

# ECO 343: Economic Inequality and the Role of Government

Princeton University

Spring 2015

Lectures: Tuesday, 7.30p

This version of syllabus: February 20, 2016

Prof. Ilyana Kuziemko

322 Wallace Hall

kuziemko@princeton.edu

**Overview.** In the US and some other developed countries, economic inequality has risen to historic levels in recent decades. What are the causes of this trend—“natural” market forces (e.g., globalization) or changes in public policy (e.g., erosion of the minimum wage)? Are measures currently proposed to counteract inequality and poverty—e.g., progressive taxation, transfer programs to low-income families—effective? An emphasis is placed on understanding what basic microeconomic theory as well as empirical evidence can (and cannot) tell us about these questions.

**Prerequisites.** Students should have already completed econometrics (either ECO 302 or ECO 312). A comfortable understanding of intermediate microeconomic theory (ECO 300 or ECO 310) is assumed. We will use some multivariate calculus (nothing too painful), and you will use Stata (or a similar statistical software package) for some problem sets.

**Course materials.** There is no single text for the course, and readings will consist mostly of articles and book chapters. A few chapters of *Public Finance and Public Policy* by Jon Gruber (all chapter numbers in the reading assignments refer to the third edition, though any edition suffices) will be assigned, and I will put a few copies of the text on reserve. All papers assigned on the reading list can be found online or on the course website.

A “skeletal” version of my lecture slides will be handed out at the beginning of each class for you to have during lectures but will not be posted online. If you miss a lecture, please get a copy of the notes from a classmate.

**Grades.** A final grade will be determined as follows:

Participation 10%

Midterm 25%

Problem sets 25%

Final 40%

Students are encouraged to collaborate on problem sets, but everyone must write up his or her own answers.

**Assistant in Instruction.** Dan Herbst, an economics Ph.D. student focusing in labor economics, is the AI for the course. His email is dherbst@princeton.edu. Timing for precepts and Dan’s office hours are TBA.

**Office hours and other meetings.** Wednesday, 11a, 322 Wallace Hall. If there is demand, I will organize *voluntary*, loosely organized group discussion sessions.

# Schedule of topics covered

## I: Overview

### A. Economic inequality: The basic facts

#### Readings

- Atkinson, Piketty, and Saez (2011). “Top Incomes in the Long Run of History” (skip sections 2.3 and 3.1)
- Gruber, ch. 17.1

#### Concepts

- Measures of dispersion
- Simulation of dynamic processes

### B. What are the consequences of rising inequality?

#### Readings

- Hanouer (2014). “The Pitchforks are Coming...For us Plutocrats.” (Politico)
- Porter (2014). “Income Equality: A Search for Consequences” (NYT)
- Wilkinson (2009). “Thinking Clearly About Inequality” (Cato)

#### Concepts

- Review of empirical identification challenges
- Diminishing returns (algebraic and graphical treatment)

## II: Why has pre-tax income inequality increased?

### A: Technology (Skill-biased technological change, “polarization”)

#### Readings

- Autor, Katz, and Krueger (1998). “Computing Inequality: Have Computers Changed the Labor Market?” (up to page 1180)
- Autor (2014). *Polanyi’s Paradox and the Shape of Employment Growth* (Sections I-V)
- Akerman, Gaarder, and Mogstad (2015). “The Skill Complementarity of Broadband Internet” (skip IV.C, V.B and any discussion of ‘LP approach’)

#### Concepts

- Supply-demand model of the labor market

## **B: Assortative mating**

### Readings

- Yglesias (2014). “Your marriage is probably making inequality worse” (Slate)
- Eika, Mogstad, and Zafar (2014). *Educational assortative mating and household income inequality* (skip discussion of Norwegian results)

### Concepts

- Joint distributions
- Household labor supply

## **C. Trade and globalization**

### Readings

- Krugman (2008). “Trade and wages, reconsidered” (up to p. 117)
- Autor, Dorn, and Hanson (2013). “The China Syndrome: Local Labor Market Effects of Import Competition in the United States” (up to the paragraph that begins on p. 2135 and ends on p. 2136)

### Concepts

- Heckscher-Ohlin model
- Instrumental variables

## **D. “Superstars,” market size, executive compensation, financial deregulation**

### Readings

- Bakija, Cole, and Heim (2012). “Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from US Tax Return Data” (only highlighted portions)
- Bivens and Mishel (2013). “The pay of corporate executives and financial professionals as evidence of market power”
- Kaplan and Rauh (2013). “It’s the Market: The Broad-Based Rise in the Return to Top Talent”
- Philippon and Reshef (2012). “Wages and Human Capital in the US Finance Industry: 1909–2006”

### Concepts

- Monopoly models
- Principal-agent models

## **E. Immigration**

## F. Decline of unionization

### Readings

- DiNardo and Lee (2004). “Economic Impacts of New Unionization on Private Sector Employers: 1984–2001”
- Gladwell (2006). “The Risk Pool” (The New Yorker). Only highlighted passages.

### Concepts

- Regression discontinuity
- Differential treatment effects
- Partial v general equilibrium effects
- Spillovers and multiple equilibria

## G. Decline in the real value of minimum wage

### Readings

- Allegretto et al. (2013). “Credible research designs for minimum wage studies” (read sections 1-4 and 7, just skim 6, skip section 5 and all appendices)
- Yglesias (2013). “Martin Luther King’s Case for a Guaranteed Basic Income” (Slate)

### Concepts

- Monopsony model of the labor market (and introduction to welfare analysis)
- Differences-in-differences estimation
- Forming optimal control groups
- Wages, compensating differentials and total effective compensation

## IV. From the pre- to post-tax distribution: Redistributive policies

### A. Optimal income taxation (theory)

#### Readings

- Gruber, Ch. 19
- Gruber, Ch. 20.1, 20.3, Ch. 21.1.
- Friedman (2009). *Capitalism and freedom* (First two sections of Ch. 10)
- Mankiw (2013). “Defending the one percent” (just skim)

#### Concepts

- Social welfare function
- Moral hazard
- Tagging

## **B. Optimal income taxation (empirics)**

### Readings

- Gruber, Ch. 21.2
- Diamond and Saez (2011). “The case for a progressive tax: from basic research to policy recommendations” (just skim)

### Concepts

- Elasticity of labor supply
- Extensive v. intensive margin

## **C. Capital taxation (we might skip)**

### Readings

- Gruber, Ch. 22
- CBO, “The Distribution of Major Tax Expenditures in the Individual Income Tax System”

### Concepts

- Tax expenditures

## **D. Poverty policy**

### Readings

- Gruber, Ch. 12
- Gruber, Ch 17.2–17.5
- Heckman et al. (2010). “The rate of return to the HighScope Perry Preschool Program”
- Cutler and Gruber (1996). “Does Public Insurance Crowd Out Private Insurance?”
- Yglesias (2014). “Fight Poverty by Giving Poor People Money” (Slate)
- Mani et al. (2013). “Poverty Impedes Cognitive Function”

### Concepts

- Moral hazard
- Non-cognitive skills
- Crowd-out
- Cost-benefit analysis
- Randomized controlled trials
- In-kind versus cash assistance

## **E. Racial discrimination (TBA)**

## V. The politics of redistribution

### Readings

- Meltzer and Richard (1981). “A rational theory of the size of government” (skim)
- Charité, Fisman, and Kuziemko (2015). *Reference Points and Redistributive Preferences: Experimental Evidence* (skim)
- Kuziemko and Washington (2015). “Why did the Democrats lose the South? Bringing new data to an old Debate” (Intro, Sections 2-5)

### Concepts

- Median voter model
- Paradox of voting
- Relative utility models

## Assignments and due dates

Generating summary statistics from skewed distributions (Stata “programming” exercise)

Due Week 2

Investments, efficiency and inequality (math exercise)

Due Week 3

Labor markets and inequality (short math exercises and econometric analysis)

Due Week 4

Executive compensation (short math exercise)

Due Week 5

Midterm practice problems

Not graded; solutions posted in Week 5

The union wage premium (Stata replication exercise) and trade questions (math exercise)

Due Week 8

Minimum wage (math exercise and econometric analysis)

Due Week 9

Income taxation (math exercises)

Due Week 10

Transfer programs (TBA)

Due Week 11

Median voter and politics(TBA)

Due Week 12

Final practice problems

Not graded; posted in early January

## References

- Akerman, A., I. Gaarder, and M. Mogstad (2015). “The Skill Complementarity of Broadband Internet”. In: *The Quarterly Journal of Economics* 130.4, pp. 1781–1824.
- Allegretto, S. et al. (2013). “Credible research designs for minimum wage studies”. In: Atkinson, A. B., T. Piketty, and E. Saez (2011). “Top Incomes in the Long Run of History”. In: *Journal of Economic Literature* 49.1, pp. 3–71.
- Autor, D. H. (2014). *Polanyi’s Paradox and the Shape of Employment Growth*.
- Autor, D. H., D. Dorn, and G. H. Hanson (2013). “The China Syndrome: Local Labor Market Effects of Import Competition in the United States”. In: *American Economic Review* 103.6, pp. 2121–68.
- Autor, D. H., L. F. Katz, and A. B. Krueger (1998). “Computing Inequality: Have Computers Changed the Labor Market?” In: *Quarterly Journal of Economics*, pp. 1169–1213.
- Bakija, J., A. Cole, and B. T. Heim (2012). “Jobs and Income Growth of Top Earners and the Causes of Changing Income Inequality: Evidence from US Tax Return Data”. In: Bivens, J. and L. Mishel (2013). “The pay of corporate executives and financial professionals as evidence of rents in top 1 percent incomes”. In: *The Journal of Economic Perspectives* 27.3, pp. 57–77.
- Charité, J., R. Fisman, and I. Kuziemko (2015). *Reference Points and Redistributive Preferences: Experimental Evidence*. Tech. rep. National Bureau of Economic Research.
- Cutler, D. M. and J. Gruber (1996). “Does Public Insurance Crowd Out Private Insurance?” In: *Quarterly Journal of Economics* 111.2, pp. 391–430.
- Diamond, P. and E. Saez (2011). “The case for a progressive tax: from basic research to policy recommendations”. In: *The Journal of Economic Perspectives* 25.4, pp. 165–190.
- DiNardo, J. and D. S. Lee (2004). “Economic Impacts of New Unionization on Private Sector Employers: 1984–2001”. In: *The Quarterly journal of economics* 119.4, pp. 1383–1441.
- Eika, L., M. Mogstad, and B. Zafar (2014). *Educational assortative mating and household income inequality*. Tech. rep. National Bureau of Economic Research.
- Friedman, M. (2009). *Capitalism and freedom*. University of Chicago press.
- Heckman, J. J. et al. (2010). “The rate of return to the HighScope Perry Preschool Program”. In: *Journal of Public Economics* 94.1, pp. 114–128.
- Kaplan, S. N. and J. Rauh (2013). “It’s the Market: The Broad-Based Rise in the Return to Top Talent”. In: *The Journal of Economic Perspectives*, pp. 35–55.
- Krugman, P. R. (2008). “Trade and wages, reconsidered”. In: *Brookings Papers on Economic Activity* 2008.1, pp. 103–154.
- Kuziemko, I. and E. Washington (2015). “Why did the Democrats lose the South? Bringing new data to an old Debate”. Mimeo, Princeton.
- Mani, A. et al. (2013). “Poverty Impedes Cognitive Function”. In: *Science* 341.6149, pp. 976–980.
- Mankiw, N. G. (2013). “Defending the one percent”. In: *The Journal of Economic Perspectives* 27.3, pp. 21–34.
- Meltzer, A. and S. Richard (1981). “A rational theory of the size of government”. In: *The Journal of Political Economy* 89.5, pp. 914–927.



Philippon, T. and A. Reshef (2012). “Wages and Human Capital in the US Finance Industry: 1909–2006”. In: *The Quarterly Journal of Economics* 127.4, pp. 1551–1609.