Lecture 25: Income Inequality & Black Markets

Benjamin Graham
Today’s Plan

• Papers are due now.
• Housekeeping
• Reading Quiz

• Today’s topics:
  • Income Inequality
  • Black Markets
Housekeeping

• Papers are due now.

• Next spring you should take either IR 309: Introduction to Global Governance or IR 313: Religion and Violence with Professor Saha
Reading Quiz

• What type of tax was the reading talking about?
  • A. Income Tax
  • B. Sales Tax
  • C. Value-Added Tax
  • D. Wealth Tax
  • E. Land Tax
U.S. Inequality Over Time

Income in 2007 US$

- 95th percentile
- 80th percentile
- 60th percentile
- 40th percentile
- 20th percentile

Years:
Top 1% share over time (in U.S.)

Annual U.S. income share of the Top 1%

- 1928: 23.9%
- 2007: 23.5%
- Great Depression

Dates:
- 1910
- 1930
- 1950
- 1970
- 1990
- 2010
Notes on Piketty

• Wealth inequality vs. income inequality
  • Earned vs. inherited income
  • Wealth Taxes, Land Taxes, and Estate Taxes

• Financial Times plays cop
  • Comes away looking a little petty and foolish

• $R > G$ is probably less important than savings rates of the rich and poor
Deadweight Loss

TR = Tax Revenue
DL = Deadweight Loss

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Global Inequality

**Worldwide gaps**

Global inequality—between world citizens—is higher than inequality within even the most unequal individual countries.

(Gini coefficient)

Sources: For United States and Sweden, Luxembourg Income Survey database; for Brazil, Socio-Economic Database for Latin America and the Caribbean (SEDLAC); for the world, Milanovic (forthcoming). The 2008 world Gini is a preliminary estimate.

Note: Gini based on disposable income.
Global Inequality

[Graph showing trends in global inequality from 1970 to 2005, comparing different estimates and methodologies.]
Is Income Inequality Self-Correcting in Democracies?

- Income inequality may be self-correcting in a democracy. Can we work through how that would work?

- Hints:
  - A. Each person gets one vote
  - B. The government sets the level of redistribution — i.e. the level of taxes and the level of government spending on welfare, unemployment etc.
Five Reasons for Failure to Self Correct in the U.S.

• Bonica et al. 2014, JEP article
• 1. Ideological shift toward a particular form of free market capitalism
• 2. Immigration and low voter turnout among the poor
• 3. Rising real incomes means a higher share of the public don’t need social safety net programs.
• 4. Campaign contributions, lobbying etc. give the rich a disproportionate voice in the political process.
• 5. Institutions the limit the accountability of politicians to voters and induce gridlock
Hundred Dollar Bills

- 80% of U.S. currency is in $100 bills
  - Under mattresses (savings)
  - Used in the “informal economy”

- Seignorage is worth about $20 billion a year to the U.S.
  - Used to be more - credit cards are displacing cash
The Black Market

- Upsides of operating in the black market
  - A. No taxes
  - B. No regulation (e.g. drugs, guns, prostitution, stolen goods)
  - C. Anonymity
- Downsides of operating in the black market
  - A. No protection from the cops
  - B. No access to banks
    - This is a tough combination
When do Black Markets Emerge?

- Any time taxes, tariffs, or regulations are high
  - Cash-only businesses, under-the-table employment
    - Avoid taxes, avoid labor laws
  - Smuggling avoids tariffs and quotas
  - Bans on goods/services people want to sell and consume don’t stop trade in those goods/services
Why is there still black market weed in Colorado?

• A. Because taxes are high
• B. Because people don’t know it’s legal
• C. Because businesses are heavily regulated
• D. A & B
• E. All of the above
Why do people hire nannies under the table?

• A. Because taxes are high
• B. Because employment paperwork is onerous
• C. Because some nannies are undocumented
• D. A & B
• E. All of the above
U.S. Drug Interdiction

• Why do we spray poppies in Afghanistan and Colombia?