



Institute for
New Economic Thinking
AT THE OXFORD MARTIN SCHOOL

Does the income concept matter when assessing inequality and redistribution?

Rafael Carranza (with Brian Nolan)

Comparative Economic Inequality Conference 2023

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Debate around this question

Why US Inequality Is Higher Than Europe's

Project Syndicate

Nov 12, 2019 | THOMAS BLANCHET, LUCAS CHANCEL, and AMORY GETHIN

*"(...) 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)

Opinion **Global Economy**

Europe has rediscovered the social market economy

Covid compelled governments to intervene to support livelihoods,
spurring a tide of labour reforms

MARTIN SANDBU

FINANCIAL TIMES

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’.

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.

Outline II: The measurement of inequality

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.
3. Micro-Macro gap.
 - a. Distributional National Accounts (DINA).

Income definitions

1. **Factor income:** Flows stemming from labor and capital

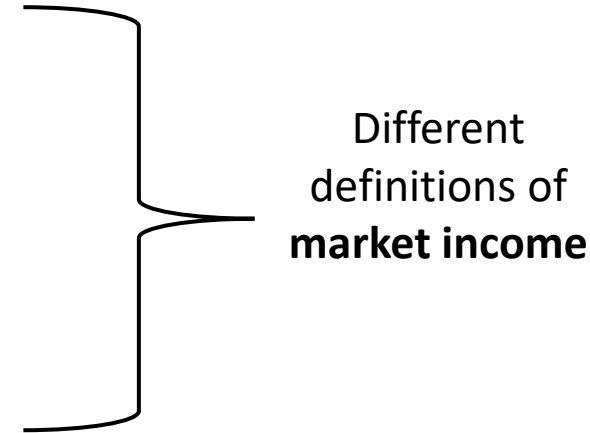
2. + Private pensions

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:**

$$Gini(factor) - Gini(disposable)$$

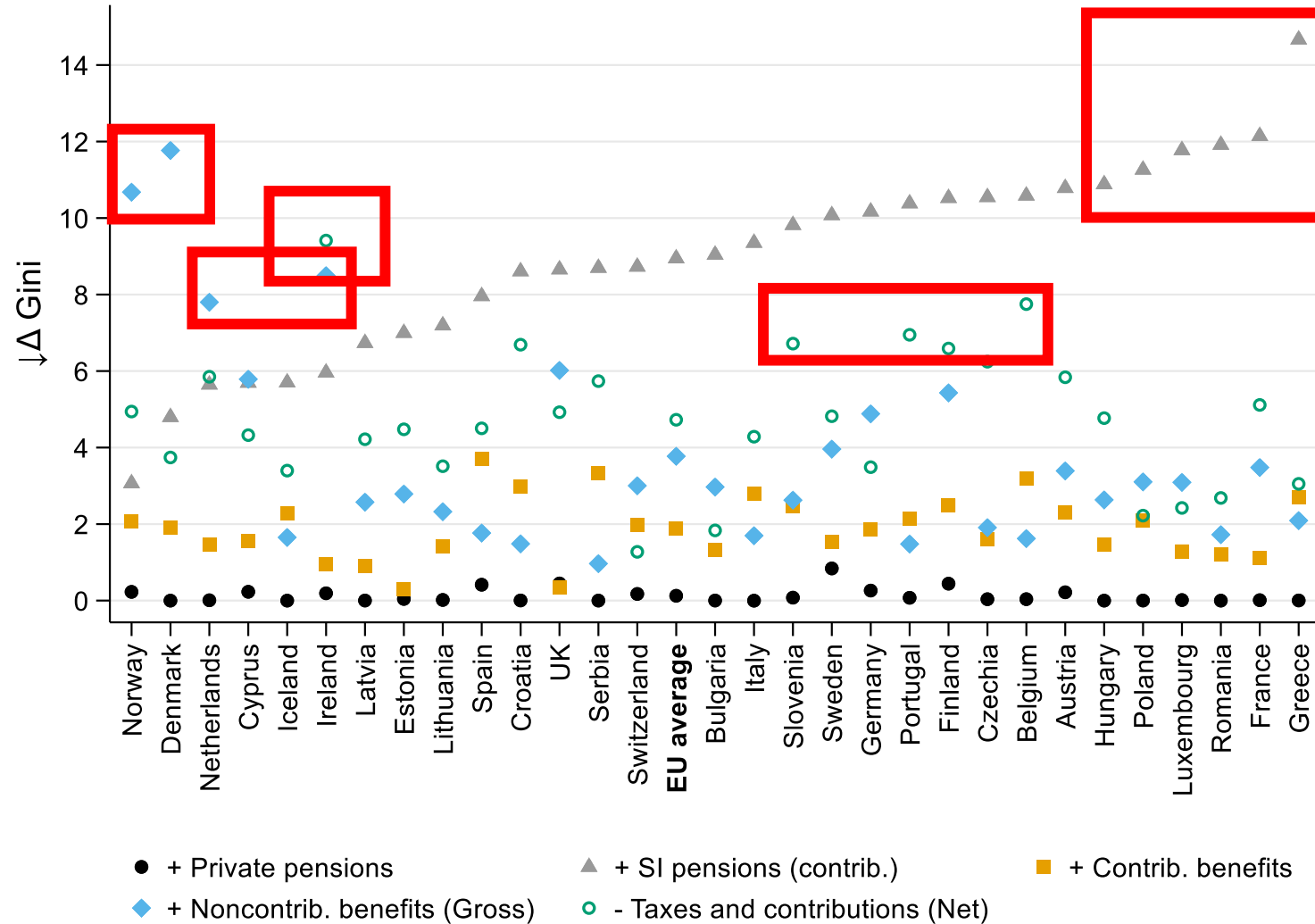
- **Component analysis:** Sequential contribution to reducing inequality.
 - e.g., role of private pensions:

$$Gini(factor) - Gini(factor + private pensions)$$

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



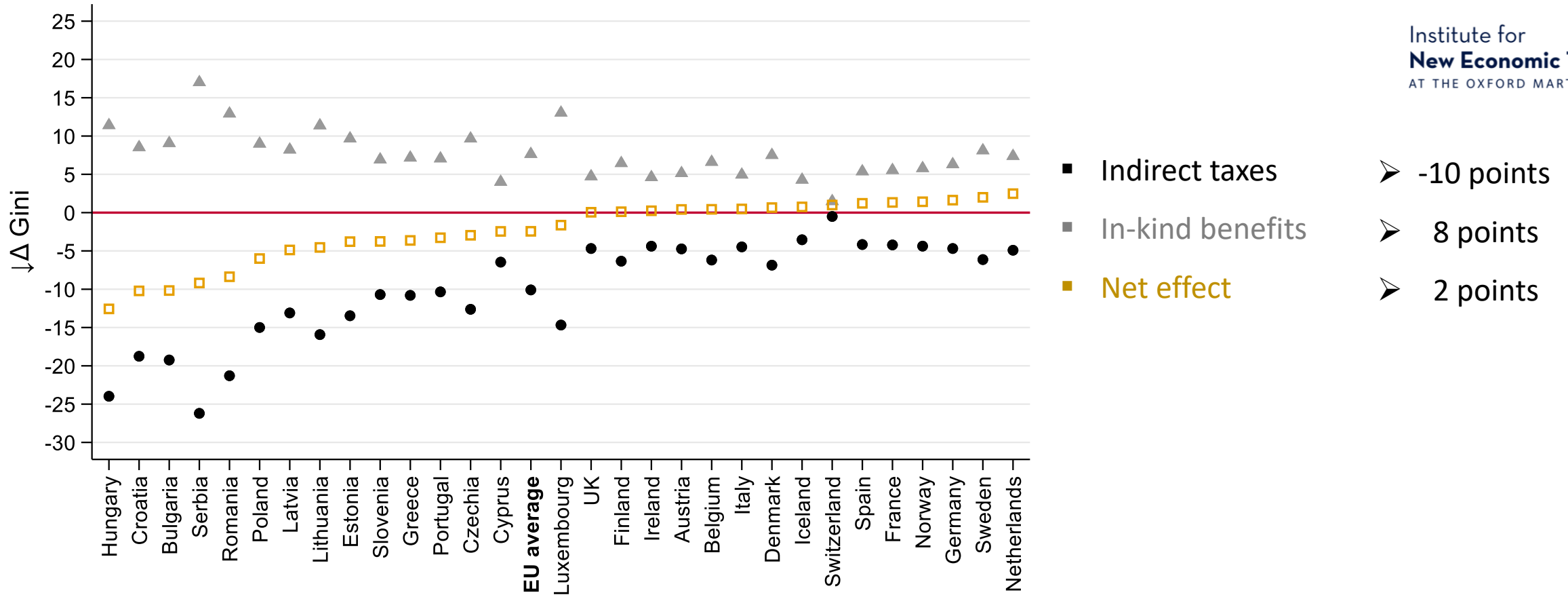
Most relevant components:

- 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.
 - Zwiijnenburg 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.
 - Canberra group (2011), WID (2020), OECD (forthcoming).

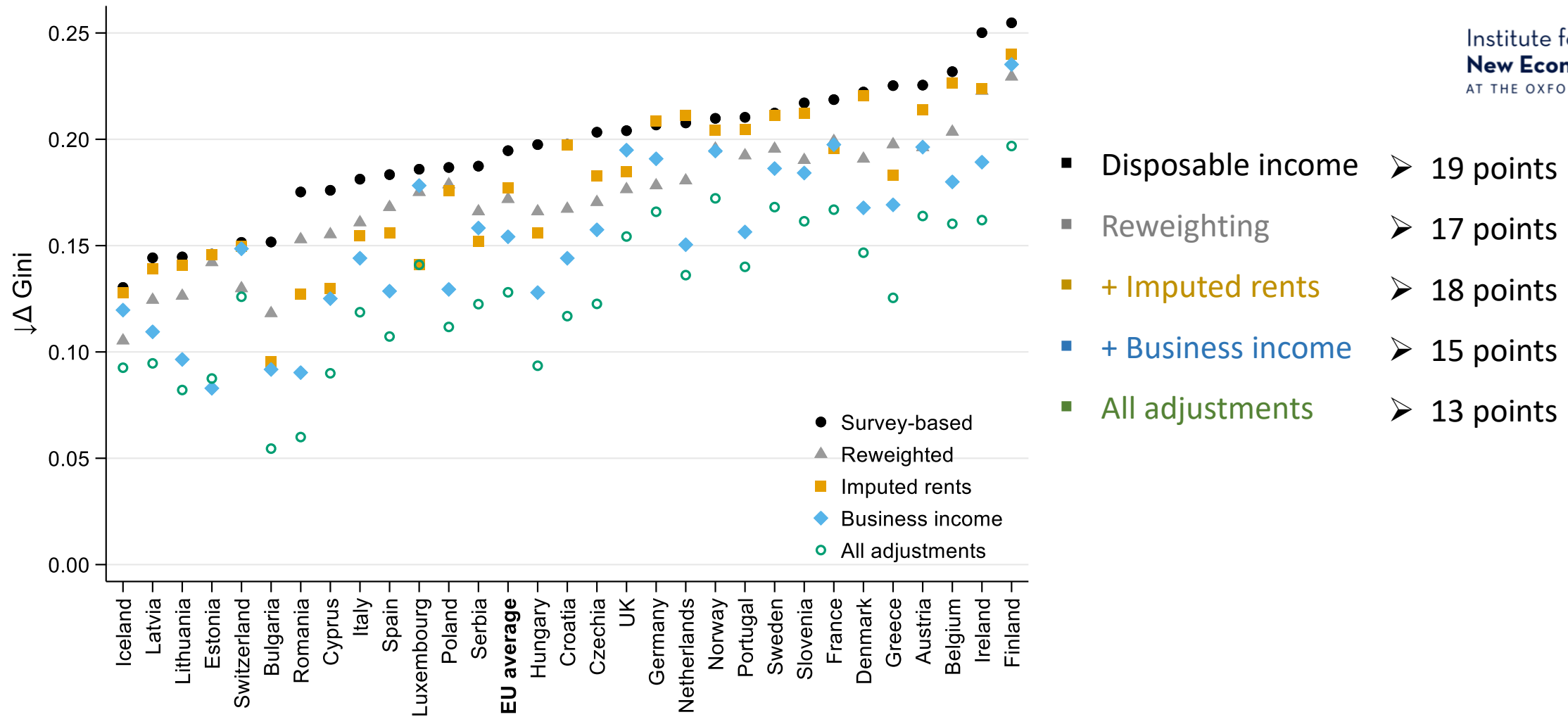
Negative net effect for half of countries



Net disposable income...

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

Adjustments reduce redistributive effect



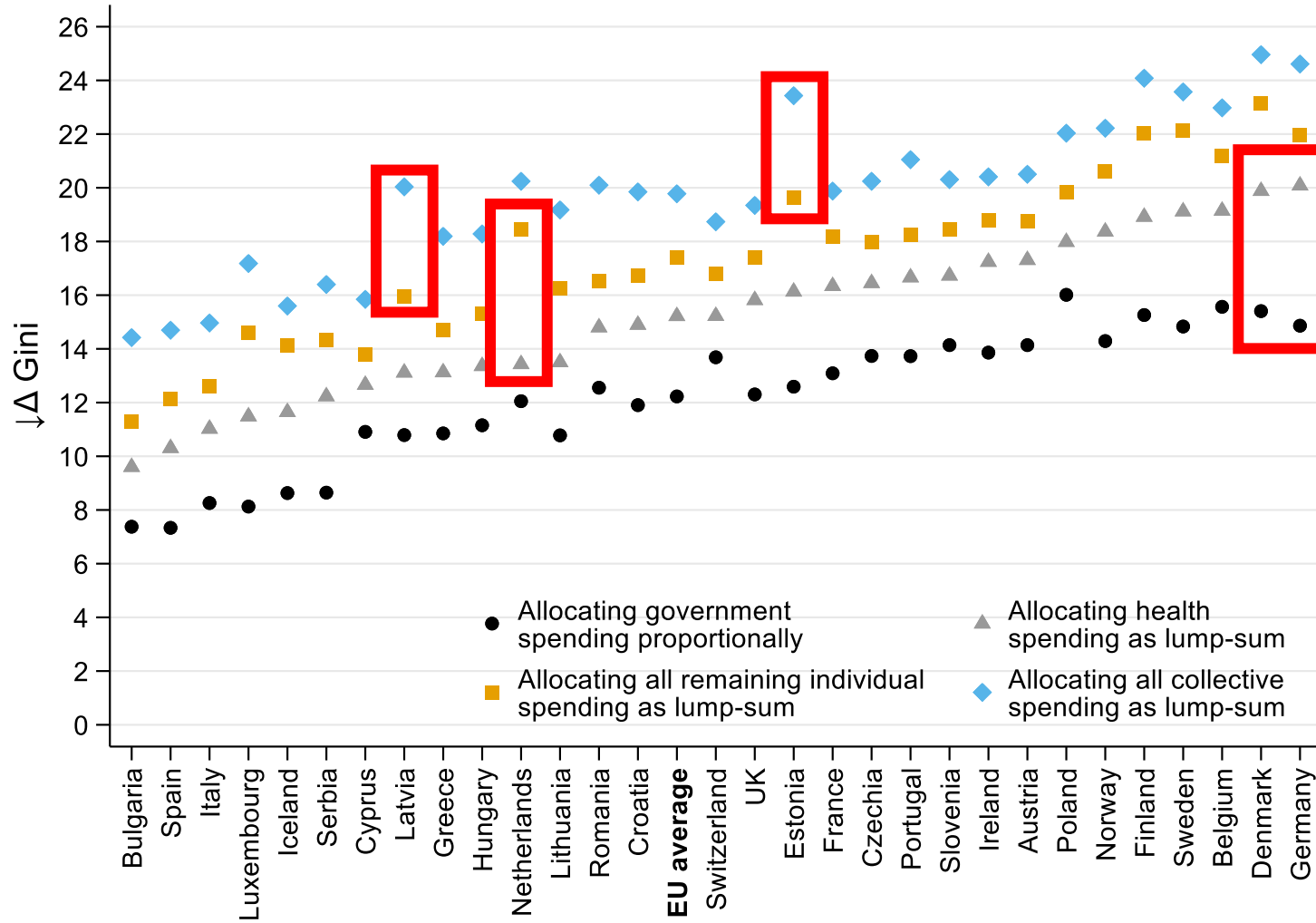
3. Micro-Macro gap

- Recent developments in Distributional National Accounts (DINA)
 - Piketty et al., (2018, 2019), WID (2020).
- How to allocate government income? Proportional or uniform allocation.

Public expenditure es 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 ➤ 12 points
- ▲ Uniform allocation of:
 - Health spending ➤ 15 points
 - Individual spending ➤ 17 points
 - All spending ➤ 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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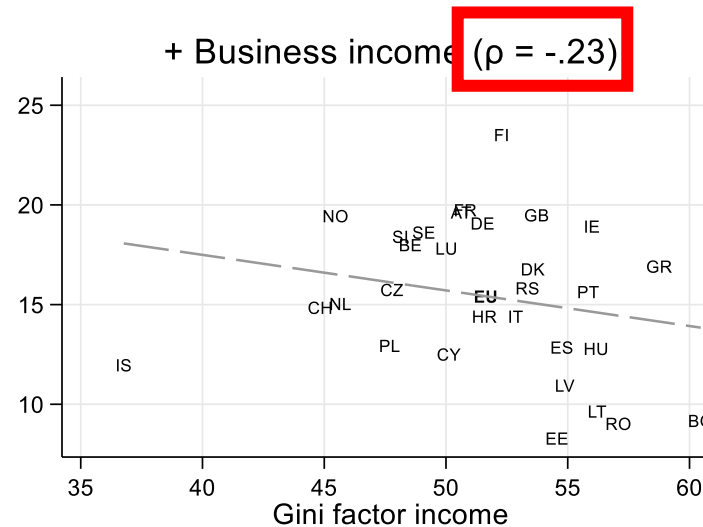
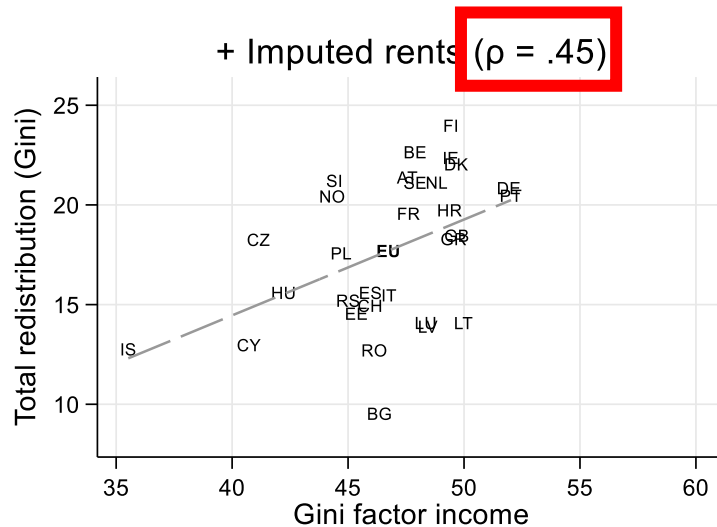
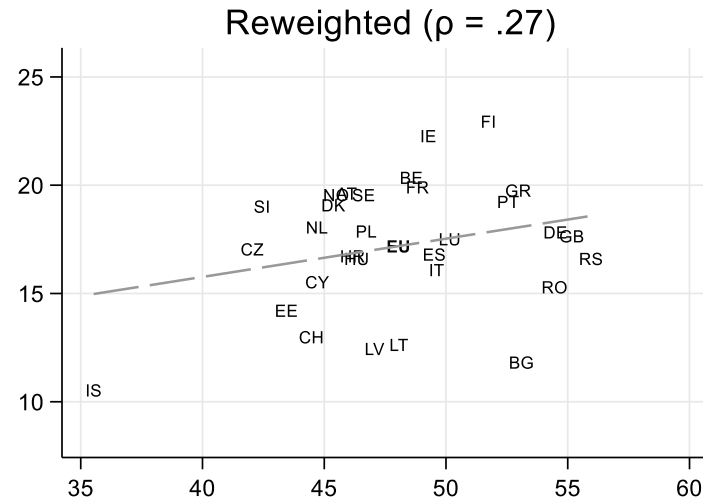
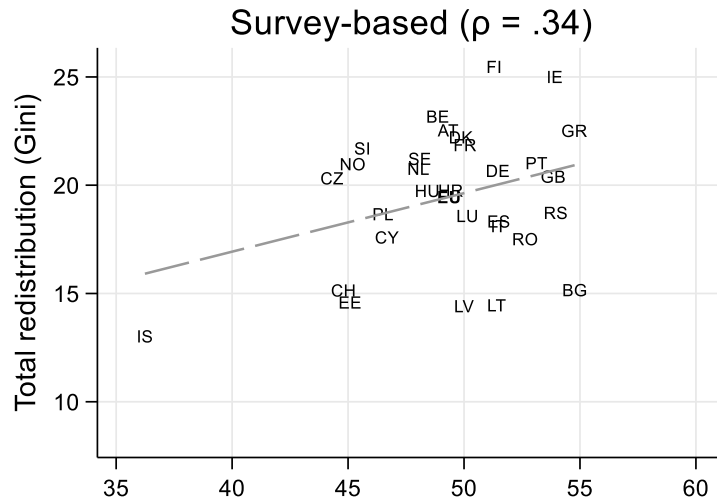
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Initial inequality and redistribution



Correlation varies substantially

Due to:

1. Relevant impact on inequality.
2. Limited impact on redistribution