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CONCEPT: INCOME INEQUALITY IN THE USA AND WORLDWIDE

● **Income inequality** – the different levels of income earned across households.

□ Income inequality is a relevant economic issue: “The rich are getting richer, and the poor are getting poorer.”

Income Inequality in the United States			
Annual Income	Percentage of All Households	Annual Income	Percentage of All Households
Under \$10,000	7.1%	\$35,000 - \$49,999	14.0%
\$10,000 - \$14,999	5.8%	\$50,000 - \$74,999	17.9%
\$15,000 - \$24,999	11.8%	\$75,000 - \$99,999	11.9%
\$25,000 - \$34,999	10.9%	Over \$100,000	20.5%

Source: U.S. Census Bureau

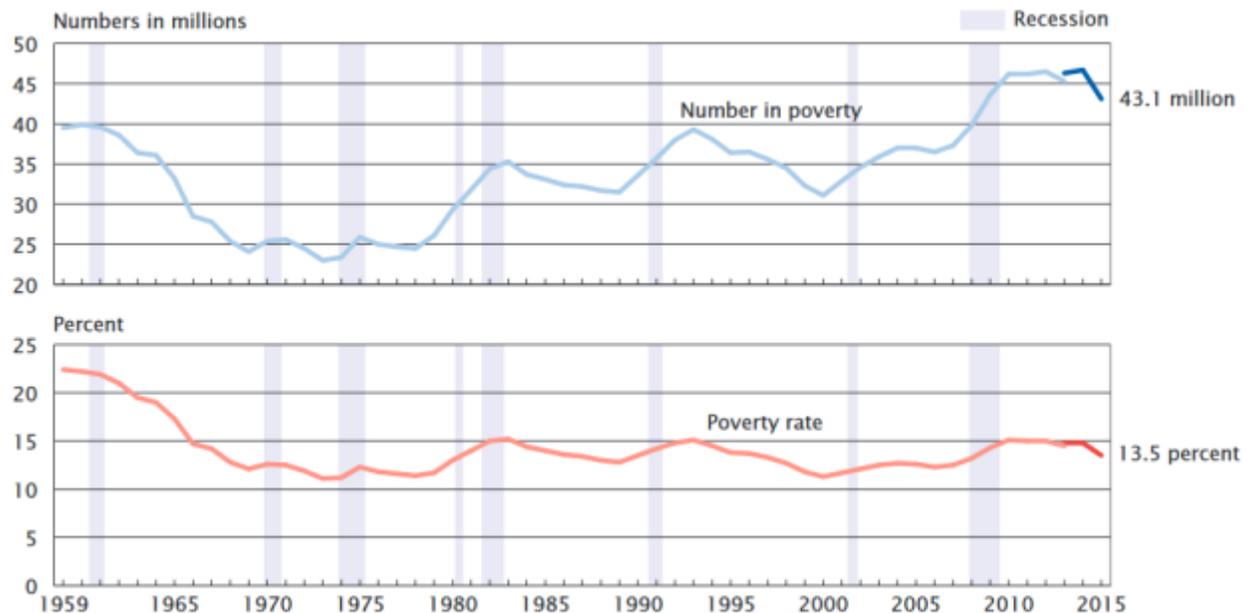
□ The United States is not the only culprit. Some countries have more drastic income inequality than the USA.

Income Inequality Around the Globe			
Country	Ratio of Income Received by Highest 20% to Lowest 20%	Country	Ratio of Income Received by Highest 20% to Lowest 20%
Bolivia	21.9%	Germany	4.5%
Brazil	17.4%	France	4.4%
Thailand	15.2%	Ireland	4.2%
Paraguay	15.0%	Sweden	3.7%
United States	14.8%	Japan	3.0%

Source: World Bank, Eurostat, and Statistics Canada

CONCEPT: POVERTY

- The **poverty line** is a level of income set by the government. Any family _____ this threshold is in poverty.
 - The poverty line depends on the size of the household
 - The 2017 poverty line for a four-person household is: _____
 - The **poverty rate** is the _____ of the population that is in poverty.



Source: U.S. Census Bureau, Current Population Survey

- Data about poverty excludes some sources of income for the poor.
 - **In-kind transfers** – a program that provides goods and services (i.e. food) rather than _____ to poor families
- Some significant trends associated with poverty include:
 - Poverty is correlated with race. Blacks and Hispanics are _____ times more likely to live in poverty than whites.
 - Poverty is correlated with age. Children are _____ likely to be members of poor families than the elderly.
 - Poverty is correlated with family composition.
 - Families headed by a single female (no spouse) are _____ times more likely to live in poverty.
- The conditions of poverty are generally self-_____.
 - The **poverty trap** is the mechanisms that cause poor people to _____.
 - **Credit constraint** – inability to get a loan even if the person expects to pay it back
 - Poor children generally attend worse schools (low funding) → _____ human capital

CONCEPT: POLICIES TO REDUCE POVERTY

- The government has created several programs and policies to help people in poverty
 - Minimum Wage Laws
 - **Welfare** – government programs that supplement the incomes of people in need
 - Negative Income Tax – poor families receive subsidies rather than pay taxes
 - Earned Income Tax Credit works like a negative income tax in the United States

EXAMPLE: Negative income taxes

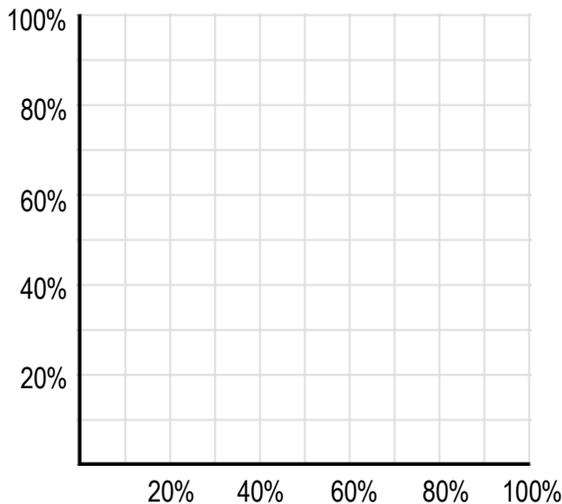
Taxes owed = (1/4 of income) - \$10,000	
Poor family earns \$12,000 Taxes owed =	"Rich" family earns \$60,000 Taxes owed =

- In-kind Transfers
 - Charities provide food, clothing, and toys during Christmas season
 - **Food stamps** are government _____ to buy food at grocery stores
 - Free healthcare available through Medicaid
- The use of anti-poverty programs causes issues with the **incentive to work**
 - Since benefits are lost as more income is earned, it could be **more costly** for a poor family to work.
 - Suppose a program guarantees every family an income of \$20,000. Anyone who would earn less than \$20,000 would be better off not working and receiving the government money.
 - Issue with Obamacare → as poor families earn more money, they no longer receive cheap healthcare.
 - The extra money they earn must be spent on the increased healthcare costs
 - Thus, there is no increase to the standard of living, even though income increased.

CONCEPT: LORENZ CURVE AND GINI COEFFICIENT

- The **Lorenz curve** helps visualize the _____ between rich and poor households.
 - The horizontal axis → _____ percentage of _____
 - The vertical axis → _____ percentage of _____
 - The Lorenz curve breaks the population into **quintiles**, each representing _____ percent of the population

Cumulative percentage
of _____



Quintile	Percentage of Total Income	Cumulative Percentage of Total Income
Lowest 20 percent	3.4%	
Second 20 percent	8.6%	
Third 20 percent	14.7%	
Fourth 20 percent	23.3%	
Highest 20 percent	50.0%	
Total	100%	

- The line of **perfectly equal distribution** depicts a situation with _____ income inequality
- The line of **complete inequality** depicts a situation where _____ household earns all the income
- The **Gini coefficient** is a ratio showing the level of income inequality in an economy.
 - Gini coefficient = 0 → completely _____ distribution of income
 - Gini coefficient = 1 → completely _____ distribution of income

$$Gini\ coefficient = \frac{A}{(A + B)}$$

A = area between Line of Equal Distribution and the Lorenz curve
B = area below Lorenz curve and above the x-axis

PRACTICE: Which of the following would represent the Lorenz curve of a nation where everyone earned equal income?

- a) The Lorenz curve would have a negative slope.
- b) The Lorenz curve would be U-shaped.
- c) The Lorenz curve would be a straight line with a slope of 1.
- d) The Lorenz curve would not exist.

PRACTICE: Which of the following is true regarding the Gini coefficient?

- a) The Gini coefficient will only fall when population rises quickly
- b) As income inequality rises, the Gini coefficient will fall
- c) As income inequality falls, the Gini coefficient will fall
- d) The Gini coefficient breaks the population into quintiles based on income

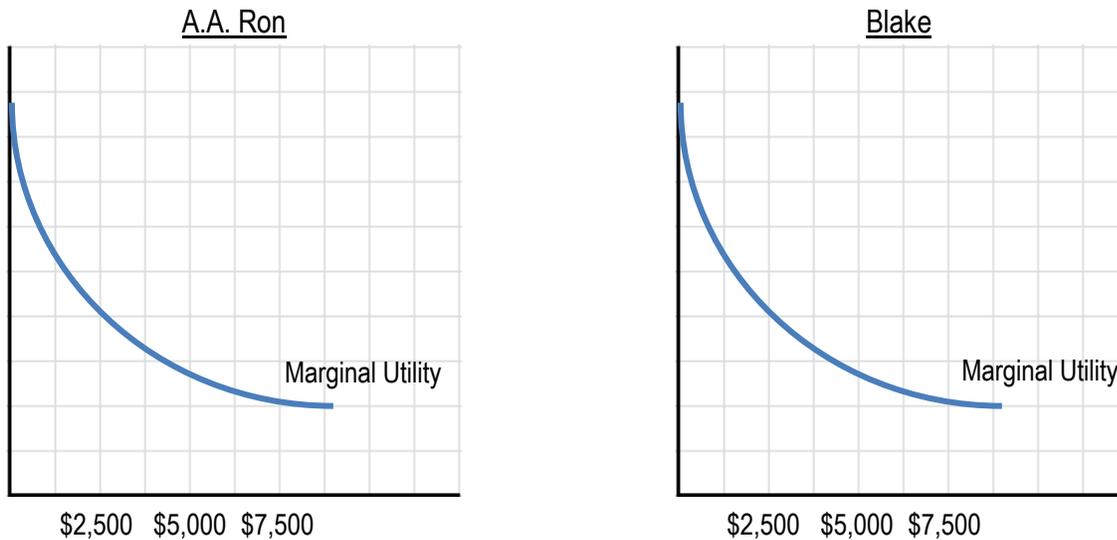
PRACTICE: The country of Newland has a Lorenz curve where the area between the line of equal distribution and the Lorenz curve is 0.22 and the area below the Lorenz curve is .46. What is the Gini coefficient for Newland?

- a) 0.22
- b) 0.32
- c) 0.46
- d) 0.68

CONCEPT: INCOME EQUALITY AND EFFICIENCY

- In the case of perfect equality, we maximize the total _____ of the population
 - **Utility** – a quantitative measure of _____ or satisfaction
 - **Marginal Utility** – the additional satisfaction from consuming one more unit (i.e. spending one more dollar)

EXAMPLE: Imagine an economy with two people, A.A. Ron and Blake (pronounced bah-lah-kay). A.A. Ron earns \$2,500 and Blake earns \$7,500. What happens if the government collects all income as revenue and distributes it evenly?



- In the case of perfect equality, the population lacks the _____ to work hard
 - "If you make the same income whether you work hard or not, why work hard?"
 - Greater equality comes with the _____ of reduced efficiency.
 - This is the **equality-efficiency trade-off**