

Chapter Twelve: Income Redistribution - Conceptual Issues (256 - 274)

Distribution of Income (257)

Should we even consider it as an issue?

Pareto optimality – an initial distribution of wealth....

Allows us to maximize what?

The principle of voluntary action

BUT: Welfare economics indicates that happiness and wealth not the same

And some wealth redistribution, at low cost,

Could vastly increase some people's happiness

AND: All policy has distributional implications

Where to put a park, what road to build, a new naval base...

Distribution of income:

Ricardo and the "Iron Law of Wages"

Malthusian economics

The Sustenance Wage

The "culturally minimal" sustenance wage

The poverty line

First developed in 1960s

An ABSOLUTE amount of money necessary to "survive"

Set at three times the cost of providing for food

Adjusted for family size

Assumes no Engels law...

Measures income, (not consumption)

In the U.S., number of people under it has declined

From 23% (1960) to 13% (2010)

Factors that increase the likelihood of being below the poverty rate....

Black, (Hispanic), Under 18, Divorced Female, DF w/children

Also, drug use, chronic unemployment, mental disease, etc.

Very tangled arguments about causality

Poverty vs. Squalor, Broke vs. Poor

Income Distribution

Envy?

Table 12.1 from book....

But note, top 5% have their own issues – the super-rich

Important notes about how the data is collected and calculated....

Cash plus in-kind transfers

In-kind transfers are NOT part of estimated income calculations

Food stamps, subsidized housing, public education, healthcare

Also, misses home production (numeric example)

The opportunity cost of home production varies widely across income groups
(see family size below)

Census Income ignores Taxes

Income figures measure Before Tax income

But people only consume after-tax income

(Numeric example.....)

Census Income is Measured Annually

A monthly measure would be absurd, does yearly work?

The Permanent income hypothesis, the life cycle hypothesis

(Numeric example.....)

Consumption vs. Income data

Consumption data tells a different story....

After all, consumption increases utility, not income

Also, income and consumption measures are diverging

Income disparities have gone up, but not consumption ones...

(numeric example....)

What is the Unit of Observation

Multi-person households

Changes in the family.....

Divorce (numeric example)

Uncounted people...

Some numbers –

74 percent of the poor own a car or truck; 70 percent have a VCR; 64 percent have a DVD player; 63 percent have cable or satellite TV; 53 percent have a video game system; 50 percent have a computer; 30 percent have two or more cars; and 23 percent use TiVo. Rasmussen's findings, reported by [The Washington Examiner](#)

poverty level for a family of four (2010) \$22,314

Rationales for Income Redistribution

Simple Utilitarianism

$$W = F(U_1, U_2, U_3 \dots, U_n)$$

The Utilitarian social welfare function, assumes $U = f(W, n, \dots)$

Pareto optimal indicates gains to utility even with identical income

The additive social welfare function is

$$W = U_1 + U_2 + U_3, \dots + U_n$$

Graph of Optimal welfare (income) distribution

Assumes: Utility is determined simply by Wealth (income)
 It does NOT have to be a linearly declining relationship
 But it DOES have to be identical between people
Diminishing marginal utility of wealth
 Otherwise \$ 100 to me or Bill Gates is irrelevant
 Diminishing MU for goods vs. income
Assume total income is fixed (the surplus)
 Redistributing wealth (income) has efficiency implications

The above leads to COMPLETE EQUALITY

Assumption 1. Is it possible to determine whether individuals have identical utility functions?
IN DEFENSE – Sen; any judgment we make about other people depends on our understanding of ourselves, and our ability to project our own feelings/desires onto others. Basically, we are all human, and can understand each other precisely enough

Also, one can make an ethical argument, even if we are not identical, we should be treated as if we were for purposes of income distribution.

Assumption 2. Can we assume decreasing marginal utility? It seems that for many (not all) goods, this is true, but does that mean it is also true for the aggregate (income) of all goods? If MU_i is constant at all levels of income?

Assumption 3. Is the surplus really fixed? It seems this would only be true if leisure was not part of the utility function, and/or there are no incentive effects when income is redistributed.

John Rawles “A Theory of Justice” (Buchanan/Tullock “A Calculus of Consent”)

What would people choose about society if they didn't know who they would be in Society?

Choosing from "behind the veil of ignorance"

Rawles argues that if we don't know who we would/will be – we will Maximin

The Maximin Criterion

Maximin is a strategy where you maximize the minimum result

$$W = \text{Min}(U_1, U_2, U_3, U_n)$$

Discussion of Rawlesian ethics

Pareto Efficient Income Redistribution

How to model Altruism in a Utility function

$U_1 = F(U_1, U_2, \dots, U_n)$ where we weight differing utility depending on various factors

In this formulation, redistribution may be Pareto-improving

We gain utility from the benefits others receive

Public vs. Private charity

So long as the government has an advantage in distribution, it can be
pareto-improving

Likewise the concept of "fair share"

The purchase of "social cohesion – *bread and circuses*"

Non-individualistic Views

So far, we have been using a utilitarian outlook

Summing up the happiness of individuals

Plato argued for an income distribution (republic) of 4:1

This was INDEPENDENT of user's tastes

So going from 4:1 to 500:100 would be worse than going to 40:10

Going absolutely from 4:1 to 10:1 is Pareto-improving

Empirically, many people claim to believe this

Far fewer actually seem to though. Kibitzes, communes, etc.

Trish the Witch

Related to this is **Commodity Egalitarianism**

This does not focus on all income, but rather on some commodities

Some commodities (health care, Food, primary education)

Should be provided to all at some level

But other commodities (TVs, Cigarettes, Alcohol) should not

Is it o.k. to give money to a beggar who smokes?

Both of the above imply giving as act that is good in and of itself

In other words, results don't matter, charity itself is good.

This still doesn't mean you feed the CHUDS

Other Considerations

All the above assumes income is common property,
that society (government) can redistribute at will.
But should distribute and can distribute are different things

Process vs. Outcomes

A different argument is that a fair process results in a fair distribution,
Even it that distribution is highly unequal (Robert Nozick 1974)
Attacked Utilitarianism “the Utility Monster”, The experience Machine
Jevons “better an unhappy man that satiated swine”

Robert Nozick “Anarchy, State and Utopia”

Nozick argued that “Income Distribution” is a meaningless phrase
Because income is earned by individuals
The only things you can do is redistribute wealth (often by destroying income)

Don't look for a good social welfare function, look for good rules
Equality of opportunity, not results
Deals well with different abilities, talents, and preferences
Also addresses chance
Did Bill Gates get lucky? Sure – so what.

Mobility

Related to the above, if the market provides enough mobility
Income distribution is of no particular ethical interests
If the poor move up (displacing some above them)
Then static numbers conceal churning within the distribution
Empirically, those who think they can move up
Are not that concerned with income distribution
Related point: concern is often within groups, not between groups
Who is jealous of Thaksin?
There is a fair amount of income mobility in the U.S.
Historically, much more so than Europe
that gap has closed in recent decades (Stiglitz)

Expenditure Incidence (268)

Measuring the actual impact of government redistribution efforts
Expenditure incidence can be either tax or spending.

Relative Price Effects

If you subsidize something, who benefits, the buyer or seller?

Book example: housing

U.S. example; university education

Post WWII G.I. Bill, definitely buyers.

Since then, much evidence to suggest Universities

University price inflation triple rate of inflation since late 1980s

*338*2 vs. 4,400*

So similar to tax incidence, who a program is target at and who benefits

Are distinctive things.

USAID

Public Goods

Do we all benefit equally?

Chatachuk park for the Poor, Middle-Class or Wealthy?

What about Defense?

Valuing In-Kind transfers

Again, how to measure them.

And do we measure them from the recipient

or donor's standpoint?

In kind transfers are administratively more complex

And often are inefficient

And often are about producer support

Graph this out..... (recall previous graphs about health care)

Conclusion (272)

Summary (273)

Discussion Questions (273)

Chapter