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Income Inequality and Poverty

Full Length Text — Part: 5 Chapter: 27
Micro Only Text — Part: 3 Chapter: 15

To Accompany “Economics: Private and Public Choice 12th ed.”
James Gwartney, Richard Stroup, Russell Sobel, & David Macpherson
Slides authored and animated by:
James Gwartney, David Macpherson, & Charles Skipton

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How Much Income Inequality Exists in the United States?

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Share of Money Income by Quintile

	Lowest 20% of recipients	Second quintile	Third quintile	Fourth quintile	Top 20% of recipients
Family income before taxes					
1950	4.5	12.0	17.4	23.4	42.7
1960	4.8	12.2	17.8	24.0	41.3
1970	5.4	12.2	17.6	23.8	40.9
1980	5.1	11.6	17.5	24.3	41.6
1990	4.6	10.8	16.6	23.8	44.3
2000	4.3	9.8	15.4	22.7	47.7
2004	4.0	9.6	15.4	23.0	47.9
Impact of taxes & transfers on 2005 household income					
Before	3.4	8.8	14.4	23.0	50.3
After	4.4	9.9	15.3	23.1	47.3

Sources: Bureau of the Census and Congressional Budget Office — see text for list of references.

- Income inequality fell in the 1950s and 1960s, but since the 1970s it has been increasing.
- Due to transfer programs and the progressive taxation of income, after tax and transfer income is more equal than before tax income.

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Factors Influencing Income Distribution

- A high portion of annual income inequality is due to differences in:
 - age,
 - education,
 - family size,
 - marital status,
 - number of earners in the family, and,
 - time worked.
- Young, inexperienced workers, students, single-parent families, and retirees are over-represented among those with low incomes.

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High and Low Income Families, 2005

	Bottom 20% of income recipients	Top 20% of income recipients
Education of householder		
Percent with less than high school	32.0	2.0
Percent with college degree or more	9.0	58.0
Age of householder (percent distribution)		
under 35	33.0	12.0
35 - 64	45.0	80.0
65 and over	23.0	8.0
Family status		
Married-couple family (% of total)	48.0	92.0
Single-parent family (% of total)	52.0	8.0
Persons per family	2.9	3.4
Earners per family	0.8	2.2
% of married-couple families in which wife works full-time	13.0	63.0
% of total hours worked supplied by group	9.0	26.0

Source: <http://www.census.gov>, and author calculations from the March 2006 Current Population Survey.
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Why Has Income Inequality Increased?

- Income inequality in the U.S. has increased due to the **growth** of:
 - both single-parent and dual-earner families as a share of the total,
 - earnings differentials on the basis of skill and education,
 - the number of “winner-take-all” markets, and,
 - lower marginal tax rates inducing high earners to report more income.

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Income Mobility and Inequality in Economic Status

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Income Mobility

- Annual income data hide the movement of people up and down the income distribution over time.
- Tracking of household income over time shows there is considerable movement both up and down the income spectrum.

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Income Mobility

Income Status of Family in 1988	Percentage Distribution by Income Status of Family in 1998				
	Top paid quintile	Next highest quintile	Middle quintile	Next lowest paid quintile	Lowest paid quintile
Highest quintile	53.2	23.2	14.9	5.7	3.0
Next highest quintile	25.8	31.1	23.7	12.9	6.5
Middle quintile	12.6	27.5	28.3	20.7	10.9
Next lowest-paid quintile	4.3	11.0	22.6	36.3	25.7
Lowest paid quintile	4.3	6.4	12.4	23.6	53.3

Source: Katherine Bradbury and Jane Katz, "Women's Labor Market Involvement and Family Income Mobility When Marriages End," *New England Review*, Fourth Quarter 2002, pages 41-74.

- The table above allows us to see how families in each income bracket in the U.S. fared 10 years later.
- Does it appear to you that there is a significant amount of income mobility in the U.S. economy?

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Questions for Thought:

1. Do you think the current distribution of income in the United States is too unequal?
2. Indicate three factors that have contributed to an increase in income inequality in the United States since the mid-1970s.
3. (*Which of the following is true?*)
Data on income inequality in the U.S. indicate
 - a. The “rich” stay rich and the “poor” stay poor.
 - b. there is substantial movement among income groupings in the United States.

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Poverty in the United States

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Changing Composition of the Poor

	1959	1976	2005
Number of poor families (<i>millions</i>)	8.3	5.3	7.7
Percent of poor families headed by a:			
<i>Female</i>	23	48	53
<i>Black</i>	26	30	27
<i>Elderly person (aged 65+)</i>	22	14	9
<i>Person who worked at least some during the year</i>	70	55	61
Poverty rate (%)			
<i>All families</i>	18.5	10.1	9.9
<i>Married-couple families</i>	15.8	7.2	5.1
<i>Female-headed families</i>	42.6	32.5	28.7
<i>All individuals</i>	22.4	11.7	12.6
<i>Whites</i>	18.1	9.1	10.6
<i>Blacks</i>	55.1	31.1	24.9
<i>Children (under age 18)</i>	27.3	16.0	17.6

Sources: U.S. Dept. of Commerce, *Characteristics of the Population Below the Poverty Line: 1982*, Table 5; and <http://www.census.gov>. Copyright ©2009 Thomson South-Western. All rights reserved.

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Transfer Payments and the Poverty Rate

- Income transfers have expanded substantially since the mid-1960s.
- These transfers have been largely ineffective at reducing the poverty rate.
 - Though per capita income has increased substantially over time (109% since 1965), the poverty rate of working-age Americans has stayed about the same.

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Poverty Rate, 1947-2005

Year	Poverty Rate (%)
1947	32.0
1959	18.5
1965	13.9
1968	10.0
1975	9.7
1980	10.3
1990	10.7
2000	8.7
2005	9.9

Sources: U.S. Dept. of Commerce, *Characteristics of the Population Below the Poverty Level: 1982*, Table 5; and *Income, Expenditures, and Taxes*.

- The official poverty rate of families declined sharply during the 1950's and 60's ... but has been relatively constant at about 10 percent since 1968.

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Poverty Rate, 1947-2005

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1947	32.0
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1980	10.3
1990	10.7
2000	8.7
2005	9.9

Sources: U.S. Dept. of Commerce, *Characteristics of the Population Below the Poverty Level: 1982*, Table 5; and *Income, Expenditures, and Taxes*.

- The orange shaded part of the bars indicate the drop in the poverty rate when non-cash benefits are counted as income.
- With non-cash benefits added, the poverty rate during most of the period since 1968 has ranged from 7% to 8%.

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Income Transfer Effects

- Income supplements large enough to significantly increase the economic status of poor people will:
 - encourage behavior that increases the risk of poverty
 - create high implicit marginal tax rates that reduce the recipient's incentive to earn.
- **Samaritan's dilemma:** the dilemma that occurs when income is transferred to the poor because the transfers reduce the opportunity cost of choices that lead to poverty. Thus, providing income transfers to the poor and discouraging behavior that leads to poverty are conflicting goals.

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Income Inequality: *Some Concluding Thoughts*

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Income Inequality

- Positive economics cannot determine how much inequality should be present.
- Income inequality reflects differences between individuals and influences their incentive to develop resources and engage in productive activities.
- The nature of the process, as well as the pattern of income distribution, is relevant to the issue of fairness.

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Questions for Thought:

1. What is the poverty threshold income level? How is it measured? Is the threshold adjusted for family size? Is it adjusted for inflation?
2. What impact did the expansion in government income transfers during the 1960s have on the poverty rate? Was the War on Poverty successful? Why or why not?
3. Do individuals have a property right to income they acquire from market transactions? Is it a proper function of government to tax some people in order to provide benefits to others? Why or why not?

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Questions for Thought:

4. What determines whether a distribution of income is fair? Do you think that the major income transfer programs of the U.S. are fair?
5. The outcome of a state lottery game is certainly a very unequal distribution of the prize. Some players are made very rich while other lose their money. Is this outcome fair? Is the process fair? Discuss.

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**End
Chapter 27**

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