Chapter 14

# ECONOMIC INEQUALITY

*Essentials of Economics in Context* (Goodwin, et al.), 2nd edition

## Chapter Overview

This chapter starts by introducing the Gini coefficient as a standard measure of economic inequality. It then presents data on income and wealth inequality in the United States, along with a discussion of economic mobility. It also provides international and global data on inequality. The fourth section considers the causes and consequences of inequality, considering both higher-income and lower-income countries. The fifth section focuses on financialization and its relationship to inequality. The final section considers potential policies to address inequality and reform the financial sector.

## Chapter Objectives

After reading and reviewing this chapter, you should be able to:

1. Describe trends in income and wealth inequality in the United States in the past few decades.
2. Discuss how economic mobility relates to inequality.
3. Describe recent trends in global inequality, including why the global Gini coefficient is higher than the Gini coefficient of almost every country.
4. Discuss the major causes of rising economic inequality.
5. Describe what is meant by financialization and how it relates to rising inequality.
6. Discuss policy measures that can reduce inequality in higher-income and lower-income countries.

## Key Terms

Gini coefficient
economic mobility

financialization
Kuznets curve hypothesis

**Active Review**

*Fill in the Blank*

1. If income were perfectly equally distributed within a country, the value of the Gini ratio for that country would be _____.

2. The distribution of wealth tends to be _____ (more/less) unequal than the distribution of income.

3. The potential for an individual or household to change their economic conditions over time is known as _____.

4. The Kuznets curve hypothesis states that inequality should first _____ (increase/decrease) during the initial stages of economic development and then _____ (increase/decrease) with further development.

5. The process of increasing size and importance of the financial markets in the operation of the economy is known as_____.

6. The main policy many European countries use to lower inequality is _____.

*True or False*

7. If income is very unevenly distributed in a country, its Gini coefficient will be negative.

8. The richest fifth of American households receive more than half of all income.

9. The Gini coefficient in the United States is currently around 0.49.

10. It is possible for a household to have negative net wealth.

11. White households in the United States have, on average, about double the net worth of black households.

12. While income inequality is relatively high in the United States, its economic mobility is also high.

13. The lowest country-level Gini coefficients are about 0.30.

14. Over the last few decades, the global Gini coefficient has significantly increased.

15. A commonly accepted cause of rising inequality in many countries is an increase in political partisanship.

16. Globalization is a major factor for the growth of top incomes in rich countries.

17. Climate change is increasing inequality in lower-income countries.

18. Economic inequality tends to be associated with higher rates of economic growth.

19. The Glass-Steagall Act was passed as a response to the 2007-2008 financial crisis.

20. The most effective policy to reduce income inequality in the United States would be to raise the minimum wage.

21. A tax on financial transactions would further increase income inequality.

*Short Answer*

22. Briefly explain why the global Gini coefficient is decreasing even though the Gini coefficient for most countries is increasing.

23. List the six main causes of rising inequality in most higher-income countries.

**Self Test**

1. In the year 2020, suppose the Gini ratio for Canada was 0.30 and the Gini ratio for the US was 0.50.  In the year 2025, suppose the Gini ratio for Canada rises to 0.35 and that for U.S. was 048. Which of the following statements is true?

   a. Canada has greater inequality than the US.
   b. Canada has greater inequality in 2025 than it did in 2020.
   c. Inequality in U.S. has increased from 2020 to 2025.
   d. Both (a) and (c) are false.
   e. All of the above are false.

2. The richest fifth of Americans receive about what percent of all income?

   a. 35%
   b. 43%
   c. 52%
   d. 63%
   e. 75%

3. The Gini coefficient for wealth in the United States is approximately …

   a. 0.35
   b. 0.49
   c. 0.62
   d. 0.71
   e. 0.85

4. Which one of the following statements is false?

   a. The top 10 percent of American households by wealth own more than the bottom 50 percent of households.
   b. Median household income in the United States is higher for white and Asian households compared to black and Hispanic households.
   c. Median household assets tend to increase with higher levels of education.
   d. Median household assets are nearly twice as high for white households as compared to black and Hispanic households.
   e. Individuals in the United States that identify as lesbian, gay, bisexual, or transgender (LGBT) have lower average assets than those who identify as straight.

5. What is the most common way to measure economic mobility?

   a. Comparing one's income as an adult to their parents' income.
   b. Comparing one's education level to their parents' education.
   c. Comparing one's income in retirement to their income during their working years.
   d. Comparing one's income as they change jobs over their lifetime.
   e. Comparing one's potential to relocate to new states or countries over time.

6. Which of the following statements is true?

   a. The U.S. has the lowest Gini ratio of all major industrialized countries.
   b. The U.S. has the highest Gini ratio of any country.
   c. Gini ratios for income tend to be higher than Gini ratios for wealth.
   d. The U.K. has a higher Gini ratio than the U.S.
   e. Countries with high levels of equality have high Gini ratios.

7. Which of the following countries has the lowest Gini coefficient?

   a. The United States
   b. China
   c. South Korea
   d. Russia
   e. Brazil

8. The global Gini coefficient for income is approximately …

   a. 0.49
   b. 0.67
   c. 0.78
   d. 0.85
   e. 0.94

9. What is the main reason the global Gini coefficient has changed over the last few decades?

   a. The growth of the global middle class
   b. Financialization
   c. The growth of corporate power
   d. Changes in tax codes
   e. Technological changes

10. Which one of the following is not an explanation for the increase in economic inequality in most higher-income countries?

    a. An ageing population
    b. Increasing national debt levels
    c. The declining power of labor unions
    d. Technological changes
    e. Financialization

11. What is the Kuznets curve hypothesis?

    a. That economic inequality increases with economic development.
    b. That economic inequality decreases with economic development.
    c. That economic inequality first increases, then decreases, with economic development.
    d. That economic inequality first decreases, then increases, with economic development.
    e. None of the above.

12. Which one of the following impacts is most accepted by economists to be a consequence of increasing inequality?

    a. Greater economic growth
    b. Lower economic growth
    c. Higher homicide rates
    d. Greater social cohesion
    e. Greater public investment

13. Which one of the following statements is false?

    a. The Glass-Steagall Act separated investment and commercial banks.
    b. The shadow banking system is subject to fewer regulations than standard banks.
    c. The financial sector in the United States accounts for about 8 percent of GDP.
    d. The financial sector has been increasing relative to GDP in the U.S. but decreasing relative to GDP in other high-income countries.
    e. Household in the United States have become more dependent on the financial sector in recent decades.

14. According to the International Labor Organization, the main cause of increasing inequality in higher-income countries is …

    a. Globalization
    b. Inflation
    c. Tax law changes
    d. Technological change
    e. Financialization

15. Which one of the following statements is false?

    a. The gains during recent economic recoveries in the United States went mostly to richer households.
    b. Stock buybacks have contributed to rising financialization.
    c. Increasing financialization is associated with rising inequality.
    d. Recent financial crises have tended to lower economic inequality.
    e. Most American households own stocks, either directly or through their retirement accounts.

16. Policies to reduce inequality include all the following, *except*:

    a. Lowering corporate taxes
    b. Increasing minimum wages
    c. Strengthening labor unions
    d. Increasing investment in human capital
    e. Providing support to low-income workers

17. What is the main policy used to lower Gini coefficients in most European countries?

    a. High minimum wages
    b. A system of progressive taxes
    c. A system of progressive transfers
    d. Shorter work weeks
    e. Student loan forgiveness

18. Which one of the following has not been proposed as a way to reduce inequality in low-income countries?

    a. Eliminate fossil fuel subsidies
    b. Increase the rights of women
    c. Raise the minimum wage
    d. Increase spending on public services
    e. Increase tariffs

19. Proposals for regulating the financial system all of the following except:

    a. A financial transactions tax
    b. Fostering bank mergers
    b. Reinstituting a version of the Glass-Steagall Act
    c. Blocking the revolving door between lobbying and politics
    d. Encouraging cooperatives

20. A Tobin tax is a tax on …

    a. large banks
    b. high-income households
    c. financial transactions
    d. corporate profits
    e. large estates

**Answers to Active Review Questions**
1. 0
2. more
3. economic mobility
4. increase; decrease
5. financialization
6. a system of progressive transfers
7. False
8. True
9. True
10. True
11. False. White household assets are about 12 times higher than black household assets.
12. False. Economic mobility in the U.S. is relatively low.
13. True.
14. False.
15. False.
16. True.
17. True
18. False.
19. False. The Glass-Steagall Act was passed in 1933 in response to the Great Depression.
20. False. Raising the minimum wage in the U.S. would not have a large effect on inequality because many minimum wage earners are from households that aren't poor.
21. False.
22. Economic growth in countries such as China, India, and other low- and middle-income countries is unevenly distributed as income gains are primarily found in urban areas. However, this economic growth has significantly increased the global middle class. A few decades ago, the world income distribution displayed two peaks – the

world's poor and the world's rich. Now, the largest group is in the middle of the global income distribution. Thus overall, global inequality is decreasing.

23. The six main causes are: demographic changes, globalization, technological change, the decline of labor unions, domestic policy changes, and financialization.

**Answers to Self Test Questions**

| | |
|---|---|
| 1. B | 11. C |
| 2. C | 12. B |
| 3. E | 13. D |
| 4. D | 14. E |
| 5. A | 15. D |
| 6. E | 16. A |
| 7. C | 17. C |
| 8. B | 18. E |
| 9. A | 19. B |
| 10. B | 20. C |