Should we worry about inequality?

Lane Kenworthy

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Too much income inequality is unfair

This used to be the chief objection to high or rising income inequality
Too much income inequality is harmful

Now the main objection tends to be that inequality has harmful effects on outcomes we value

- Economic growth
- Economic stability
- Household income growth
- Household balance sheets
- Equality of opportunity
- Education
- Health
- Family stability
- Safety
- Residential mixing
- Trust
- Happiness
- Democracy
The "income inequality is harmful" hypotheses
Economic growth

Joseph E. Stiglitz
Winner of the Nobel Prize in Economics

The Price of Inequality
How Today's Divided Society Endangers Our Future
Economic growth

Hypothesis

Less consumer demand, because the rich spend a smaller share of their income than the middle class and the poor

Reduced work effort and innovation, due to perceived lack of fairness in pay
Economic stability

Hypothesis

Households with stagnant incomes increase debt in order to sustain consumption growth, and they go too far.

The rich have excess savings, which fuels speculative investment and bubbles.

The rich press policy makers to loosen regulations on finance.
Household income growth
Household income growth

Hypothesis

As the top 1% gobble up an increasing share of the economic growth, incomes of middle-class and poor households grow more slowly than they otherwise would.
Household balance sheets
Hypothesis

1. Middle-class and poor households borrow more in order to maintain absolute consumption growth in the face of slow income growth

2. Upper-middle- and middle-class households borrow more in order to maintain their relative position vis-à-vis the rich — especially in housing
Equality of opportunity

Hypothesis

Affluent parents are better able to buy success for their children

Poor kids lose hope
Equality of education, health, happiness

Hypothesis

Income is positively associated with education, health, and happiness, so a widening of the income gap should cause a widening of the income gradient in education, health, and happiness
Average education, health, safety, family stability, trust, happiness
Average education, health, safety, family stability, trust, happiness

Hypothesis

Possible mechanisms include declining marginal utility of income, status competition and stress, envy, segregation
Democracy
Democracy

Hypothesis

Americans with higher income have more influence on policy decisions than those with less, so an increase in the income gap should produce an increase in the influence gap.
Hypotheses and evidence
"Government is harmful"
"Government is harmful"
"Government is harmful"

The Friedman-Laffer-Murray-Reagan arguments consist of two claims

1. There is a tipping point beyond which government has harmful effects
2. Existing rich countries have passed that tipping point
"Income inequality is harmful"

The "income inequality is harmful" hypotheses are similar

1. There is a tipping point beyond which income inequality has harmful effects

2. Existing rich countries, or at least some of them, have passed that tipping point
"Income inequality is harmful"

#1: No one disputes that there is a tipping point

#2: Existing rich countries are on the wrong side of the tipping point

This is plausible, and there is some supportive evidence

But we should use a tough evidentiary standard
How should we assess #2?

Compare

Within countries over time

Across countries at a given point in time

*Change over time across countries*
Change in income inequality, 1979-2007

- **United States**
- **United Kingdom**
- **Portugal**
- **New Zealand**
- **Canada**
- **Finland**
- **Norway**
- **Australia**
- **Italy**
- **Sweden**
- **Spain**
- **Ireland**
- **Japan**
- **Germany**
- **France**
- **Netherlands**
- **Switzerland**
- **Denmark**

- □ Bottom 99% Gini
- + Top 1% share
- ● Average

Status: No change, Increase
I'll show you a simplified version of the findings

I'll mostly leave out what I do with respect to Controls, Lags, Measurement choices.
Economic growth
Economic growth

Change in GDP per capita vs. Change in bottom 99% Gini

Change in top 1% share vs. Change in GDP per capita
Economic growth

Most other studies of rich countries also don't find that higher income inequality is correlated with slower economic growth.
Economic stability
Economic stability

Atkinson and Morelli (2010) find that "The history of systemic banking crises in different countries around the world does not suggest that either rising or high inequality is a significant causal factor."
Household income growth
Household income growth

Index

- GDP per capita
- Family income

Year

1950 60 70 80 90 2000 10

GDP per capita
P50
P20

Family income

1 2 3
Household income growth

Cross-country patterns suggest this holds for middle-income households

A 1-percentage-point increase in the top 1%'s income share slows median household income growth by about $450

Absent the 10-point rise in the top 1%'s share, US median household income 1979-2007 would have increased by $14,000 rather than by $9,500
Household income growth

Increase in median income vs. Change in bottom 99% Gini

Increase in median income vs. Change in top 1% share

Small vs. Large

Graph shows the relationship between various countries (Asl, Can, Den, Fin, Fr, Ger, Ire, It, Nth, Nor, Sp, Swe, Swi, UK, US) and changes in income and inequality measures.
Household income growth

It doesn't hold for the poor

Income growth in the bottom 20% comes mainly from increases in government transfers

Policy choices about whether to increase transfers seem to have been unaffected by income inequality (US vs UK)
Household balance sheets
Household balance sheets

Rich countries with larger increases in income inequality have tended to experience larger reductions in household saving
Household balance sheets

Alternative hypothesis

Rising household borrowing was driven by an increase in availability of credit, aggressively pushed by financial firms
Household balance sheets

Coibion et al 2014: low-income households in high-inequality regions in the US borrowed relatively less than their counterparts in low-inequality regions.

Fligstein et al 2014: much of the rise in borrowing in the US was by upper-middle-class households (>p60)
Household balance sheets

In Robert Frank's story, rising income inequality should lead to housing bubbles

But across countries, there's no correlation
Equality of opportunity
Equality of opportunity

Intergenerational mobility vs. Bottom 99% Gini

Intergenerational mobility vs. Top 1% share
Equality of opportunity

But the correlation is cross-sectional. We don't know if it holds over time.

And across commuting zones in the US, even the cross-sectional pattern isn't supportive.
Equality of opportunity

US commuting zones
Education
Equality of education, health, happiness

Unfortunately, we don't have longitudinal data for multiple countries.

So the best approach is to examine the US over time.
Equality of education

College completion

From high-income families

From low-income families

Birth year 1961-64
Birth year 1979-82
Average education

Change in college completion vs. Change in bottom 99% Gini vs. Change in top 1% share for various countries.
Health
Equality of health

Life expectancy for males at age 60

Year

1970 80 90 2000 10

Top-half earnings

Bottom-half earnings

60 77 85
Average health

Increase in life expectancy

Change in bottom 99% Gini

Change in top 1% share
Family stability
Family stability: teen births

Decrease in teen births

-5 0 9

Change in bottom 99% Gini

UK
US

Large
Small

Den Fr Ger Ire Nth Nor Sp Swe Tol Fin

Change in top 1% share

Nth Fr Sp Ger Ire Nor Swe Fin Por

UK US
Safety
Average safety

Decrease in homicides

Change in bottom 99% Gini

Change in top 1% share
Residential mixing
Residential mixing

Reardon and Bischoff (2011, 2013) find that metro areas in which income inequality increased more tended to also have larger decreases in residential mixing (increases in segregation) by income.

This holds for mixing among those at the top, but not for those at the bottom, which is consistent with the top-heavy nature of rising income inequality in the US.
Trust
Average trust

Change in trust vs. Change in bottom 99% Gini

Change in trust vs. Change in top 1% share
Average trust

The cross-country correlation is supportive, but it rests entirely on Denmark and the UK.

Also, Fairbrother and Martin (2013) find no association between change in income inequality and change in trust across the US states.
Happiness
Equality of happiness

Very happy

Top-third income

Bottom-third income

Years

1970s 1980s 1990s 2000s

0 30 40%
Average happiness

Change in happiness vs. Change in bottom 99% Gini

Change in happiness vs. Change in top 1% share
Average life satisfaction

Change in life satisfaction vs. change in bottom 99% Gini

Change in top 1% share vs. change in bottom 99% Gini

Countries: Asl, Can, Den, Fin, Fr, Ger, Ire, It, Ja, Nth, Nor, Sp, Swe, Swi, UK, US
Democracy
Democracy

Posited effects of income inequality

Trust in political institutions

Voter turnout

Party polarization

Equality of political influence
Equality of political influence
Equality of political influence

[Graph showing predicted probability of change against percent favoring change, with lines for 10th and 90th percentile, indicating increasing probability with increasing percent favoring change.]
Equality of political influence

- 10th percentile
- 90th percentile

Logistic regression coefficient

Johnson
Reagan
Clinton
GW Bush
Conclusion
Conclusion

Income inequality has done significant harm

But its harm has been less pervasive and devastating than some claim
Why so little apparent impact?

Three possibilities

Income inequality in existing rich countries is below the level at which it has a noticeable impact.

Income inequality's impact takes longer than three decades to show up.

Income inequality's impact has been blunted in high-inequality countries (e.g. UK) by policies and/or institutions.
If blunting accounts for the observed cross-country patterns ...

Income inequality's adverse effect may be large only in countries that lack such institutions and policies, such as the United States.

US policy makers perhaps should aim to change policies and/or institutions, rather than to reduce income inequality.
Should we worry about inequality? I say yes

1. It's unfair
2. It reduces middle-class household income growth
3. It increases inequality of education, health, and happiness and reduces residential mixing
Should we worry about inequality?
I say yes

4. If income inequality does increase the political influence of the rich, there could be harmful spillover effects on a range of outcomes down the road