Econ 133 – Global Inequality and Growth

Top labor incomes

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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 $\nearrow$
- 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

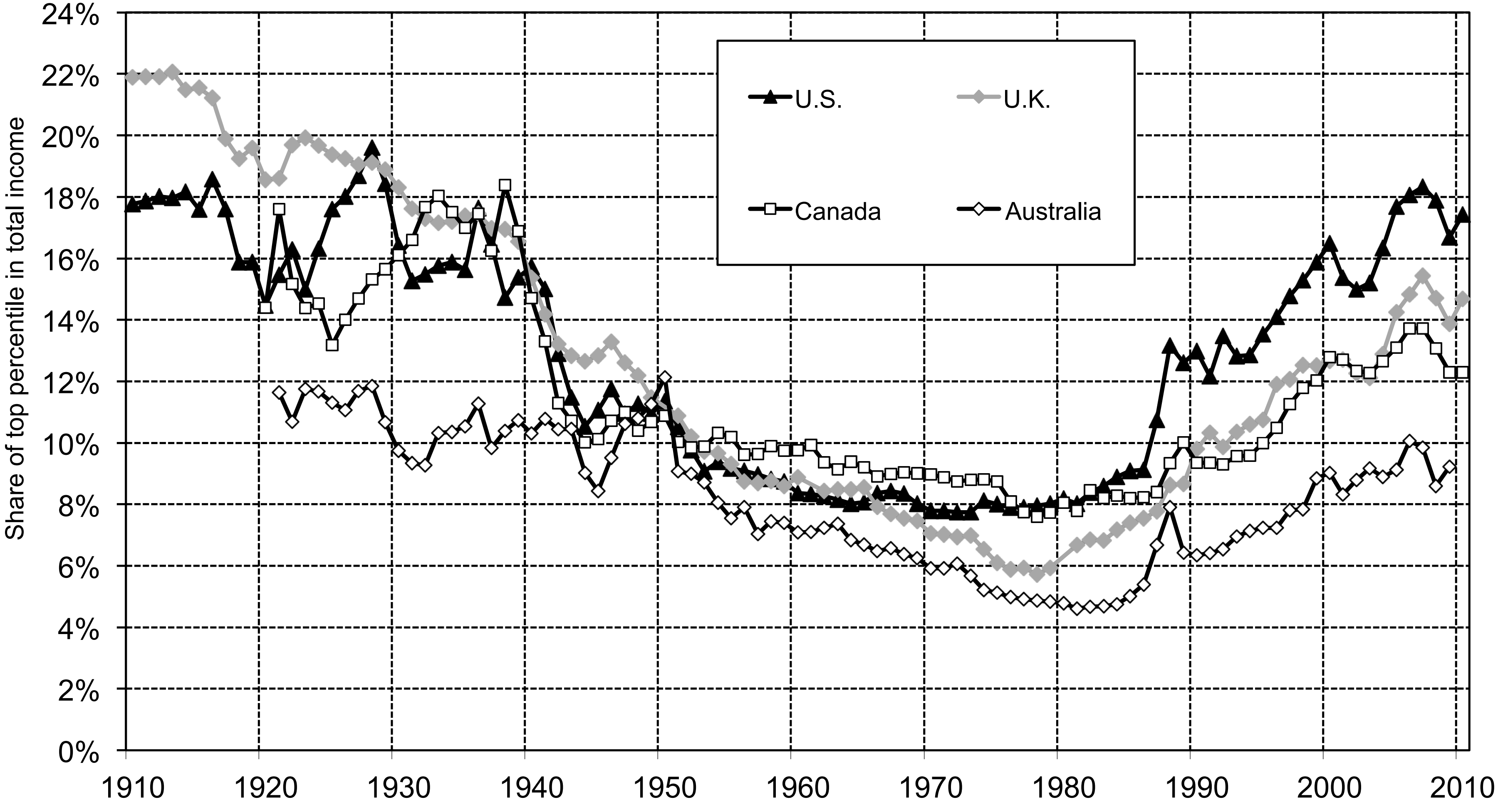
1.1 Trends in top wages

- Increase in the top 1% income share stronger in the US than anywhere else

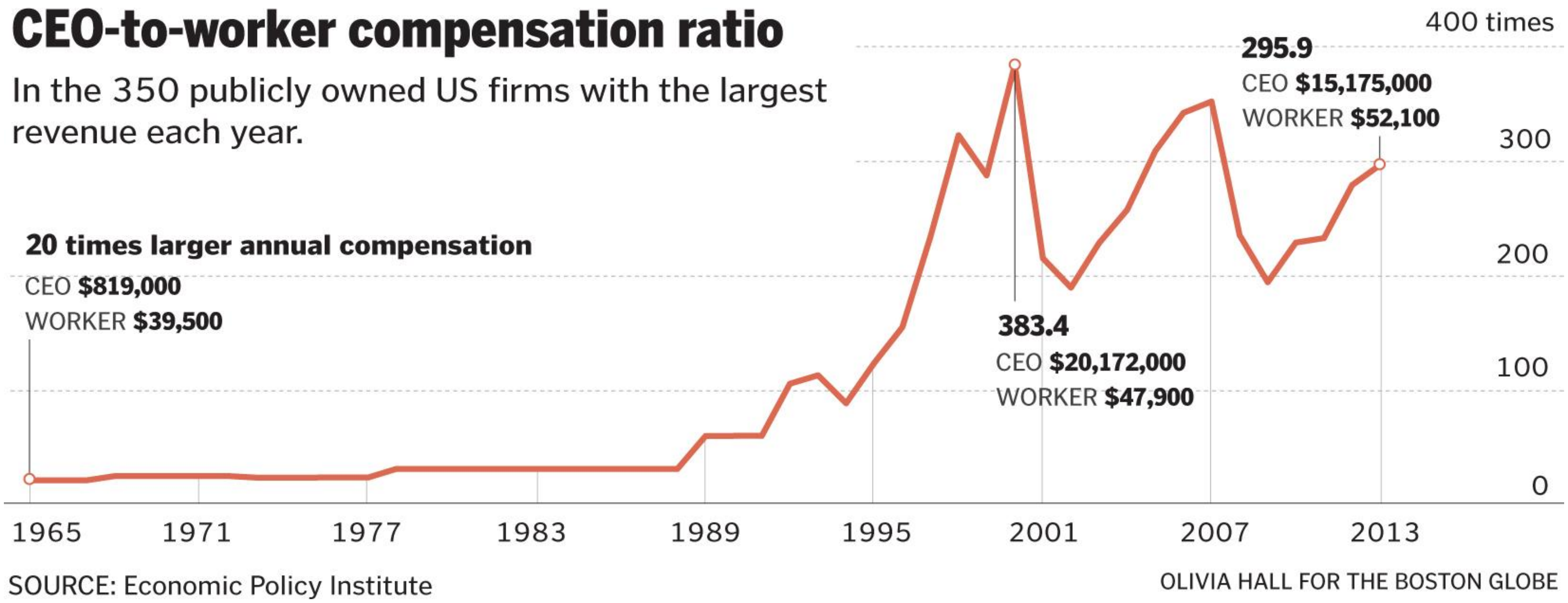
- Not an artifact of tax data

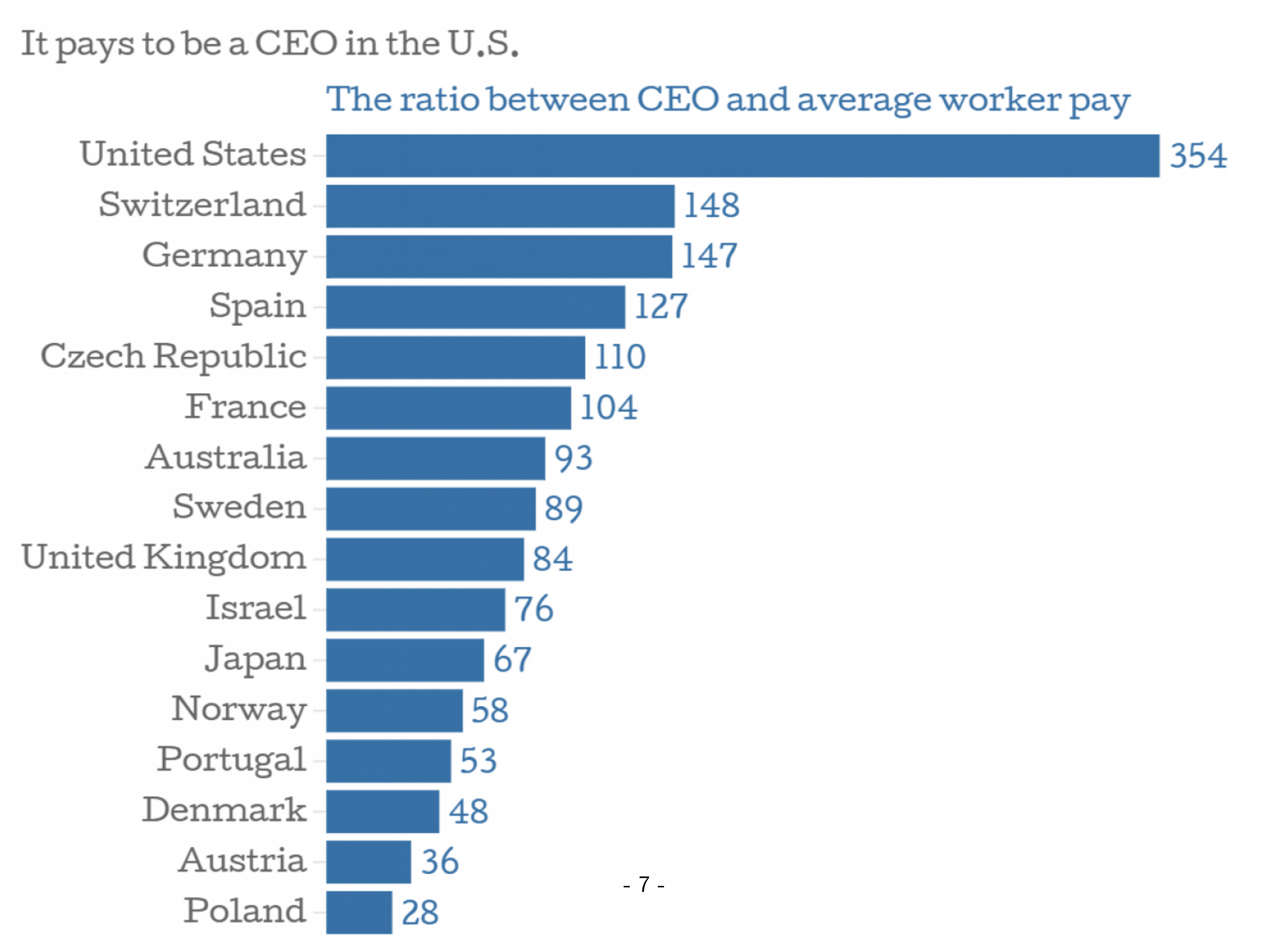
- Consistent with data on CEO pay

Figure 9.2. Income inequality in Anglo-saxon countries, 1910-2010



The share of top percentile in total income rose since the 1970s in all Anglo-saxon countries, but with different magnitudes. Sources and series: see piketty.pse.ens.fr/capital21c.


CEO-to-worker compensation ratio
In the 350 publicly owned US firms with the largest revenue each year.
20 times larger annual compensation
CEO $819,000
WORKER $39,500
383.4
CEO $20,172,000
WORKER $47,900
295.9
CEO $15,175,000
WORKER $52,100
400 times
300
200
100
0
1965
1971
1977
1983
1989
1995
2001
2007
2013
SOURCE: Economic Policy Institute
OLIVIA HALL FOR THE BOSTON GLOBE

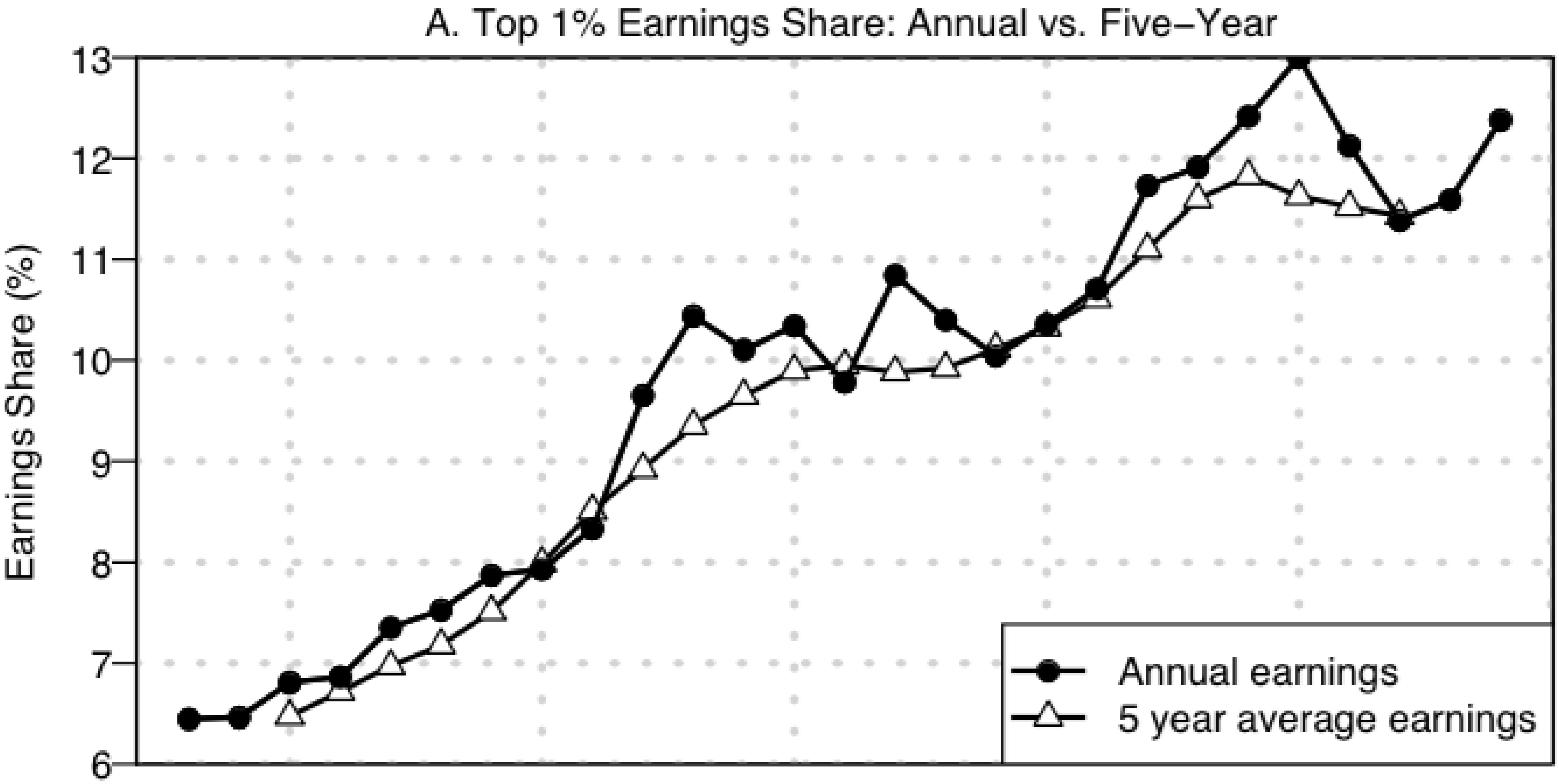

It pays to be a CEO in the U.S.
The ratio between CEO and average worker pay
United States 354
Switzerland 148
Germany 147
Spain 127
Czech Republic 110
France 104
Australia 93
Sweden 89
United Kingdom 84
Israel 76
Japan 67
Norway 58
Portugal 53
Denmark 48
Austria 36
Poland 28

1.2 Has rising mobility offset the rise in US inequality?

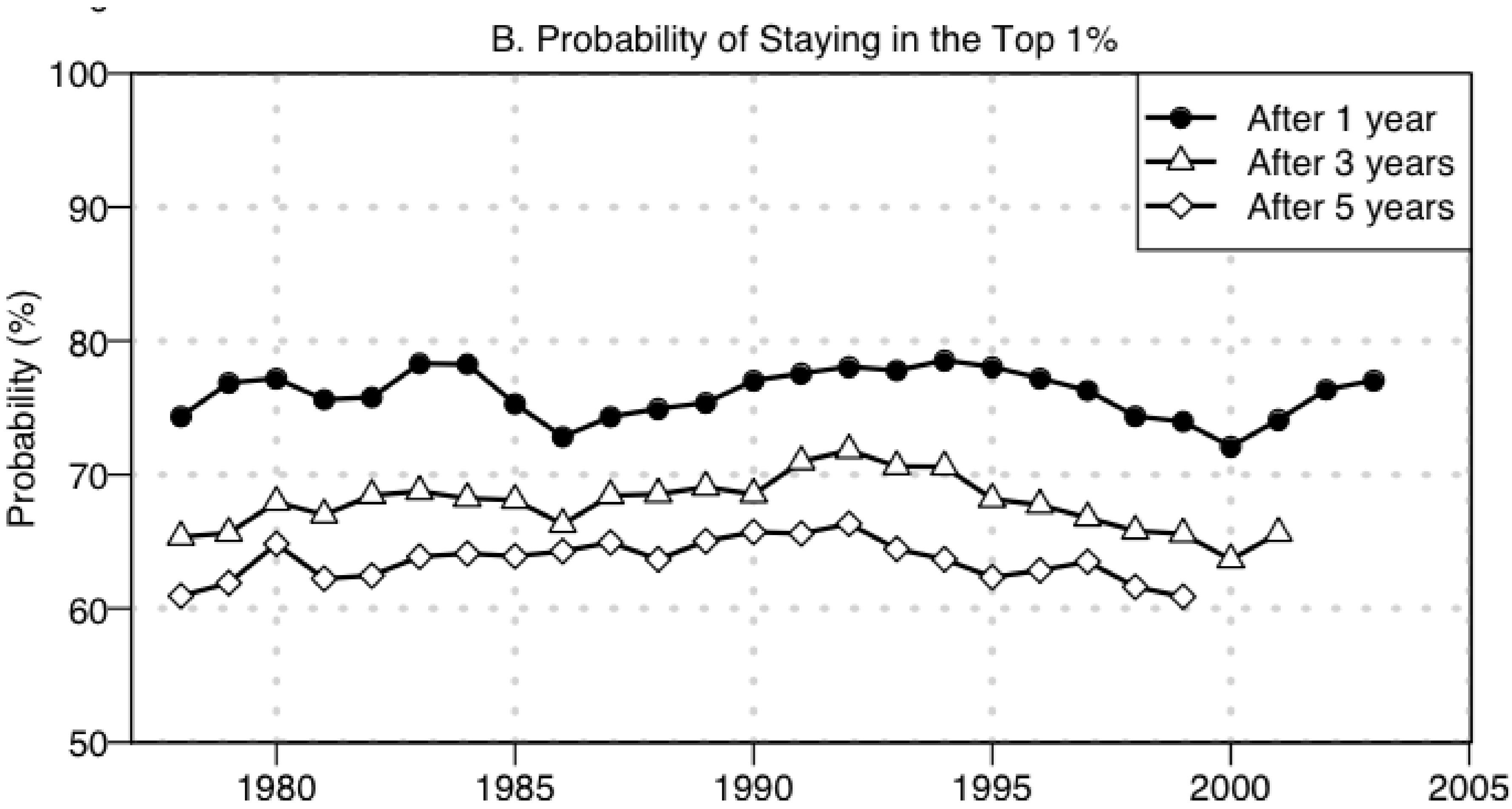
- No: mobility is stable and has not mitigated the dramatic increase in annual earnings concentration since the 1970s.

- This is true including at the very top $\rightarrow$ 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, wage = 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)

Which of the following statement is true?

A — Top marginal tax rates can affect the distribution of pre-tax income

B — Top marginal tax rates do not affect pre-tax income, only post-tax income

C — When top marginal tax rates are high, people work more

D — Top marginal tax rates have no effect on economic behavior

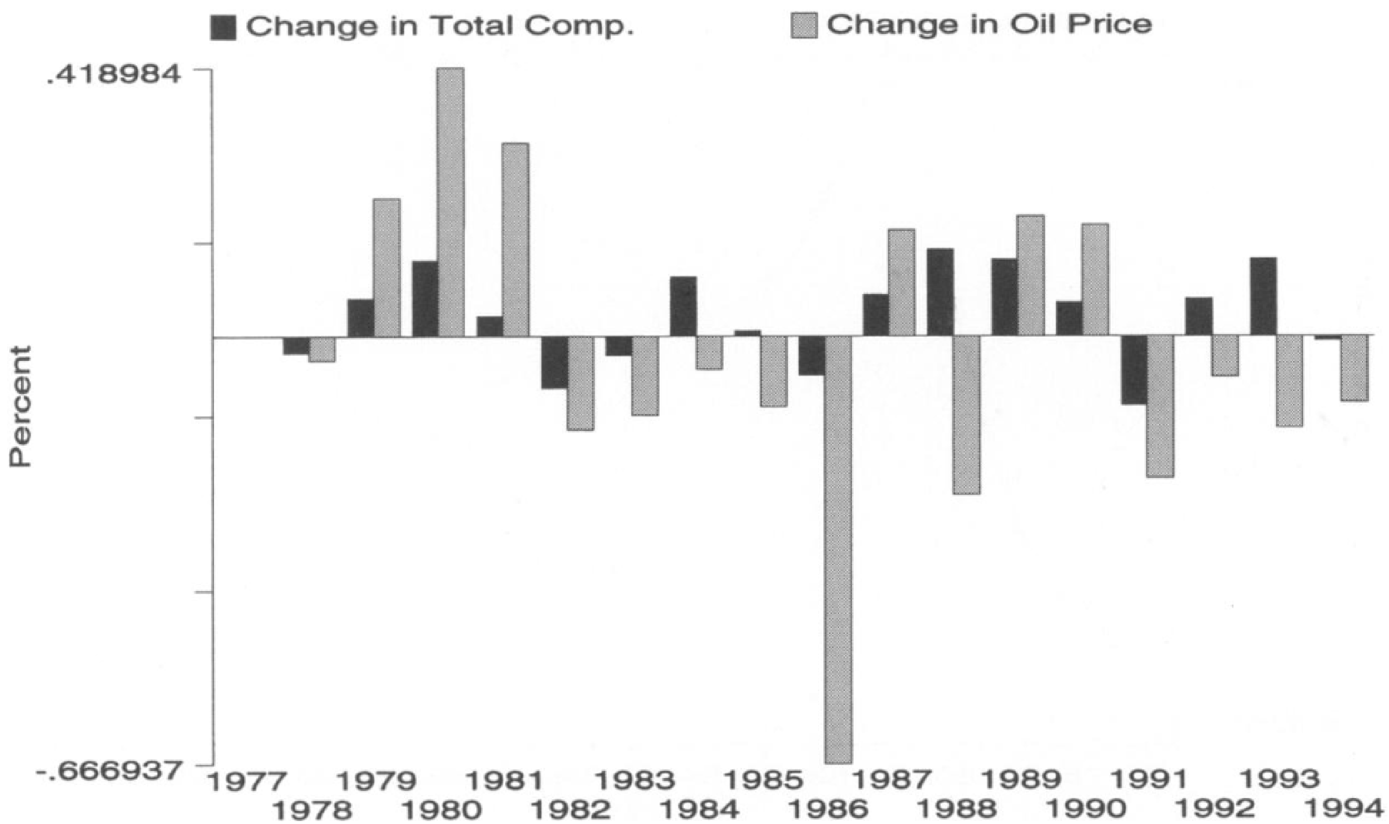
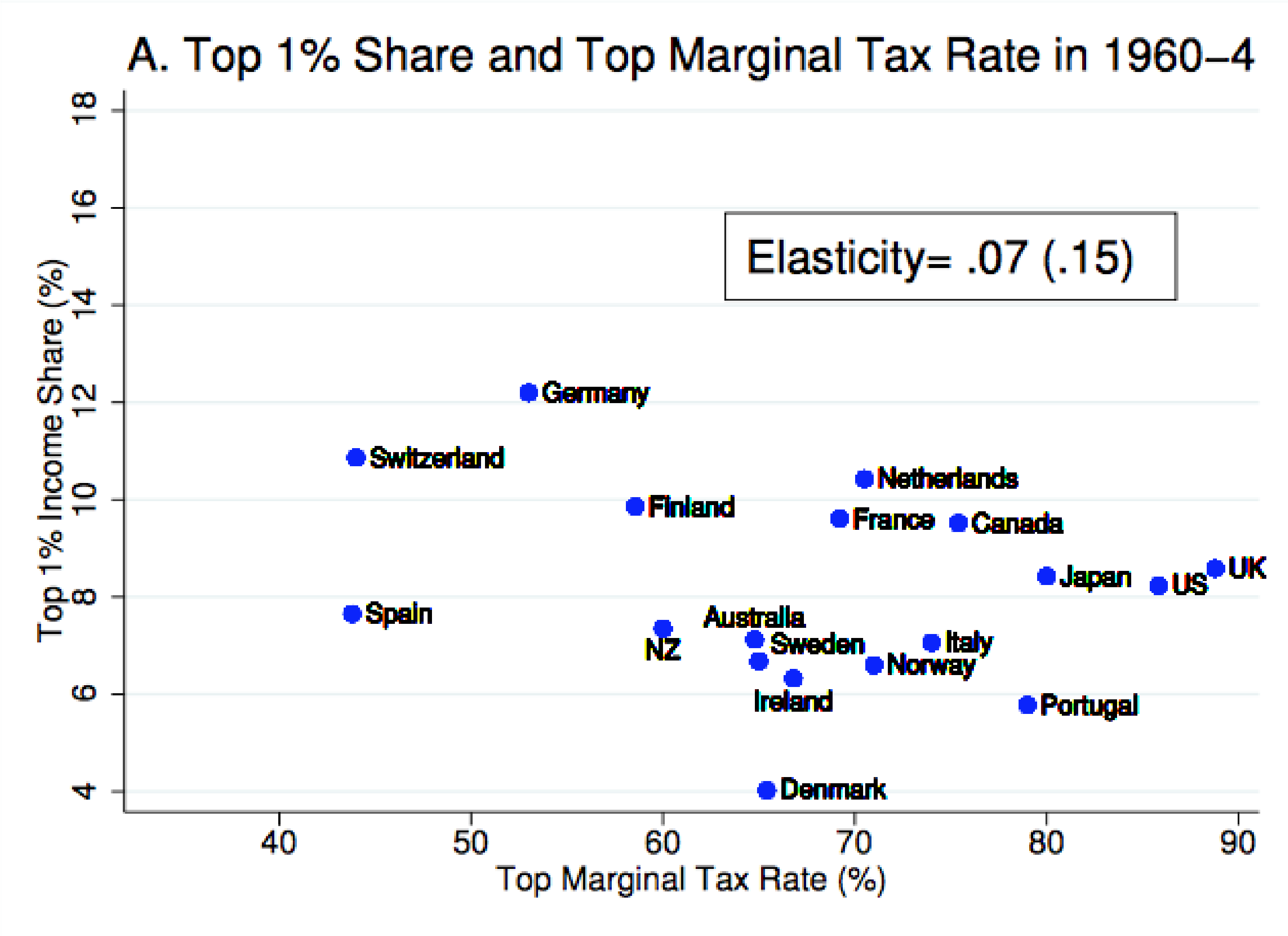
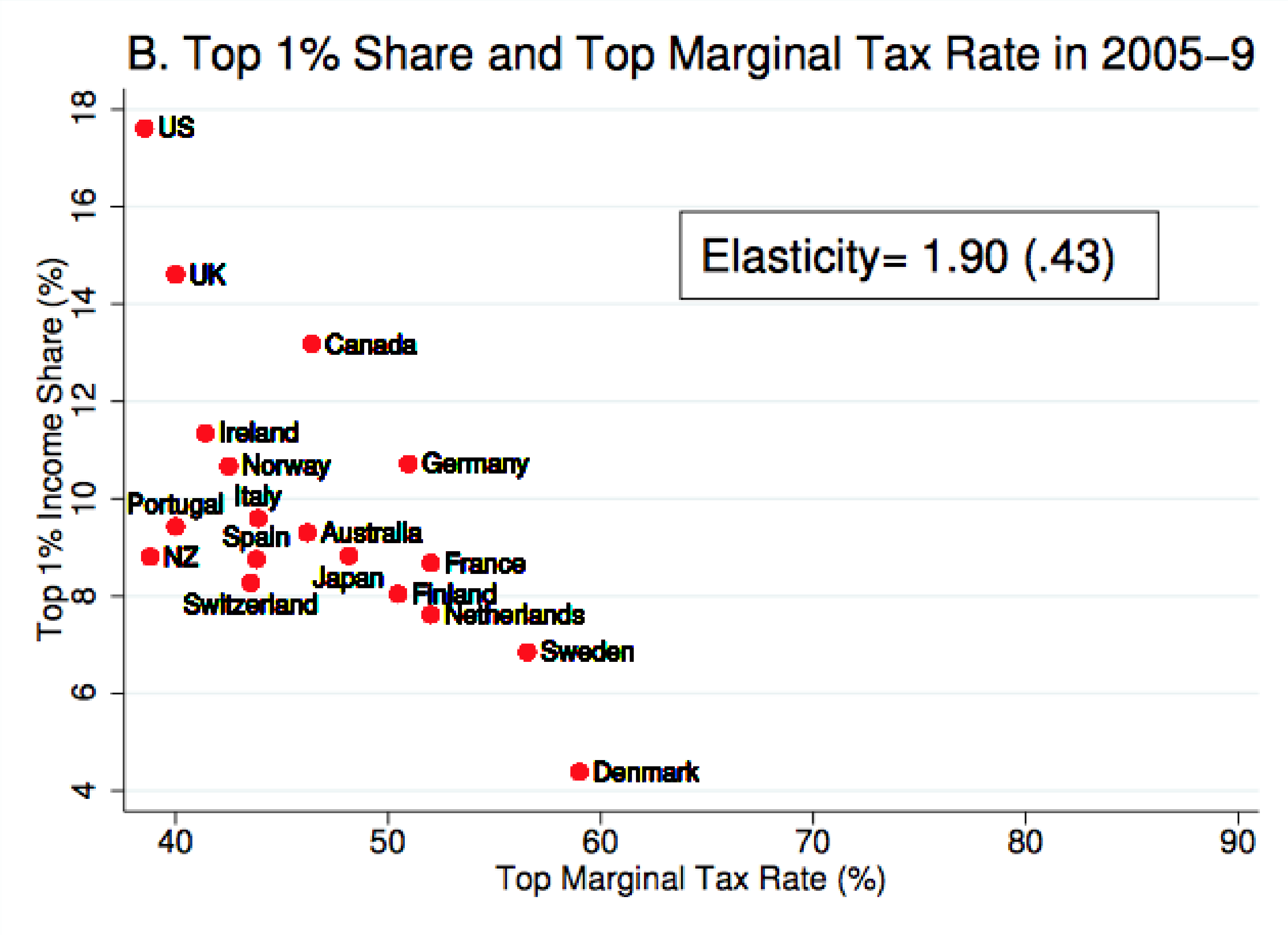


FIGURE III
Oil Industry CEO Pay and Crude Oil Price

Source: Bertrand and Mullainathan (2010)



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



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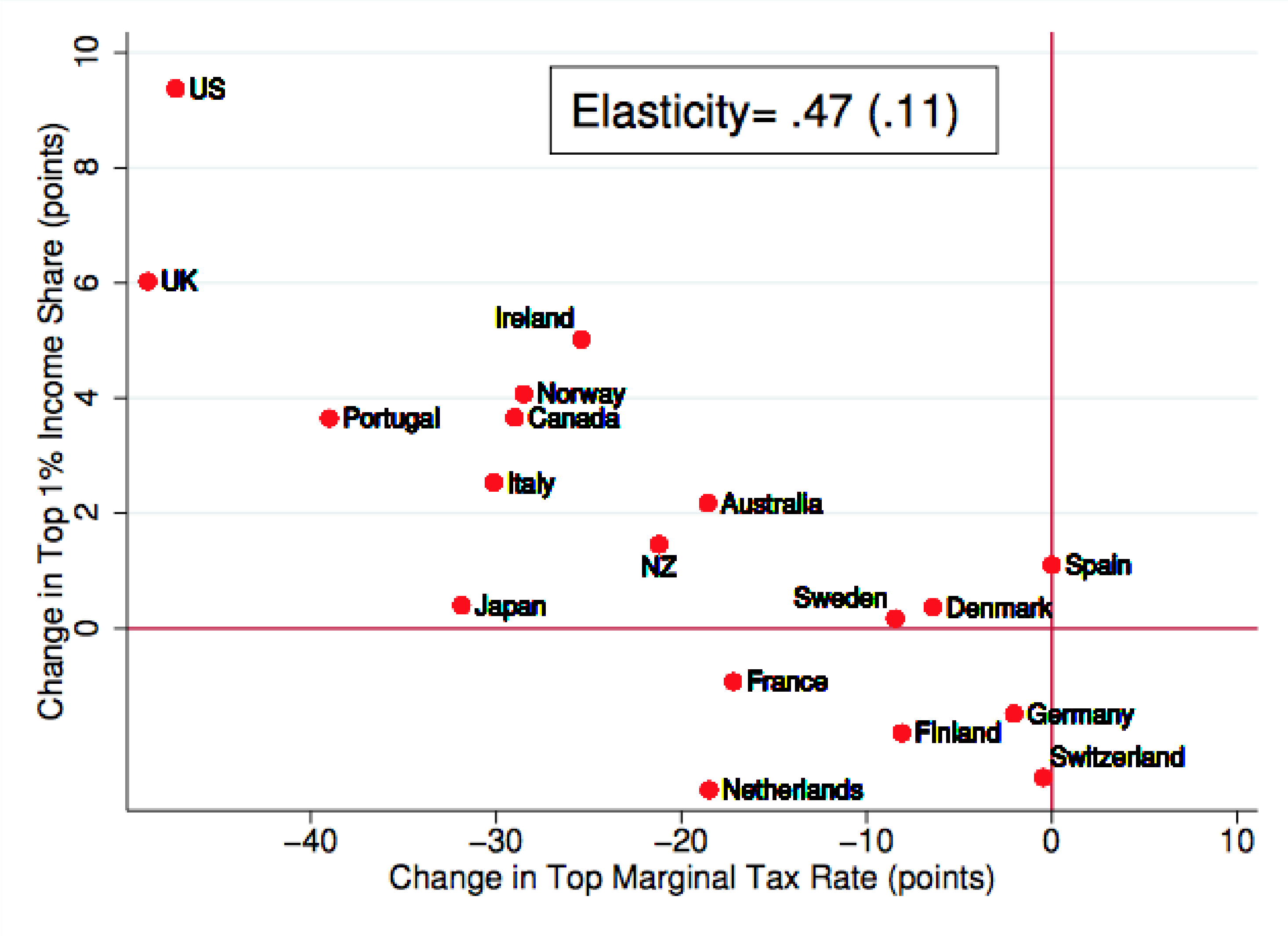

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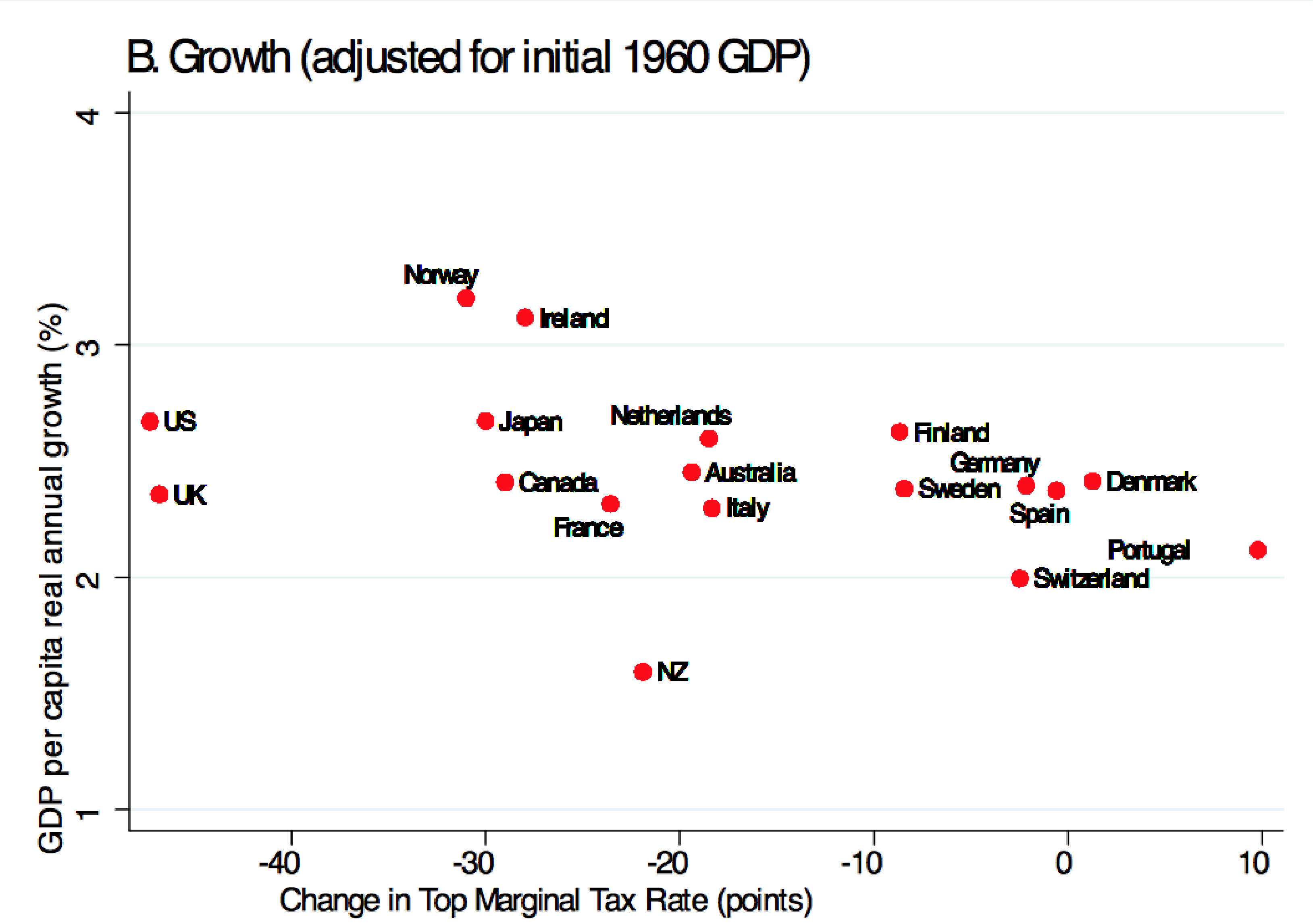
B. Growth (adjusted for initial 1960 GDP)
GDP per capita real annual growth (%)
1
2
3
4
-40
-30
-20
-10
0
10
Change in Top Marginal Tax Rate (points)
Norway
Ireland
US
UK
Japan
Canada
France
Netherlands
Australia
Italy
NZ
Finland
Germany
Sweden
Spain
Denmark
Portugal
Switzerland

3 Summary

- The rise of income inequality in the US is uniquely large and 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)

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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)