

# **Econ 133 – Global Inequality and Growth**

## **Top labor incomes**

Gabriel Zucman

[zucman@berkeley.edu](mailto:zucman@berkeley.edu)

## What we've learned so far:

- Labor income inequality has increased a lot in the US, less so in other countries
- A simple supply/demand framework can explain part of this ↗
- Changes in minimum wage, union and market power have also played an important role
- But what can explain the spectacular rise of the top 1%?

## Roadmap

- The top 1%: the US vs. the rest of the world
- Why have top wages increased so much?

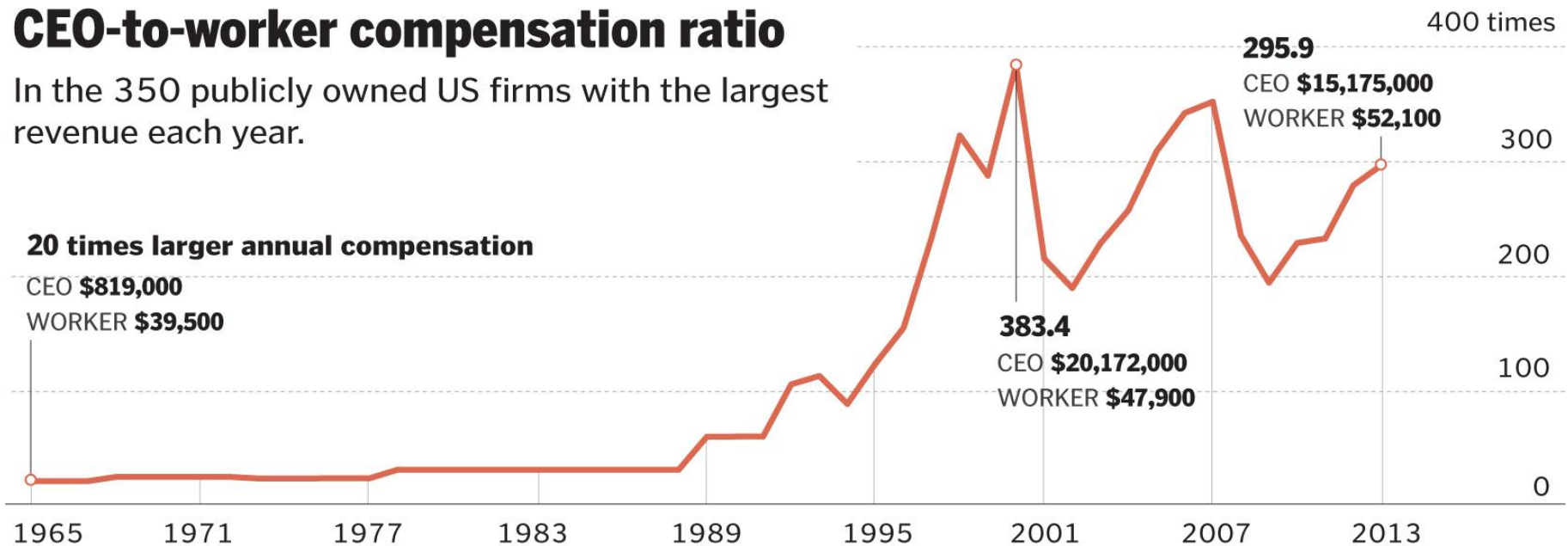
# 1 Top 1%: the US vs. the rest of the world

## 1.1 Trends in top wages

- Increase in the top 1% income share stronger in the US than anywhere else
- Not an artifact of tax data
- Consistent with data on CEO pay

## CEO-to-worker compensation ratio

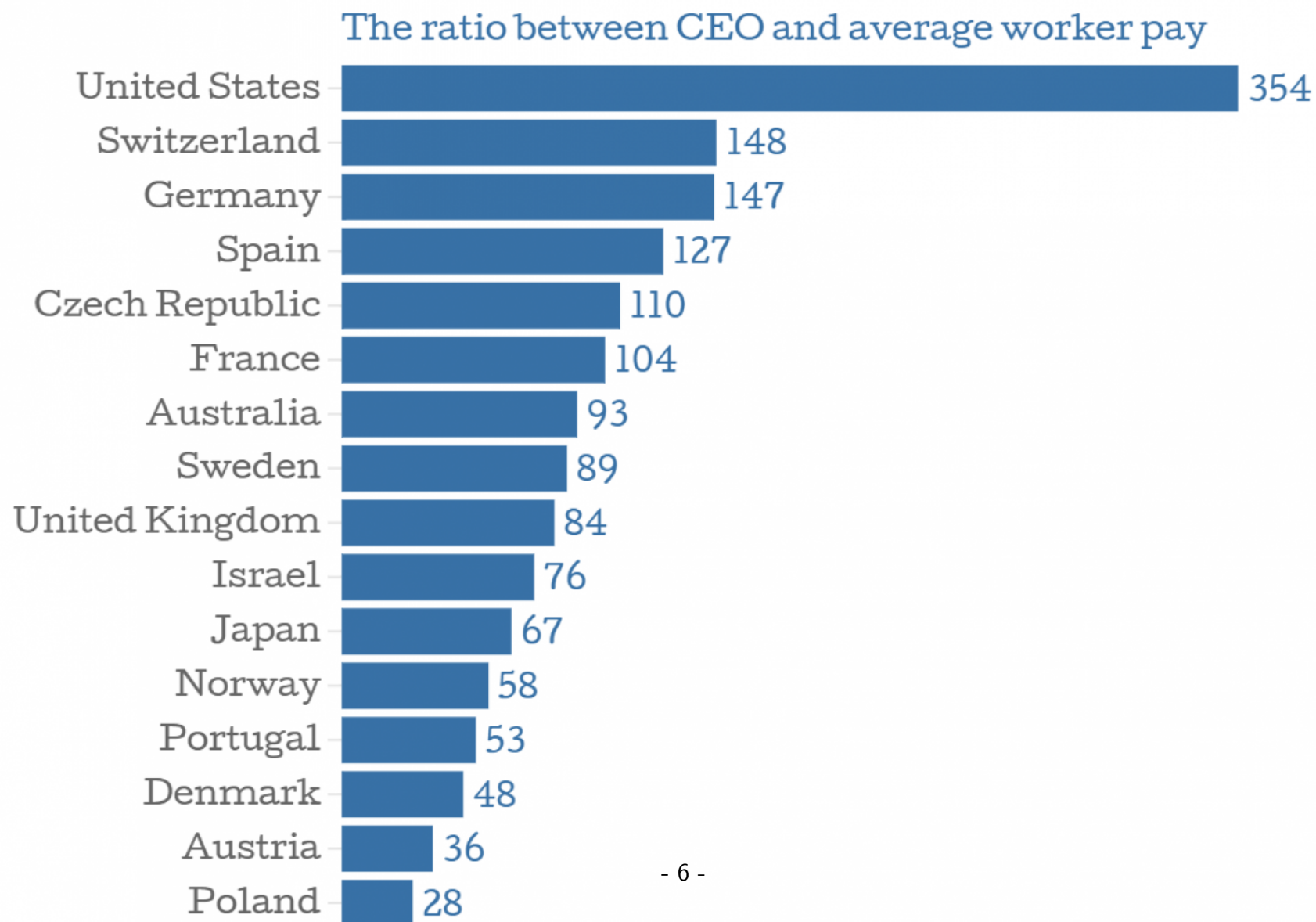
In the 350 publicly owned US firms with the largest revenue each year.



SOURCE: Economic Policy Institute

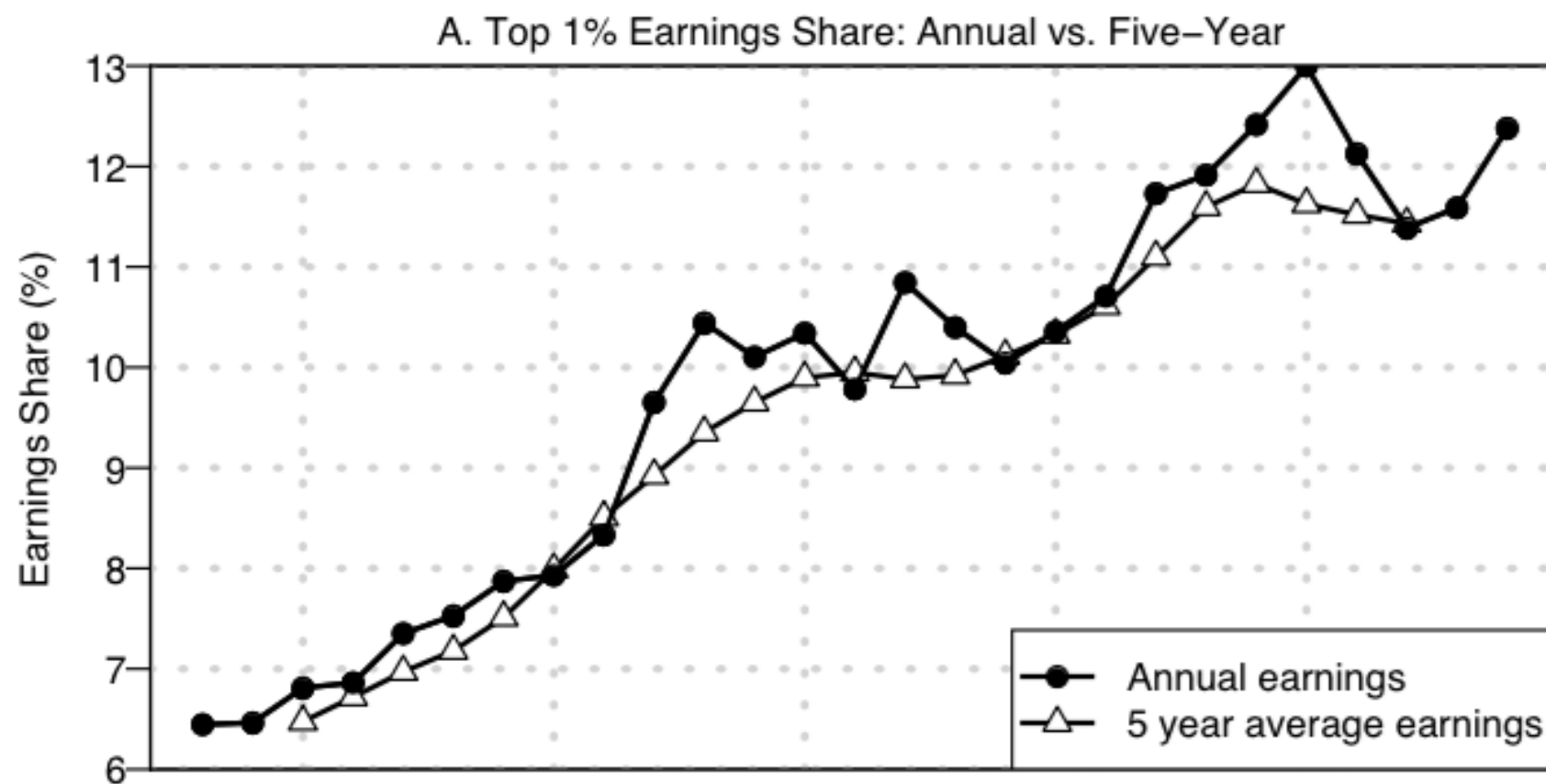
OLIVIA HALL FOR THE BOSTON GLOBE

It pays to be a CEO in the U.S.



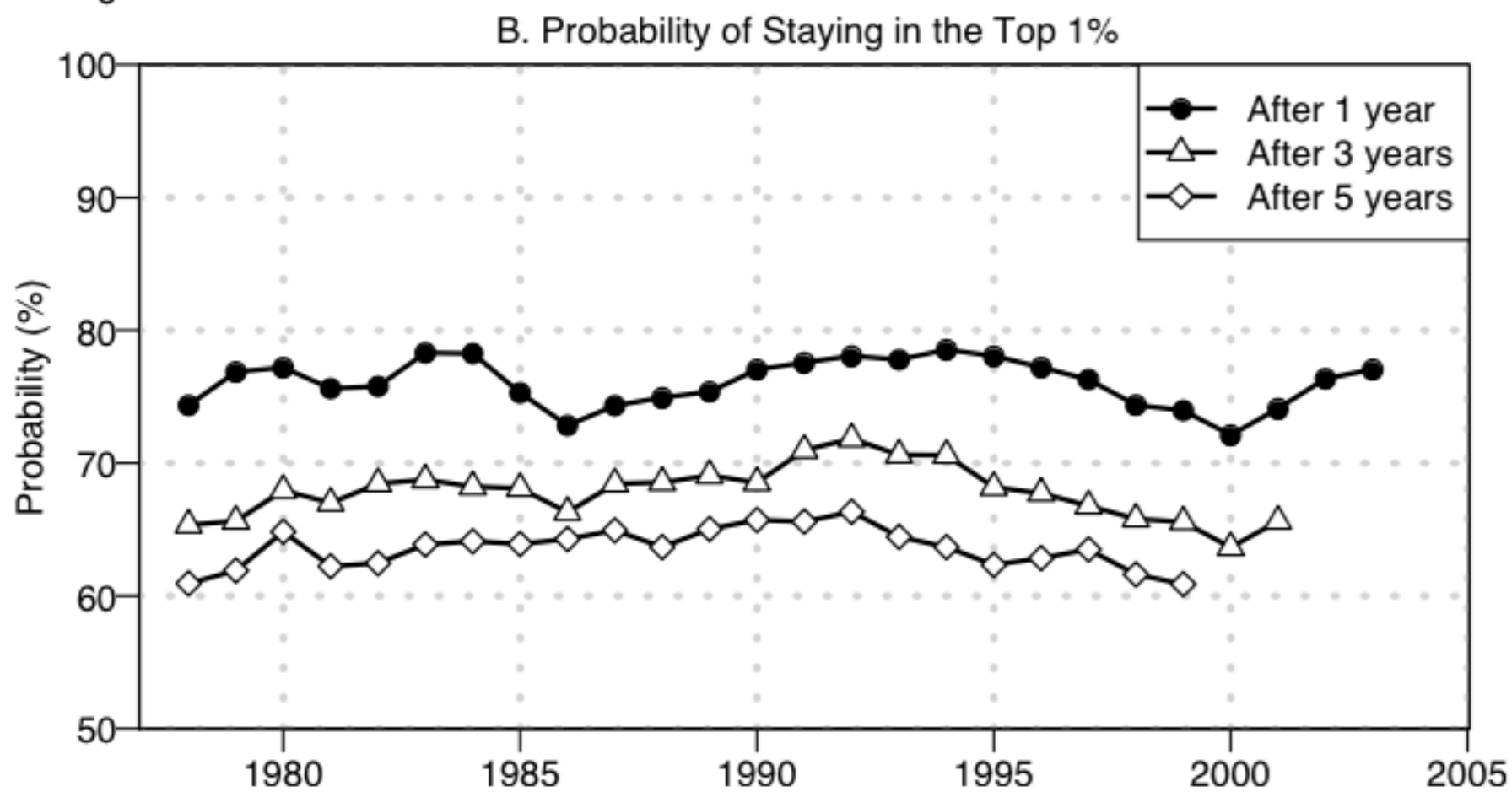
## 1.2 Has rising mobility offset the rise in US inequality?

- No: mobility is stable and has not mitigated the dramatic increase in annual earnings concentration since the 1970s.
- This is true including at the very top → top income shares provide good approximation to longer-term earnings concentration
- In particular, development of bonuses and profits from stock-options does not seem to have increased mobility a lot



Source: Kopczuk, Saez and Song (2010)





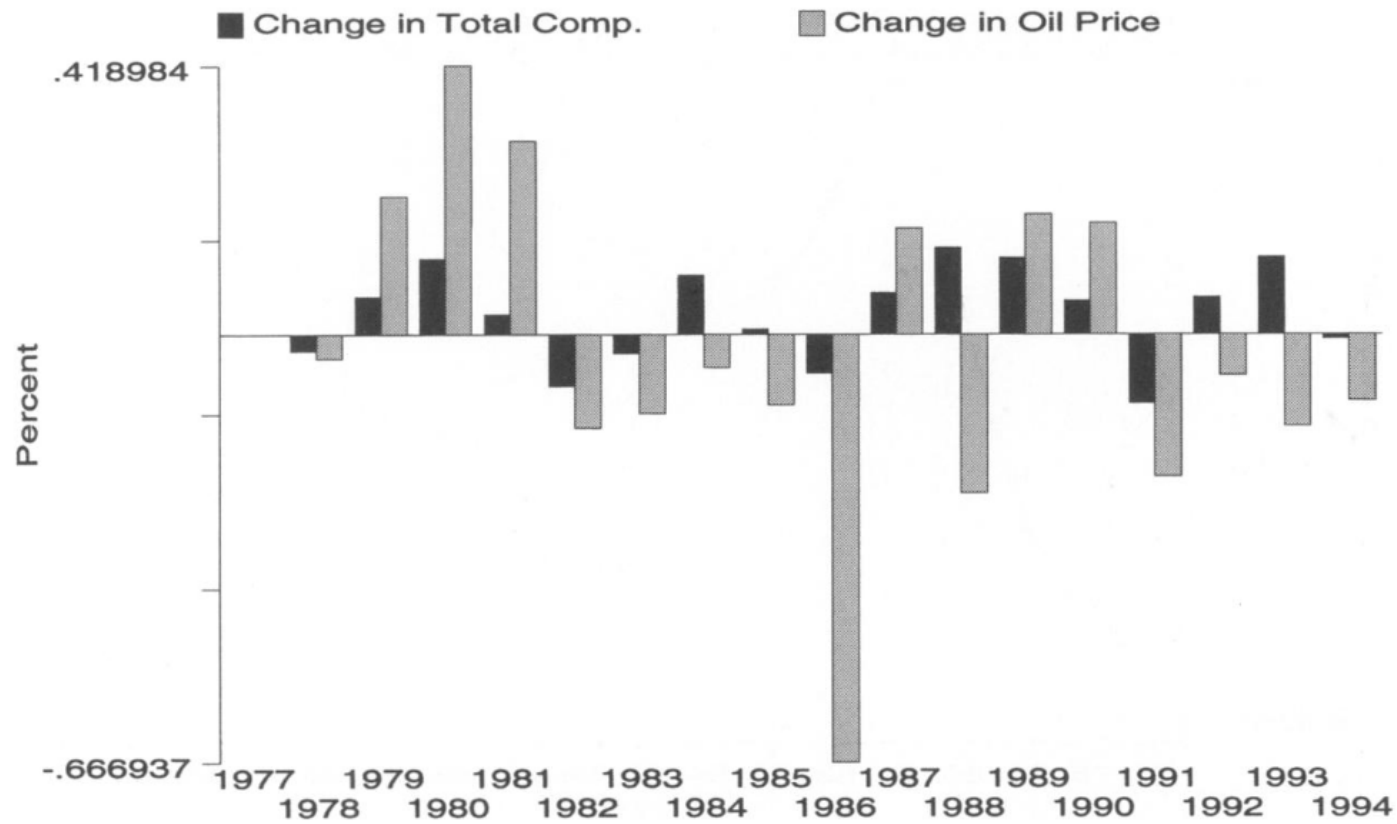
Source: Kopczuk, Saez and Song (2010)

## 2 The role of top tax rates

- Globalization and technical change occurred everywhere but surge of top income shares mostly in US (and anglo-saxon countries)
- Potential explanation: CEOs can sometime extract more than their marginal product, and do so more when top tax rates are lower
- In perfect market,  $\text{wage} = \text{marginal productivity}$
- But in practice it can be difficult to measure productivity,

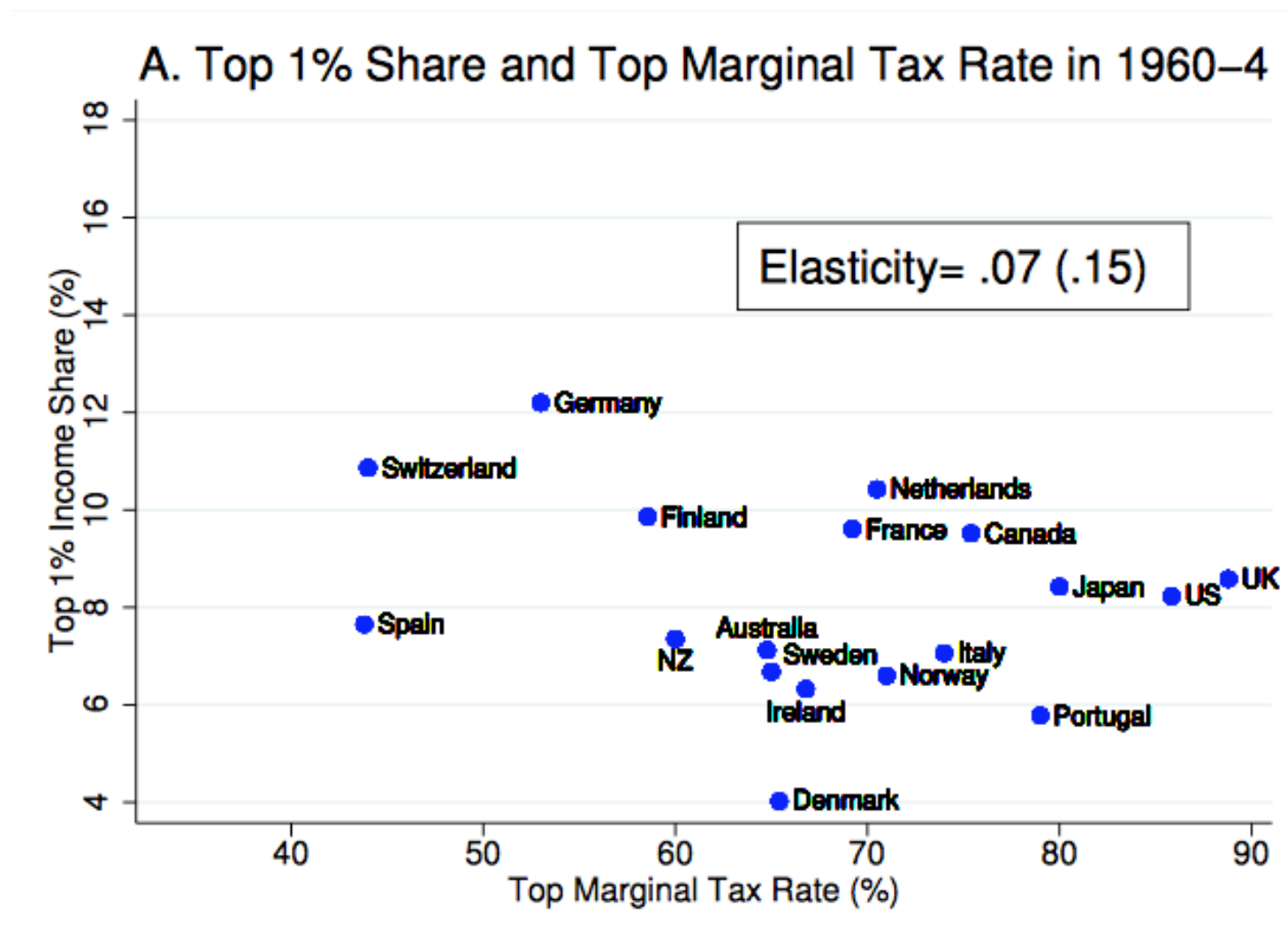
especially at the top: wage can be  $>$  marginal productivity

- Empirical evidence: Bertrand and Mullainathan (2001); Piketty, Saez and Stantcheva (2014)

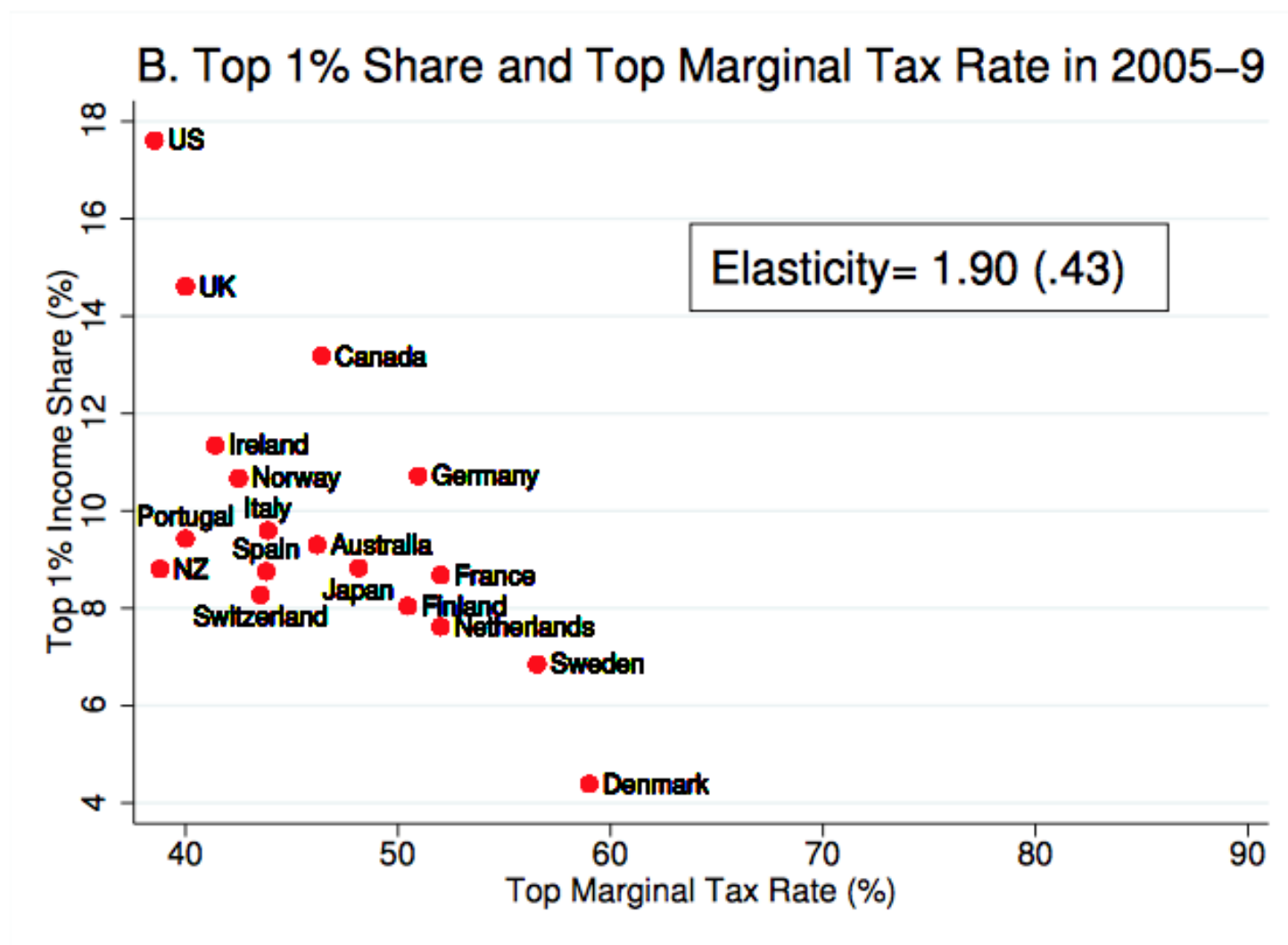


**FIGURE III**  
**Oil Industry CEO Pay and Crude Oil Price**

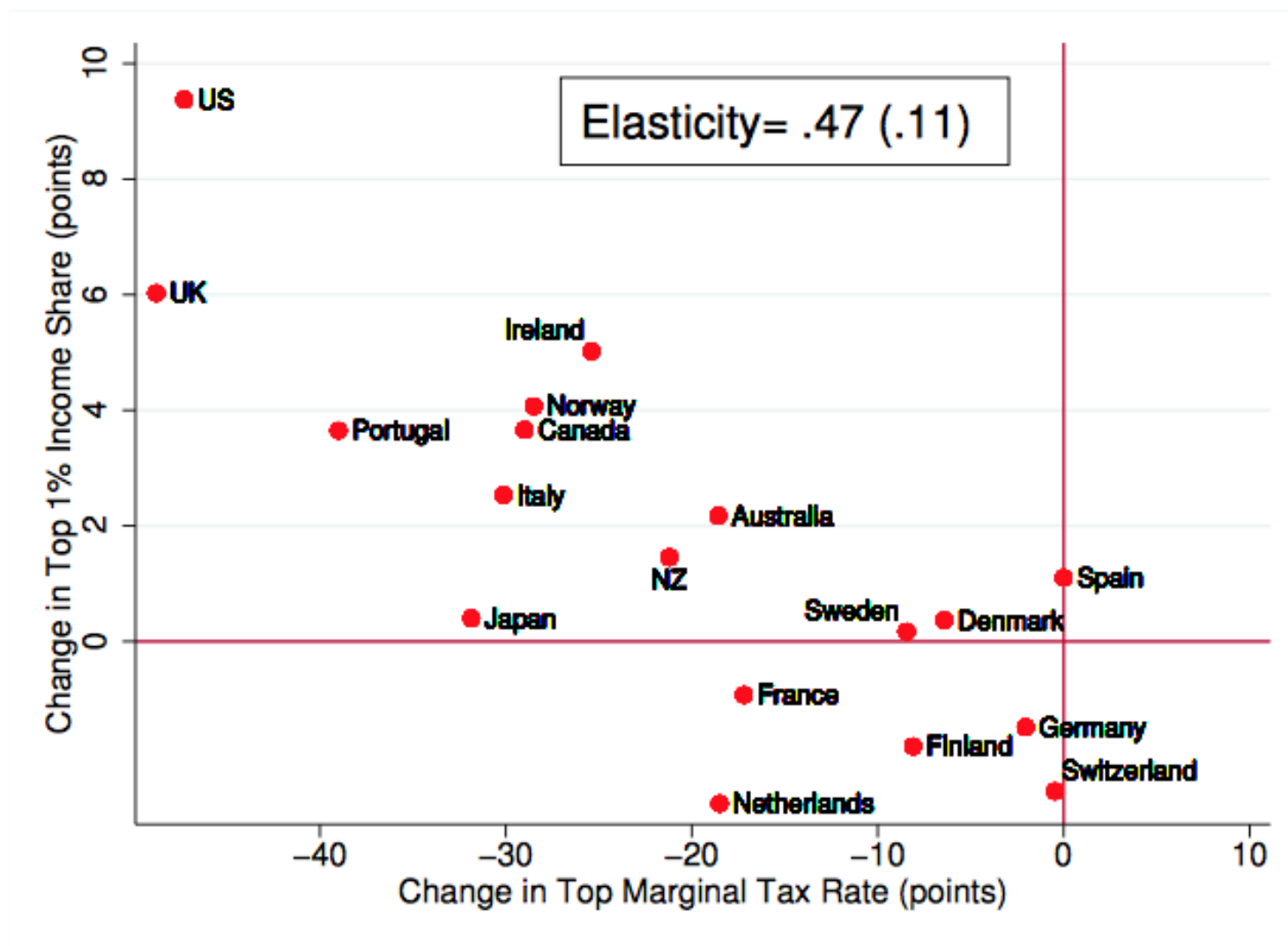
Source: Bertrand and Mullainathan (2010)



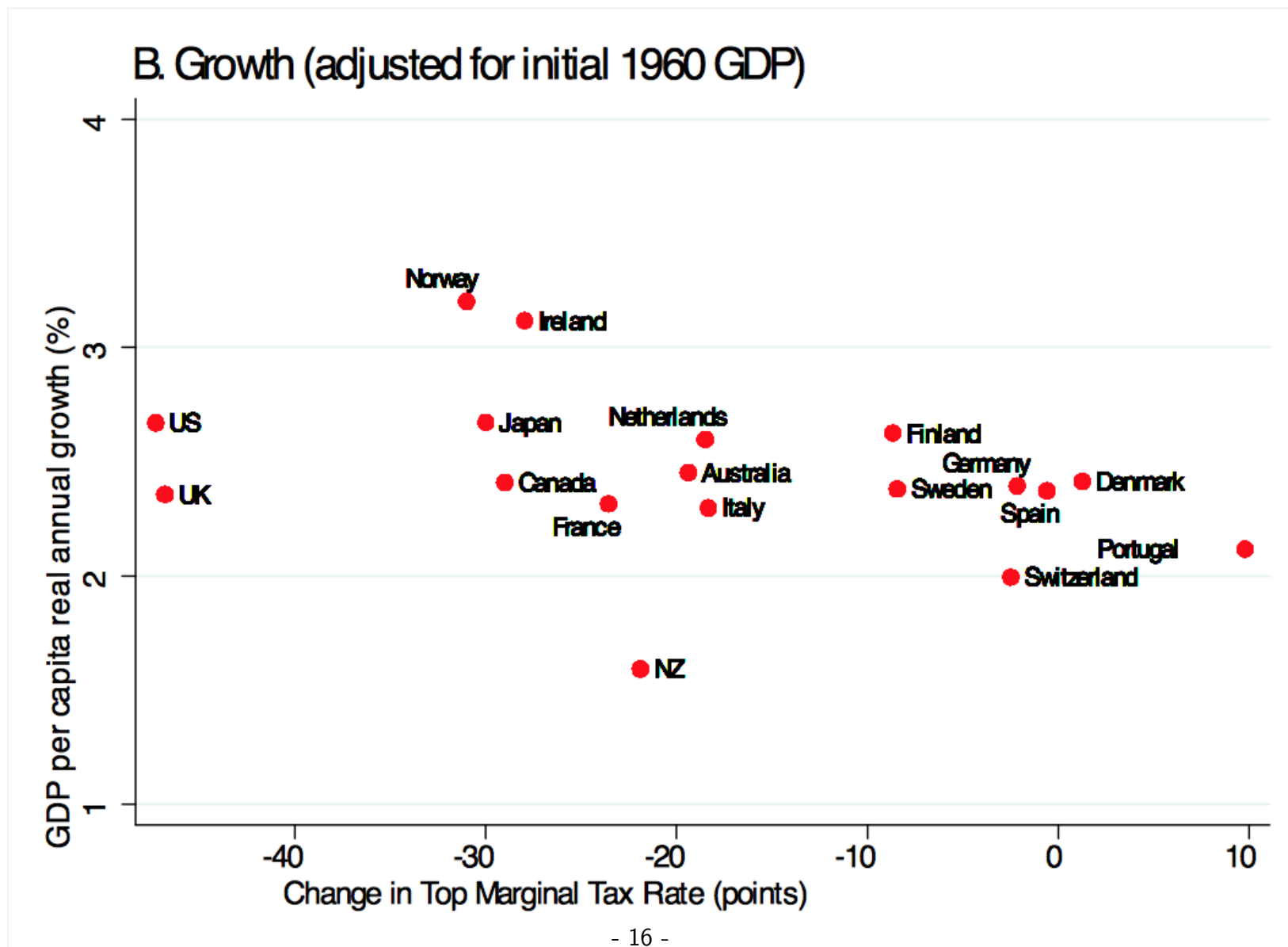
Top tax rates include central+local income taxes (Piketty-Saez-Stancheva '14)



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### 3 Summary

- The rise of income inequality in the US has not been offset by a rise in mobility
- Countries where top tax rates have fallen more are those where the top 1% income share has increased more
- This can be rationalized by a simple model where CEOs bargain their pay

## References

Bertrand, Marianne and Sendhil Mullainathan, “Are CEOs Rewarded for Luck? The Ones Without Principals Are” *Quarterly Journal of Economics* 2001 (web)

Gabaix, Xavier, and Augustin Landier, “Why has CEO Pay Increased so Much?”, *Quarterly Journal of Economics* 2008 (web)

Kopczuk, Wojciech, Emmanuel Saez, and Jae Song, “Earnings Inequality and Mobility in the United States: Evidence from Social Security Data since 1937”, *Quarterly Journal of Economics*, 2010 (web)

Piketty, Thomas, Emmanuel Saez, and Stefanie Stantcheva, “Optimal Taxation of Top Labor Incomes: A Tale of Three Elasticities”, *American Economic Journal: Economic Policy*, 2014, (web)