

Week 12 - Review

- **Positive economics:** How the economy's income *is* distributed (the data/facts).
- **Normative economics:** What society *should* do about economic inequality.
- Economics alone can't answer normative questions, we look to three political philosophies to guide our view on income redistribution.

1. The Utilitarian Tradition (Bentham & Mill)

- **Core Goal:** "The greatest good for the greatest number." The government should maximize the sum of total utility in society ($Max \sum U$).
- **Key Assumption: Diminishing marginal utility of income.**
 - An extra \$1 brings more utility (happiness/satisfaction) to a poor person than to a rich person.
- **Stance on Redistribution:** Taking from the rich and giving to the poor increases *total* utility.
 - **However**, utilitarians *do not* support complete equality.
 - **The "Leaky Bucket" tradeoff:** Taxes and transfers reduce incentives to work hard. If we redistribute too much, the total amount of income in society shrinks. Utilitarians balance the gains from equality against the losses from distorted incentives.

2. The Liberal Contractarian Tradition (John Rawls)

- **Core Goal:** Maximize the minimum utility in society.
- **Key Assumption:** The "**Veil of Ignorance.**" Imagine designing society's rules before you are born, without knowing if you will be rich or poor, talented or inept, privileged or marginalized.
- **The Strategy:** Because people are risk-averse, behind this veil, everyone would be terrified of ending up at the very bottom. Therefore, rational people would agree to the **Maximin criterion:** policies should prioritize the welfare of the *worst-off* person in society.
- **Stance on Redistribution:** Views redistribution as a form of social insurance.
 - Favors *more* redistribution than Utilitarianism, but still allows for some inequality if that inequality provides incentives that ultimately grow the economy and raise the living standards of the poorest person.

3. The Libertarian Tradition (Robert Nozick)

- **Core Goal:** Evaluate the *process*, not the *outcome*.
- **Key Assumption: Equality of opportunity** matters, equality of outcomes does not.
 - Society doesn't earn income; *individuals* do.

- Analogy: Think of grades in this Econ 101 class. A fair class doesn't give everyone a C; it ensures the grading *process* is fair, even if the resulting distribution of grades is highly unequal.
 - **Stance on Redistribution:** Opposes taking from some to give to others, provided the initial acquisition of wealth was just (no fraud or theft).
 - The government's only job is to enforce rules, property rights, and voluntary contracts.
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- **Gini Coefficient:** measure of inequality ranging from **0 (perfect equality)** to **1 (perfect inequality)**.
- The U.S. has a higher Gini than most rich countries but lower than many developing countries.

