No. 1, February 2012

Inequality: A Brief Overview

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There are many kinds of inequality, but most agree that some kind of equality of opportunity is desirable. Equality of outcomes might not be desirable, if greater rewards accruing to the lucky and skillful and diligent encourage entrepreneurial activity and hard work that benefit society as a whole. Nevertheless, the measurement of inequality usually focuses on measuring inequality in outcomes (income or wealth or health or some other measure of well-being), variously using differences between the highest and lowest outcomes or variation nearer the middle or some other part of the distribution.[1] Many authors[2] advocate focusing not on income inequality but on poverty, but many others argue that focusing on overall inequality and particularly on top income shares is warranted.[3]

Inequality and mobility

Any interpretation of inequality in outcomes depends on the level of mobility and how one interprets mobility. If mobility is caused by random up-and-down movements, such as volatility of income streams, long-run inequality summing income over years will produce lower measured inequality than the weighted average of single-year measures of inequality. But to the extent individuals don't like risky income streams, the up-and-down movements could make them worse off. There are also different rates of growth; variation in growth rates is another form of risk, but higher average growth at lower initial levels will tend to equalize outcomes over time; these are all forms of income risk[4] which can be both good and bad. One needs to distinguish absolute and relative mobility, and mobility across generations, as discussed in a series of review articles about economic mobility.[5] Greater mobility is not an unalloyed good; mobility is not desirable for the rich but is very desirable for the poor, so there is good and bad[6] mobility. Overall, it seems clear that income inequality has increased dramatically[7] in the United States over the past several decades, year-to-year variation in incomes has increased a bit less,[8] and mobility has changed very little.[9]

Policy's effect on inequality and mobility

Tax policy has a direct impact on inequality, via reductions in disposable[10] income, and indirect effects on long-run inequality and mobility by influencing behavior such as entrepreneurship. Government interventions promoting more and better education[11] are known to promote greater equality of opportunity.[12] Housing policy and transportation policy can play a role, though the Moving to Opportunity experiment[13] suggests the potential influence of housing policy may be smaller than commonly hoped. Encouraging savings and asset-building is often thought to be an effective means of promoting mobility.[14] Policies to mitigate the long-term consequences of labor market downturns may also improve long-run equality of opportunity. The social cost of assistance programs is driven up by the extra burden associated with taxation and by moral hazard, but a full accounting also should include long-run gains in outcomes later in life and in subsequent generations, which tend to make assistance programs look like good investments.

Public opinion about inequality

Less than half[15] of Americans believed it very important that the federal government act to reduce the income and wealth gap between the rich and poor in 2011, while more than half thought so in 1998. So tolerance of inequality has increased, despite "Occupy" or "99 Percent" protests, while inequality has risen sharply. Americans also feel less secure about their economic prospects and are worried about economic risks. There are several ways to interpret these facts. One is that Americans believe their own chances of winding up rich are good enough that they do not want to penalize the rich. Another is that they do not trust the government to act to reduce the income and wealth gap while avoiding widespread economic harm. The rhetoric about government's limited ability to act in the common good is widespread, despite the successes and popularity of Social Security, public education, and other major innovations of the 20th century. Health care reform may prove an interesting test case in the near future.

Notes

1 Measures such as the 90th percentile divided by the 10th percentile characterize the gap between very high outcomes and very low outcomes (e.g., the wealth or income of the rich and the poor), but there are many other measures of that gap. The Gini coefficient is more sensitive to variation around the middle of the distribution than at the top or bottom of the distribution; indexes of inequality in the generalized entropy family or Atkinson indexes are more sensitive to differences in income shares among the poor or among the rich depending on a parameter that defines the index. See Jenkins and van Kerm (2008) for more detail.

2 See, for example, Feldstein (1999) and Ravallion (2012).

3 See, for example, Piketty, Saez, and Stantcheva (2011), noting that the marginal tax rate on top earners is a key factor in determining how much inequality is driven by the very rich, and that lower taxes at the top mean fewer resources to help at the bottom.

4 See Nichols (2008) for more discussion.

5 Note also the link between inequality and intergenerational mobility, the subject of some dispute; see Corak (2012) for more.

6 See Nichols and Favreault (2008) for more discussion.

7 See, for example, Autor, Katz, and Kearney (2008) and the papers cited there. Changing tax policy and labor market policy has facilitated the growth of inequality, if not actually caused it.

8 See Nichols and Zimmerman (2008) and Nichols (2008) for details.

9 See, for example, Acs and Zimmerman (2008) for more.

10 See http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=300 for a description of the methods the Tax Policy Center uses to describe the distributional impact of tax policy.

11 See Dynarski (2005) and Maag (2011) for summaries of tax policies encouraging education; see Murray, Rueben, and Rosenberg (2007) for a discussion of direct spending on public education.

12 See Haskins, Holzer, and Lerman (2009) and Grawe (2008) for summaries of evidence on the effect of promoting education on equality of opportunity.

13 See Turner et al. (2011) for more information on the experiment.

14 However, recent evidence on a popular policy, matching savings for specified uses, a form of individual development account, found little effect of large incentives to increase rates of homeownership (the form much savings takes). See Gale et al. (2011) for the evidence. See also Duflo et al. (2005) for another savings experiment.

15 A slight majority of Americans (52 percent) now say that inequality is an acceptable part of our economic system (72 percent of Republicans find the gap an acceptable part of our economic system, whereas only 36 percent of Democrats do). Support for government action to ensure equality of opportunity greatly exceeds support for government action to ensure equality of outcomes; 70 percent say it is important for the government to increase equality of opportunity. See http://www.gallup.com/file/poll/151574/Income_Inequality_111216.pdf for a description of the Gallup poll conducted November 28–December 1, 2011. See also http://www.gallup.com/poll/111655/Americans-Split-Redistributing-Wealth-Taxing-Rich.aspx for trends in support for redistribution via higher taxes on the rich.

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