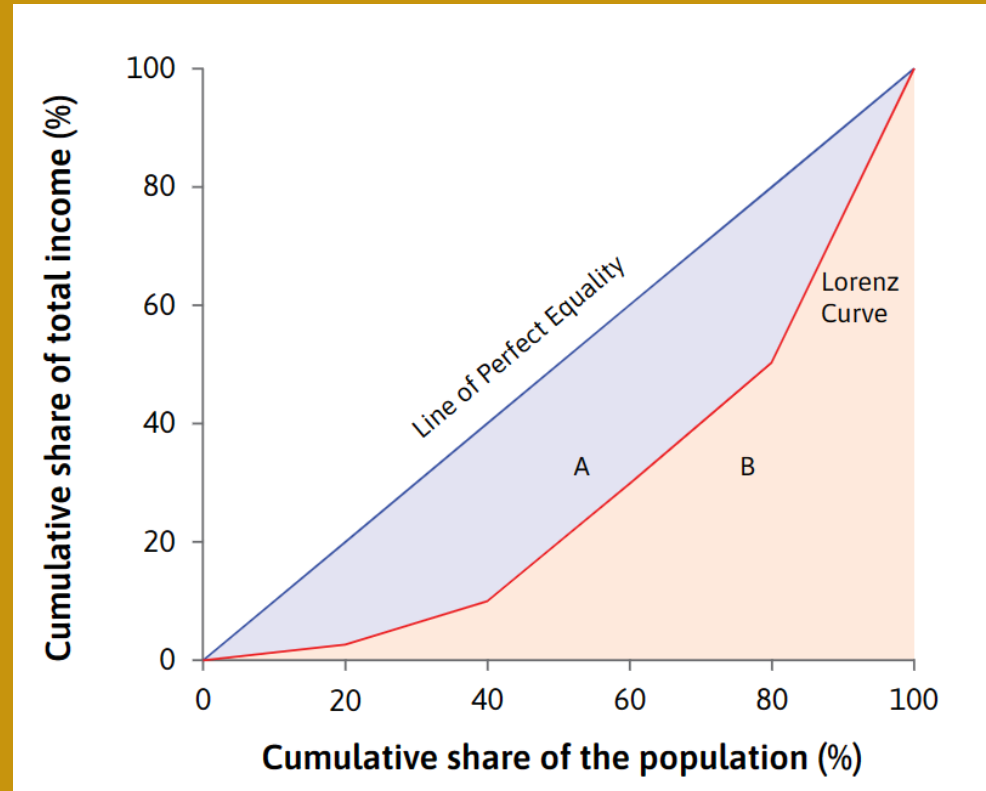
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- Lorenz curve
  - Cumulative income shares

Lorenz curve of US

Relationship between the Gini Index and the Lorenz curve

$$Gini \approx A/(A+B)$$

Income, wealth, and consumption

- Income – flow of water into the tub
  - Transitory vs permanent income
  - Market vs disposable income

- Wealth – water in the tub
  - The value of a person's assets accumulated over time.

- Consumption – water that drains out of the tub

Which of the following factors are considered when measuring income inequality?

- Accidents of birth and good fortune

- The amount of money held in individual retirement accounts

- The amount of money owed on student loans

Solutions

- Pre-distribution
  - Minimum wage
  - Protection of unions
  - Land reform
  - Expansion of educational access and quality
- Redistribution
  - Welfare program
  - Negative tax (subsidy)
  - In-kind transfers

Which country do you prefer to live in?

- Consider the following two societies, where the numbers represent mean income at each quintile:

  Economy A: 6, 10, 13, 17, 31

  Economy B: 5, 11, 16, 23, 47

Liberalism thinking of inequality - John Rawls

- People would be chiefly concerned about the possibility of being at the bottom of the income distribution.

- Maximin criterion: the government should aim to maximize the well-being of the worst-off person in society.