10 Efficiency and Equity

10.1 Lecture 22: Efficiency and Equity

10.1.1 Choosing the socially optimal allocation

- **Social welfare function (SWF)** can be thought of as a utility function for society taking individual utilities as inputs

$$SWF = f(U_1, U_2, \cdots)$$

- **Isowelfare curve** shows distributions of utility across which society is indifferent
  - **Utilitarian SWF**: $SWF = U_1 + U_2 + \cdots$
  - **Rawlsian SWF**: $SWF = min(U_1, U_2, \cdots)$

10.1.2 Inequality in the US and around the world

- The rate of absolute deprivation matters, and we measure that by poverty line.

10.1.3 Sources of Leakage

- Transfer programs lead to decrease in labor supply especially among those who qualify or are originally near the cutoff to receive the subsidy.
- Distortionary taxation leads to DWL–this is the cost of redistribution.

10.1.4 TO KNOW – Conceptual Understanding

- Explain what different social welfare functions imply about optimal allocations
- Intuitively describe the efficiency cost of redistribution

10.1.5 TO KNOW – Graphical and Math Understanding

- Show in a consumption-leisure graph how taxes on labor income could affect labor supply; then in a labor market graph, show the DWL of putting taxes on labor income
- Do simple calculations to determine welfare under different SWF

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