

Tackling inequality: the distributional impact of implementing Atkinson's alternative tax/benefit reform packages and the Living Wage in the UK

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Outline

- “Market-income inequality has been the main driver of inequality trends in disposable incomes, but redistribution policies had a substantial effect as well, especially since the mid-1990s.” OECD *Divided We Stand* (2011)
- What impact could strengthening direct redistribution by raising income tax and cash transfers have in reducing inequality
 - as well as addressing structural failings of transfer system?
- What about addressing market income inequality directly by substantially increasing the Minimum Wage?
- Simulation of proposals set out for UK in Atkinson’s *Inequality: What Can Be Done?* (Harvard, 2015), of broader strategic relevance

The UK Context

- UK inequality now much higher than in late 1970s
 - disposable income Gini up from 0.25 to 0.35
 - Market income Gini up even more, from 0.38 to 0.52
- Beveridge structure originally based primarily on social insurance benefits but now heavily means-tested
 - 25% of non-pensioners benefit spending in 1970s vs 80% now;
 - “the contributory principle plays an increasingly marginal role in the social security system, particularly for those of working age” (IFS)

The Perils of Means-Testing

- Targetting income support by direct means-testing attractive as a way to promote efficiency in tackling poverty, but
- Embeds work disincentives and poverty/unemployment traps
- Non-take-up can lead to unmet need
- (Potentially) stigmatising and erodes dignity

Alternative Strategies

- Substantial increase in income tax rates
 - to include 55% and 65% rates (current top rate 40%)
 - Increase in SI contributions for higher earners
- Substantial increase in Child Benefit
 - £90 per week for first child, £48 each for other children (up from £20 and £14);
 - child tax credit, housing benefit, council tax benefit reduced by up to amount of increase
 - paid for all children (including in high-income families)
 - taxable

Alternative Strategies

Combined with either strengthening Social Insurance

- Increase rates for pensions and working-age insurance-based benefits by at least 25% (unemployed on lower rates so larger increase)

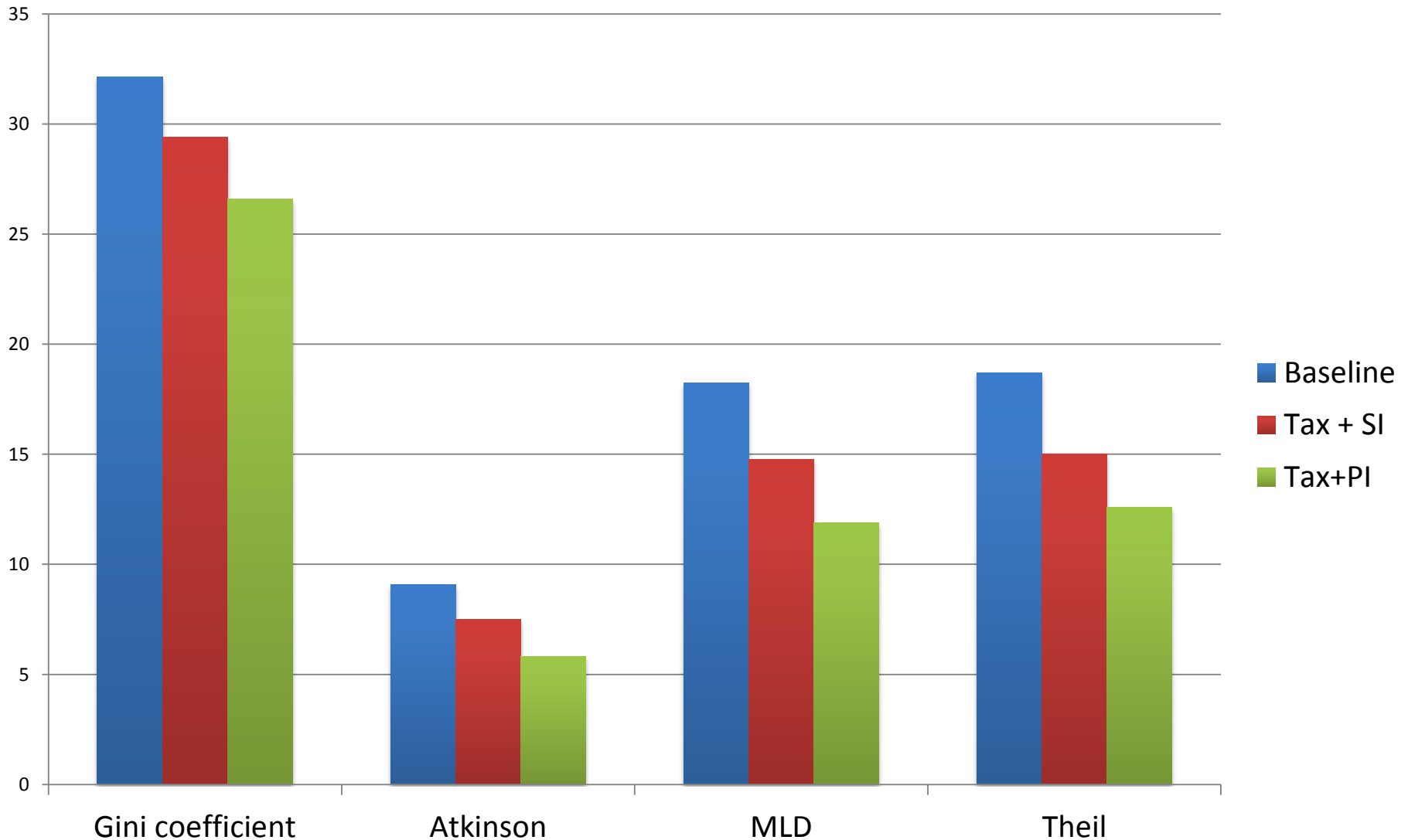
Or introducing Participation Income

- paid on individual basis to all adults, at £74 per week/£3,890 pa
- Partially replaces existing schemes
- PI not taxable but income tax allowance and NI Contribution exemption limit abolished

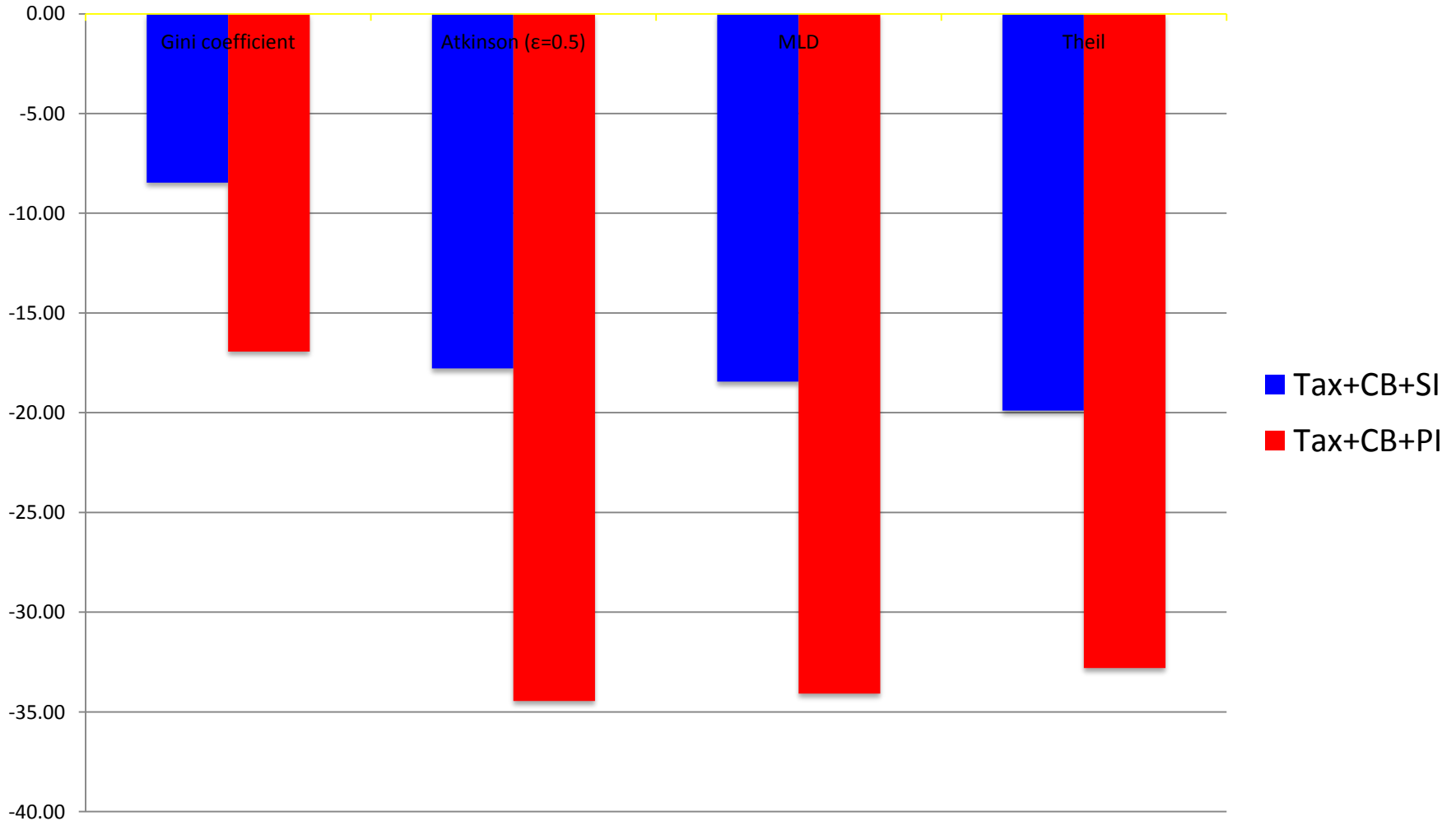
The Analysis

- Static simulation with tax/benefit model based on UK Family Resources Survey/Euromod
- First-round effects – no behavioural responses
- Compare income distribution, marginal effective tax/benefit withdrawal rates and numbers on means-tested transfers in 2014 benchmark versus reform scenarios
- Examine scale and nature of gains and losses

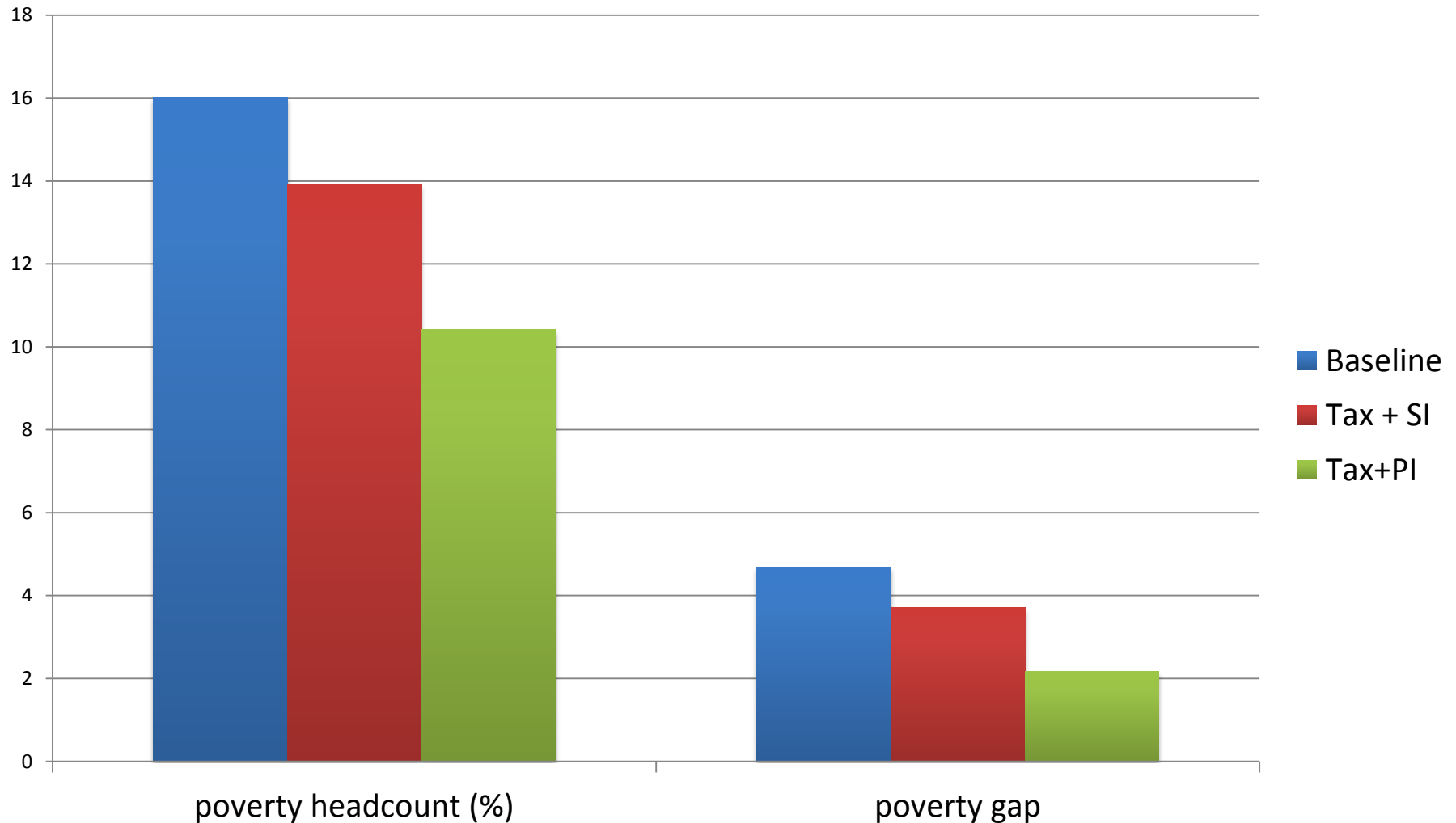
Impact on Inequality Measures of Tax+CB+SI and Tax+CB+PI Proposals



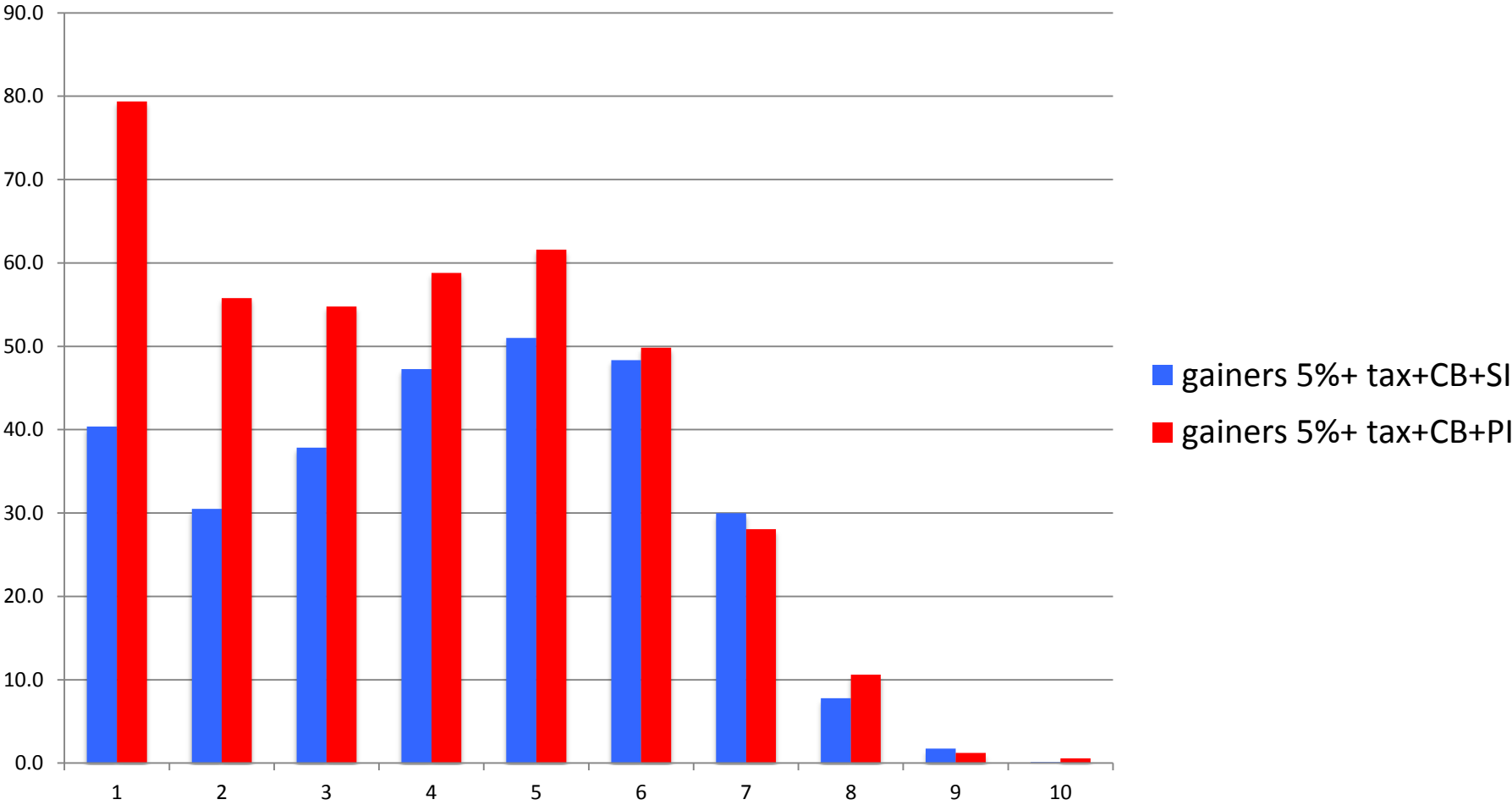
Percentage Reduction in Inequality Measures from Tax+CB+SI vs Tax+CB+PI



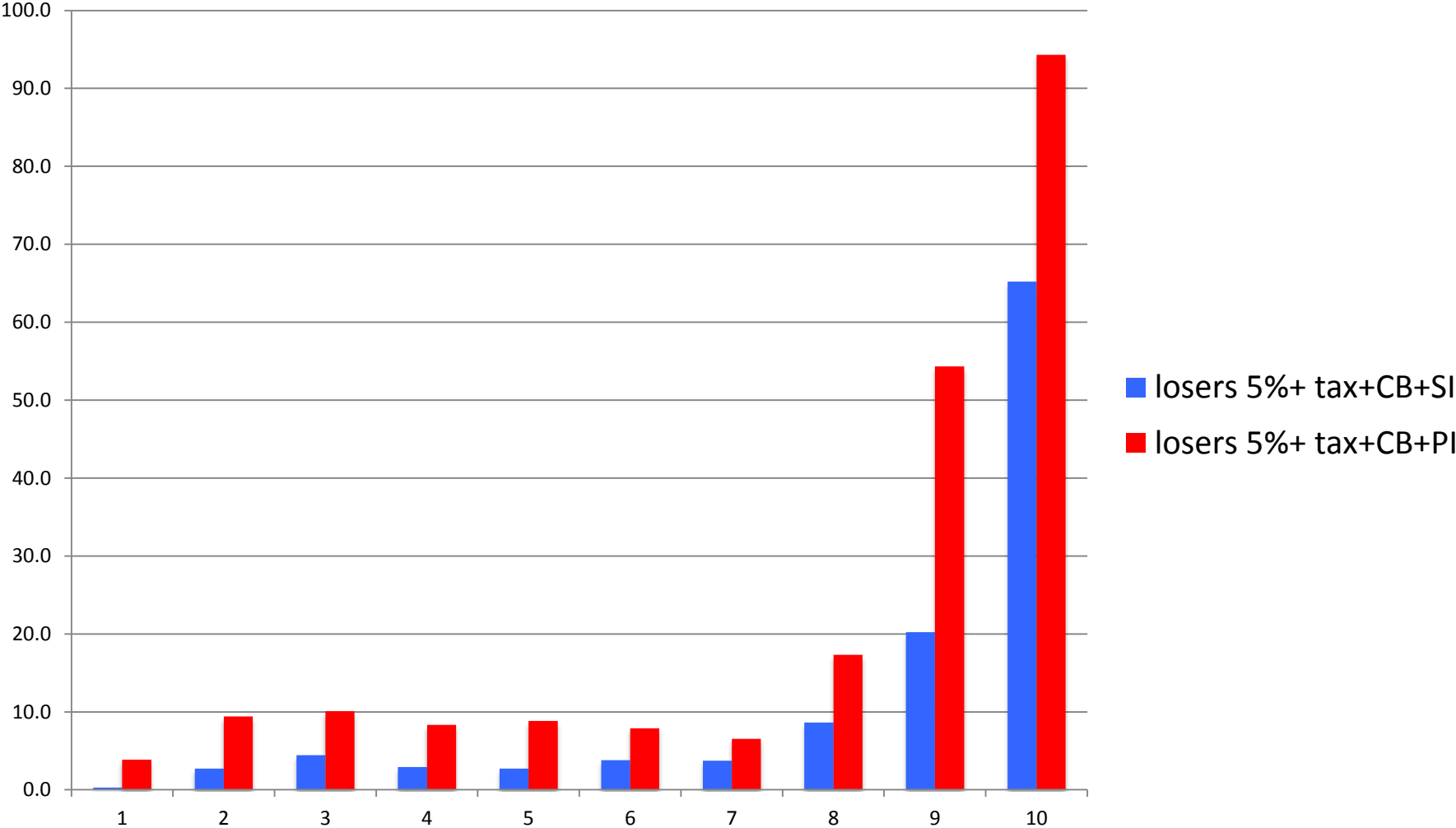
Impact on Poverty Measures of Tax+SI and Tax+PI Proposals



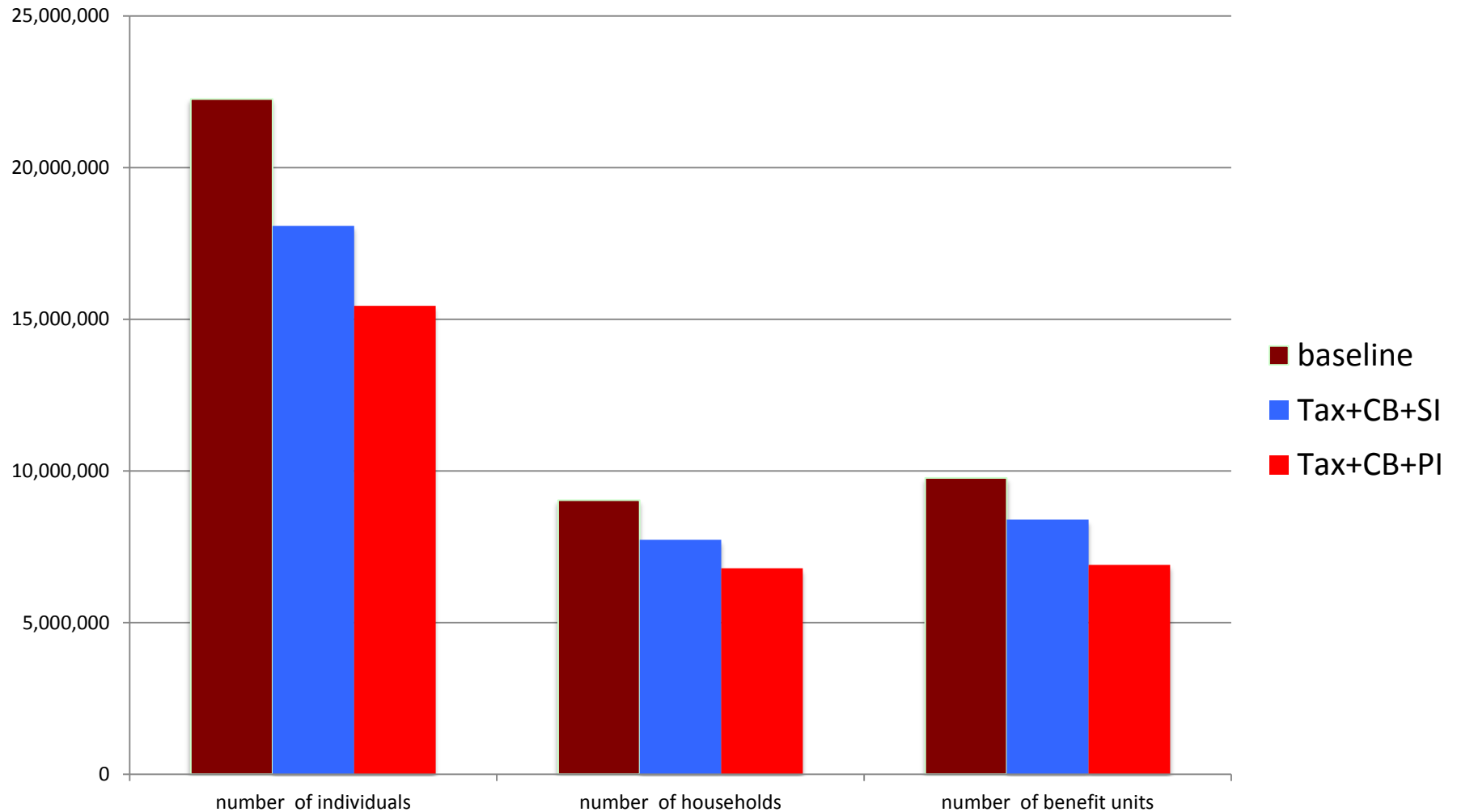
Percentage of Households Gaining by 5% or more from Tax+CB+SI versus Tax+CB+PI



Percentage of Households Losing by 5% or more from Tax+CB+SI versus Tax+CB+PI



Impact on Numbers on Means-tested Benefits of Tax+CB+SI and Tax+CB+PI Proposals



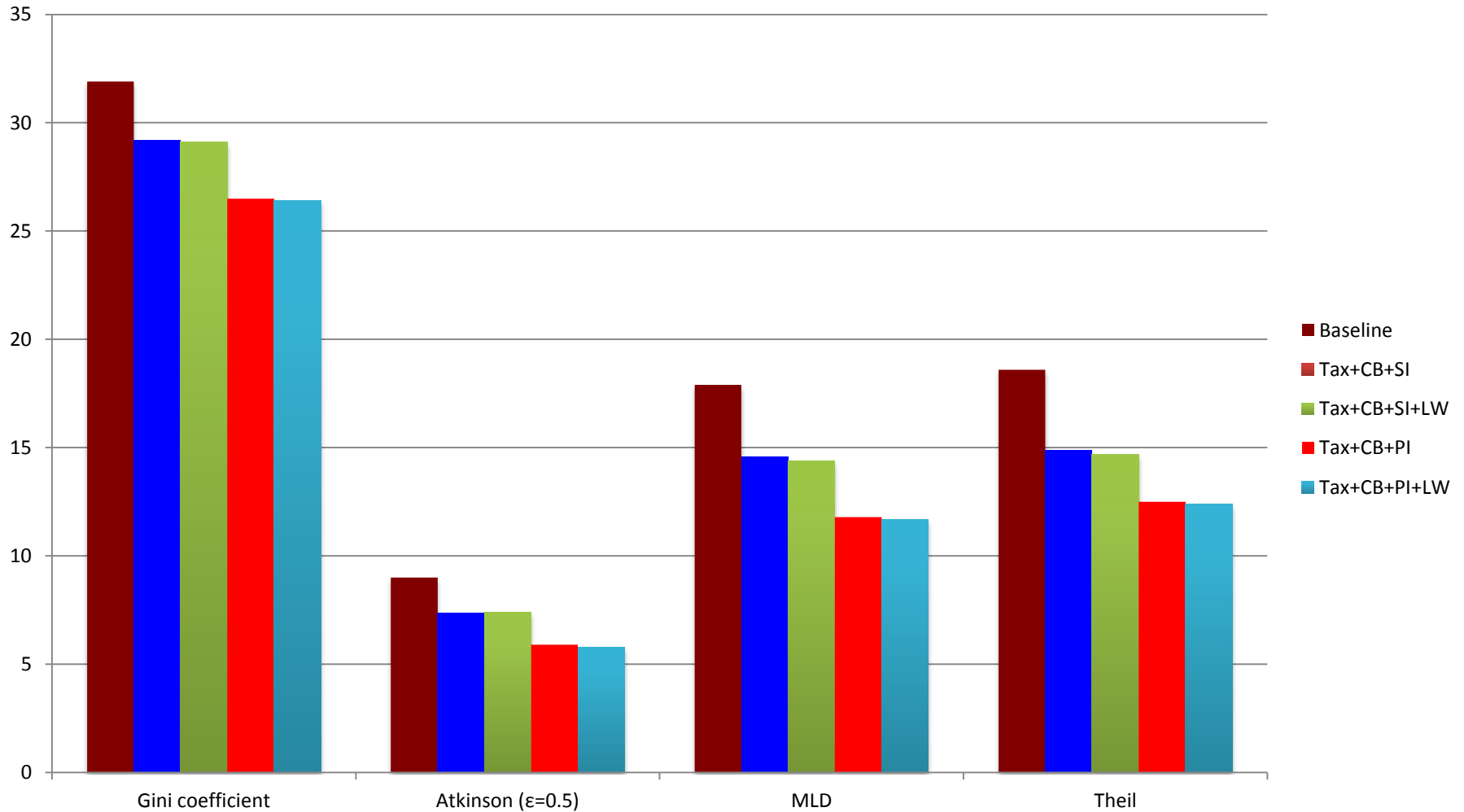
Impact on Work Incentives

- Average/median METRs on additional earnings increase in both options
 - but more with PI than SI option
 - and increase at bottom with PI but not SI option
- Incentive to participate enhanced with PI option

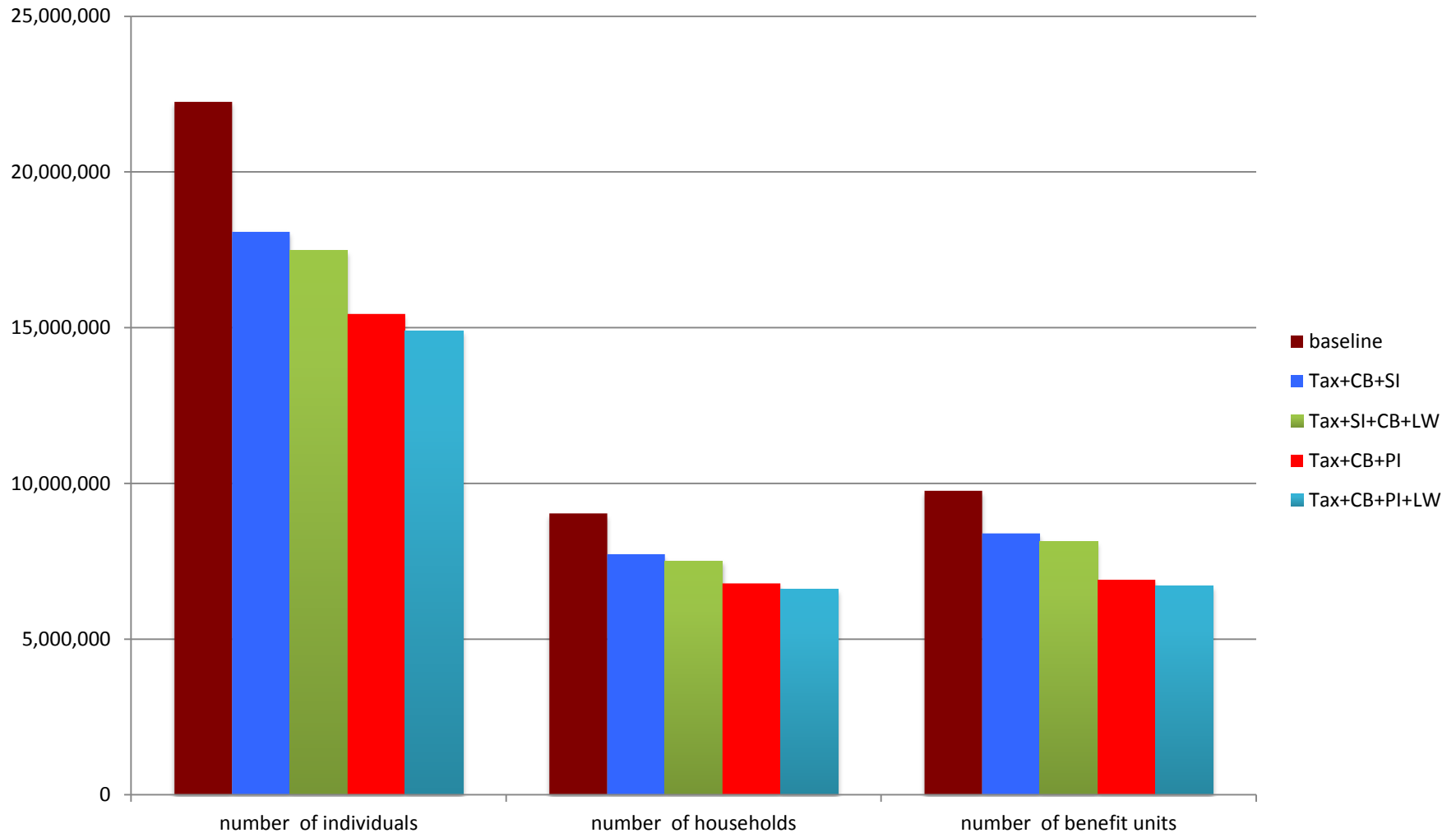
Raising the Minimum Wage

- UK MW is £6.50 per hour in baseline
- Simulate raising this to UK (estimated average) Living Wage
 - £9.15 per hour in London
 - £7.85 per hour outside London
- No impact on employment taken into account
- Hourly earnings in FRS 'corrected'

Impact on Inequality Measures of Tax+CB+SI and Tax+CB+PI Proposals with LW



Impact on Numbers on Means-tested Benefits of Tax+SI and Tax+PI Proposals with LW



Conclusions and Questions

- Strengthening direct redistribution one important plank in a strategy to reduce inequality
- Universal payments for children powerful tool
- Participation income more redistributive than raising social insurance
- MW workers are spread across the entire income distribution, so raising MW has modest redistributive effect
- Key strategic choice: increasing means-testing or (re-)finding alternative ways to target
- Does higher MW complement Basic/Participation Income or are they substitutes?