Income Distribution
ECON 473

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McGill University
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Course description and objectives

Income inequality has been a topic of long-standing interest to economists. Its importance to society is hard to overstate. Recent increases in income inequality in many developed countries have heightened this interest.

The purpose of this course is to develop a theoretical understanding of the ideal distribution of income, consumption and wealth; to build on this to develop methods of measuring inequality, life-time and intergenerational mobility; to translate these tools into empirical analysis of various countries; to analyze potential determinants of changes in income distribution and mobility; and to discuss the theory and empirics of redistributing income.

Administrative Issues

3 credits
2 lectures per week, Mon and Wed 11:35pm-12:55pm in BURN 1B36

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office hours: Mon 4.15pm-6.15pm in Leacock 320. Please sign up beforehand on the sheet I'll post on the office door.

Prerequisites and tools: *ECON 230 or ECON 250; ECON 227 or ECON 257 or equivalent; Calculus 1 and 2.*
The theoretical part of the course uses both differential and integral single-variable calculus in analyzing social welfare functions and inequality measures. The empirical part of the course requires the ability to run ordinary least squares regressions and to interpret their results. More advanced knowledge of econometrics is helpful but not required. The course will make use of some economic tools you may have already encountered in intermediate micro, related to insurance, taxation, labor supply and utility possibility frontiers; these will be reviewed in class. Although macro is not a prerequisite, you may also encounter some concepts that students who have taken intermediate macro would be familiar with.

Several problem sets will require the use of statistical software. STATA is the statistical software used by most empirical economists. Its great advantage for the purpose of this course is

that users have programmed various measures of inequality and poverty that can be downloaded (if you have write permission in the applications folder of your computer) and used. I recommend you use STATA for the empirical problem sets and the research paper, although if you know how to compute things such as the Generalized Entropy Index of inequality in other software you can use another software. To get started with STATA, watch the movies and use the data at `http://www.ats.ucla.edu/stat/stata/sk/default.htm`.

Course materials: There is no textbook covering all class topics. Some of the material is covered in two books, which are on reserve in the library:

[W] Edward N. Wolff (2009), *Poverty and Income Distribution,* 2nd edition, Wiley Blackwell.

[C] Frank Cowell (2011), *Measuring Inequality,* 3rd edition, Oxford University Press.

However, we will only use parts from each book. The books will be complemented by journal articles. I will post the articles on *mycourses* as we go along. Warning: The list of articles in the course outline is incomplete.

Continuous class attendance is strongly encouraged. Any points raised in class can end up in the examinations.

Finally, I will occasionally post links to news articles on Twitter (@mposchke) or on mycourses. These are for your background information and not required reading, except for the ones that I may from time to time discuss in class.

mycourses: I will use *mycourses* for posting relevant materials such as readings and problem sets and for making announcements. You should therefore regularly check the course's *mycourses* page.

Grading: The grade for the course will be based on two assignments, a group presentation, a final exam, and class participation. The *final exam* will account for 60% of the grade and will take place in the end-of-term exam period. It will be a three-hour closed book exam covering the entire course. If you miss it due to medical reasons, the usual McGill procedures apply.

The *group presentation* will account for 10% of the grade. Presentations will last 20-30 minutes and will be scheduled throughout the course. I will make guidelines for a good presentation available in due time. Groups will consist of four students who will be tasked to prepare the presentation together and can decide on how to execute it. The papers to be presented are listed below. Since the first presentations will take place early, you need to select a paper for presentation by Jan 21. To do so, I will create a discussion topic for each paper listed below on *mycourses.* To sign up for joining the group presenting that paper, post your name there. First come, first served.

Once all presentations have been assigned, I will publish preliminary target dates for presentations. I will assign each group a final date with at least one week's notice before the presentation. Each group needs to send me their presentation at least 30 minutes before class. All group members need to be present at the presentation. I expect the rest of the class to be engaged with presentations, and strongly encourage all to read at least the introduction of papers that are presented.

There will also be two *assignments*, each worth 12.5% of the final grade. Each assignment may consist in short essays and in exercises that involve working with theory and/or with data. Due dates *tba.* No late assignments will be accepted.

I may also on occasion give you questions to ponder at home that will not be formally evaluated, but that will be discussed in the following class. Participation in these discussions and your class participation more generally account for the final 5% of the grade.

Obligatory statements: In case of absence at the final exam for medical reasons, please refer to the University Regulations Concerning Final Examinations. Note: According to Senate regulations, instructors are not permitted to make special arrangements for final exams. Please consult the Calendar, section 4.7.2.1, General University Information and Regulations at www.mcgill.ca. Also note: In accord with McGill University's Charter of Students' Rights, students in this course have the right to submit in English or in French any written work that is to be graded. Finally: In the event of extraordinary circumstances beyond the University's control, the content and/or evaluation scheme in this course is subject to change.

McGill University values academic integrity. Therefore all students must understand the meaning and consequences of cheating, plagiarism and other academic offences under the code of student conduct and disciplinary procedures (see `http://www.mcgill.ca/integrity/` for more information).

L'université McGill attache une haute importance à l'honnêteté académique. Il incombe par conséquent à tous les étudiants de comprendre ce que l'on entend par tricherie, plagiat et autres infractions académiques, ainsi que les conséquences que peuvent avoir de telles actions, selon le Code de conduite de l'étudiant et des procédures disciplinaires (pour de plus amples renseignements, veuillez consulter le site `http://www.mcgill.ca/integrity`).

Course outline

The course outline is subject to revisions, the order of topics may be changed, and topics may be dropped or added depending on the pace of the course. I have made the outline very detailed to give you a good impression of what to expect.

1. Introduction (W1)

2. Measurement

    (a) Some popular inequality measures (C 2, W3.1-3.3)

    (b) Theory and measurement (C 1, 3)

3. Inequality within and across countries

    (a) Income inequality (W3.4-3.5, *Review of Economic Dynamics* special issue, Piketty and Saez (2003))

    Presentations 1-3 (Canada, Germany, Mexico)

(b) Wealth inequality (W5)

(c) Consumption inequality (Krueger and Perri 2006)

(d) Mobility (W6, Solon (2002))

(e) Global income inequality and a bit of history (Atkinson, Piketty and Saez 2011)

Presentations 4-5

4. Income inequality and its sources

(a) Factor shares and their evolution

Presentation 6

(b) The labor market and wage dispersion

(c) The human capital model (W8, X)

(d) "Explained" and "unexplained" inequality

(e) Skill-biased technical change...

... and welfare

(f) "Polarization"

(g) Structural change

Presentation 7

(h) Wage dynamics

(i) Job ladders, search

(j) Unemployment

Presentation 8

(k) The "top 1%", CEOs

Presentations 9-10

(l) Trade

(m) Changing institutions

5. Wealth inequality and its sources

(a) A simple model of wealth dynamics

(b) Motives for saving (W10, X)

(c) A simple model of "incomplete markets"

(d) Entrepreneurship and wealth accumulation

6. Income redistribution

(a) An overview of redistributive policies

(b) Do they work?

(c) Consequences of inequality and redistribution for individual behavior (partial equilibrium)

(d) Consequences of inequality and redistribution for macro outcomes (general equilibrium): saving, investment, growth

List of papers for group presentations

1. Brzozowski, Gervais, Klein and Suzuki (2010) on inequality in Canada

2. Fuchs-Schndeln, Krueger and Sommer (2010) on inequality in Germany

3. Binelli and Attanasio (2010) on inequality in Mexico

4. Bourguignon and Morrisson (2002) on long run trends

5. Sala-i Martin (2006) on very long run trends

6. Elsby, Hobijn and Şahin (2013) on the labor income share in the U.S.

7. Buera and Kaboski (2012) on structural change and new jobs in services

8. Elsby, Hobijn and Şahin (2011) on unequal unemployment

9. Alvaredo, Atkinson, Piketty and Saez (2013), Kaplan and Rauh (2013) on the top 1%

10. Mankiw (2013), Gabaix and Landier (2008) on CEOs and entrepreneurs

References

Alvaredo, F., Atkinson, A. B., Piketty, T. and Saez, E. (2013), 'The top 1 percent in international and historical perspective', *Journal of Economic Perspectives* **27**(3).

Atkinson, A. B., Piketty, T. and Saez, E. (2011), 'Top incomes in the long run of history', *Journal of Economic Literature* **49**(1), 3–71.

Binelli, C. and Attanasio, O. (2010), 'Mexico in the 1990s: The main cross-sectional facts', *Review of Economic Dynamics* **13**(1), 238 – 264. ¡ce:title¿Special issue: Cross-Sectional Facts for Macroeconomists¡/ce:title¿.
URL: *http://www.sciencedirect.com/science/article/pii/S1094202509000581*

Bourguignon, F. and Morrisson, C. (2002), 'Inequality among world citizens: 1820-1992', *American economic review* pp. 727–744.

Brzozowski, M., Gervais, M., Klein, P. and Suzuki, M. (2010), 'Consumption, income, and wealth inequality in canada', *Review of Economic Dynamics* **13**(1), 52 – 75. ¡ce:title¿Special issue: Cross-Sectional Facts for Macroeconomists¡/ce:title¿.
URL: *http://www.sciencedirect.com/science/article/pii/S1094202509000611*

Buera, F. J. and Kaboski, J. (2012), 'The rise of the service economy', *The American Economic Review* **102**(6), 2540–2569.

Elsby, M. W., Hobijn, B. and Şahin, A. (2011), 'Unemployment dynamics in the oecd', *Federal Reserve Bank of San Francisco Working Paper* **2009-04**.

Elsby, M. W. L., Hobijn, B. and Şahin, A. (2013), 'The Decline of the U.S. Labor Share', *Brookings Papers on Economic Activity* .

Fuchs-Schndeln, N., Krueger, D. and Sommer, M. (2010), 'Inequality trends for germany in the last two decades: A tale of two countries', *Review of Economic Dynamics* **13**(1), 103 – 132. ¡ce:title¿Special issue: Cross-Sectional Facts for Macroeconomists¡/ce:title¿.
URL: *http://www.sciencedirect.com/science/article/pii/S1094202509000532*

Gabaix, X. and Landier, A. (2008), 'Why Has CEO Pay Increased So Much?', *Quarterly Journal of Economics* **123**(1), 49–100.

Kaplan, S. N. and Rauh, J. (2013), 'It's the market: The broad-based rise in the return to top talent', *Journal of Economic Perspectives* **27**(3).

Krueger, D. and Perri, F. (2006), 'Does income inequality lead to consumption inequality? evidence and theory', *The Review of Economic Studies* **73**(1), 163–193.

Mankiw, N. G. (2013), 'Defending the one percent', *Journal of Economic Perspectives* **27**(3).

Piketty, T. and Saez, E. (2003), 'Income inequality in the united states, 1913–1998', *The Quarterly Journal of Economics* **118**(1), 1–41.

Sala-i Martin, X. (2006), 'The world distribution of income: Falling poverty and convergence, period', *The Quarterly Journal of Economics* **121**(2), 351–397.
URL: *http://qje.oxfordjournals.org/content/121/2/351.abstract*

Solon, G. (2002), 'Cross-country differences in intergenerational earnings mobility', *The Journal of Economic Perspectives* **16**(3), 59–66.