

Econ 133 – Global Inequality and Growth

Inequality between individuals: The role of government

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Roadmap

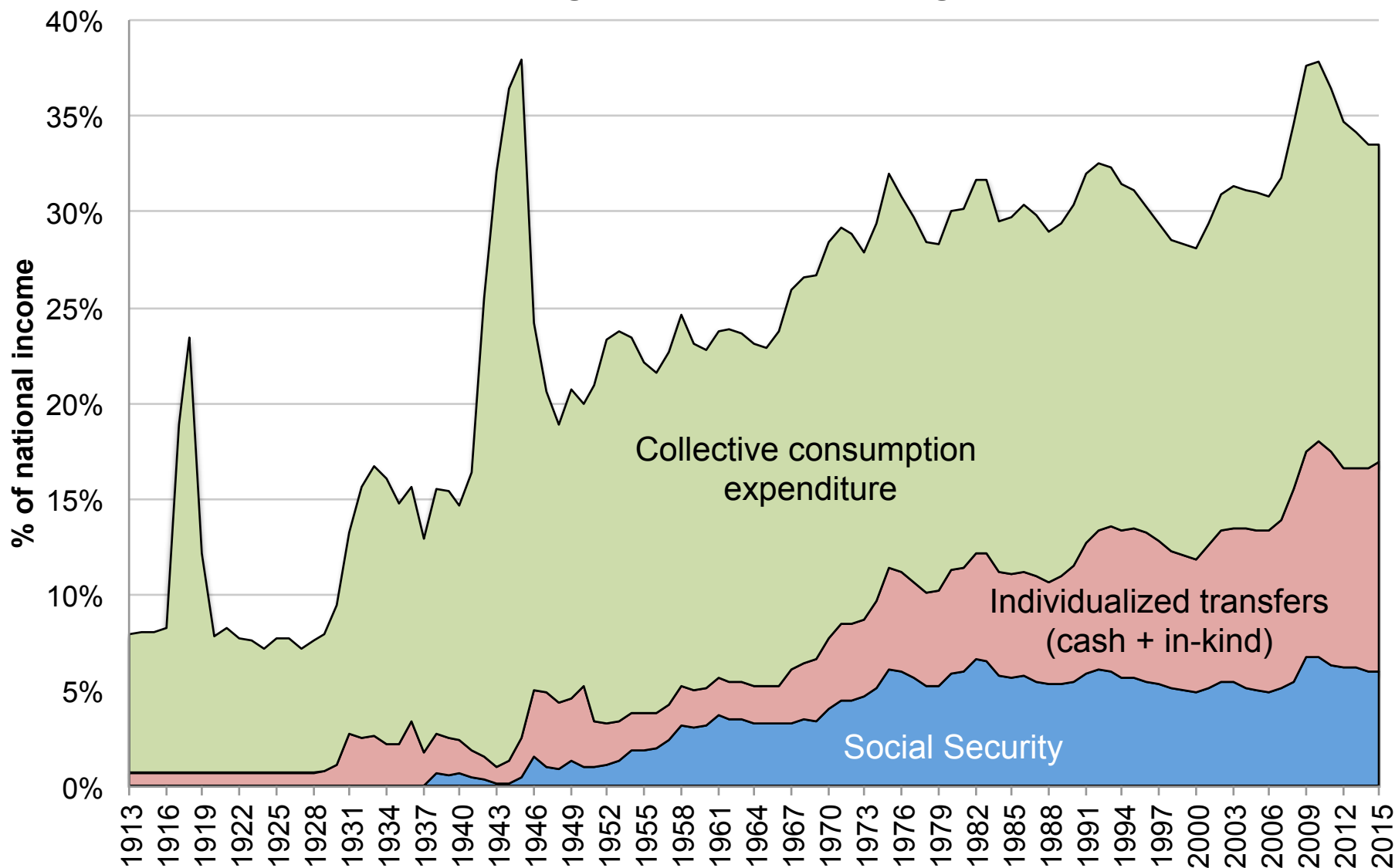
- What does the government do?
- Post-tax vs. pre-tax inequality
- Who pays taxes?
- Who receives government transfers?

1 What does the government do?

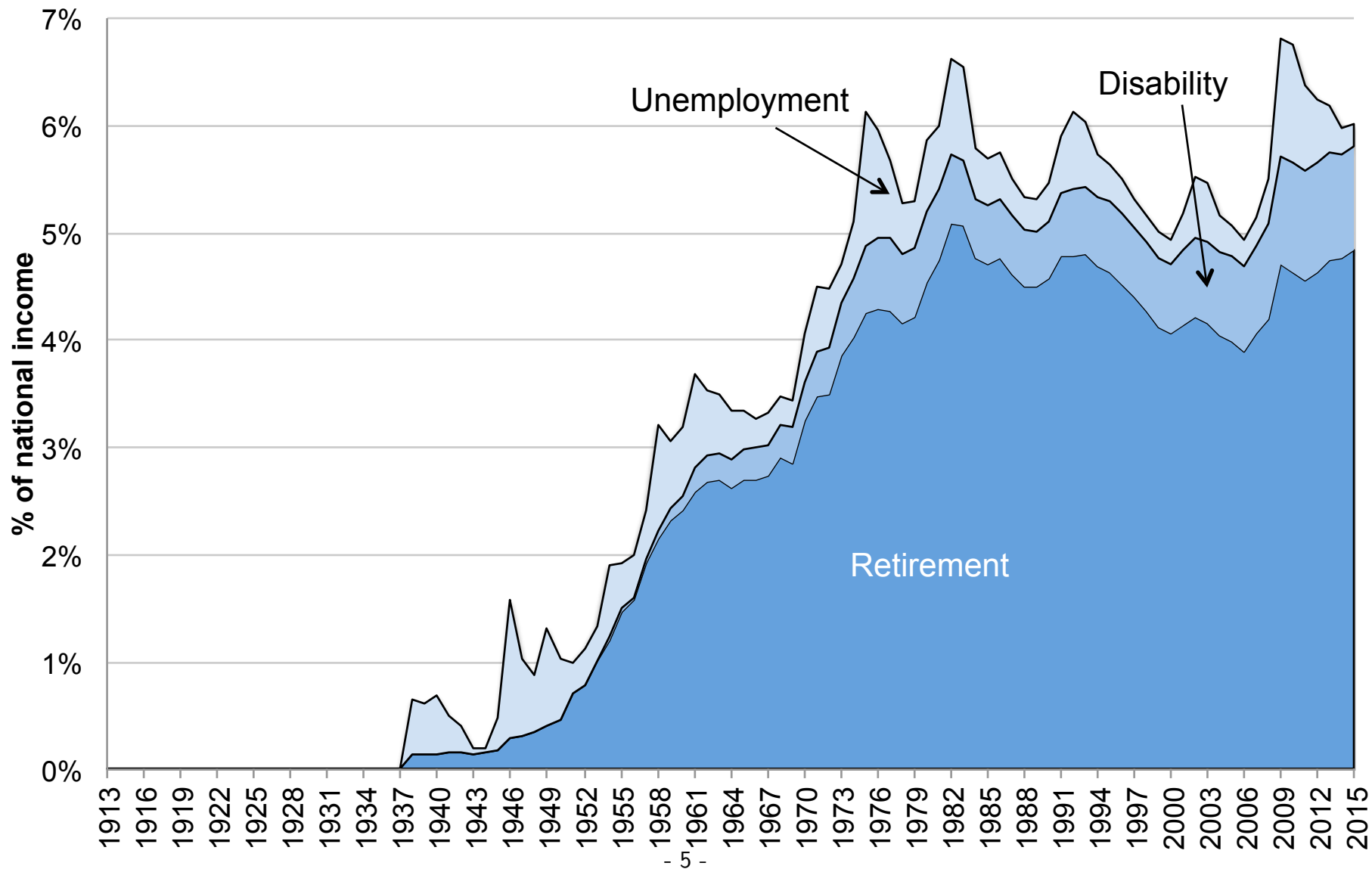
Governments tax and redistribute a big fraction of national income

- US: 1/3 of national income
- Europe: 40-50% of national income
- Developing countries: 5-30% of national income
- Strong correlation between development and size of gov.

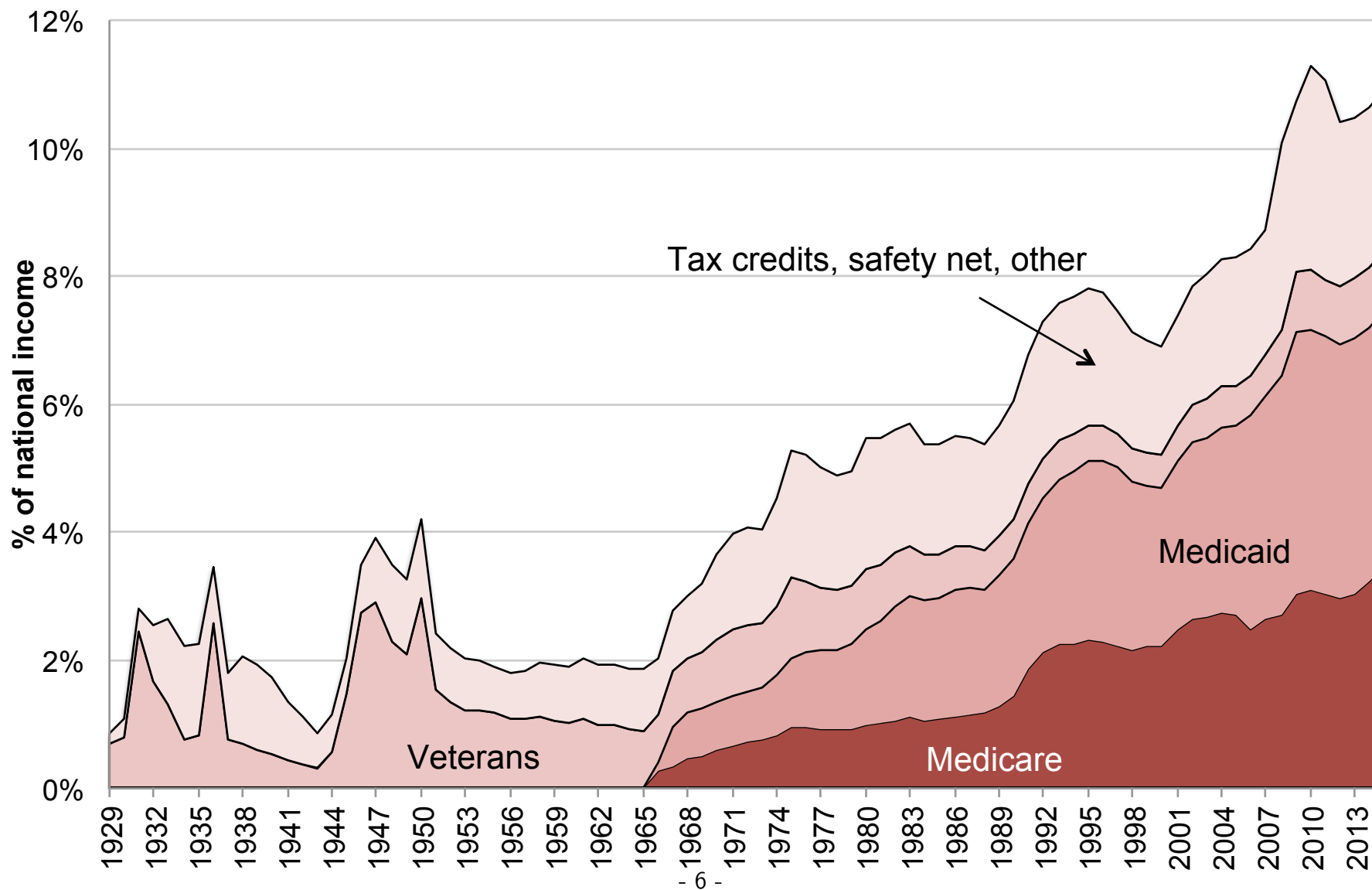
US government spending



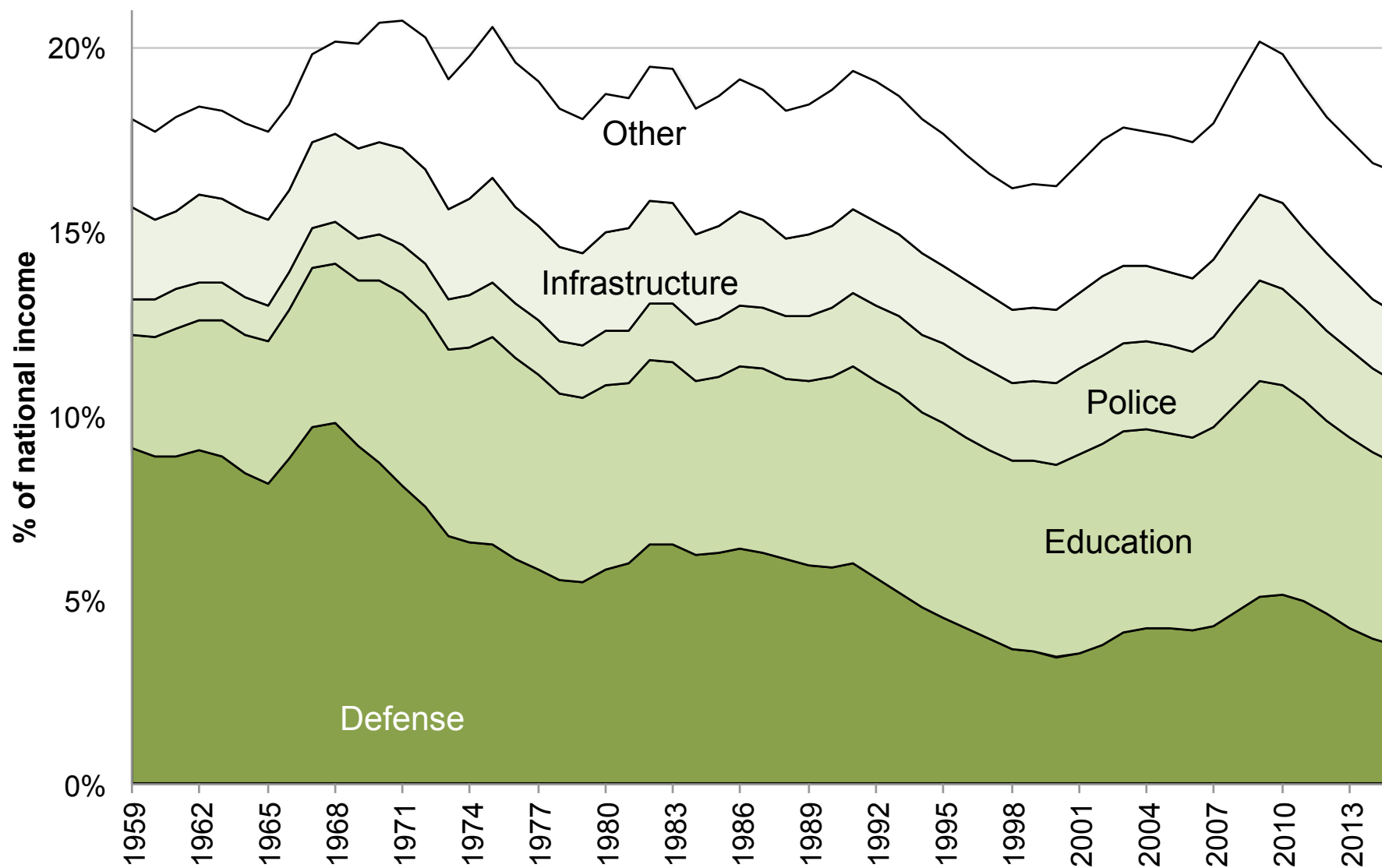
Social Security spending



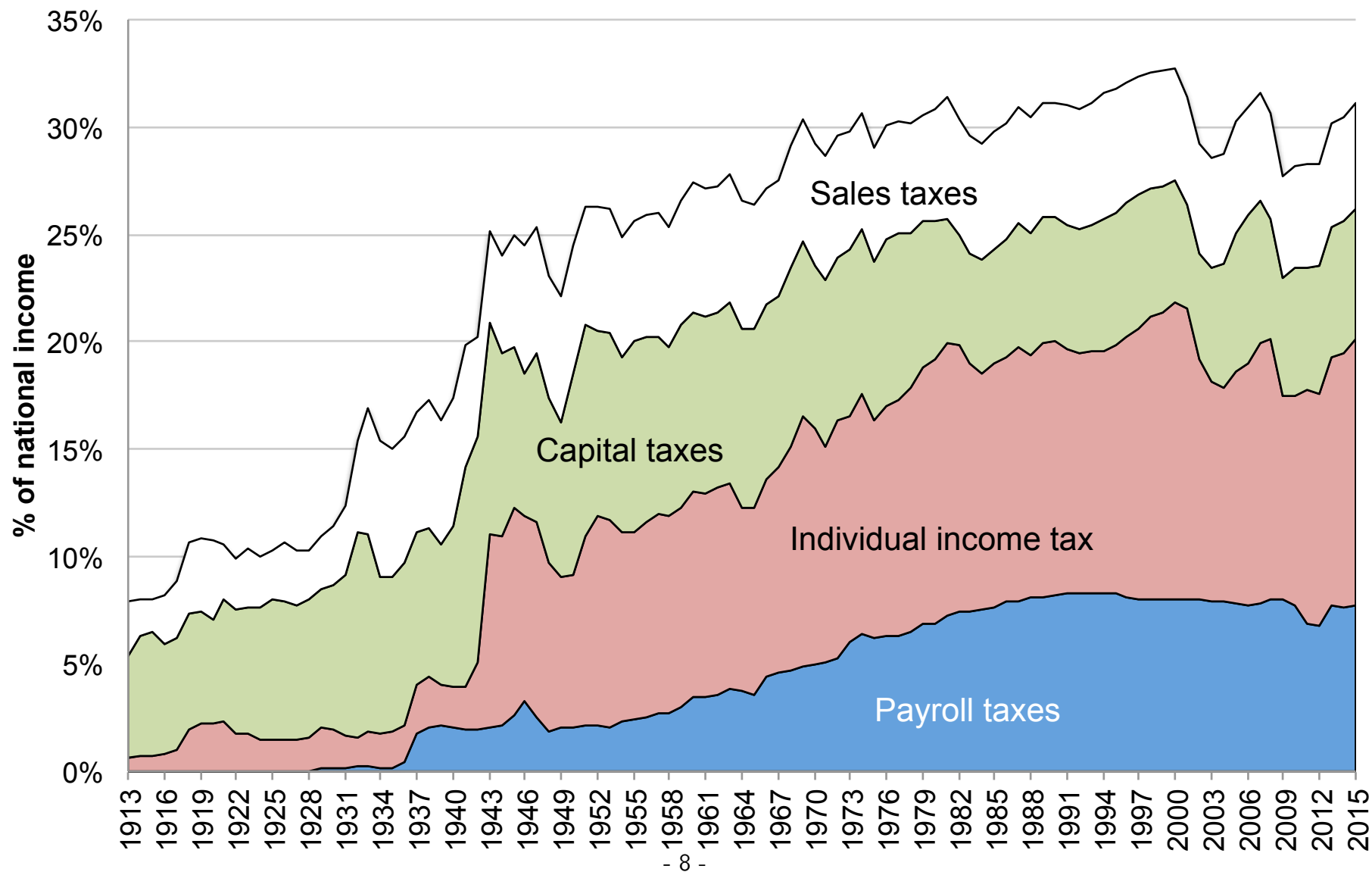
Individualized transfers (cash + in-kind)



US government collective consumption expenditure



Tax revenue in the US



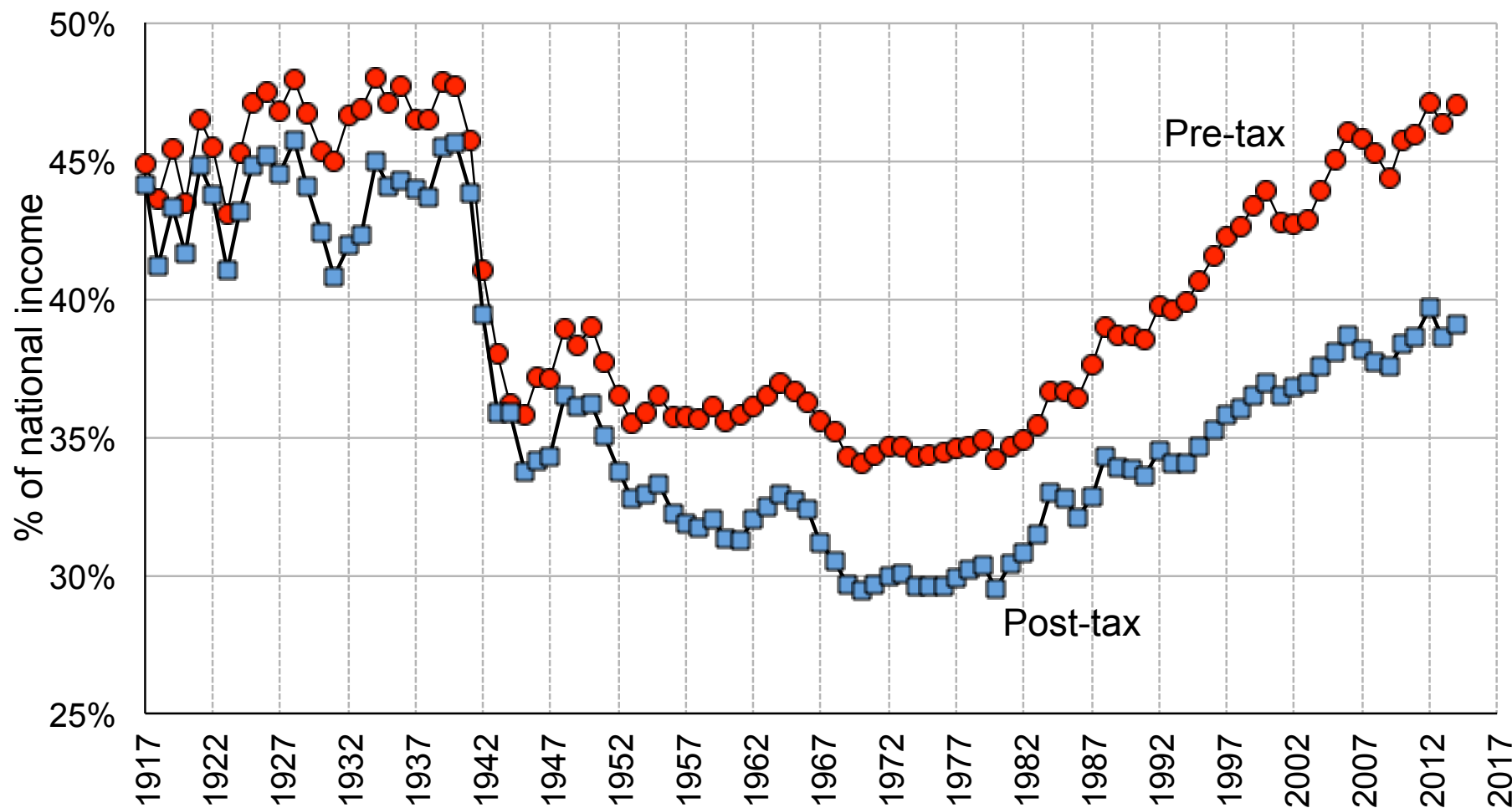
2 Post-tax vs. pre-tax inequality

- Denote z pre-tax income, $y = z - T(z) + B(z)$ post-tax income
- If inequality in y is less than inequality in $z \Leftrightarrow$ tax and transfer system is redistributive (or progressive)
- If inequality in y is more than inequality in $z \Leftrightarrow$ tax and transfer system is regressive
- US tax and transfer system is overall redistributive: post-tax

income is more equally distributed than pre-tax income

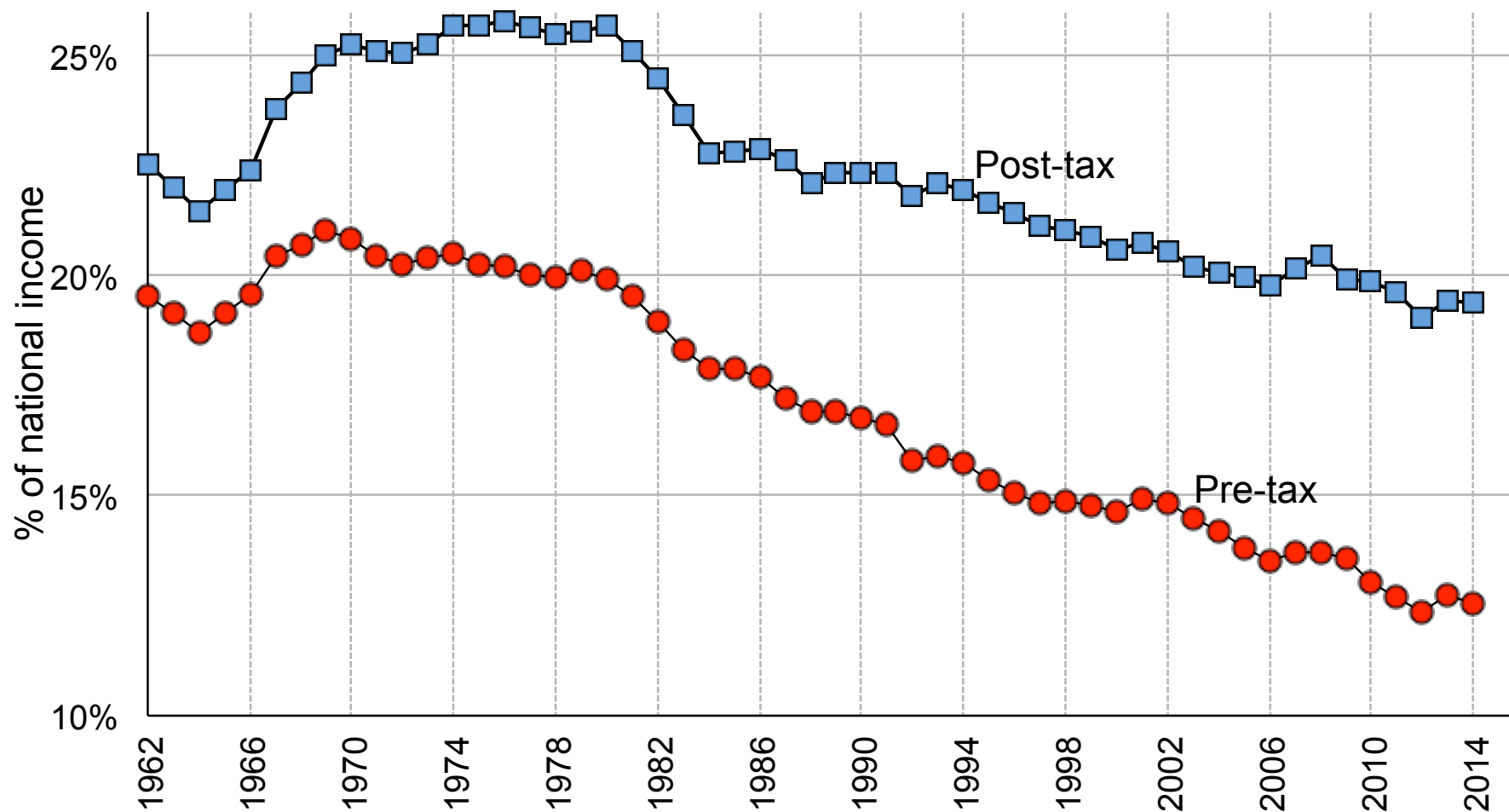
- But redistribution of limited size and has not offset rise in pre-tax inequality
- Excluding health transfers, negligible net redistribution toward bottom 50%

Top 10% national income share: pre-tax vs. post-tax

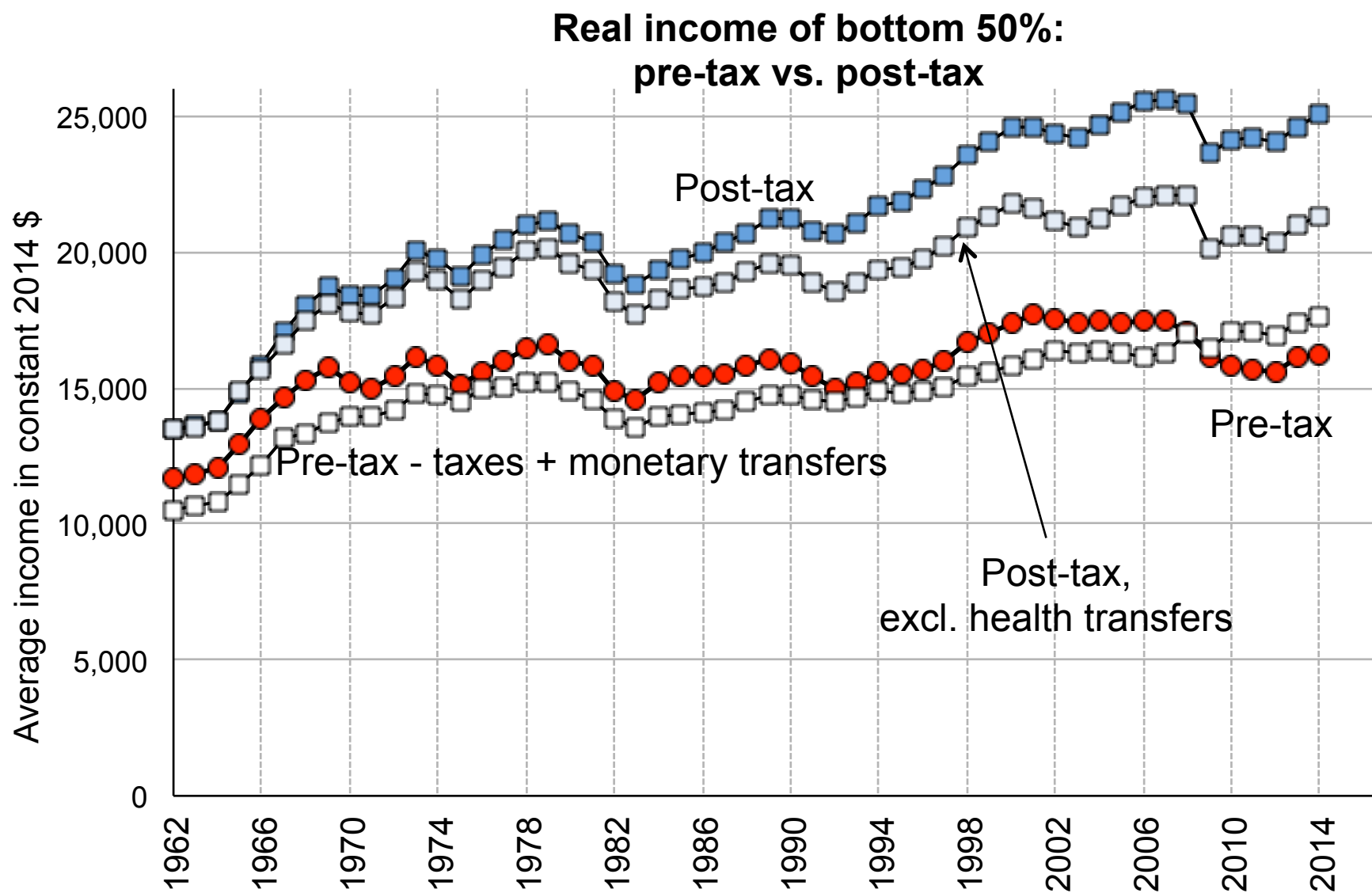


Source: Appendix Tables II-B1 and II-C1

Bottom 50% national income share: pre-tax vs. post-tax



Source: Appendix Tables II-B1 and II-C1

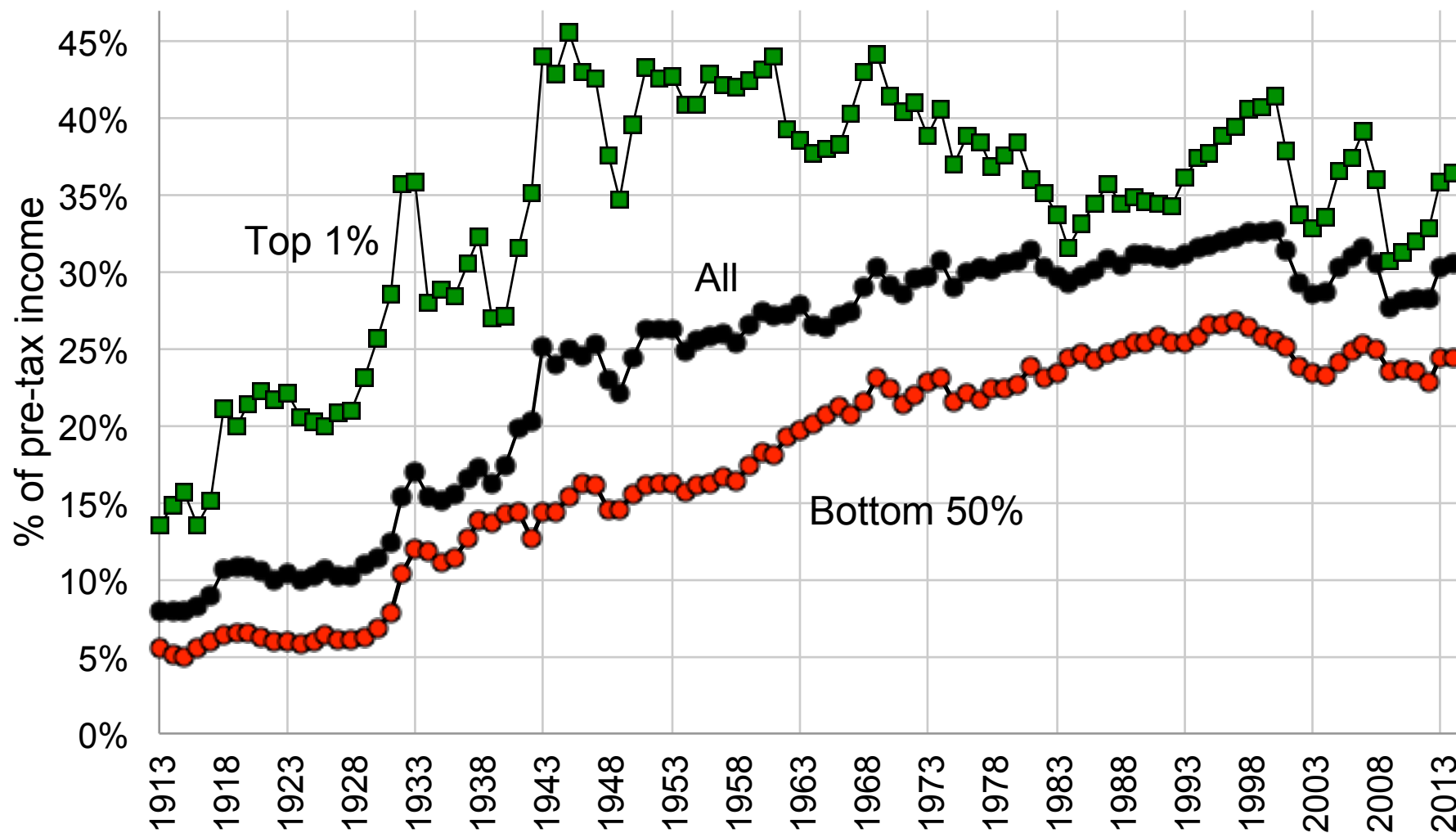


Source: Appendix Tables II-B7, II-C7 and II-C3c.

3 Who pays taxes?

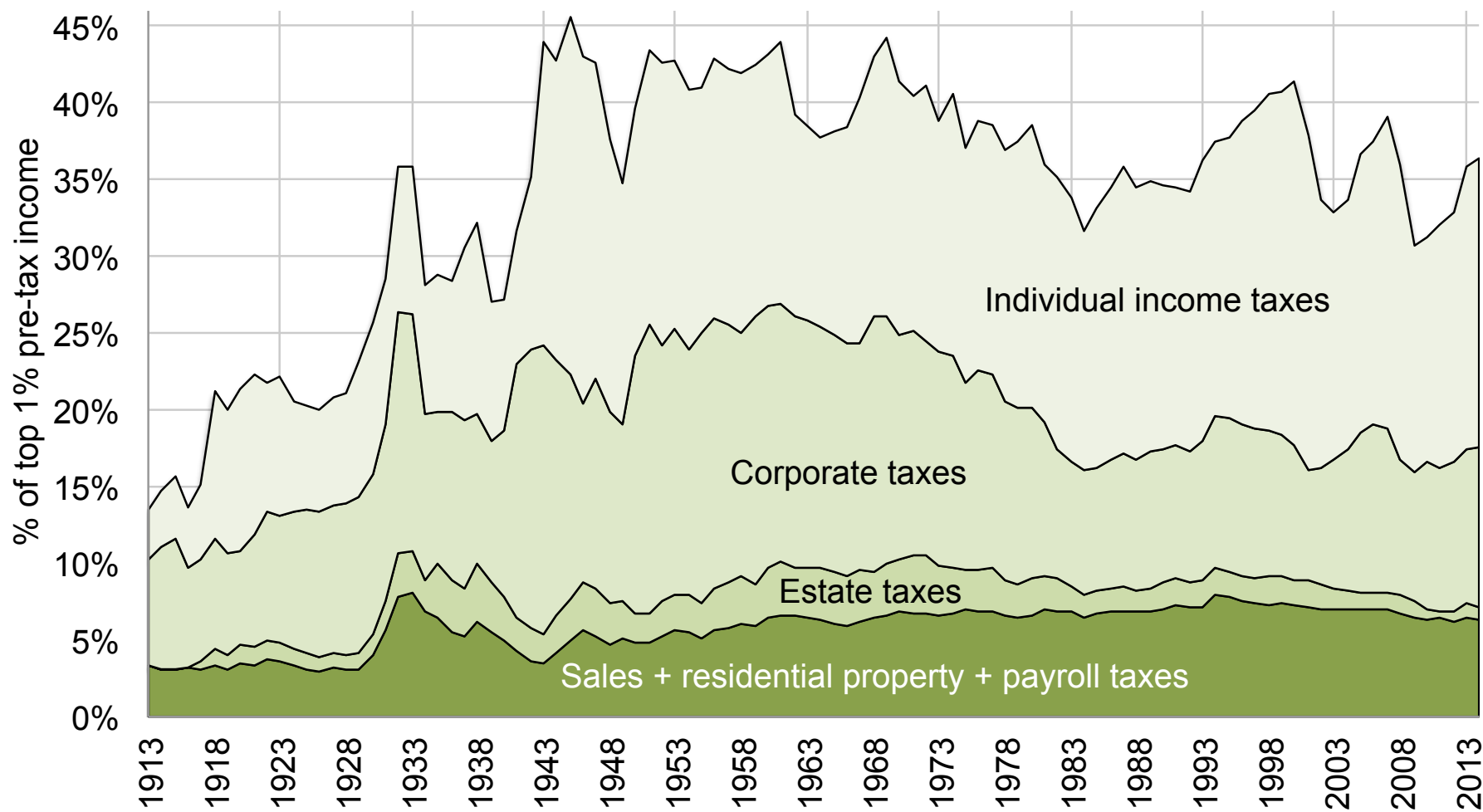
- A tax system is progressive when average tax rate $T(y)/y$ rises with income y
- Decline in tax progressivity in the US since the 1960s, largely because of
 - Decline of progressive capital taxes
 - Rise in regressive payroll taxes

Average tax rates by pre-tax income group



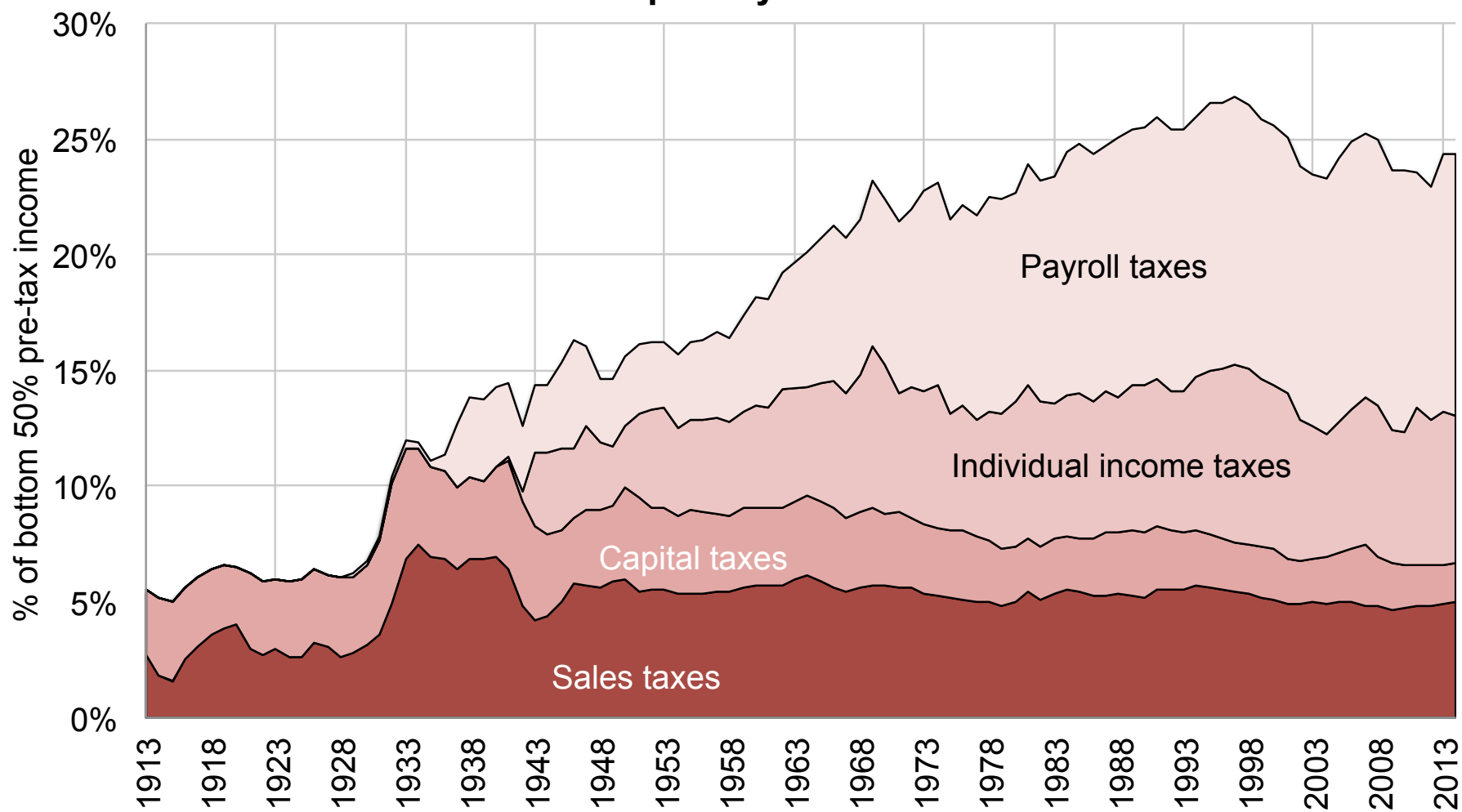
Source: Appendix Table II-G1.

Figure S.22: Taxes paid by the top 1%



Source: Appendix Table II-G2

Taxes paid by the bottom 50%

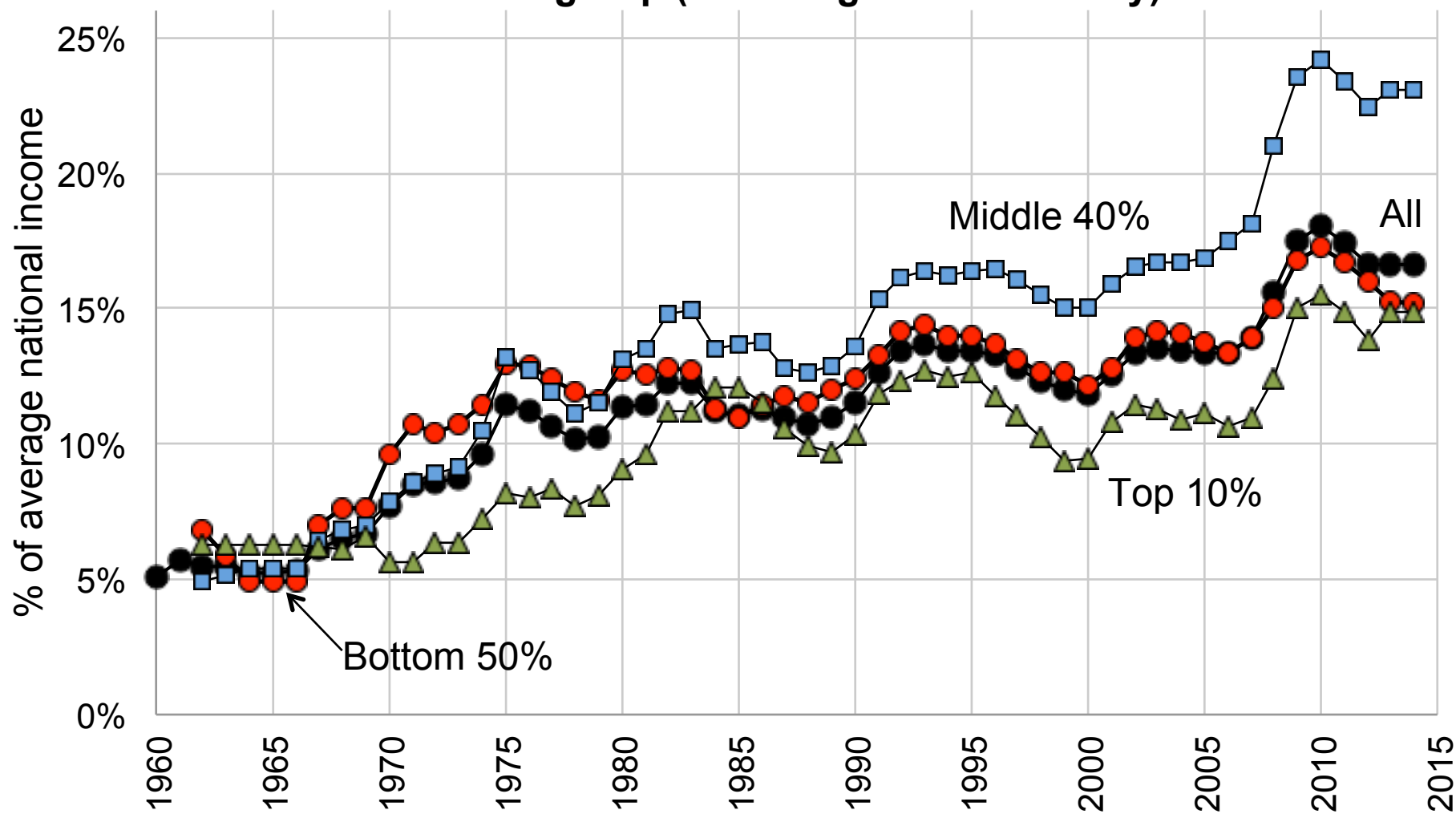


Source: Appendix Table II-G2

4 Who receives government transfers?

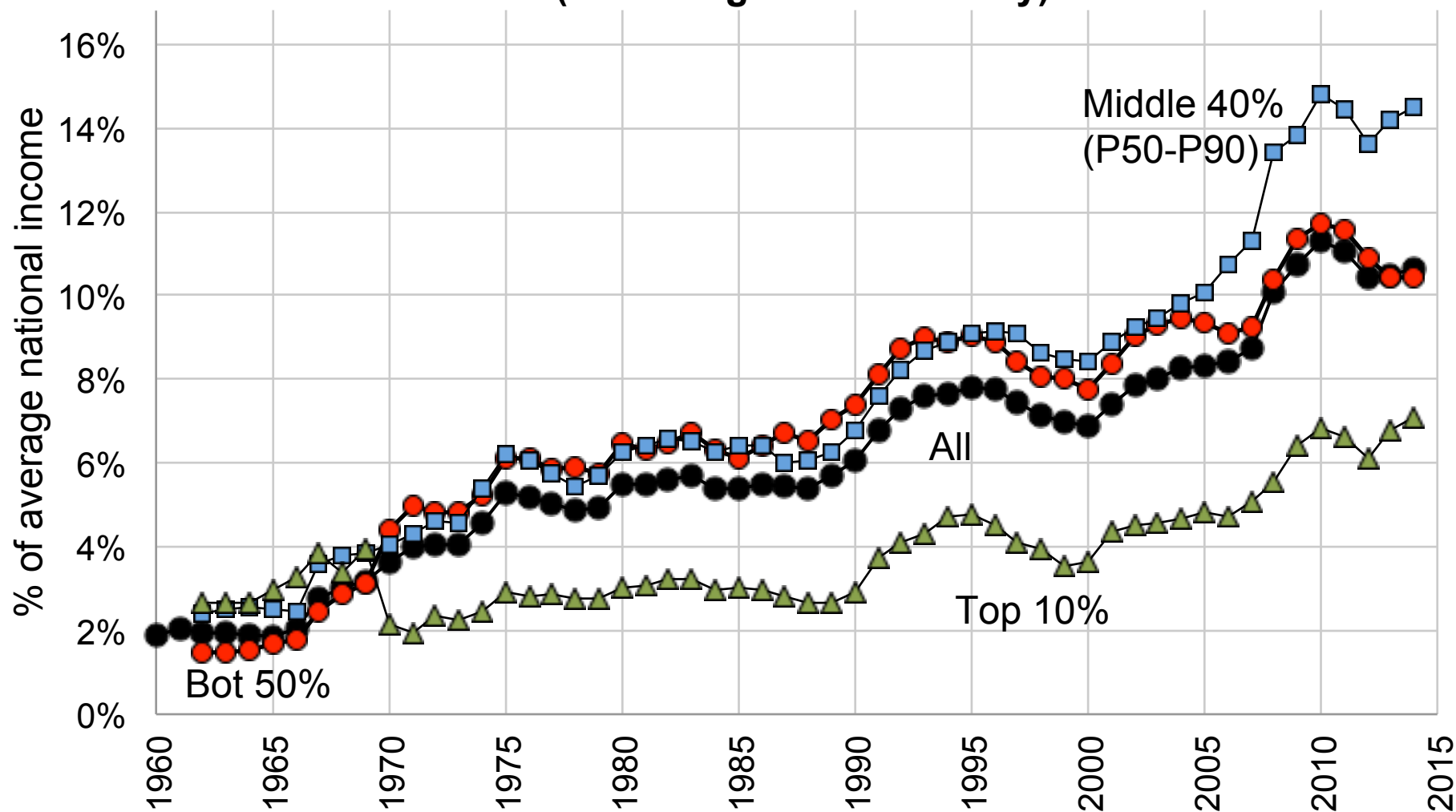
- Individualized transfers have increased a lot in the US since 1960s, because of rise in health transfers (+ Social Security)
 - Middle-class & retirees have benefited the most from this increase
 - Bottom 50% has benefited less: rise in Medicaid and EITC but collapse in safety net spending
- Overall bottom 50% receives less transfers than middle class today

Figure S.13: Average individualized transfer by post-tax income group (including Social Security)



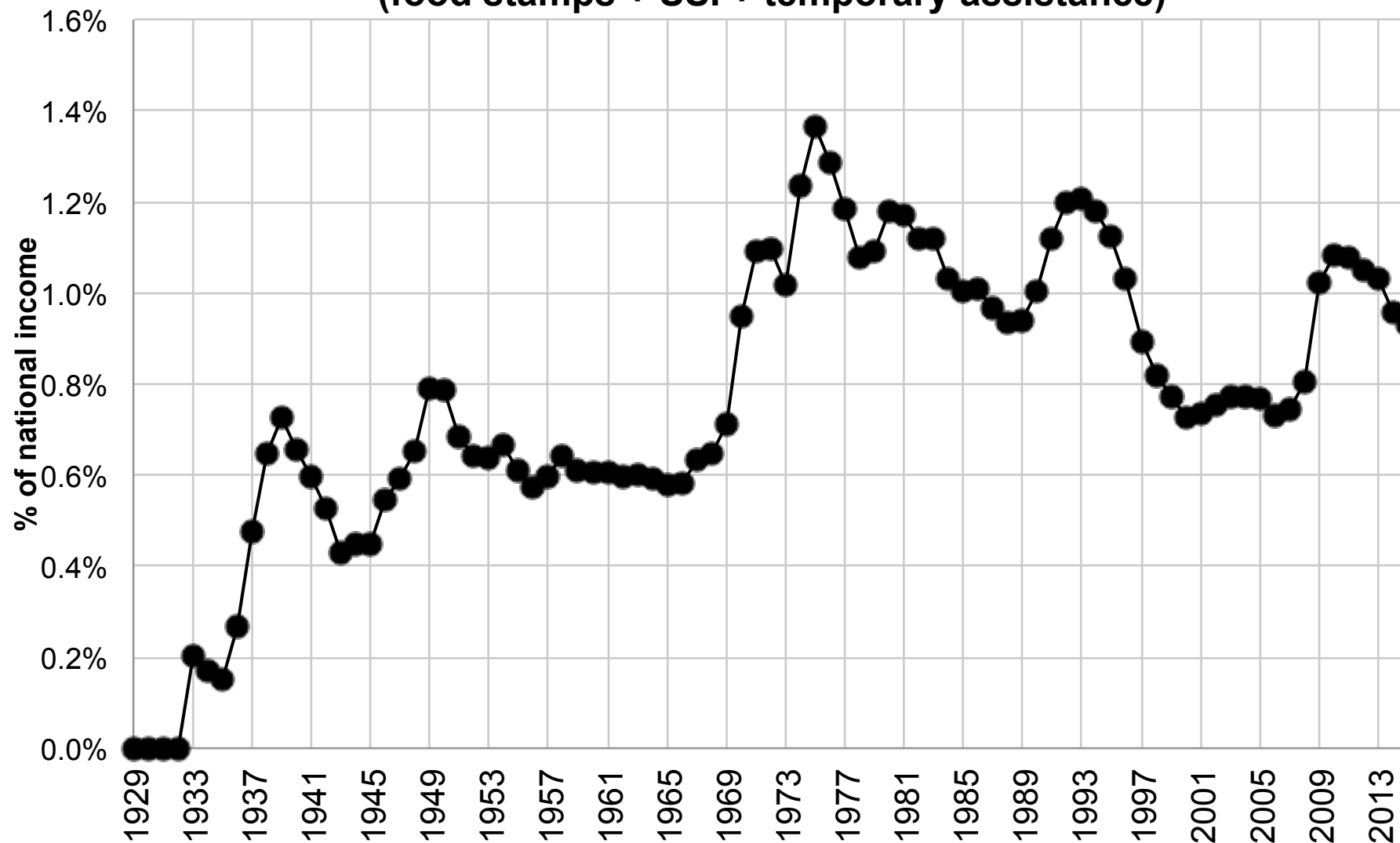
Source: Appendix Table II-G4b.

Average individualized transfer by post-tax income group (excluding Social Security)



Source: Appendix Table II-G4.

Government spending on safety net (food stamps + SSI + temporary assistance)



In the United States today, government intervention (total taxes + total transfers):

A — Does not affect the distribution of income

B — Exacerbates inequality

C — Reduces inequality

D — Has offset the rise of pre-tax inequality since the 1980s

5 Summary

- Government spending has increased in the US since the 1960s
- This owes to a rise in individualized transfers, which benefit elderly and middle-class Americans most
- Taxes have \searrow for the top 1% income and \nearrow for the bottom 50%
- Overall, government redistribution has offset only a small fraction of the rise in pre-tax inequality

References

Piketty, Thomas, Emmanuel Saez, and Gabriel Zucman, “Distributional National Accounts: Methods and Estimates for the United States”, working paper, 2016 (web)