Income and Wealth Inequality: Crash Course Economics #17

Crash Course: Economics
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Jacob: Welcome to Crash Course Economics, I'm Jacob Clifford...

Adriene: ...and I'm Adriene Hill. The world is full of inequality. There's racial inequality, gender inequality, health, education, political inequality, and of course, economic inequality. Some people are rich, and some people are poor, and it can seem pretty impossible to fix.

Jacob: Well, maybe not.

(Intro)

Jacob: So there are two main types of economic inequality: wealth inequality and income inequality. Wealth is accumulated assets, minus liabilities so it's the value of stuff like savings, pensions, real estate, and stocks. When we talk about wealth inequality, we're basically talking about how assets are distributed. Income is the new earnings that are constantly being added to that pile of wealth. So when we talk about income inequality, we're talking about how that new stuff is getting distributed. Point is, they're not the same. Let's go to the Thought Bubble

Adriene: Let's look at both types of inequality at the global level. Global wealth today is estimated at about 260 trillion dollars, and is not distributed equally. One study shows that North America and Europe, while they have less than 20% of the world's population, have 67% of the world's wealth. China, which has more people than North America and Europe combined, has only about 8% of the wealth. India and Africa together make up almost 30% of the population, but only share about 2% of the world's wealth. We're teaching economics, so we can focus on income inequality. These ten people represent everyone on the planet, and they're lined up according to income. Poorest over here and richest over here. This group represents the poorest 20%, this is the second poorest 20%, the middle 20%, and so on. If we distributed a hundred dollars based on current income trends, this group would get about 83 of those dollars, the next richest would get 10 dollars, the middle gets four, the second poorest group would get two dollars, and the poorest 20% of humans would get one dollar.

Branko Milanovic, an economist that specializes in inequality, explained all this by describing an "economic big bang" - "At first, countries' incomes were all bunched together, but with the Industrial Revolution the differences exploded. It pushed some countries forward onto the path to higher incomes while others stayed where they had been for millennia." According to Milanovic, in 1820, the richest countries in the world - Great Britain and the Netherlands - were only three times richer than the poorest, like India and China. Today, the gap between the richest and poorest nations is like 100:1. The gaps are getting bigger and bigger. Thanks, Thought Bubble.

The Industrial Revolution created a lot of inequality between countries but today globalization and international trade are accelerating it. Most economists agree that globalization has helped the world's poorest people, but it's also helped the rich a lot more. Harvard economist Richard Freeman noted, "The triumph of globalization and market capitalism has improved living standards for billions while concentrating billions among the few." So, it's kind of a mixed bag. The very poor are doing a little better, but the very rich are now a lot richer than everybody else.

There are other reasons inequality is growing. Economists point to something called "skill-biased technological change." The jobs created in modernized economies are more technology-based, generally requiring new skills. Workers that have the education and skills to do those jobs thrive, while others are left behind. So, in a way, technology's become a complement for skilled workers but a replacement for many unskilled workers. The end result is an ever widening gap between not just the poor and the rich, but also the poor and the working class. As economies develop and as manufacturing jobs move overseas, low skill low pay and high skill high pay work are the only jobs left. People with few skills fall behind in terms of income. In the last thirty years in the US, the number of college-educated people living in poverty has doubled from 3% to 6%, which is bad! And then consider that during the same period of time, the number of people living in poverty with a high school degree has risen from 6% to a whopping 22%. Over the last fifty years, the salary of college graduates has continued to grow while, after adjusting for inflation, high school graduates' incomes have actually dropped. It's a good reason to stay in school!

There are other reasons the income gap is widening. The reduced influence of unions, tax policies that favor the wealthy, and the fact that somehow it's okay for CEOs to make salaries many, many times greater than those of their employees. Also, race and gender and other forms of inequality can exacerbate income equality.

Jacob: Let's dive into the data for the United States. We'll start by mentioning Max Lorenz, who created a graph to show income inequality. Along the bottom we have the percent of households from 0-100% and along the side we have the percent share of income. By the way, we're using households rather than just looking at individuals because many households have two income earners. So this straight line right here represents perfect income equality. So every household earns the same income. And while perfect income equality might look nice on the surface, it's not really the goal. When different jobs have different incomes, people have incentive to become a doctor or an entrepreneur or a YouTube star - you know, the jobs society really values. So this graph, called the Lorenz curve, helps visualize the depth of inequality.

Now, for 2010, the US Census Bureau found that the poorest 20% of Americans made 3.3% of the income. And the richest 20% made over 50% of the income. So that's pretty unequal but has it always been like this? Well, in 1970, the bottom group earned 4.1% of the income and the top earned 43.3%. By 1990, things were even less equal so the 2010 numbers are just a continuation of the trend. And it isn't just the poorest group that's losing ground. Over those 40 years, each of the bottom groups or 80% households earned smaller and smaller shares of the total income.

Now, from the Lorenz curve we can calculate the most commonly used measure of income equality - the GINI Index. Now without jumping into too much of the math, it's basically the size of the gap between the equal distribution of income and the actual distribution. Now, 0 represents complete equality and 100 represents complete inequality. Now, you might be surprised to learn the US doesn't have the highest income inequality, but it does have the highest among Western industrialized nations. The UK has the highest in the EU.

Adriene: The debate over income equality isn't about whether it exists. It obviously does. The fight is over whether it's a problem and what should be done about it. Let's start with those who don't think it's a big deal. They tell you that the data suggests that the rich are getting richer and the poor are getting poorer, but that might not be the case. Instead, it could be that all the groups are making more money but the rich's share is just growing faster. Like, let's say you own an apple tree and we pick 10 apples. You keep 6 and give me 4. A week later we pick 20 apples, you take 15 and give me 5. So my share of the total went down from 40% to 25% but each of us still got more apples. So it's true that people in the lowest income bracket have earned a little more money in the last 40 years but in the last 20 years, that average income has been falling. Meanwhile, the rich have continually gotten richer.

So, what's the richest guy on earth have to say about it? Bill Gates said, "Yes, some level of inequality is built in to capitalism. It's inherent to the system. The question is, what level of inequality is acceptable? And when does inequality start doing more harm than good?" There's a growing group of economists who believe income inequality in the US today is doing more harm. They argue that greater income inequality is associated with a lot of problems. They point to studies that show countries with more inequality have more violence, drug abuse and incarcerations. Income inequality also dilutes political equality, since the rich have a disproportionate say in what policies move forward, and the rich have an incentive to promote policies that benefit the rich.

So, how do we address this inequality? There's not a lot of agreement on this. Some argue that education is the key to reducing the gap. Basically, workers with more and better education tend to have the skills that earn higher income. Some economists push for an increased minimum wage, which we're going to talk about in another episode. There's even an argument that access to affordable, high quality childcare would go a long way. And some think governments should do more to provide a social safety net, focus on getting more people to work and adjust the tax code to redistribute income.

Jacob: Some economists call for the government to increase income taxes and capital gains taxes on the rich. Income taxes in the US are already somewhat progressive, which means that there are tax brackets that require the rich to pay a higher percent of income. Right now, it peaks at around 40% but some economists call for increases up to 50 or 60%. One idea is to fix loopholes that the rich use to avoid paying taxes. Other economists argue that taxing the rich won't be as effective as reducing regulation and bureaucratic red tape. It's unclear which path we're going to take but extreme income inequality at the national and global level needs to be addressed.

Motivation to improve income inequality may come from a genuine desire to help people and level the playing field, or the fear of Hunger Games-style social upheaval. But either way, the issue can't be ignored.

Adriene: Even Adam Smith, the most classical of classical economists, said, "No society can surely be flourishing and happy of which the far greater part of the members are poor and miserable." Thanks for watching, we'll see you next week.

Jacob: Thanks for watching Crash Course Economics. It was made with the help of all of these nice people. You can help keep Crash Course free for everyone forever by supporting the show at Patreon. Patreon is a voluntary subscription service where you can support the show with monthly contributions. We'd like to thank our High Chancellor of Learning, Dr. Brett Henderson and our Headmaster of Learning, Linnea Boyev, and Crash Course Vice Principal Cathy and Kim Philip. Thanks for watching, DFTBA.