Inequality and Poverty: Analysis and Policy

Fifth lecture: Redistribution or predistribution or both to mitigate inequality and poverty?

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Course web page: http://rszarf.ips.uw.edu.pl/inequality/
Making a step from analysis to policy

• Analysis
  • We have conceptual and operational understanding of inequality and poverty
  • We have a lot of data about inequality and poverty
  • There are many theories how to explain the patterns observed in the data
  • What to do now? Make policy!

• Policy
  • Inequality and poverty are problems for the public and for politicians
  • There are radical and moderate ideas how to use the state apparatus to mitigate poverty and inequality
  • We should explore these ideas, but restricted to the moderate ones – redistribution of income and predistribution of sources of income based on human rights system (no violation of freedom, no violation of property etc.)
What is redistribution and predistribution?

- Let’s assume that there is no state (no taxes, transfers etc.)
  - Distribution of ownership of capital and jobs => distribution of income => inequality and poverty in standards of living between individuals and households

- Two steps to redistribution system
  1. First step to redistribution: introduction of income tax
     - Income tax changes distribution of income: some pay more in taxes some pay less
  2. Second step to redistribution: introduction of social transfer
     - Social transfer changes distribution of income: some get social transfer and some do not, some get more and some get less of social transfer

- REDISTRIBUTION means influencing of the distribution of income by tax and transfer system

- What about influencing sources of income (e.g. capital, land, real property, job) and not income itself? That question leads us to possibility of pre-distribution approach distinct from redistribution which is post-distribution of original income from capital, work etc.

- PRE-DISTRIBUTION means influencing not income by taxes and transfers but sources of income e.g. making education available for all, land reform, by regulation, organisation and financing and other standard state measures
Strategies in redistribution approach: progressive vs non-progressive

• **Redistribution for reducing income inequality and poverty**
  - **Progressive tax system**: the rich pay absolutely and relatively more than the middle class and the middle class pay more than the poor
  - **Regressive transfer system**: the poor get more in transfers than any other class
  - An assumption should be made that progressive tax and regressive transfer system is not changing ranking of pre-fiscal incomes e.g. the rich after redistribution are not poor but less rich (maybe with some exemptions for those who are rich mainly by cheating and corrupting)

• Redistribuion that is exacerbating inequality and poverty
  - **Regressive tax system**: the rich pay nothing, only the middle class and the poor pay (indirect) taxes
  - **Progressive transfer system**: the rich gets more in transfers (e.g. generous subsidies to capital owners) than the poor (e.g. tiny cash benefits)
Redistributive hypothesis. After more distributive public intervention there is
• less capital and work inequality and poverty
• less wealth and income inequality and poverty than in the free market world
Financing of national social protection system – basic idea

M. Cichon et al., Financing social protection, ILO, 2004
Redistribution from the rich by taxation – there are many options

Graph 1: Options for taxing high incomes and wealth

Source: Schratzenstaller (2013).
Redistribution to the poor by different types of cash transfers

<table>
<thead>
<tr>
<th>Type of cash transfers</th>
<th>Objectives and beneficiaries</th>
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<tbody>
<tr>
<td><strong>Conditional cash transfers</strong></td>
<td>Regular income transfers to poor households conditional on particular actions and/or changes in behaviour to enhance education and health outcomes</td>
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<tr>
<td><strong>Unconditional cash transfers</strong></td>
<td>Regular income transfers without behavioural conditions to help improve households' income and thus meet basic needs</td>
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<tr>
<td><strong>Cash for public work</strong></td>
<td>Cash payments in exchange for labour in public works projects, with the aim of increasing household income and often also reducing seasonal or temporary vulnerability</td>
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<tr>
<td><strong>Child benefits/grants</strong></td>
<td>Cash grants for households with children to meet their basic nutrition, health and education needs - these may be for all children or a targeted subset (e.g., children under 5 or children in families below the poverty line)</td>
</tr>
<tr>
<td><strong>Disability grants</strong></td>
<td>Cash grants for people with disabilities to support access to services and basic needs; particularly relevant for those that cannot work and/or generate income</td>
</tr>
<tr>
<td><strong>Retirement pensions</strong></td>
<td>Regular income assistance to the elderly to help meet their subsistence needs - these may be contributory*, non-contributory and funded by government revenue, or some combination</td>
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</table>

* **Contributory** means financed from social insurance fund i.e. insured people pay their contributions to common fund and in case they face typical life risks (e.g. illness, disability, old age) they get pensions or other cash transfers from the fund.
Universal Basic Income (UBI) as a special case of cash transfer

UBI is a type of unconditional cash transfers
1. UBI is not only for people living in poverty, it *is for all people* within community or society e.g. for all citizens
2. UBI is not conditional i.e. *not requiring any kind of behaviour change from recipients* e.g. they should not looking for job and demostrate this to authorities
3. UBI is in *cash to hand or to bank account*, this is not a voucher or free public service
4. UBI is basic in amount i.e. *only for standard basic needs on the social minimum level*

UBI is a theoretical concept and proposal to reform the redistributive system in a radical way. It is proposed often in times of crisis as a remedy, but there are doubts if it is fair, affordable and feasible.
From market income to extended income: with tax, transfer and public services

Components of the redistributive instruments

Earnings of Person 1
+ Earnings of Person 2
+ Income from capital
+ Private transfers
+ State transfers

= Household market income

Household gross income

= Household disposable income

- Direct taxes

Household equivalent disposable income

= Disposable income + Value of public services

= Household extended income

Several types of household income in the redistributive paradigm

Comparison of inequality and poverty for households market incomes with households equivalised disposable and extended incomes gives us information about the impact of tax, transfers and public services on income inequality and poverty
From market income to final income with tax, transfer, subsidies, public services and user fees

Main question for progressive redistribution: what is the impact of benefits (pluses) and taxes (minuses) taken together on inequality and poverty in society? Compare market income inequality and poverty with final income inequality and poverty

Nora Lustig, Fiscal Policy, Income Redistribution and Poverty Reduction in Low and Middle Income Countries, Center for Global Development, 2017
Whole package of social policies and their impacts on the process from individual labour earnings to adjusted household disposable income

Social policies:
- Labor market and education policies, migration and gender policies, etc.
- Family policies (child and elderly care), etc.
- Tax policies (wealth, capital, income)
- Cash transfers and tax policies
- Education and health (access and coverage) policies

Inequality and poverty in individuals’ labor earnings

Inequality and poverty in households’ adjusted disposable incomes

Redistribution on charts
From market income inequality to final income inequality: comparison of several countries

Redistribution by tax and transfer system: trends for US and Germany

- **Market income** (before social transfers and income taxes)
- **Gross income** (market income plus social transfers)
- **Disposable income** (gross income minus taxes)

- Gini for market income minus Gini for gross income = impact of transfers on income inequality
- Gini for market income minus Gini for disposable income = impact of transfers and taxes
Respective redistributive effects of direct taxes and cash transfers

Note: Data refer to the working-age population.
Reality of redistribution for working-age people in different countries

Transfers received by working-age individuals in low and high-income groups, 2013 or latest year available

Two different cases

**Poland**
- Top 20% received 99.5% of average transfer
- Bottom 20% received 71.3% of average transfer

**Germany**
- Top 20% received 63.9% of average transfer
- Bottom 20% received 147.1% of average transfer

*Basic Income as a policy option: Can it add up? Data and Figures*
Redistribution by tax and benefit systems: impact on relative poverty

Figure 2 Disposable and market income poverty (PL60) across 49 LIS countries (latest data year)

Notes:
- For Belgium, Chili, Egypt, Georgia, Hungary, India, Italy, Mexico, Russia, Paraguay, Serbia, Slovenia and Uruguay data for income taxes are not available.
- For Norway 2013, private transfers are not available; we calculate all incomes without adding private transfers.

Source: Database Caminada & Wang (2019) based on LIS, and own calculations

Taxes and benefits impacts on poverty

Above 0: reduction of poverty. Transfers reduce poverty.

Below 0: aggravation of poverty. Taxes increase poverty.

Figure 3 Antipoverty effect of social transfers and income taxes across 49 LIS countries

Share of different age groups lifted from poverty by tax and transfer systems

Share of different age groups lifted from poverty by tax and transfer systems

Non-revolutionary strategies of predistribution for reduction of inequality
Predistribution strategies to lower the inequality

- **More education** for children who grow up in less-advantaged circumstances with the aim for developing cognitive skills and productive noncognitive traits
- **More manufacturing jobs** which are more promising as a path to decent and rising pay or to high quality jobs
- **Stronger labour unions** with their positive impact on rising wages
- **Minimum wage hikes** with obligatory and universal minimum wage and its rising in real terms
- **Full employment** which is strengthening the bargaining power of the workers in relations to employers

Lane Kenworthy, *What’s wrong with predistribution*, 2013
Predistribution strategies to lower the inequality cont.

• **Codetermination**: if we give more voice to the employees in firm’s decision making we could expect more wage growth

• **Profit-sharing**: employees receive part of their compensation in the form of a portion of the firm’s profit rather than as a guaranteed wage or salary

• **Rising employment of those unemployed and inactive**: if wages are stagnant rising employment could rise incomes of the households

• **More public goods and services**: even if wages and incomes are stagnant increasing the scale of public goods and services contributed to the material well-being

Lane Kenworthy, *What’s wrong with predistribution*, 2013
Public/social insurance as a tool more suitable to mitigate inequality

• Public insurance is a widely used tool for mitigating economic and social risks
• Social risk is temporary or permanent inability to work due to life course events like illness, disability, old age, maternity, death, unemployment
• Main mechanism
  1. We contribute collectively via income taxes and social insurance contributions
  2. Those who experience the risk event or condition receive transfers or services as an entitlement

Lane Kenworthy, What’s wrong with predistribution, 2013
Wage stagnation as a new social risk

• Public insurance as a remedy for new social risk of stagnant and low wage
• Tool: low earnings subsidies, in-work benefits, earnings-contingent benefits
• Mechanism (example of US Earned Income Tax Credit)
  1. The amount of the subsidy increases with earnings up to a point
  2. then flattens out
  3. and then decreases as earnings reach into the middle class
• Proposal for reform (US case)
  • Extension of the coverage up to the middle class wages
  • The amount of the subsidy needs to rise over time in sync with economic growth

Lane Kenworthy, What’s wrong with predistribution, 2013
Social protection systems and their main conceptual constructs
The concept of social protection system based on social risks

Comment. In this formulation main rationale is the provision of external safeguards against vulnerability and intractable poverty, and not reduction of inequality per se

Lena Morgon Banks et al. Disability and social protection programmes in low and middle income countries a systematic review, 2017
Social protection strategies and instruments

**STRATEGIES**

- **PREVENT**
  - Decrease probability of a risk occurring

- **MITIGATE**
  - Decrease impact of risk if it occurs

- **COPE**
  - Relieve impact of risk once it occurs

- **TRANSFORM**
  - Address power imbalances that propagate vulnerability

**INSTRUMENTS**

- **INSURANCE**
  - Pooling of resources among individuals or households to protect against shared risks.
  - Examples: old-age pensions, unemployment insurance, disability insurance

- **SOCIAL ASSISTANCE**
  - Non-contributory transfers to groups deemed eligible because of deprivation.
  - Examples: food assistance, cash-for-work, conditional cash transfers

- **ACCESS TO SERVICES**
  - Programs and policies that ensure equitable access to basic services in areas such as health and education that are essential for protecting minimum living standards.
  - Examples: waiving of user fees, mandatory education

- **POLICY REFORMS**
  - Reforms to legislation and policies to codify and operationalise the rights of vulnerable groups.
  - Examples: fair labour standards, anti-discrimination laws
Comment. On the level of impact there is a hypothesis that social protection is important factor making societies more equitable and cohesive. If less inequality means more equity and cohesion then there is a link between social protection and inequality.

Lena Morgon Banks et al. Disability and social protection programmes in low and middle income countries a systematic review, 2017
Diverse range of social risks and social protection as coping mechanisms

<table>
<thead>
<tr>
<th>Ten types of need: Individual facing...</th>
<th>Social protection system functions designed to cope with the type of need</th>
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<tbody>
<tr>
<td>1. Sickness</td>
<td>Income-replacement transfers in cash in connection with physical or mental illness, excluding disability in case of inability to work</td>
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<tr>
<td>2. Ill health or need to mitigate the effects of ill health</td>
<td>Provision of health care goods and services needed to maintain, restore or improve health of the people protected irrespective of the origin of the disorder (= indirect income transfer)</td>
</tr>
<tr>
<td>3. Disability</td>
<td>Income-replacement transfers in cash and in kind (except health care) in connection with the inability of physically or mentally disabled people to engage in economic and social activities</td>
</tr>
<tr>
<td>4. Old age</td>
<td>Income-replacement transfers in cash and in kind (except health care) in connection with old age</td>
</tr>
<tr>
<td>5. Survivorship/loss of breadwinner</td>
<td>Income-replacement transfers in cash and in kind (except health care) in connection with the death of a family member</td>
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<tr>
<td>6. Family care/upbringing of children</td>
<td>Transfers in cash or in kind (except health care) in connection with the costs of pregnancy, childbirth and adoption, bringing up children and caring for other family members</td>
</tr>
<tr>
<td>7. Unemployment</td>
<td>Income-replacement transfers in cash or in kind (except health care) associated with unemployment</td>
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<tr>
<td>8. Inadequate housing</td>
<td>Financial transfers or in-kind transfers to meet/alleviate the cost of housing</td>
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<tr>
<td>9. Poverty and social exclusion, inadequate nutritional status</td>
<td>Income transfers in cash or in kind aimed at ensuring a minimum level of consumption (except health care), specifically intended to alleviate poverty and social exclusion that are not covered by one of the other functions. Direct/indirect transfers in cash and in kind to maintain an appropriate level of nutrition</td>
</tr>
<tr>
<td>10. Inadequate access to (basic) education</td>
<td>Free access to public education and cash/in-kind transfers to facilitate school attendance (stipends, free textbooks, etc.); the level of education to which access is guaranteed may depend on the country’s level of economic development</td>
</tr>
</tbody>
</table>

M. Cichon et al., *Financing social protection*, ILO, 2004
The idea of Integrated social policies to protect and empower people across the life cycle

- Policies supporting entrepreneurs and access to productive employment
- Food security and nutrition
- Income support (pensions, child benefits)
- Education
- Health
- Life cycle
- Social policies

- Children
- Working-age population unable to earn an income/sufficient income in the labour market, including the unemployed, underemployed and working poor
- Elderly and people with disabilities

Social protection floor for a fair and inclusive globalization, ILO, 2011
Social risks (social protection needs) in the Whole-of-Life (life cycle) approach.
Coordination within and between policies: integrating social protection with labour market programs

Social protection and labour system: three levels for analysis and intervention

**Policy Level:** Defining a vision for social protection and labour system and ensuring coherence between instruments, financing, and institutional arrangements... paying attention to: consistency and coherence across programs and functions; redistributional impacts; effects on incentives and behaviors; and sustainability and efficiency of public spending.

**Program Level:** Integrating, harmonizing, or coordinating programs... reform initiatives aiming at improving the performance of a given function, program, or set of programs.

**Administrative Level:** Building basic management, information, and administrative tools e.g. beneficiary identification systems and registries, targeting schemes, monitoring and evaluation arrangements, and contracting and payment arrangements for providers.

Social protection and labor system plus economic policies could be good for equality

Social protection floor for a fair and inclusive globalization, ILO, 2011