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

Tony Atkinson¹, Chrysa Leventi², Brian Nolan³, Holly Sutherland², Iva Tasseva²

¹ LSE, Nuffield College and INET, University of Oxford
² ISER, University of Essex
³ INET, University of Oxford

EUROMOD 20th. Anniversary Conference, University of Essex
September 2016
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

- Gini coefficient
- Atkinson
- MLD
- Theil

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

- Gini coefficient
- Atkinson ($\varepsilon=0.5$)
- MLD
- Theil

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

![Bar Chart]

- **Baseline**
- **Tax + SI**
- **Tax+PI**

**Axes:**
- Poverty Headcount (%)
- Poverty Gap

**Legend:**
- Blue: Baseline
- Red: Tax + SI
- Green: Tax+PI
Percentage of Households Gaining by 5% or more from Tax+CB+SI versus Tax+CB+PI

![Bar chart showing the 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

![Bar chart showing the percentage of households losing by 5% or more from Tax+CB+SI versus Tax+CB+PI. The chart compares the number of losers in each category, with blue bars representing Tax+CB+SI and red bars representing Tax+CB+PI. The x-axis represents the number of losers, ranging from 1 to 10, while the y-axis represents the percentage, ranging from 0 to 100. The data shows that Tax+CB+PI has a significantly higher percentage of losers compared to Tax+CB+SI, especially in the higher categories. ]
Impact on Numbers on Means-tested Benefits of Tax+CB+SI and Tax+CB+PI Proposals

- **Tax+CB+SI**
- **Tax+CB+PI**

<table>
<thead>
<tr>
<th>Category</th>
<th>Baseline</th>
<th>Tax+CB+SI</th>
<th>Tax+CB+PI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of individuals</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of households</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of benefit units</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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

- Gini coefficient
- Atkinson ($\epsilon=0.5$)
- MLD
- Theil

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

<table>
<thead>
<tr>
<th></th>
<th>number of individuals</th>
<th>number of households</th>
<th>number of benefit units</th>
</tr>
</thead>
<tbody>
<tr>
<td>baseline</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax+CB+SI</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax+SI+CB+LW</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax+CB+PI</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax+CB+PI+LW</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
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?