Does the income concept matter when assessing inequality and redistribution?

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Debate around this question

“(...) after accounting for all taxes and transfers, the United States appears to redistribute a greater fraction of its national income to the poorest 50 percent than any European country.”

(Blanchet, Chancel & Gethin, 2022; p. 482)
Research on redistributive capacity

• Growing interest in how the State reduce inequality.

• Transfers explain most redistribution.
  • Atkinson et al., 1995; Caminada et al. 2019; Causa & Hermansen 2020; Jesuit & Mahler 2010; Joumard et al., 2012; OECD 2011; Pontusson & Kenworthy 2005.

• Taxes are more important among working-age individuals.
  • Avram et al., 2014; Fuest et al., 2010; Gornick and Smeeding, 2018; Guillaud et al., 2020.

• USA and Europe are equally redistributive – predistribution is different.
  • Piketty et al., 2018; Bozio et al., 2020; Blanchet et al., 2021.

• Divergence in findings means we need to revisit current ‘stylized facts’.

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Conceptual differences for redistribution

• Several conceptual and analytical decisions involved:

  1. How to define ‘market income’?
  2. Focus on monetary transfers only?
  3. Focus on household or national income?
  4. Correcting surveys for non-response among the rich?
  5. How to measure redistribution?
Contributions

1. Impact of these decisions on:
   • Differences in pre- and redistribution among European countries.
   • Contribution of each income component towards total redistribution.

2. Close the gap between the different ways to measure inequality.
   • ‘Traditional’ literature versus Distributional National Accounts (DINA).
   • Conceptual differences difficult comparisons (Carranza et al., 2022).
Outline I: Redistributive analysis

• Consistent structure to evaluate analytical choices
  • Same unit (households) and same equivalence scale.

• Assessing the impact of treating income components as market income.
  • Pensions, contributory benefits, non-contributory, taxes, etc.
  • Which components make the biggest difference.
We repeat our analysis under three methodological approaches.

1. ‘Traditional’ measures of inequality.
   a. Household surveys.

2. Statistical and conceptual adjustments.
   a. Indirect taxes and in-kind transfers.
   b. Additional income components: imputed rent and business profits.
   c. ‘Top income’ corrections.

   a. Distributional National Accounts (DINA).
1. **Factor income**: Flows stemming from labor and capital

2. + Private pensions

3. + Contributory pensions (social security)

4. + Other contributory benefits

5. + Non-contributory benefits = **Gross income**

6. - Taxes and contributions = **Disposable income**
Data and definitions

• Data for 30 European countries in 2018 (EU-SILC).
  • Complemented with DINA microfiles.

• Redistributive effect:
  \[ Gini(factor) - Gini(disposable) \]

• Component analysis: Sequential contribution to reducing inequality.
  • e.g., role of private pensions:
    \[ Gini(factor) - Gini(factor + private pensions) \]
Survey-based redistributive effect

• Redistribution ranges from 13 to 26 points.
  • EU average: 19 points of the Gini.

• Most redistributive:
  • Finland (26), Ireland (25), Belgium (23).

• Least redistributive:
  • Iceland (13), Latvia (14) Switzerland (15).

• 50% of countries between 18 and 22 points.
Heterogeneity in *how* it happens

Most relevant components:
- Contributory pensions (9 pts).
- Taxes and contributions (4.7 pts).
- Non-contributive benefits (3.8 pts)
2. Statistical/conceptual adjustments

• We repeat the analysis under different adjustment/concepts.

1. Final income = Disposable income - indirect taxes + in-kind benefits.
   • Zwijnenburg et al. (2016), Thomas (2021), Herault and Jenkins (2022).

2. ‘Missing rich’ (external adjustment – reweighting).
   • Lustig (2019), Blanchet et al. (2021), Carranza et al. (2022).

3. Including imputed rents and business profits as income.
Negative net effect for half of countries

- Indirect taxes: -10 points
- In-kind benefits: 8 points
- Net effect: 2 points

Net disposable income...

- Minus indirect taxes (proportional)
- Plus individual government spending (lump-sum)
- Net effect (sum)

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Adjustments reduce redistributive effect

- Disposable income ➢ 19 points
- Reweighting ➢ 17 points
- + Imputed rents ➢ 18 points
- + Business income ➢ 15 points
- All adjustments ➢ 13 points
3. Micro-Macro gap

• Recent developments in Distributional National Accounts (DINA)

• How to allocate government income? **Proportional** or **uniform** allocation.

Public expenditure is divided into:

1. Individual spending.
   a. In health.
   b. Other spending (education, housing, etc.)

2. Collective spending (infrastructure, defence, etc.).
Allocation of government spending

- Proportional
- Uniform allocation of:
  - Health spending  ➢ 12 points
  - Individual spending ➢ 15 points
  - All spending ➢ 17 points
  ➢ 20 points
Summary and discussion

• Multiple concepts and methods to measure redistribution.
  - On average, Gini falls anywhere between 12 and 20 points.
  - Large heterogeneities in how countries reduce inequality.

• Two main factors that drive differences:
  - How to treat contributory pensions.
  - How government spending in health is allocated.

• What should the ‘correct’ adjustment be?
  - Pensions do play a redistributive role (perhaps partial).
  - ‘Missing incomes’ adjustments reduce redistribution – not very informative for this purpose.
  - Assigning government spending requires additional specificity.
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Initial inequality and redistribution

Correlation varies substantially

Due to:
1. Relevant impact on inequality.
2. Limited impact on redistribution