Top End Inequality

facts, interpretations, policies

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Lecture 3

Inequality, Economic Opportunity, and Public Policy
Economics 85600

1. “just desert” lies behind discussions of the top 1%

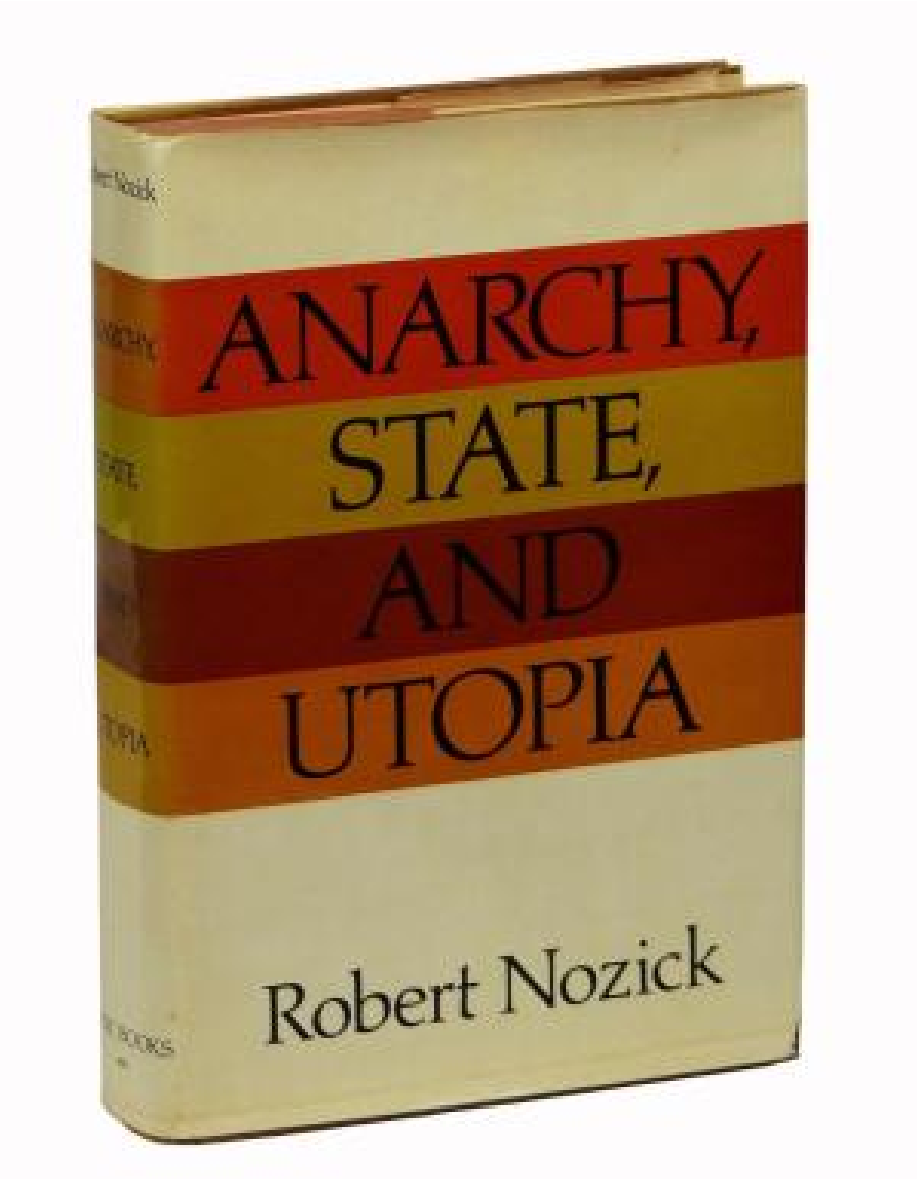


Figure 1: Robert Nozick’s famous book offers a defense of the top 1%

1. Nozick makes the Wilt Chamberlain objection

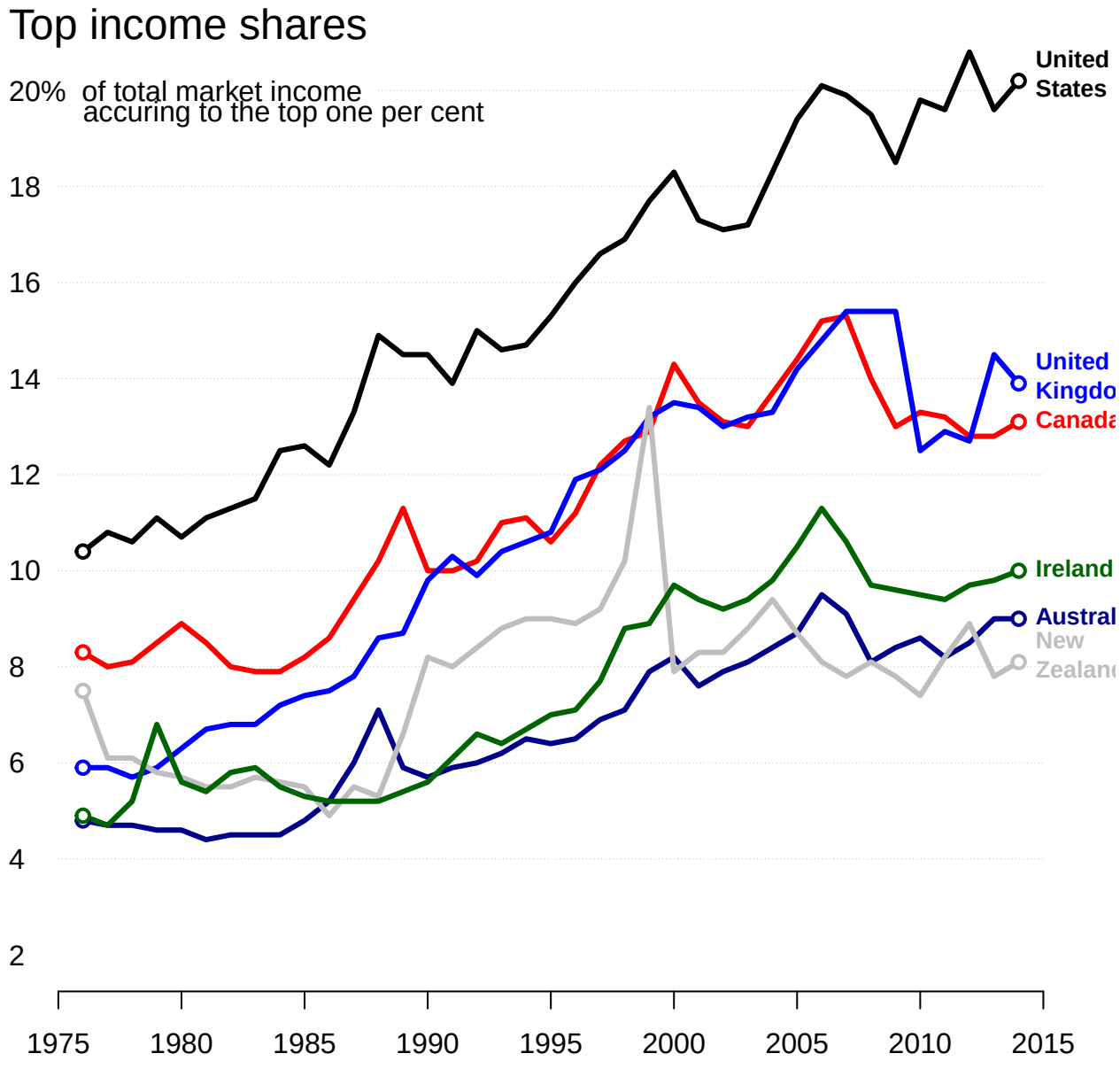
Figure 2: Wilt Chamberlain was a tall man with a big pay cheque

1. Nozick makes the Wilt Chamberlain objection

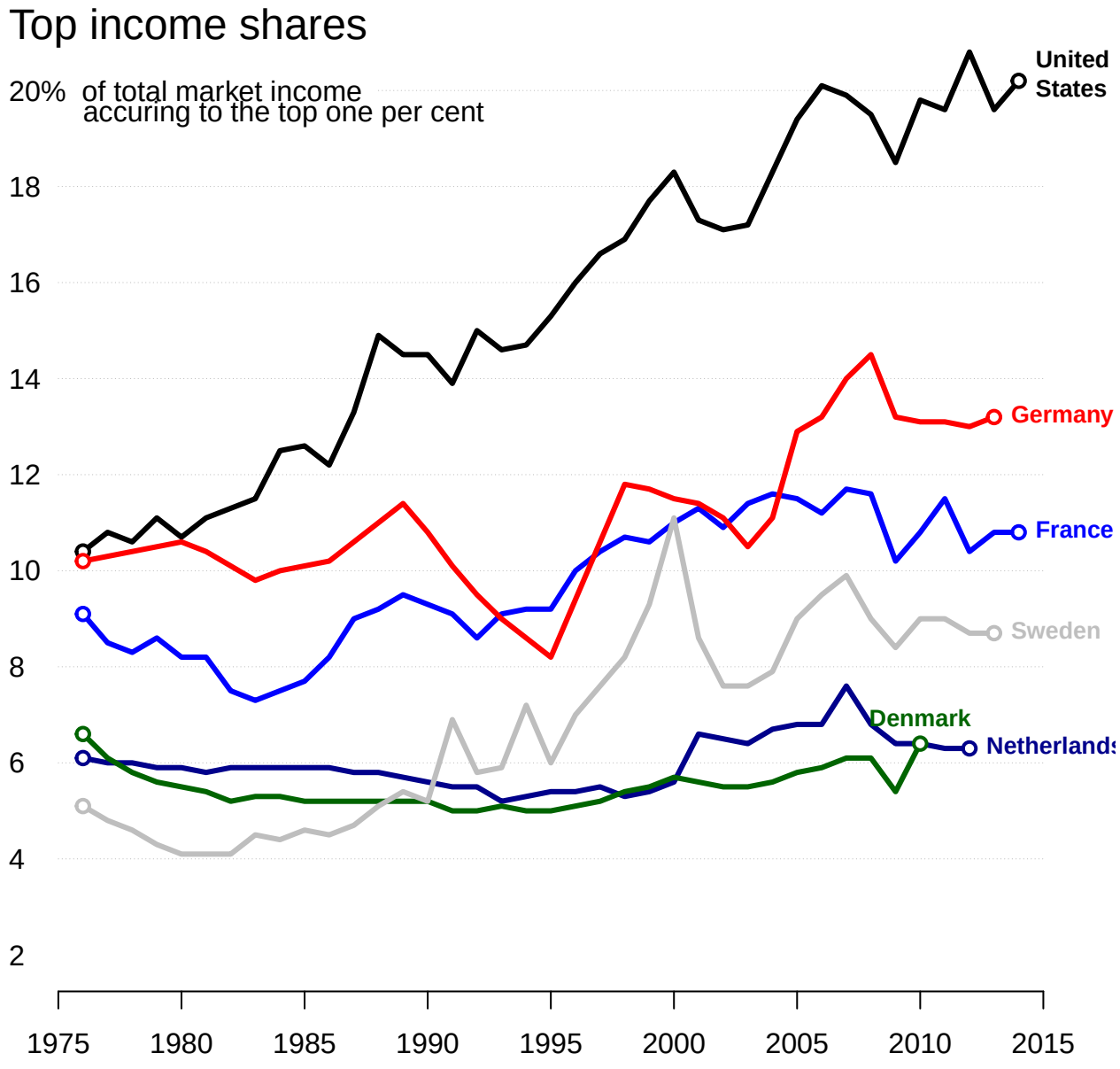
> *. . . suppose that Wilt Chamberlain is greatly in demand by basketball teams, being a great gate attraction . . . He signs the following sort of contract with a team: In each home game, twenty-five cents from the price of each ticket of admission goes to him. . . . The season starts, and people cheerfully attend his team's games; they buy their tickets, each time droppoing a separate twenty-five cents of their admission price into a special box with Chamberlan's name on it. They are excited about seeing him play; it is worth the total admission price to them. Let us suppose that in one season one million persons attend his home games, and Wilt Chamberlain winds up with $250,000, a much larger sum than the average income and larger even than anyone else has. Is he entitled to this income? Is this new distribution . . . unjust?*

Robert Nozizk (1974) *Anarchy, State, Utopia*, page 161.

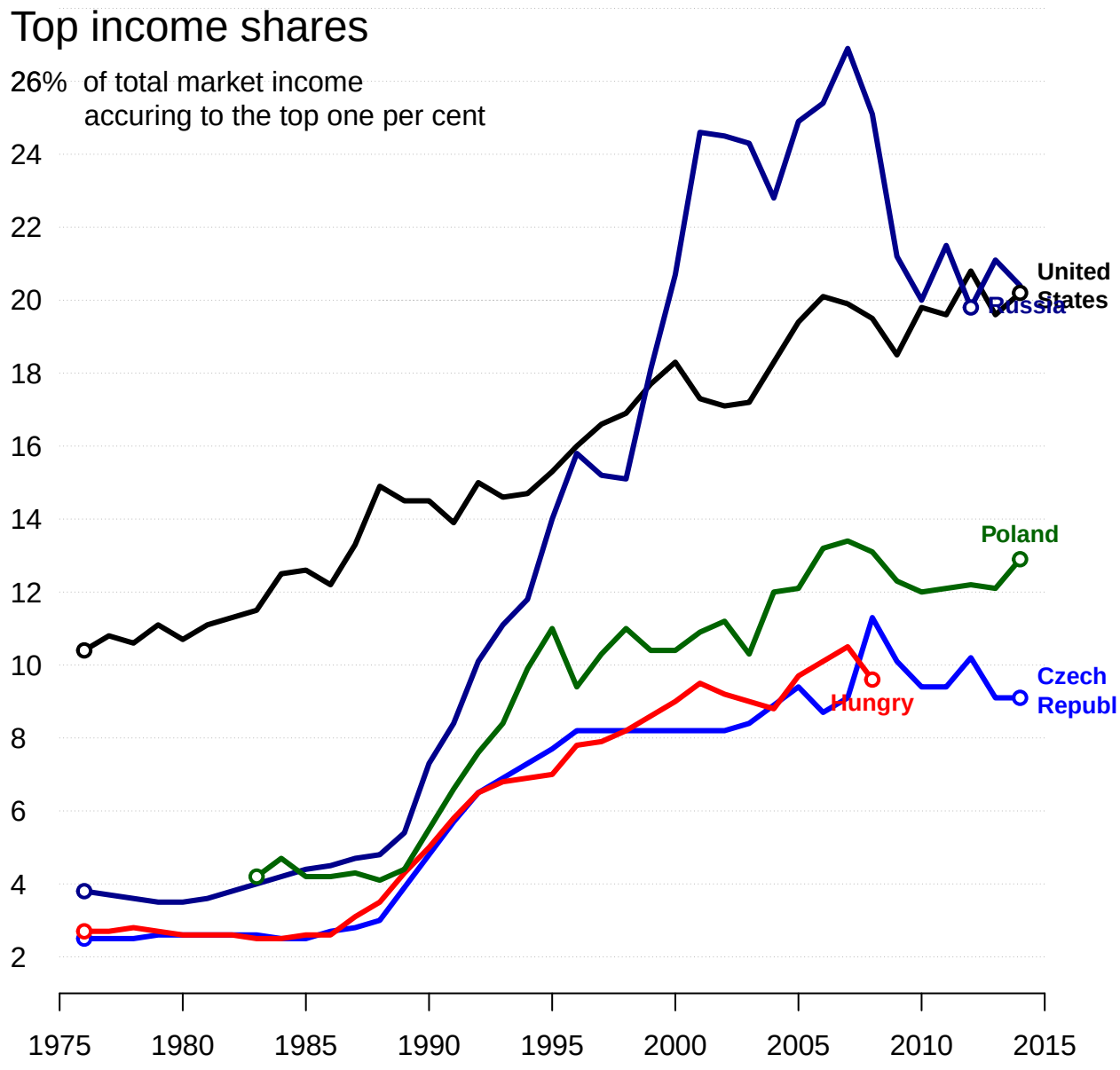
2. Top end inequality on the rise in the "anglosphere"



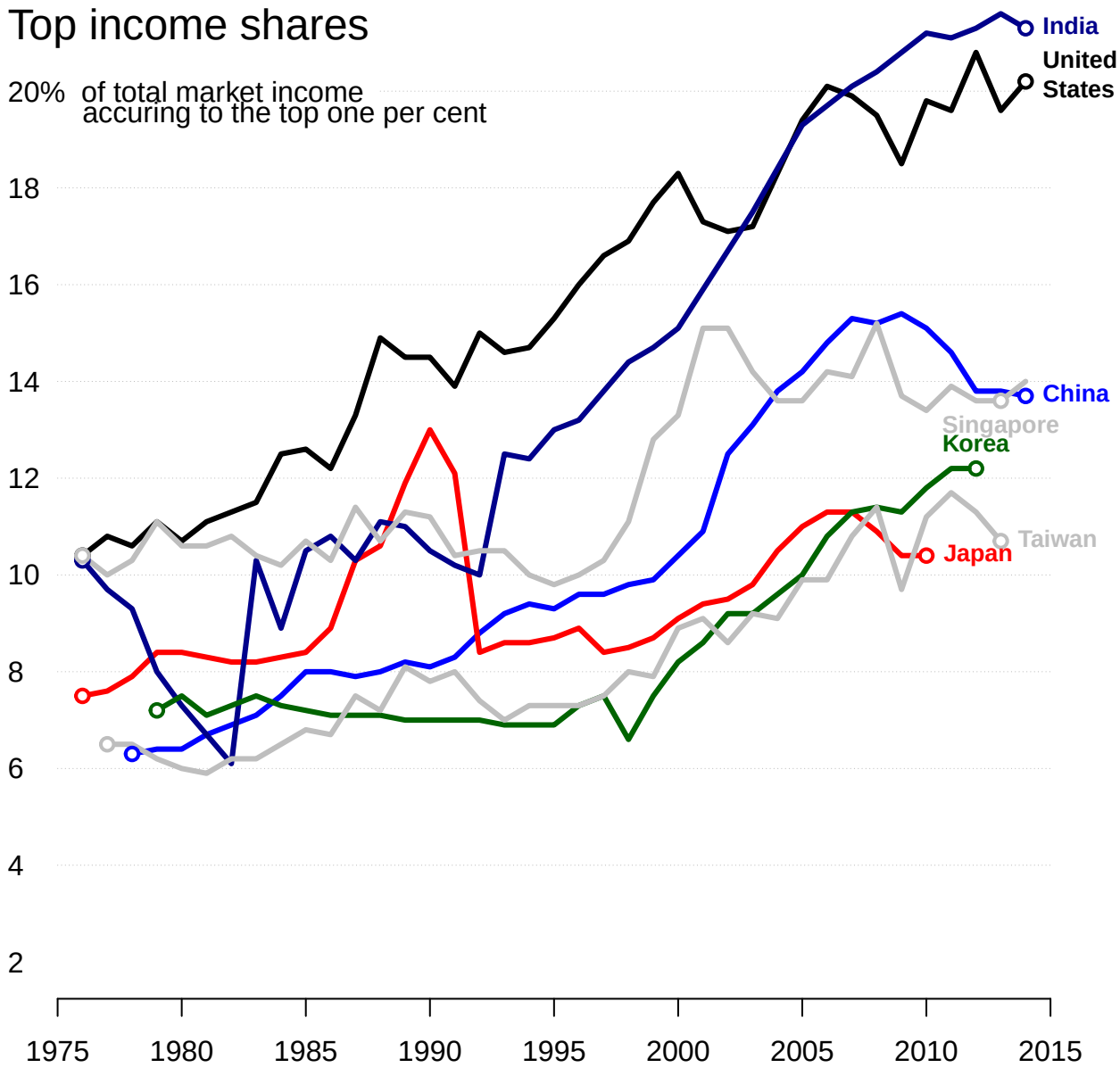
2. . . . but not rising so much in continental europe



2. . . . though certainly rising in eastern europe



2. . . . and varying a good deal in Asia



2. Administrative data are the source for top end incomes

- The World Inequality Database
  - accessible at https://wid.world/data/
  - developed and housed at the Paris School of Economics
- Advantages and challenges of "administrative"" data and of "survey"" data
  - discussed in the opening sections of Atkinson, Piketty, Saez (2011), "Top Incomes in the Long Run of History", which is a summary of a two volume book
  - use all data critically, with an eye to strengths and weaknesses for the purpose at hand
  - play to the data's strengths while minimizing the weaknesses

2. Administrative data are the source for top end incomes

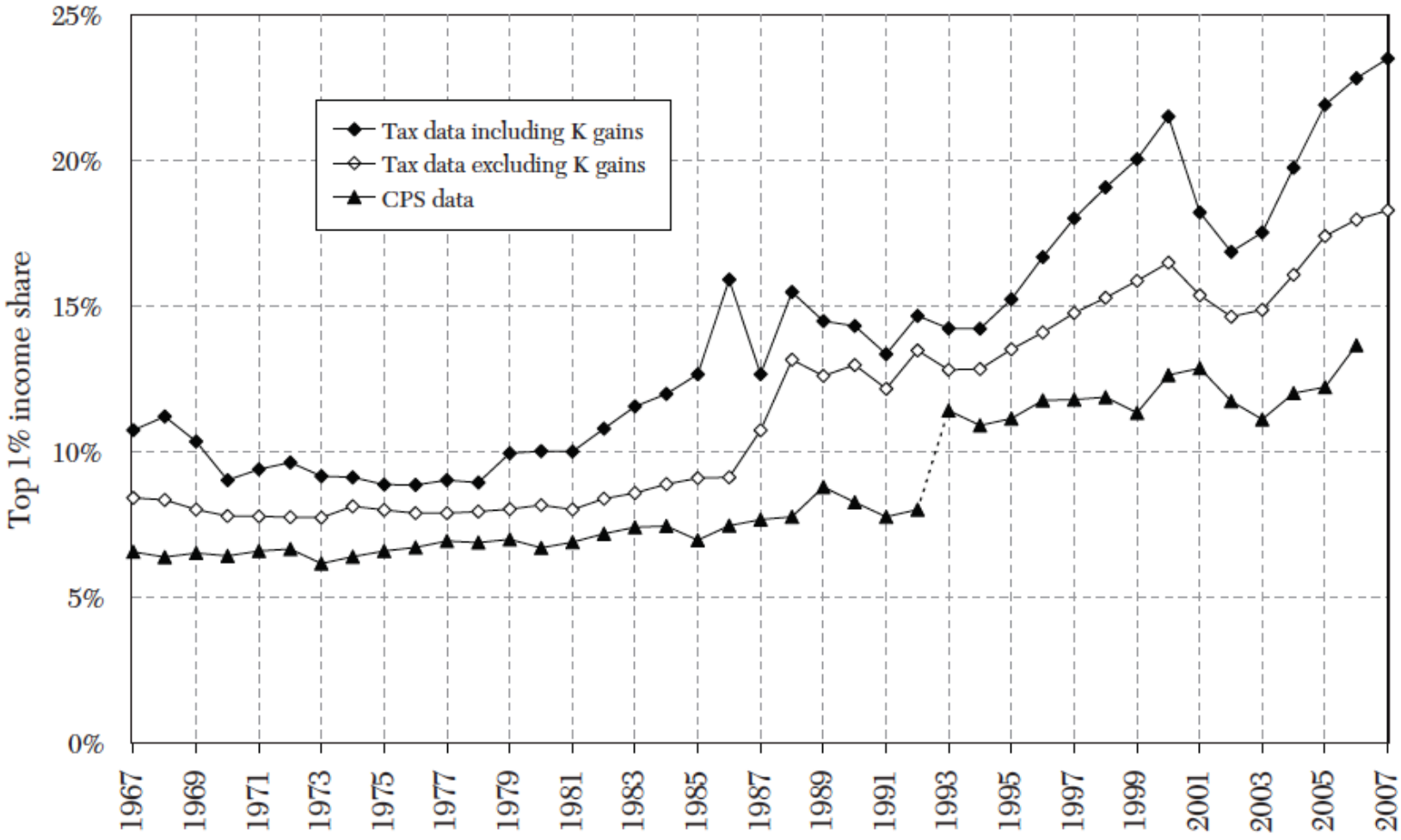


Figure 3: Comparing Top 1 Percent Income Share from Tax and CPS Data

3. The challenge this poses to explaining rising inequality

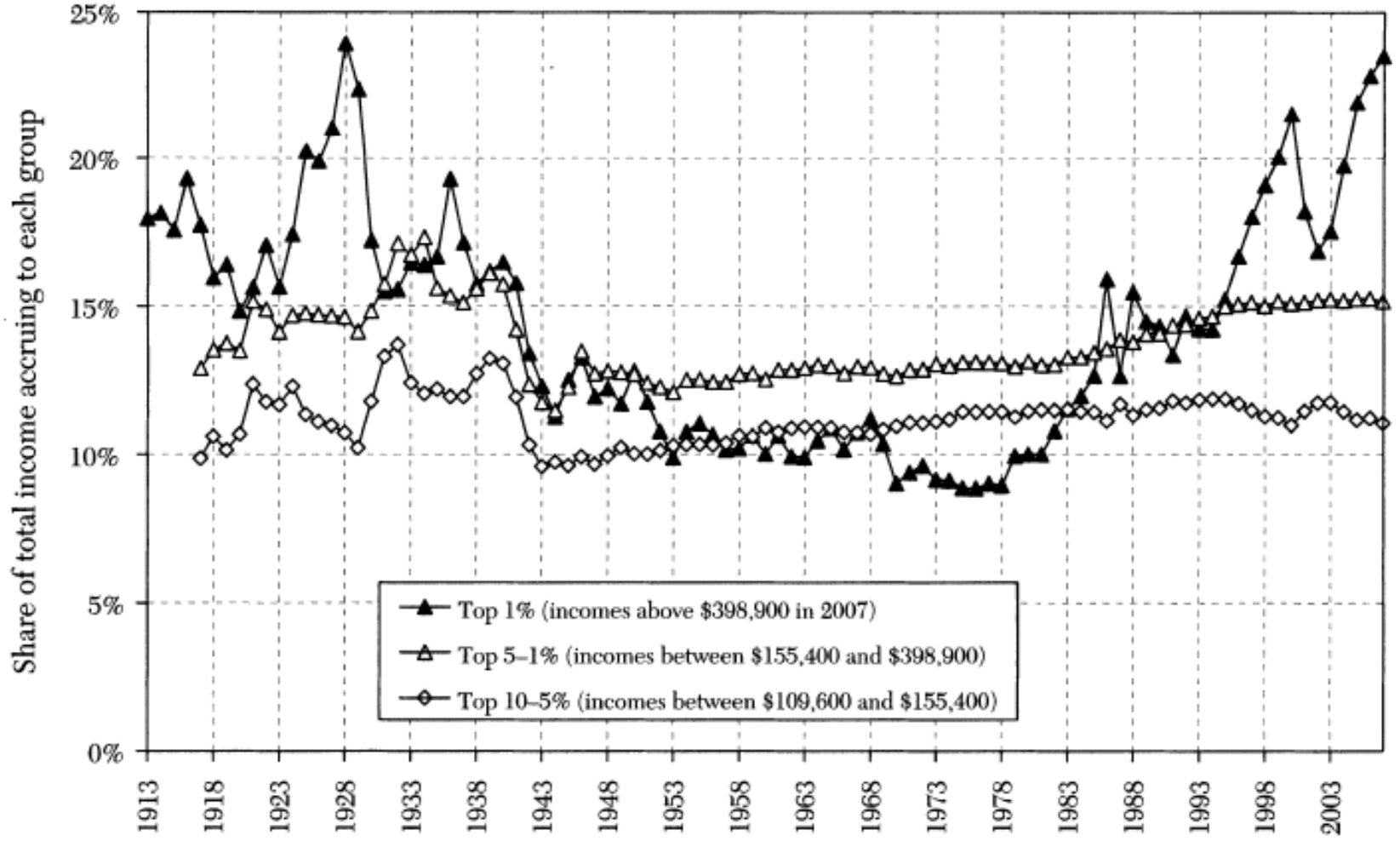


Figure 4: Decomposing top decile US Income Share

3. The “Skill Biased Technical Change” argument

- “Technical change”" influences the structure of pay
  - which skills does the computer complement, for which is it a substitute?
  - cognitive versus non-cognitive, routine versus non-routine
  - think about machine learning and artificial intelligence
- Does this fit the facts?
  - predict the rise of the top 1 % ?
  - the concentration of income even within the top 1 % ?
  - the composition of income?

3. The economic basis for "Winner take all" markets

- Sherwin Rosen (1981). "The Economics of Superstars"
  - what is the logic of this model?
    - the demand side is characterized by a concern for quality
    - the supply side by scale of the personal market
  - what does Rosen mean when he writes:

"When the joint consumption technology and imperfect substitution features of preferences are combined, the possibility for talented persons to command both very large markets and very large incomes is apparent."

3. The economic basis for "Winner take all" markets

- Sherwin Rosen (1981). "The Economics of Superstars"
  - what is the logic of this model?
  - what are the comparative statics of the model?
- writing in 1981 Rosen concludes his paper with wonder and awe:

  "What changes in the future will be wrought by cable, video cassettes, and home computers?"

3. The economic basis for "Winner take all" markets

performance pay as an enabling institution or as a cause of higher inequality?

- Rosen begins his paper by assuming a fixed distribution of "talent", called q, that is "costlessly observable"
- Lemieux, MacLeod, and Parent (2009). "Performance Pay and Inequality" begin their paper by asking how pay is structured when "talent" is not observable
  - performance pay is used in this situation
  - the rise of performance pay contracts is associated with the rise in US earnings inequality

3. Performance pay as a cause of higher inequality?

- Notice the data used in Lemieux, MacLeod, and Parent (2009)
  - Panel Study of Income Dynamics
    - what kind of data ?
    - what concerns does it raise for the analysis?
    - what limitations does it put on interpreting the results?
- Two issues/propositions
  - performance pay more closely links "talents" to pay
    - "wages are more closely linked to both observed (education, etc.) and unobserved (worker specific fixed effects) worker characteristics in performance-pay than in non-performance-pay jobs"
  - there is more wage inequality among performance pay jobs
    - "wage dispersion has risen faster in performance-pay jobs than in other jobs over this period"

3. Performance pay as a cause of higher inequality?

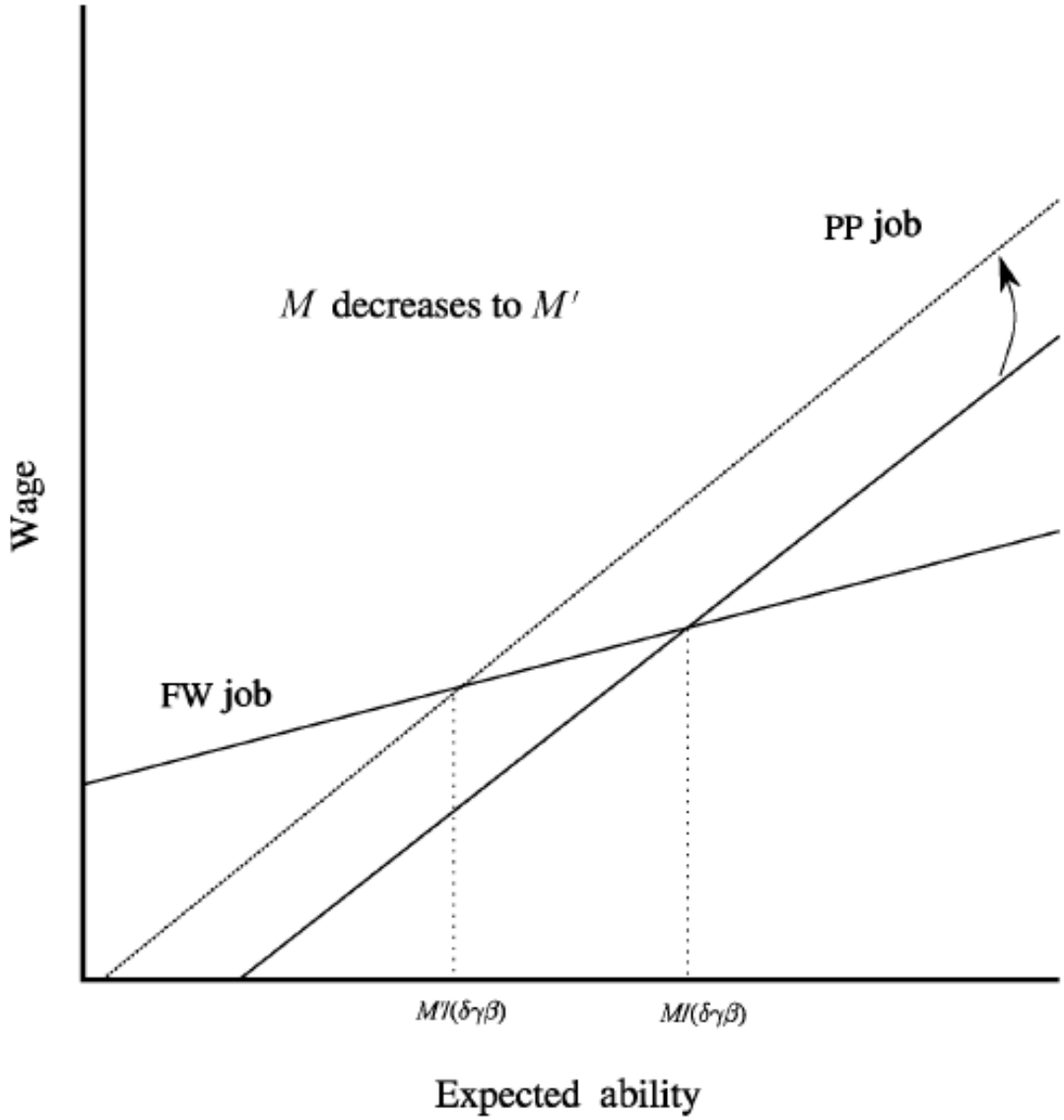


Figure 5: Effect of Monitoring Cost Decrease

3. Performance pay as a cause of higher inequality?

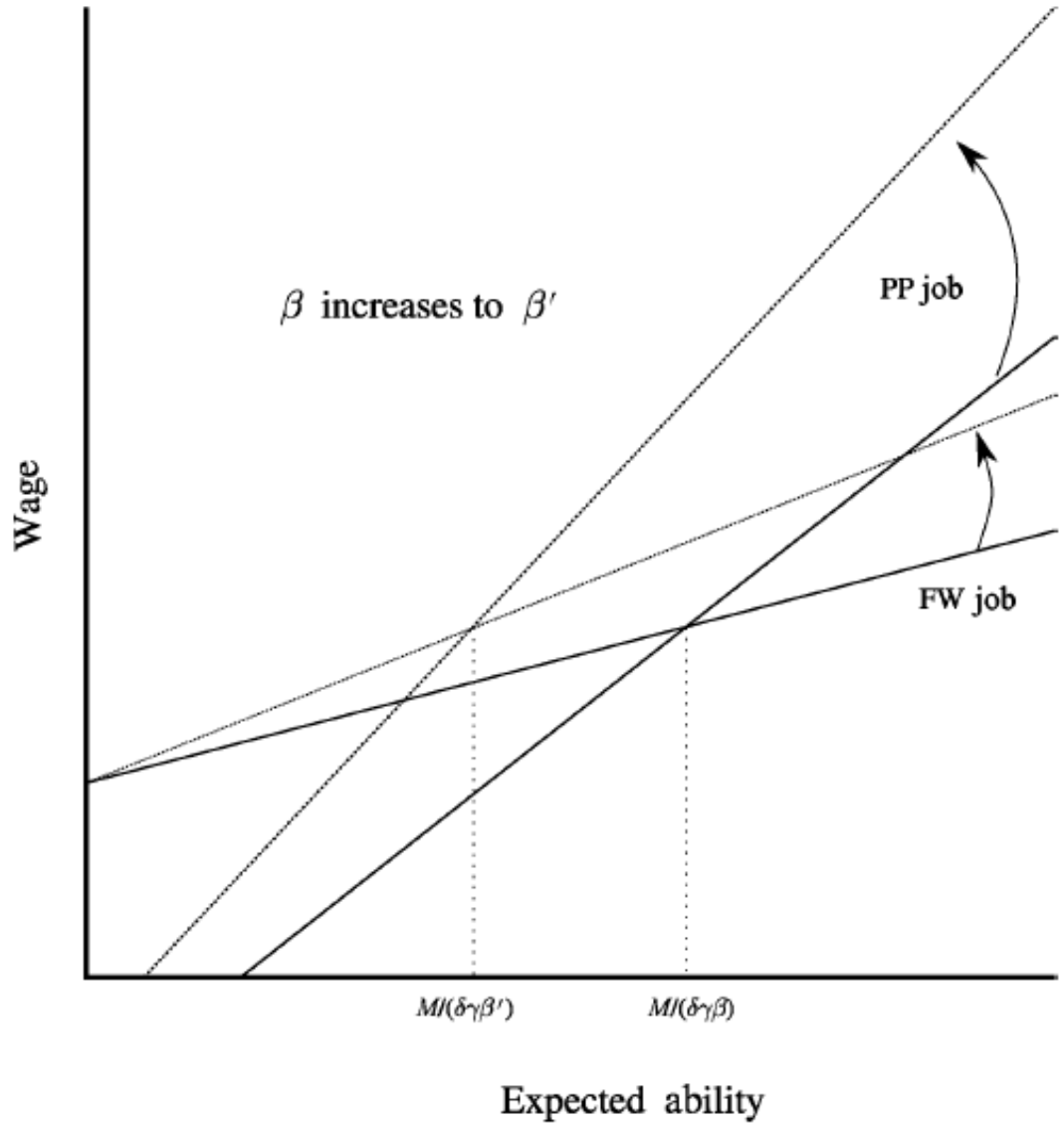


Figure 6: Effect of higher return to ability

3. Performance pay as a cause of higher inequality?

SUMMARY STATISTICS: PANEL STUDY OF INCOME DYNAMICS 1976–1998

	Non-performance-pay jobs (1)	Performance-pay jobs (2)
Average hourly earnings ($79)	8.38	10.86
Education	12.52	13.39
Potential experience	19.74	19.61
Employer tenure	7.62	9.25
Married	0.72	0.77
Unionized	0.28	0.14
Nonwhite	0.13	0.09
Paid by the hour	0.66	0.31
Paid a salary	0.32	0.51
Annual hours worked	2,122	2,286
Number of workers (total: 3,053)	2,616	1,271
Number of job matches (total: 7,442)	5,657	1,785
Number of observations (total: 26,146)	16,466	9,680

Notes. The sample consists of male household heads aged 18–65 working in private sector wage and salary jobs. All figures in the table represent sample means. Education, potential experience, and employer tenure are measured in years. Potential experience is defined as age minus education minus 6. Performance-pay jobs are employment relationships in which part of the worker's total compensation includes a variable pay component (bonus, commission, piece rate). Any worker who reports overtime pay is considered to be in a non-performance-pay job. Workers are considered unionized if they are covered by a collective bargaining agreement.

Figure 7: About 37% of workers are in Performance Pay Jobs

3. Performance pay as a cause of higher inequality?

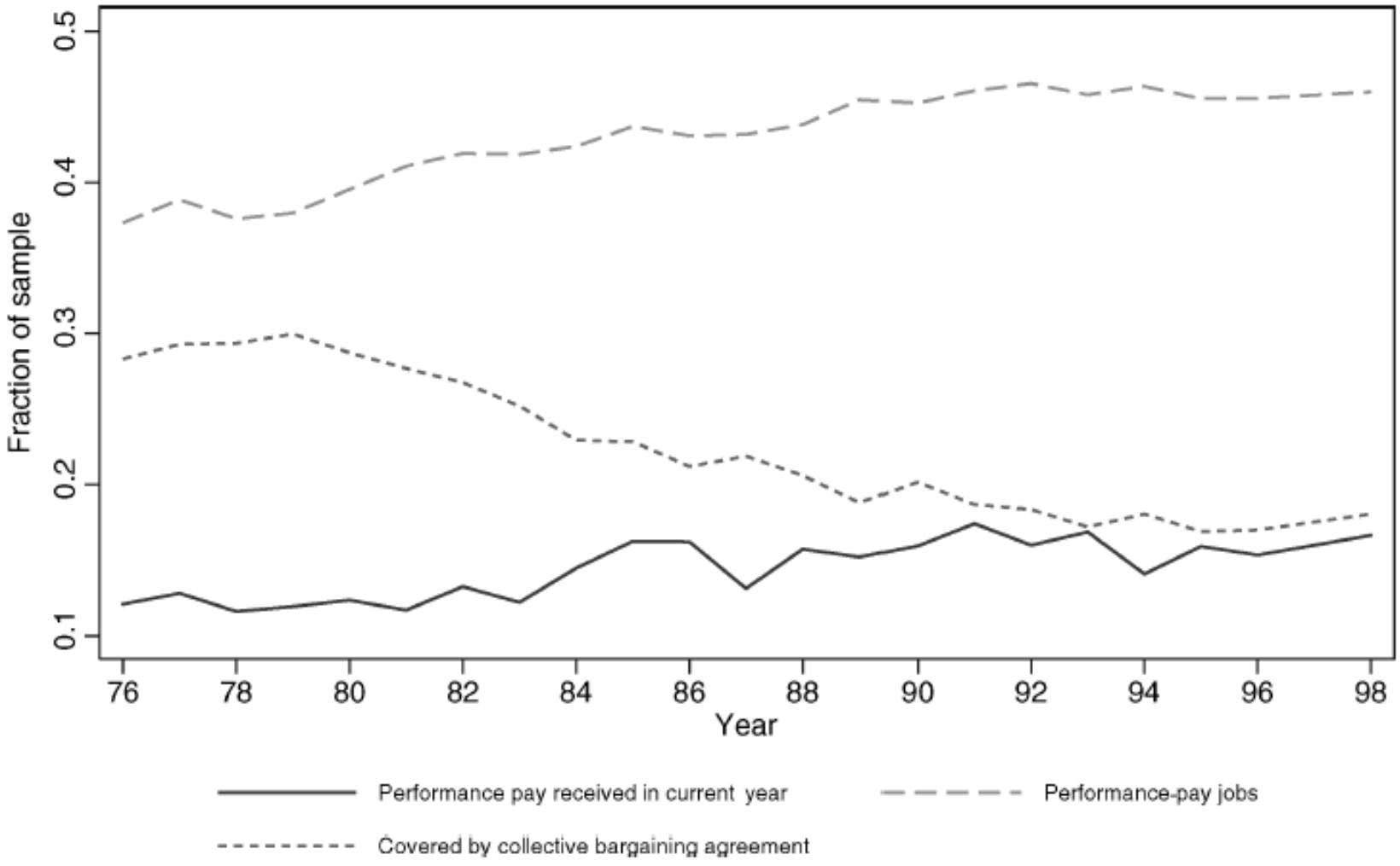


Figure 8: Performance Pay Jobs increased during the 1980s

3. Performance pay as a cause of higher inequality?

SKILLS-RELATED WAGE DIFFERENTIALS AND PERFORMANCE-PAY (PP) JOBS

	Sample					
			All jobs			
	PP jobs	Non-PP jobs				
	OLS	OLS	OLS	FE	OLS	FE
Estimation method	(1)	(2)	(3)	(4)	(5)	(6)
Performance-pay job dummy	—	—	−0.4526	−0.2061	−0.2406	0.1414
			(0.1019)	(0.0723)	(0.1251)	(0.0998)
Years of education	0.0929	0.0665	0.0637	0.0167	0.0584	0.0040
	(0.0071)	(0.0039)	(0.0040)	(0.0091)	(0.0047)	(0.0096)
Education × performance-pay job	—	—	0.0365	0.0169	0.0217	−0.0079
			(0.0071)	(0.0048)	(0.0092)	(0.0071)
Education × 1990–1993	—	—	—	—	0.0161	0.0222
					(0.0085)	(0.0056)
Education × performance-pay job × 1990–1993	—	—	—	—	0.0190	0.0280
					(0.0137)	(0.0089)
Potential experience (effect at 20 years)	0.4259	0.2882	0.3010	0.4545	0.3002	0.4231
	(0.0535)	(0.0288)	(0.0294)	(0.1258)	(0.0294)	(0.1256)
Experience × performance-pay job	—	—	0.1162	0.0149	0.1018	−0.0278
			(0.0584)	(0.0501)	(0.0581)	(0.0509)
Tenure (effect at ten years)	0.1670	0.2197	0.2262	0.1158	0.2271	0.1191
	(0.0268)	(0.0154)	(0.0154)	(0.0129)	(0.0154)	(0.0129)
Tenure × performance-pay job	—	—	−0.0666	0.0278	−0.0677	0.0196
			(0.0301)	(0.0237)	(0.0303)	(0.0239)
Number of observations	9,680	16,466	26,146	26,146	26,146	26,146

Figure 9: Returns to education higher and growing faster in Performance Pay Jobs

4. Next steps, issues for a fuller discussion

1. Just who are these more "talented" people, and what is the nature of their work?
2. Is "productivity" attributable to individuals?
   - skill based differences in pay
   - ability to capture rents
3. How do we make sense of international differences?
4. What are the intergenerational implications as income flows change wealth?
5. Just what are the origins of these differences in "talent"?

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