



The IFS Deaton Review

Tax and welfare reform: The challenge of labour market inequality

Geary Lecture

ESRI, December 4th 2019

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Motivating theme: Can't address all the concerns about low wages and earnings inequality through the tax and welfare system alone.

Key challenge: How do we balance tax/benefit policy with other policies: min wages, human capital policies, competition policy, etc?

First: a little background to the *IFS Deaton Inequality Review...*

<https://www.ifs.org.uk/inequality/>



The IFS Deaton Review

The IFS Deaton Review: Inequalities in the 21st Century

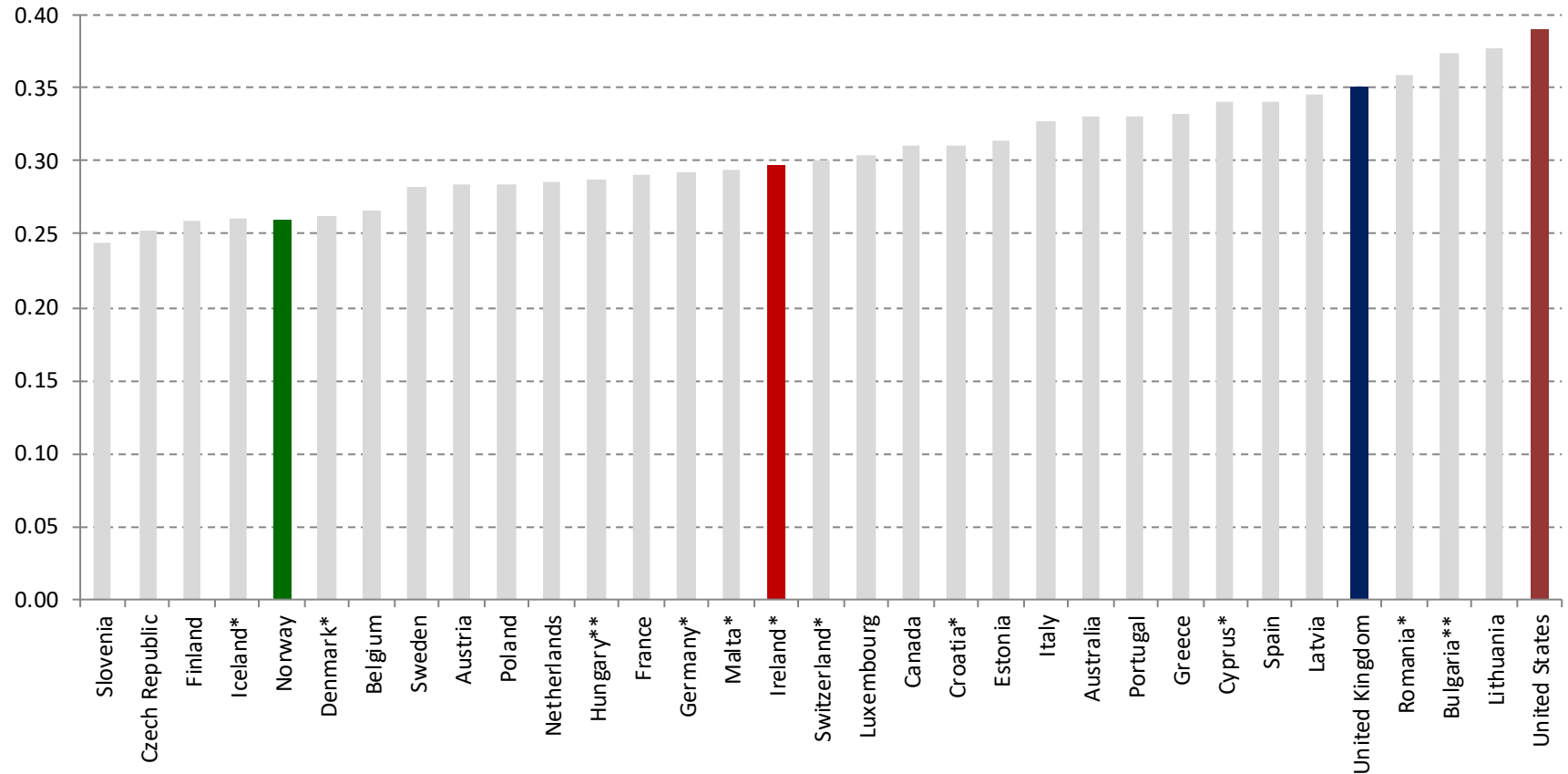
An ambitious 5-year study of inequality

Bringing together the best available evidence from across the social sciences to answer the big questions:

- Which inequalities matter most?
- How are different kinds of inequality related?
- What are the underlying forces that come together to create them?
- What is the right mix of policies to tackle adverse inequalities?
- For developed economies with the UK as the running example, but comparative in nature....

Measured by the Gini, the UK is unequal by European standards

Gini coefficient of equivalised net household incomes in selected countries, 2016



The Gini measures for market income are larger, .5 in UK and .53 in Ireland.

Figures from 2015 are marked with an asterisk (*). Figures from 2014 are marked with two asterisks (**).

Note: Data on EU states that joined in or before 2004 are from the OECD. Data on other countries from World Bank.

Source: Joyce and Xu, IFS, 2019



Inequality

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Inequality is not just about income

- Income inequality is important, but so are inequalities in
 - wages, wealth, consumption, health, family life, political voice,
- Need to look at inequalities between groups as well as individuals
 - gender, ethnicity, generations, places,
- The focus is on understanding the *drivers* of these inequalities and the *best policy mix* to mitigate their adverse impacts.

The IFS Deaton Review: An International Panel

Chair



The IFS Deaton Review



Angus Deaton
Princeton University

Panel



Orazio Attanasio
IFS & Yale



James Banks
IFS & Manchester University



Lisa Berkman
Harvard University



Tim Besley
London School of Economics



Richard Blundell
IFS & UCL



Pinelopi Goldberg
Yale University & World Bank



Paul Johnson
IFS & UCL



Robert Joyce
IFS



Kathleen Kiernan
University of York



Lucinda Platt
London School of Economics



Imran Rasul
IUCL & IFS



Debra Satz
Stanford University



Jean Tirole
Toulouse School of Economics



The IFS Deaton Review

Format of the Review

Much like the IFS's *Mirrlees Review of Tax Reform*, this Review will be published in two volumes:

- I. A volume of commissioned studies and commentaries
 - detailed studies on different aspects of inequality, with commentaries that offer perspectives or alternative views.
 - II. A book written by the panel, aimed at the general public
 - sets out what has happened to inequality, why, and what can be done.
- Country studies from Europe and North America.
 - And a sequence of academic and public policy events...

Commissioned studies and areas - with commentaries and interactions...

1. Why inequality, what inequality?
2. Political economy and political polarisation
3. Attitudes to inequality
4. Gender
5. Immigration
6. Health
7. Race and criminal justice
8. Geographical (im)mobility and spatial inequality
9. Family dynamics and social mobility
10. Early child development
11. Education systems and access
12. Labour markets
13. Firms and market power
14. Trade and globalisation
15. Corporate, capital and top taxes
16. Transfers, tax and tax credits at the bottom

Focus in this talk is on: *Tax and welfare reform:
The Challenge of Labour Market Inequality*

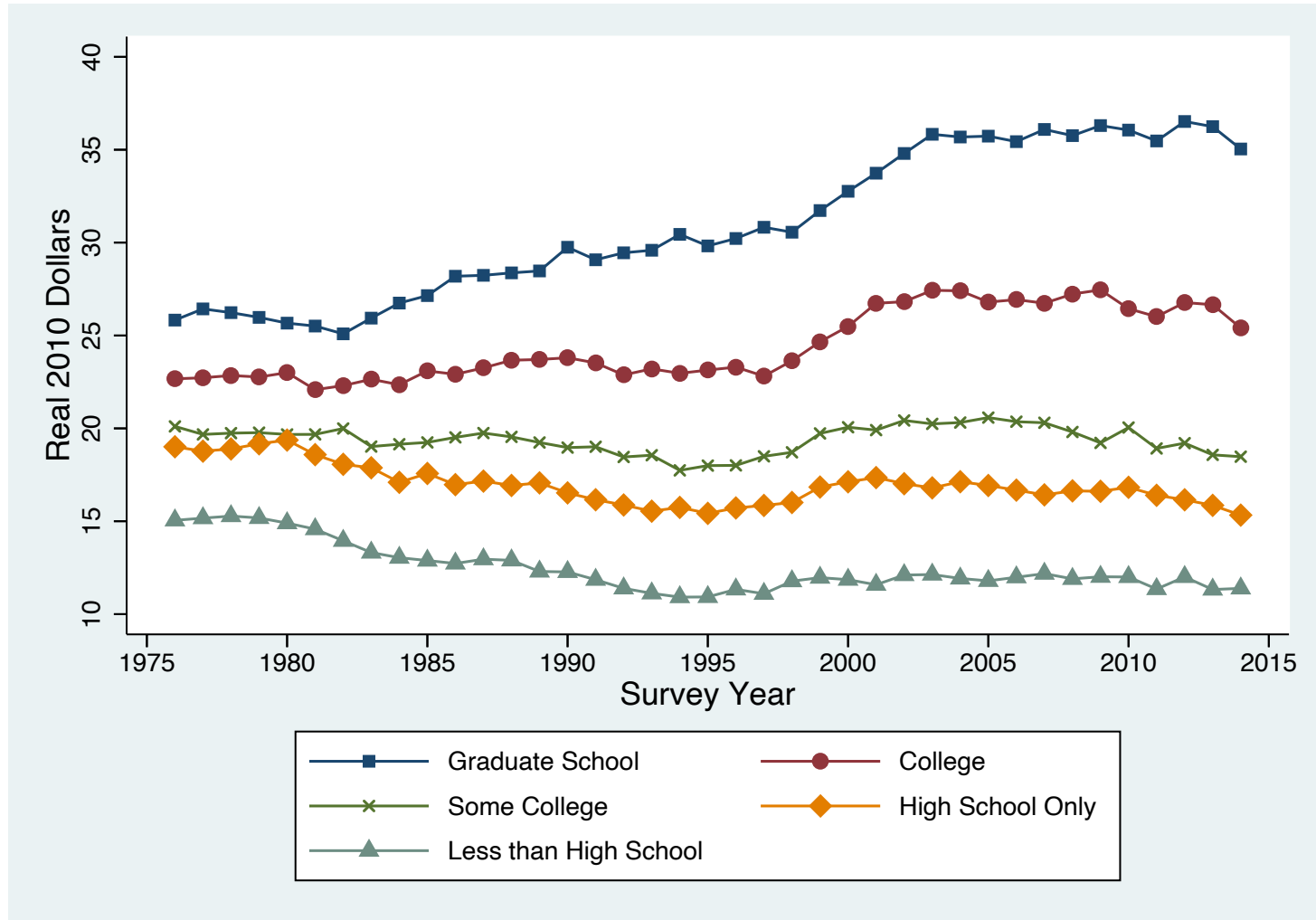
- The structure of work and of families has changed over the last three decades and continues to change apace,
 - growing earnings inequality for men and women, and adverse labour market ‘shocks’ for the low educated, especially men.
- When we place people in families in local labour markets, with childcare, marriage, savings and human capital decisions we get a different take on some key tax and welfare design questions.
 - when we put families in a dynamic context, redistribution and insurance become intrinsically linked.

Focus in this talk is on: *Tax and welfare reform:
The Challenge of Labour Market Inequality*

- A key challenge: what is the best balance of policies? e.g.
 1. How should we balance tax & welfare-benefit reform with minimum wages, contract regulation and human capital policies to address low incomes?
 2. How should we balance the taxation of top incomes and corporations with competition policy that targets rents of firms and innovators?
- Let's turn to some facts
 - → focus here is on the UK although point to some common features in Europe and North America.

Earnings inequality:

Growth in median male wages in the US by education group: US 1974/5 to 2015/6

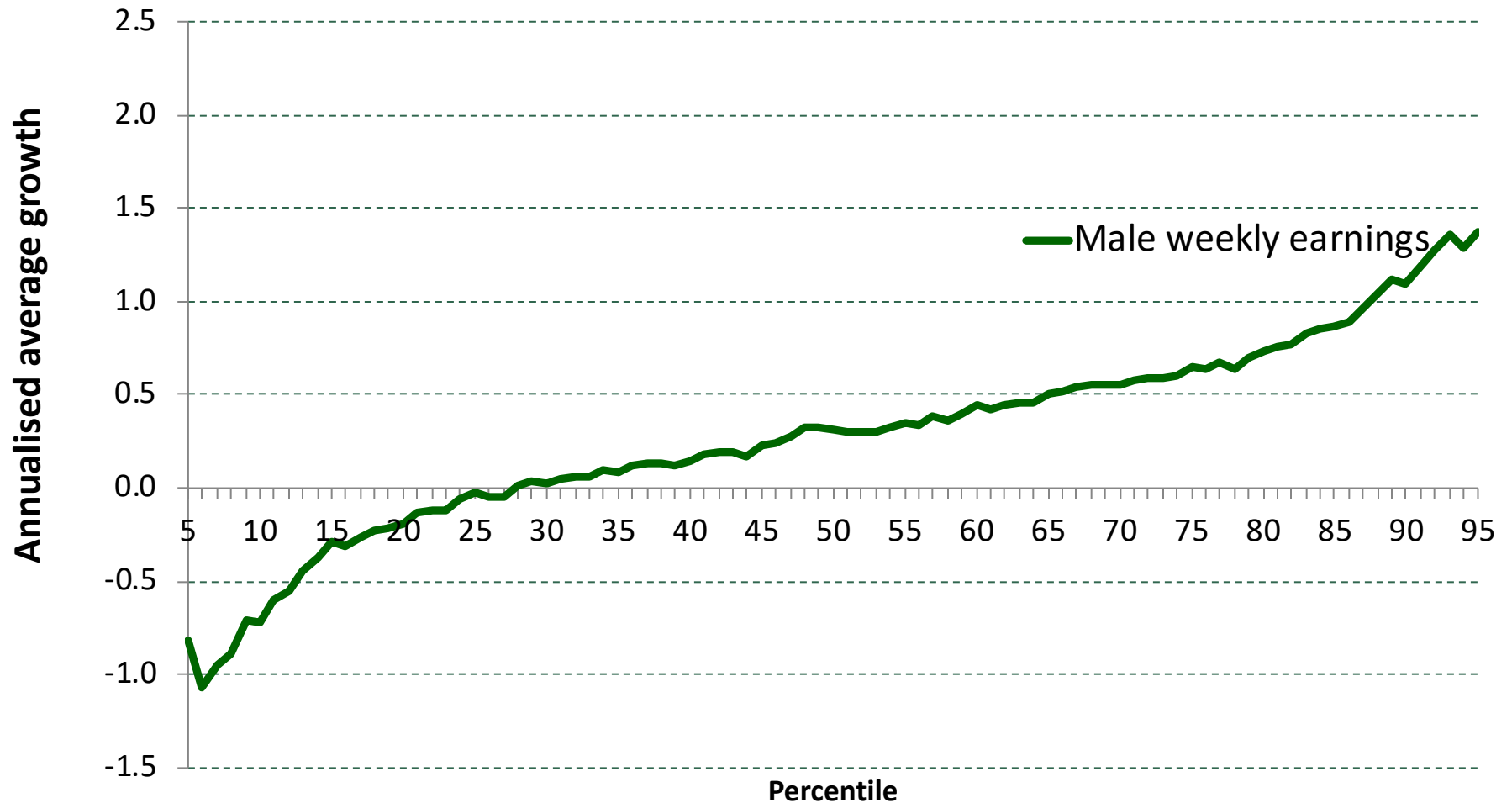


Notes: CPS, Includes self employment income and self employed households.

Source: Blundell, Joyce, Norris Keiller and Ziliak (2018)

Growth in UK male weekly earnings:

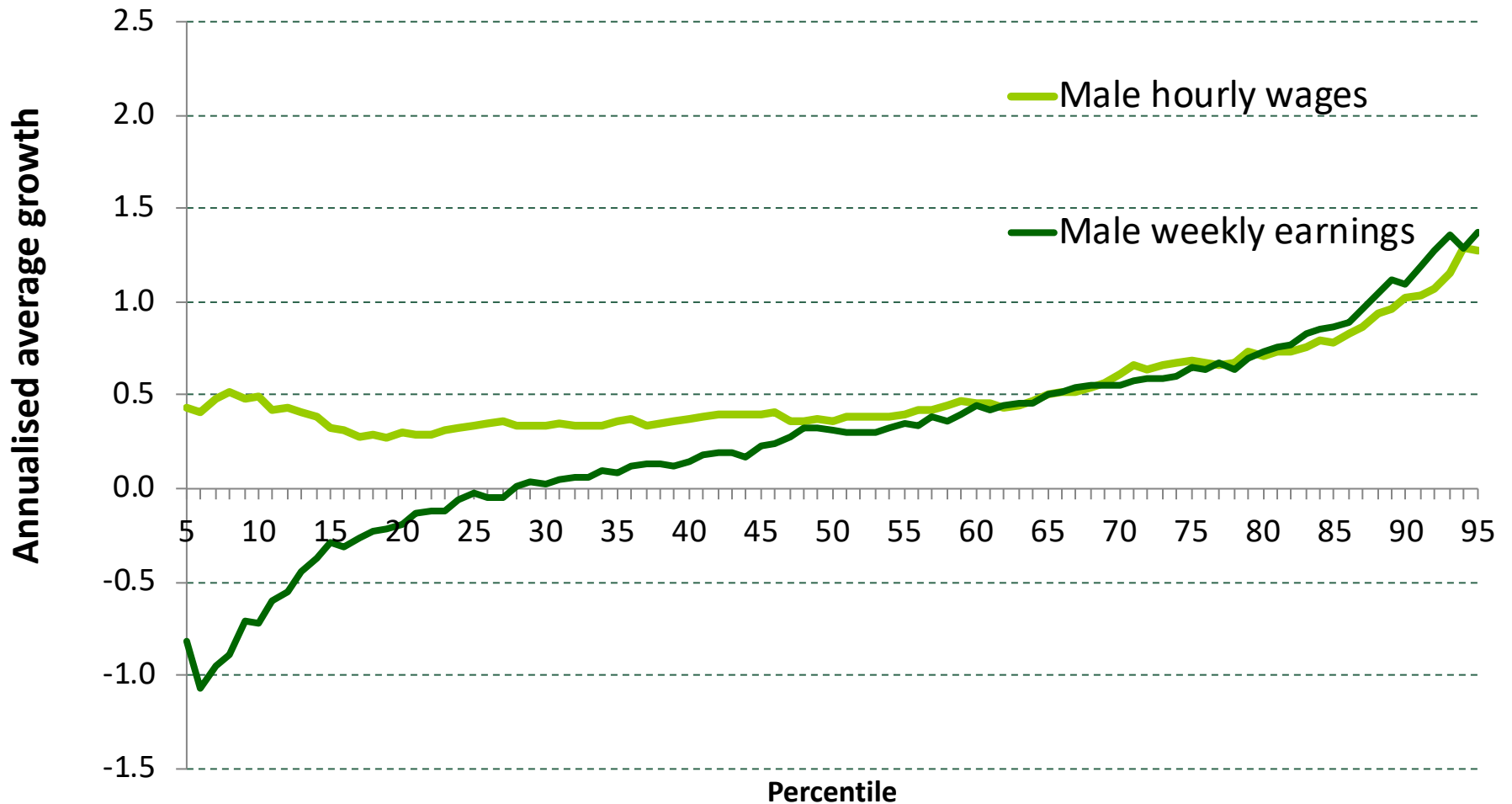
1994/95 – 2015/16



Source: Blundell, Joyce, Norris Keiller and Ziliak (2018):

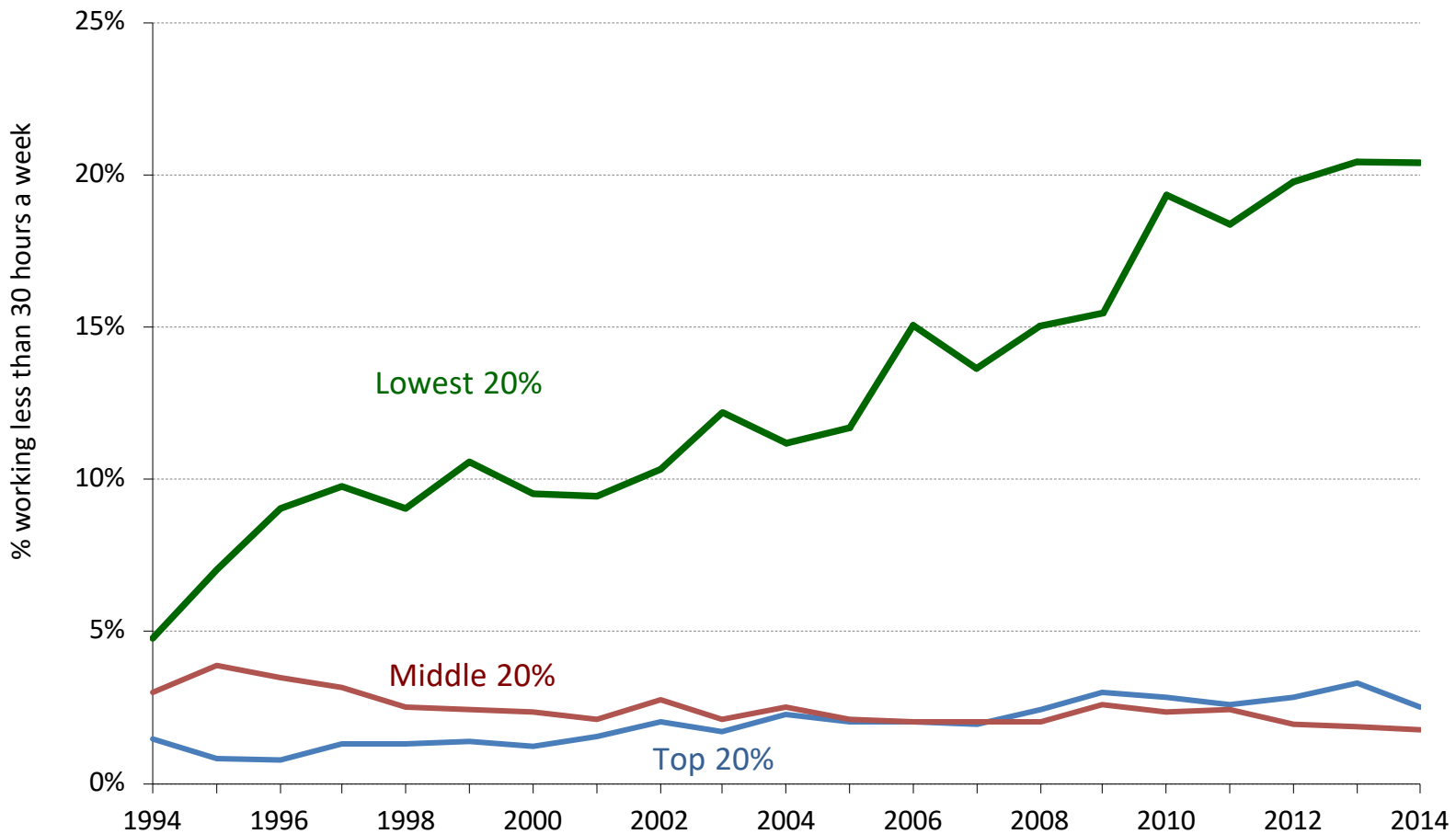
www.ifs.org.uk/publications/10031. Data used is UK FRS 1994-95 and 2015-16.

Growth in UK male weekly earnings and hourly wages: 1994/95 – 2015/16



Source: Blundell, Joyce, Norris Keiller and Ziliak (2018):
www.ifs.org.uk/publications/10031. Data used is UK FRS 1994-95 and 2015-16.

Proportion of men working less than 30 hours in the UK by hourly wage quintile – aged 25-55

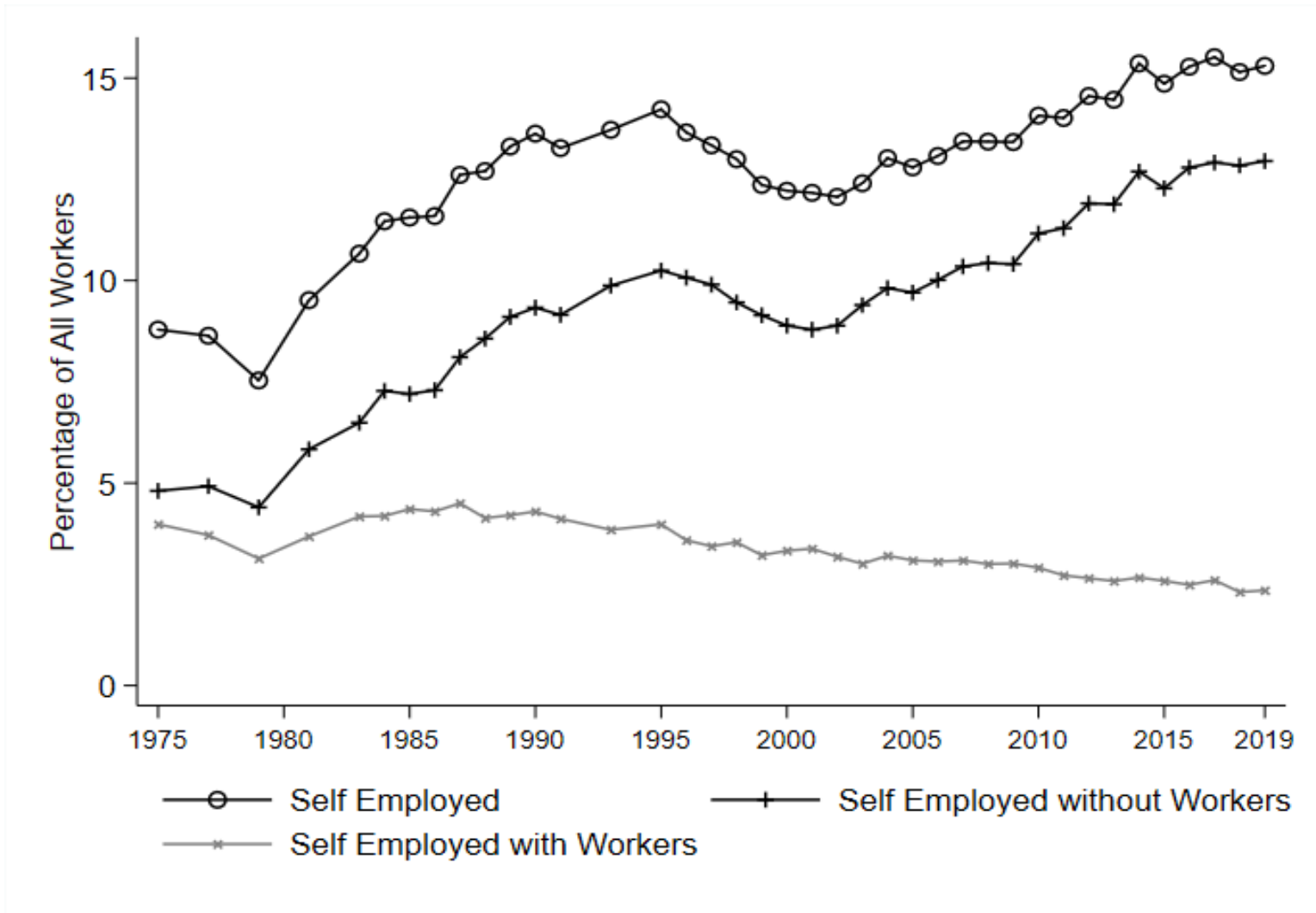


Source: IFS calculations using Labour Force Survey

Notes: LFS: Male employees aged 25-55. Giupponi and Machin (2019) show even stronger for self-employed since 2008 where there has been a growing rate of Involuntary part-timers.

Self-employment and 'alternative work arrangements'

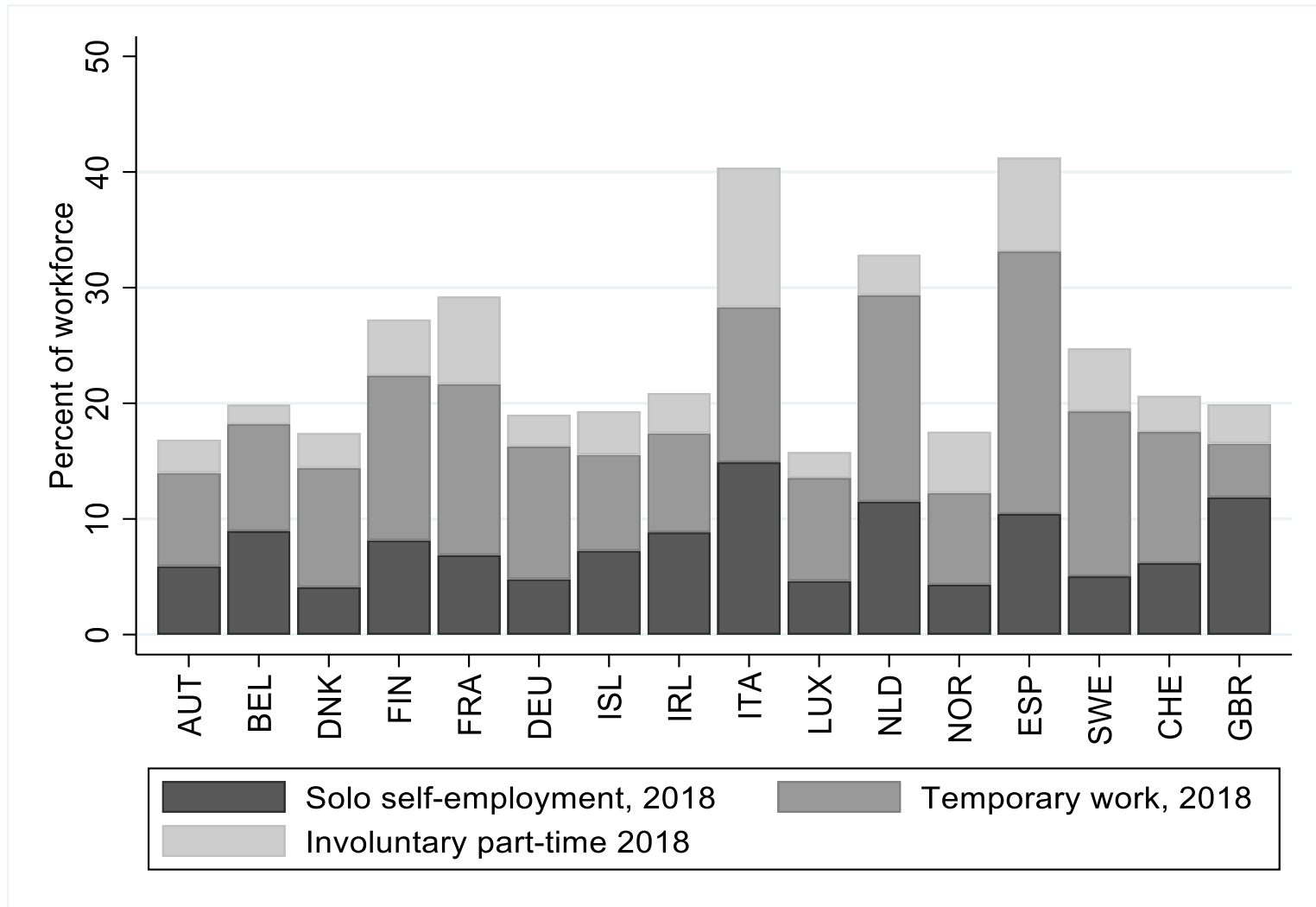
Self-employment as percent of workforce



Source: Giupponi and Machin (Deaton Review, IFS, 2019)

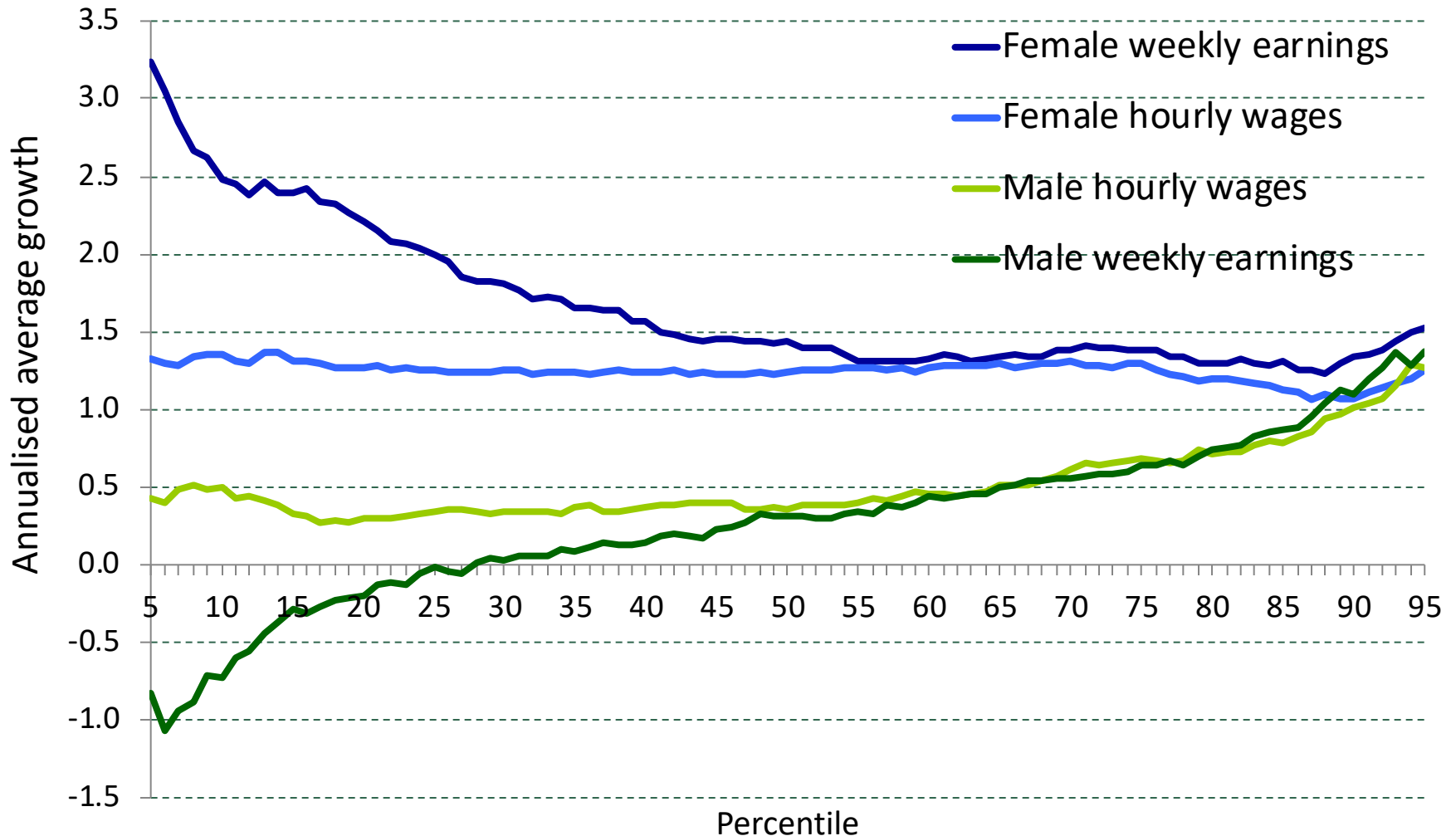
Alternative work arrangements across countries

Alternative work as percent of workforce



Source: Giupponi and Machin (Deaton Review, IFS, 2019)

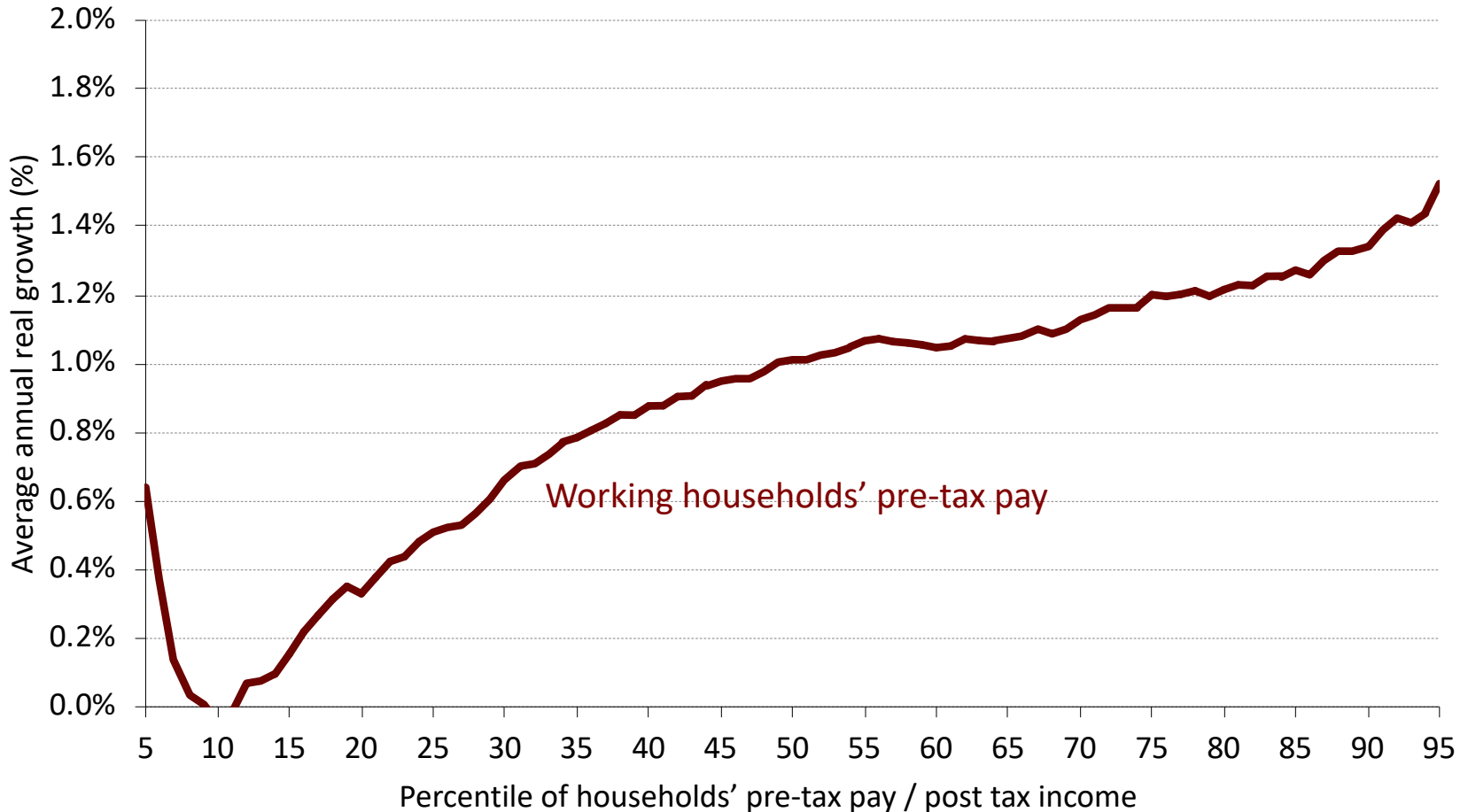
Very different growth in female hourly wages and weekly earnings: UK 1994/95 – 2015/16



But assortative partnering and the low female earnings share implies this has not improved between family inequality.... Similar results in the US; IRL?

Earnings and Incomes:

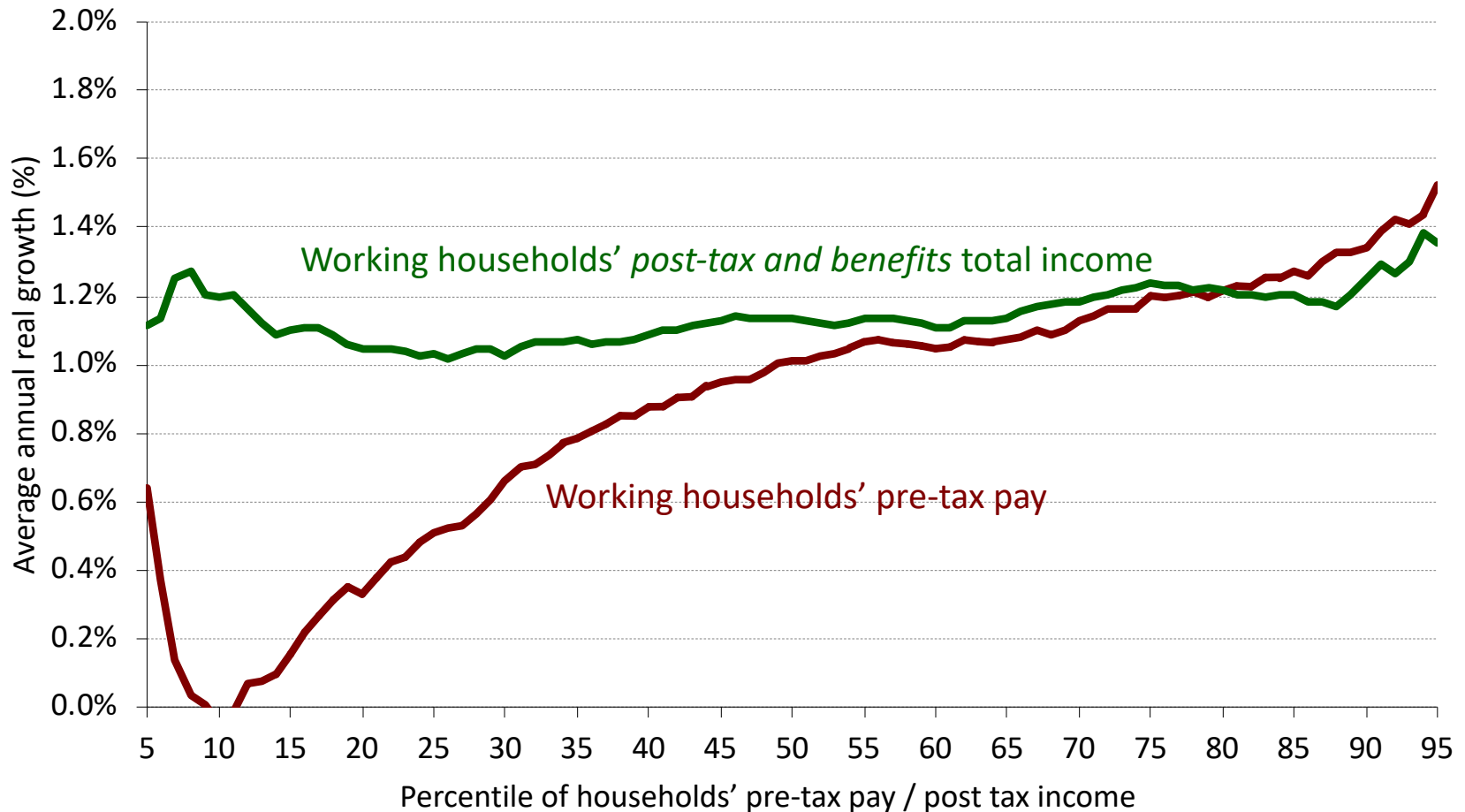
Growth in pre-tax earnings for working households in UK 1994/5 to 2015/6



Notes: Includes self employment income and self-employed households. Family Resources Survey. All income measures are equivalised.
Source: Blundell, Joyce, Norris Keiller and Ziliak (2018)

Family Earnings and Family Incomes:

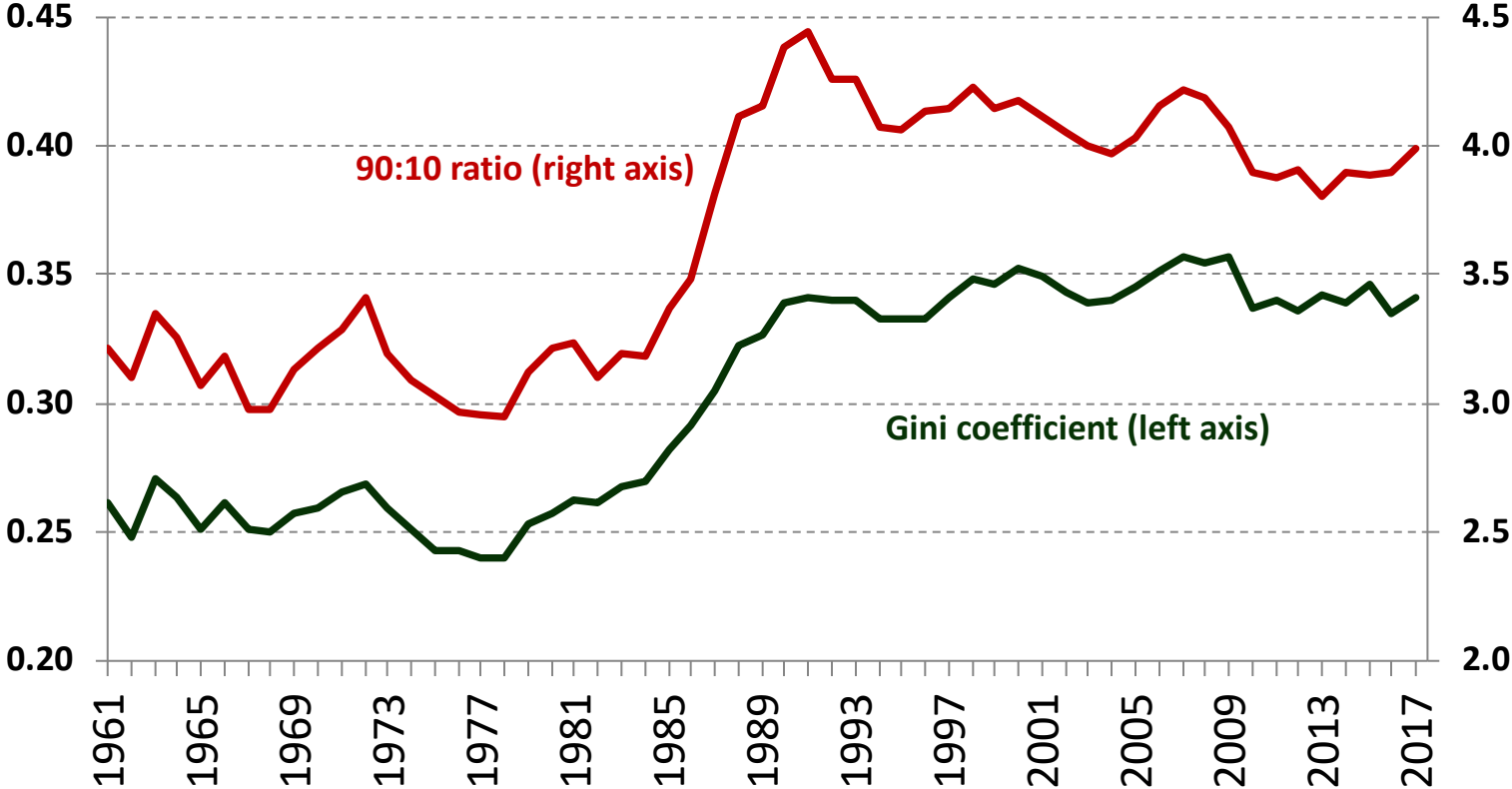
Household income growth for working households in UK 1994/5 to 2015/6



Notes: Includes self employment income and self employed households. Family Resources Survey. All income measures are equivalised.
Source: Blundell, Joyce, Norris Keiller and Ziliak (2018)

UK has a relatively high level of inequality, but household disposable income Gini has not risen in recent years...

Gini coefficient and the 90:10 ratio in Great Britain, 1961–2017

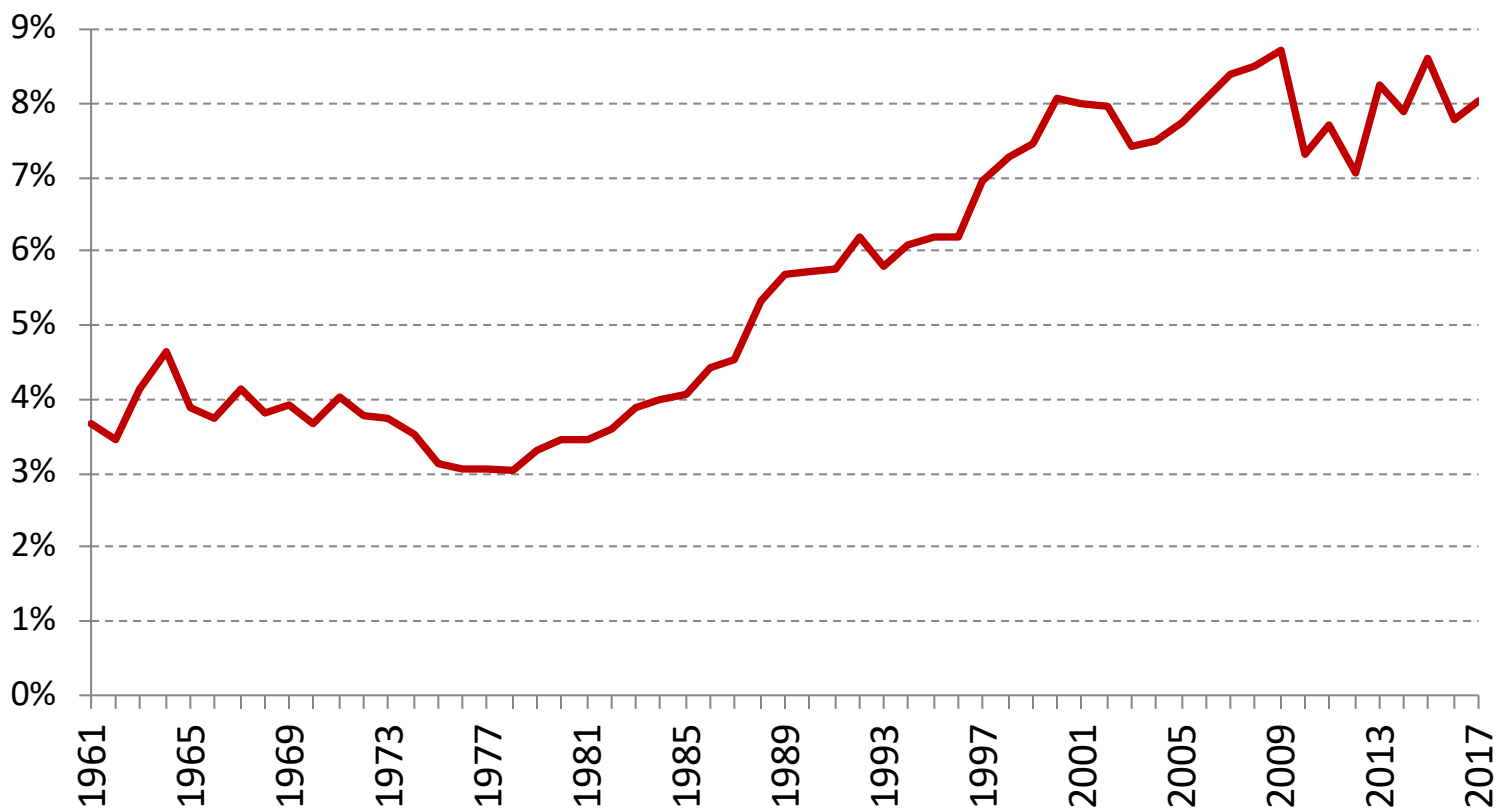


But note the top 1% share rose year on year to almost triple since 1977

Source: Joyce and Xu, 2019

The top 1% share has nearly tripled in the last 4 decades

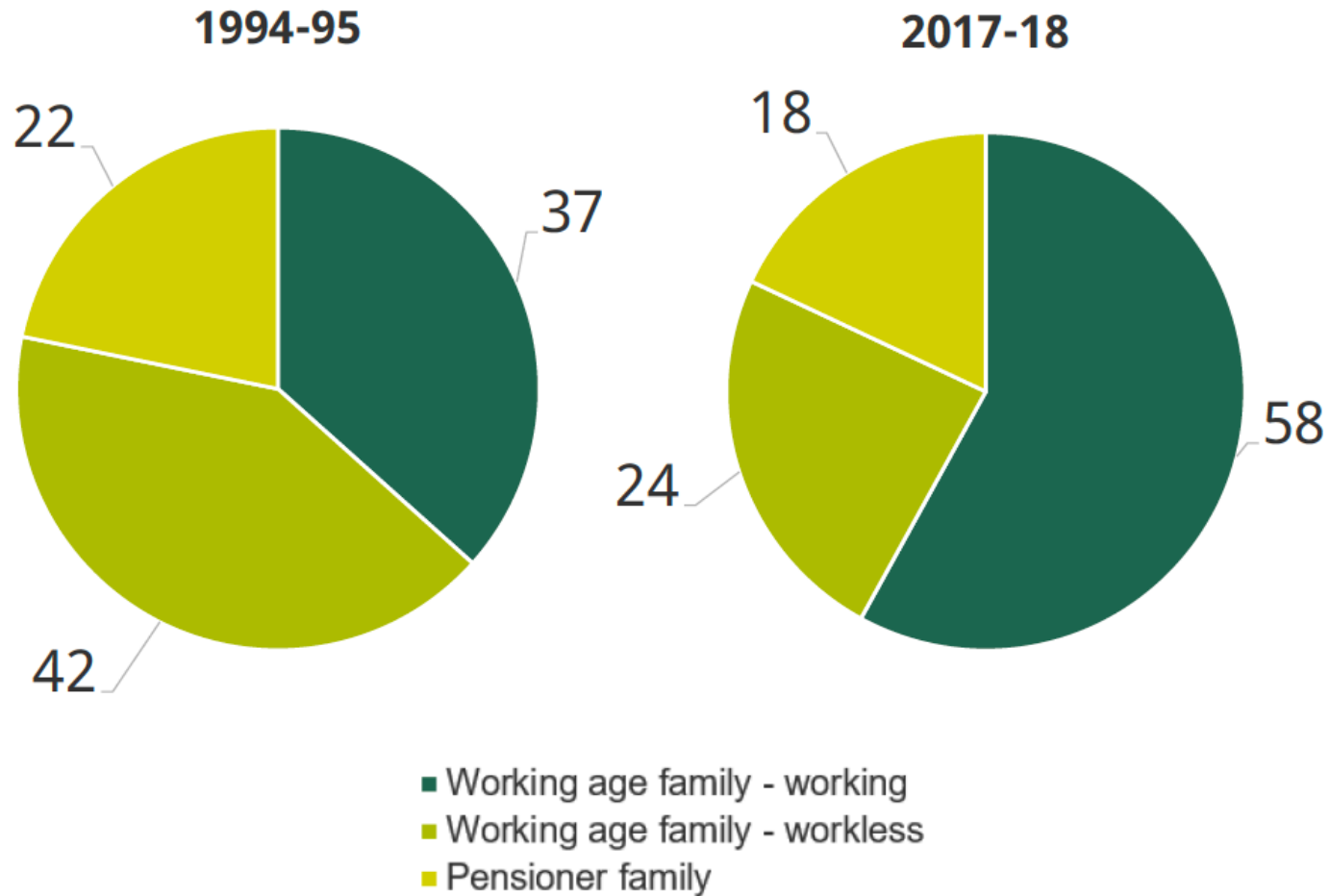
Top 1% share of net household income, UK 1961–2017



Gini and household survey income data do not capture the very top well.

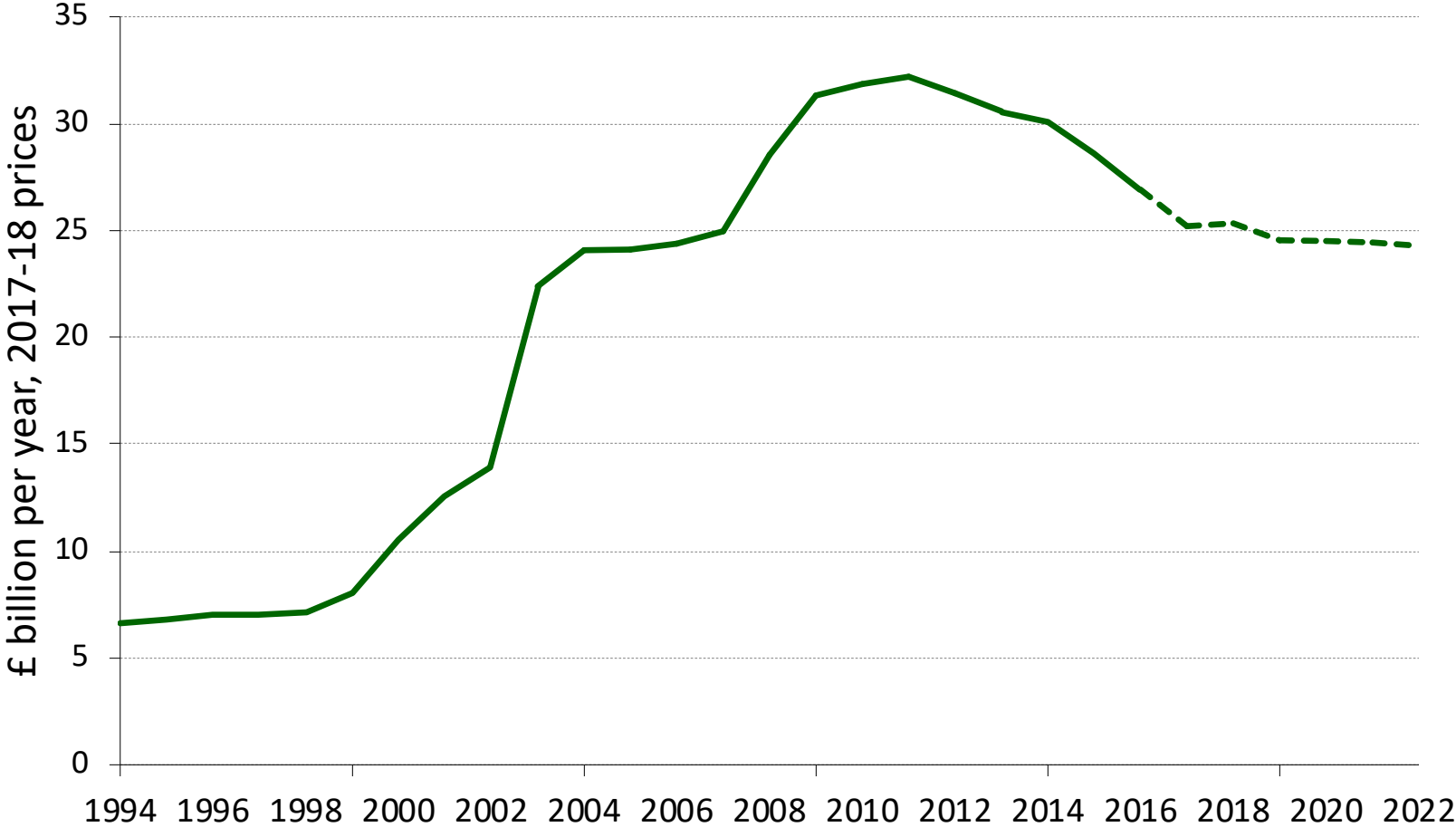
Note: Years refer to calendar years up to and including 1992 and to financial years from 1993–94 onwards, corrected with tax data. Source: Joyce and Xu, 2019

% of those in poverty by work and family type



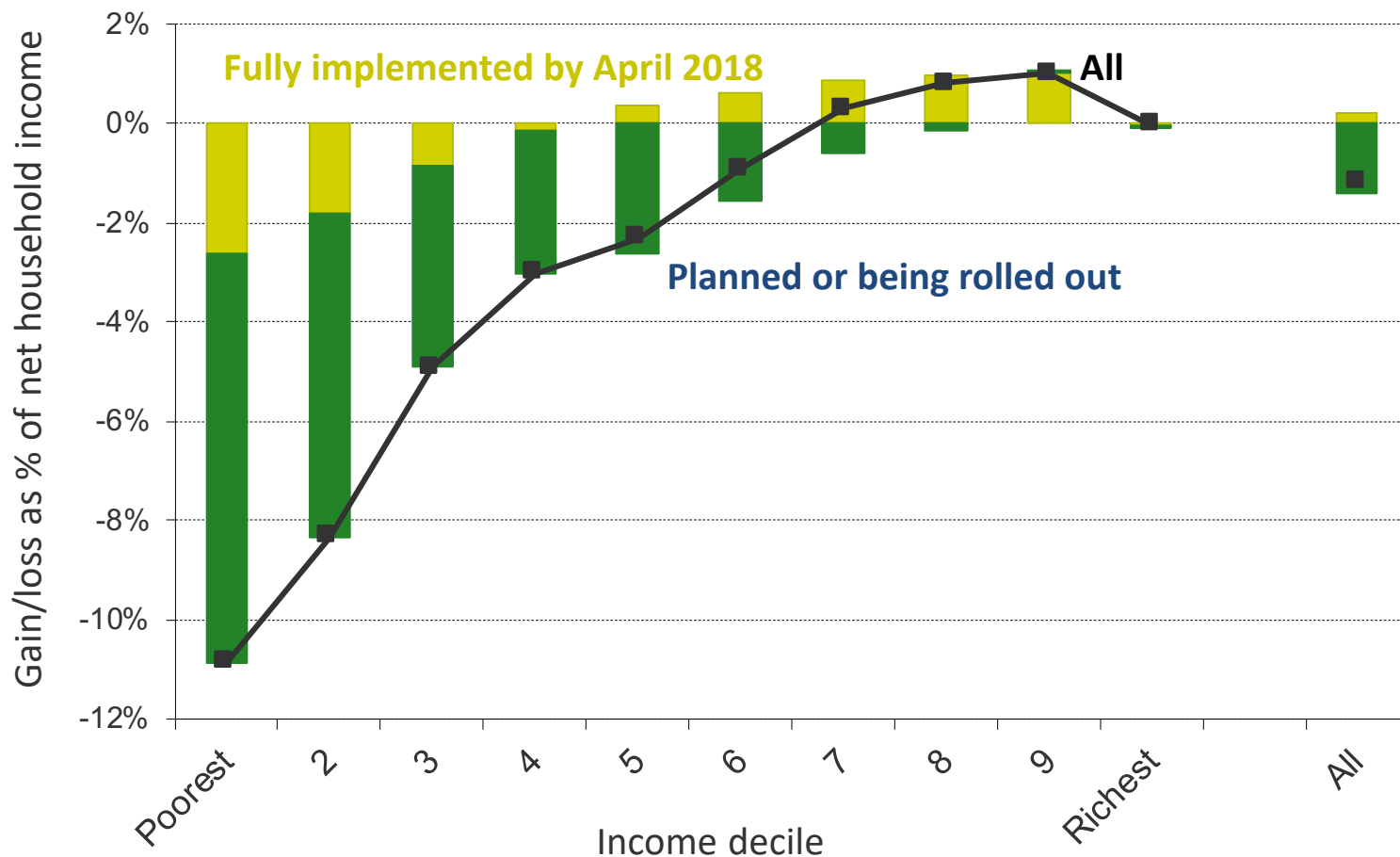
Source: IFS calculations see Figure 1 of Bourquin et al. (2019)

Real spending on tax credits and equivalents in the UK



Source: IFS calculations from DWP (UK) benefit expenditure tables.

Long run distributional impact of personal tax/benefit reforms in the UK since 2015 going forward...

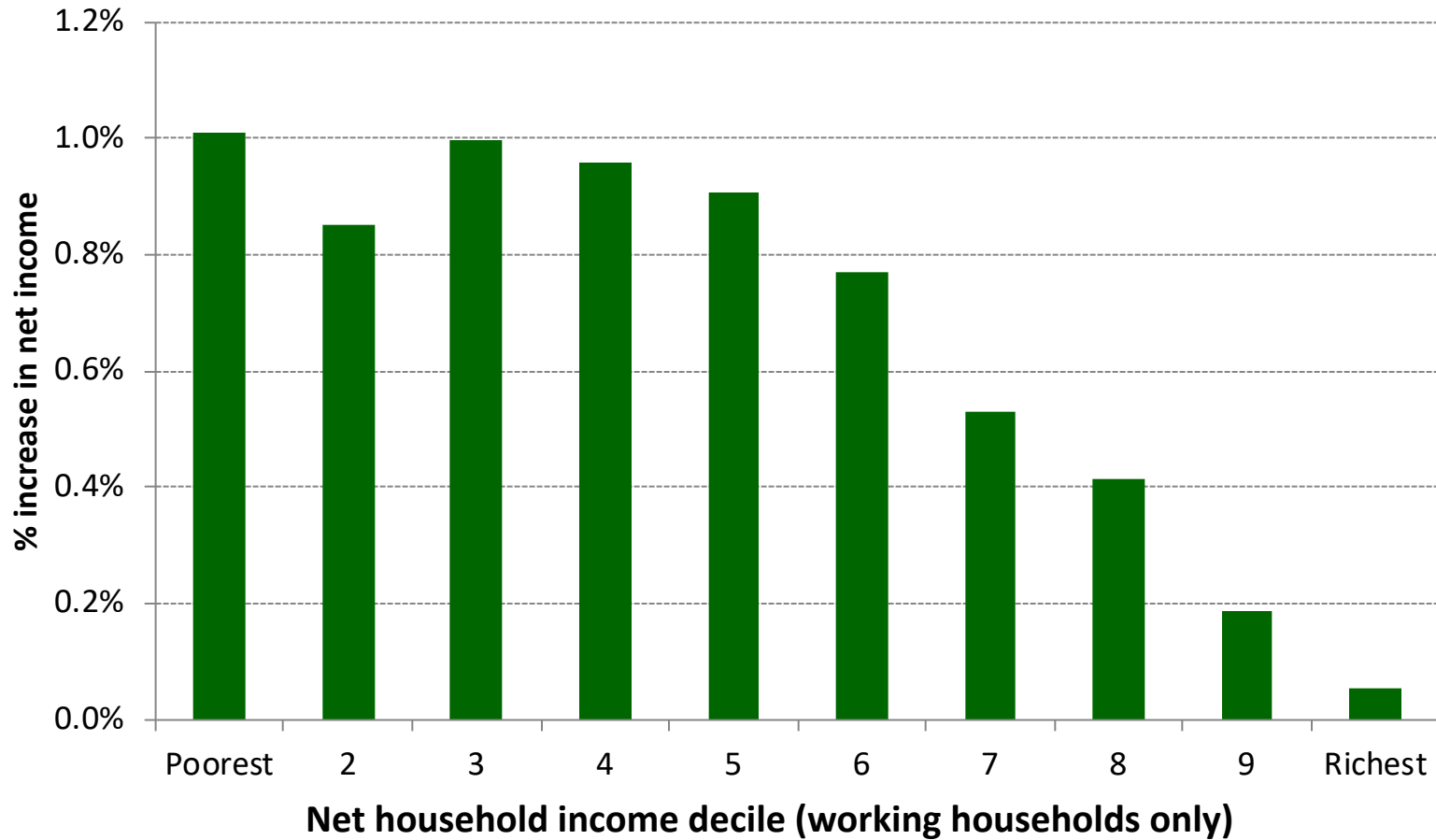


Note: Assumes full take-up of means-tested benefits and tax-credits. Policies partially rolled are Universal Credit, the 2-child limits, the replacement of DLA with PIP and the abolition of the WRAG premium in ESA.

Source: IFS calculations using the IFS micro-simulation model run on the 2015–16 FRS and 2014 LCFS.

Higher minimum wage targets the lowest-wage people, *not* the lowest-earning households

Figure shows the increase in the minimum wage between now and 2020 in the UK. Which *working households* get the extra money?



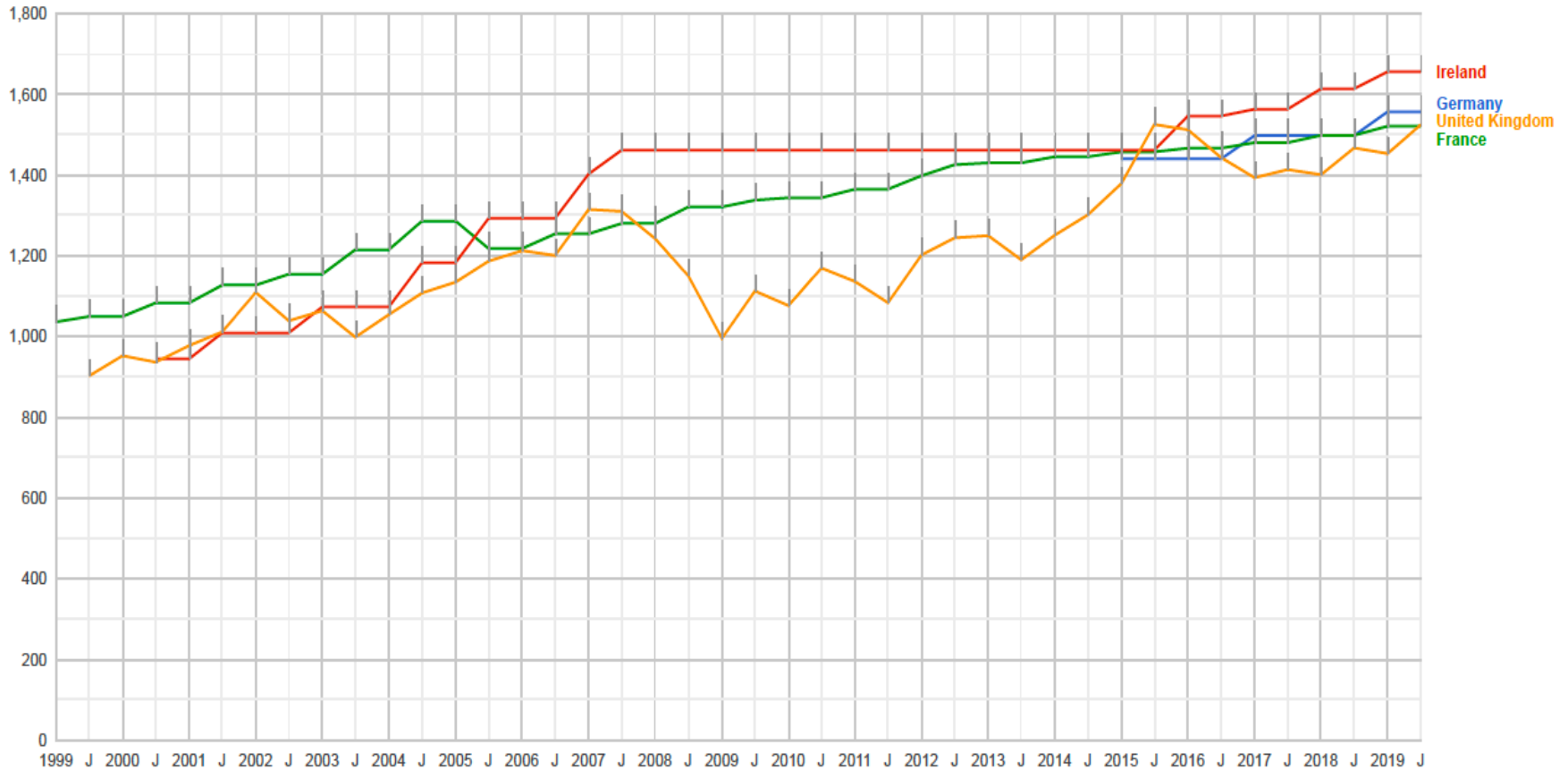
Note: Shows mechanical increase in net income arising from minimum wage rises planned between now and 2020, allowing for interaction with tax payments and benefit entitlements.

Source: Calculations using data underlying Figure 9 of Cribb, Joyce and Norris Keiller (2017):

www.ifs.org.uk/publications/9205

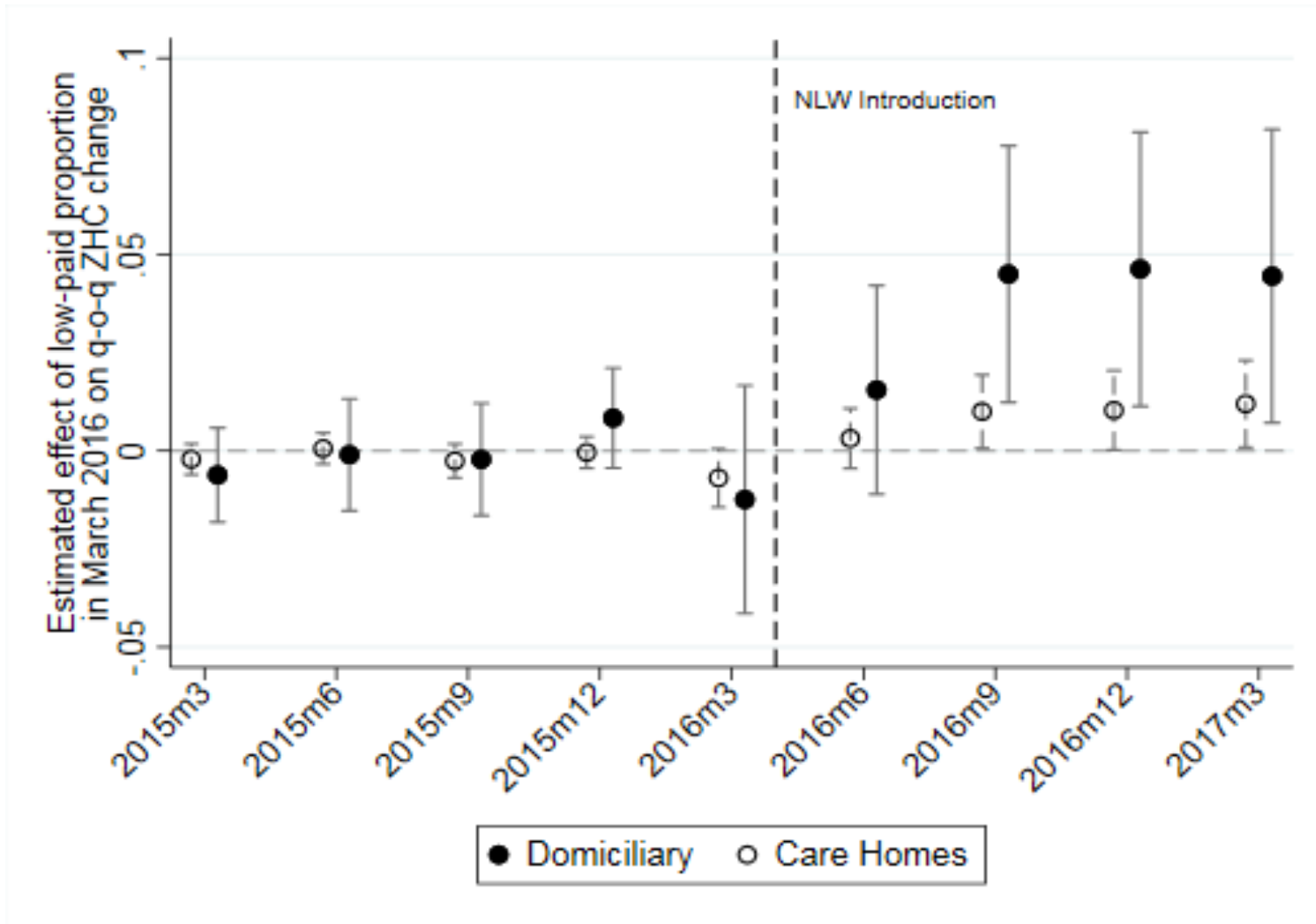
Min wage across countries

Monthly equivalent min wage



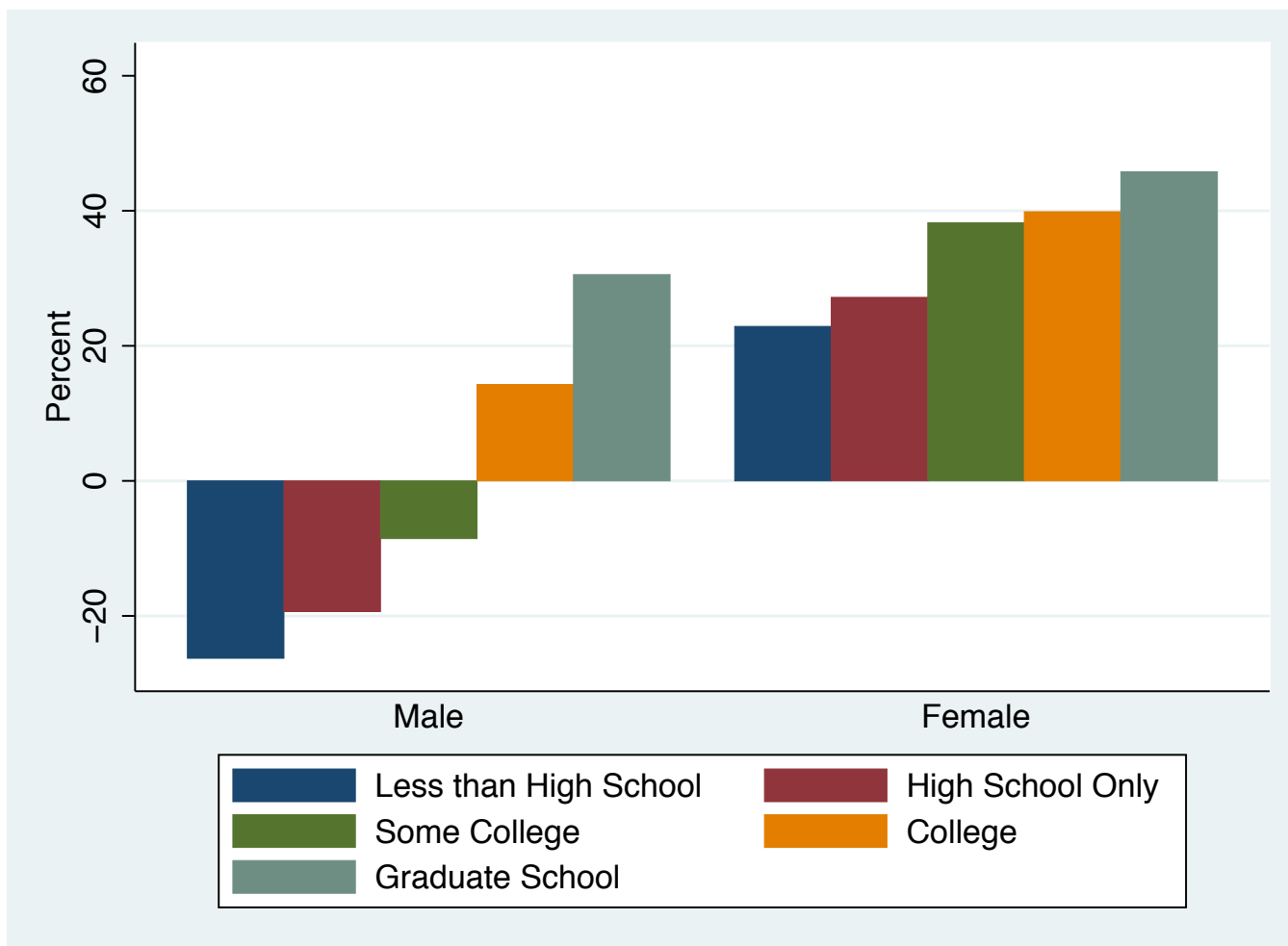
Source: Eurostat

NLW and the Proportion of Employees on ZHC in the UK



Source: Giupponi and Machin (Deaton Review, IFS, 2019)

Growth in pre-tax earnings in US: 1974/5 to 2015/6

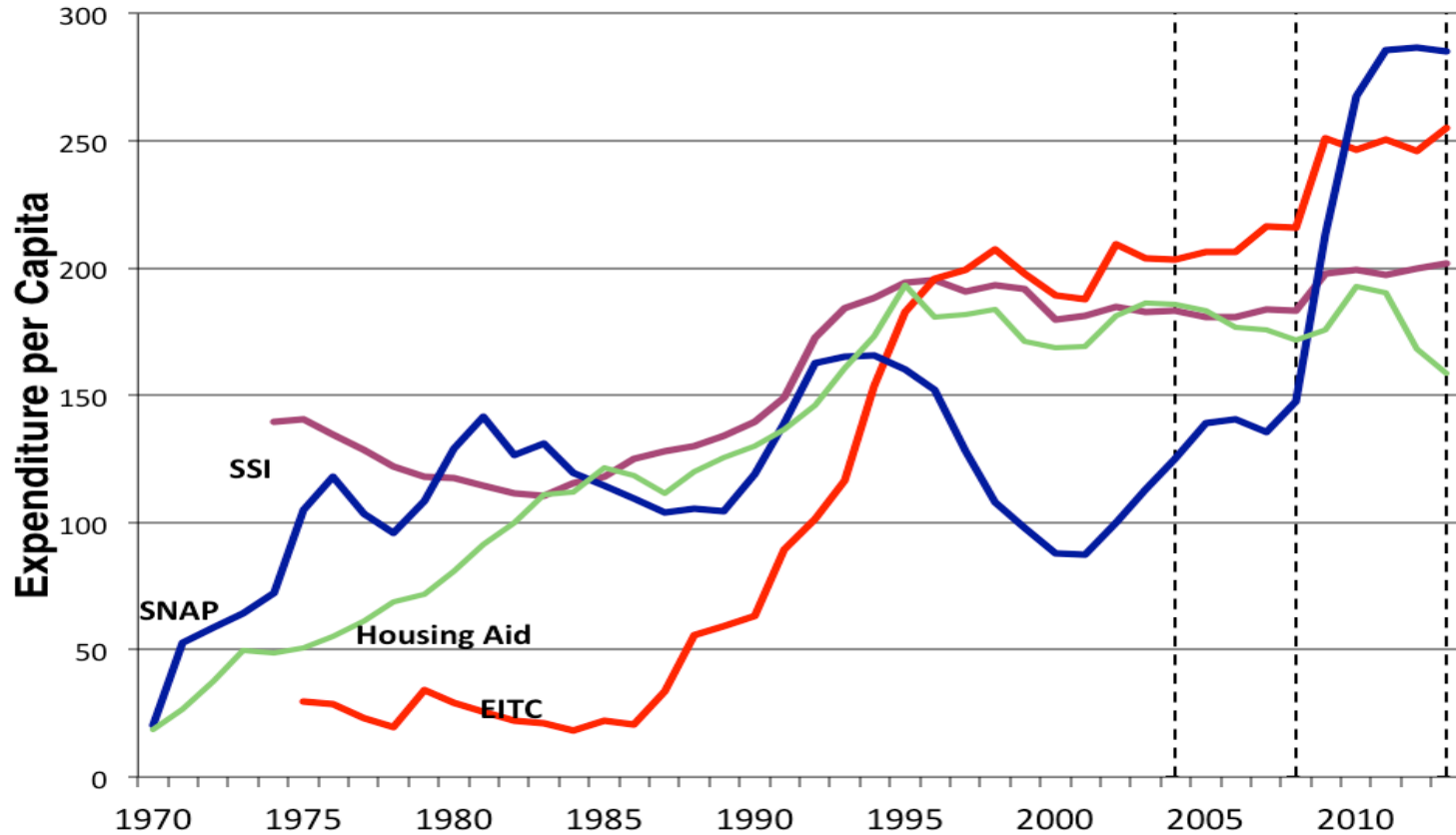


Notes: CPS, Includes self employment income and self employed households.

Source: Blundell, Joyce, Norris Keiller and Ziliak (2018)

The US experience

Growth in expenditure per capita on welfare transfers and EITC



Source: Moffitt (2018)

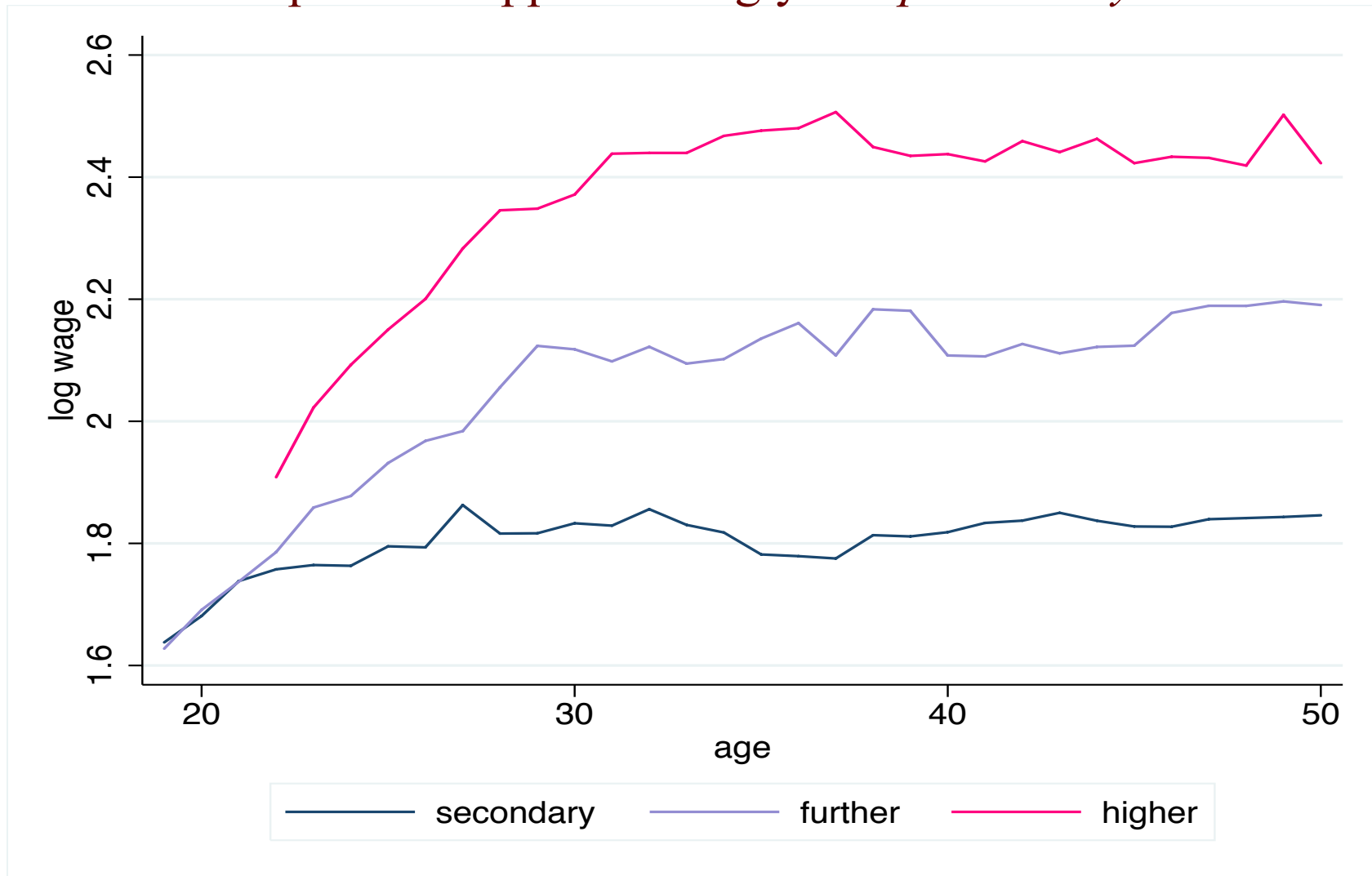
A little more detail on three key issues:

1. Wage progression
2. Training
3. The role of good/innovative firms

1. Wage progression:

It's depressing at the bottom: wage profiles by education and age

- returns to experience appear strongly *complementary* with education



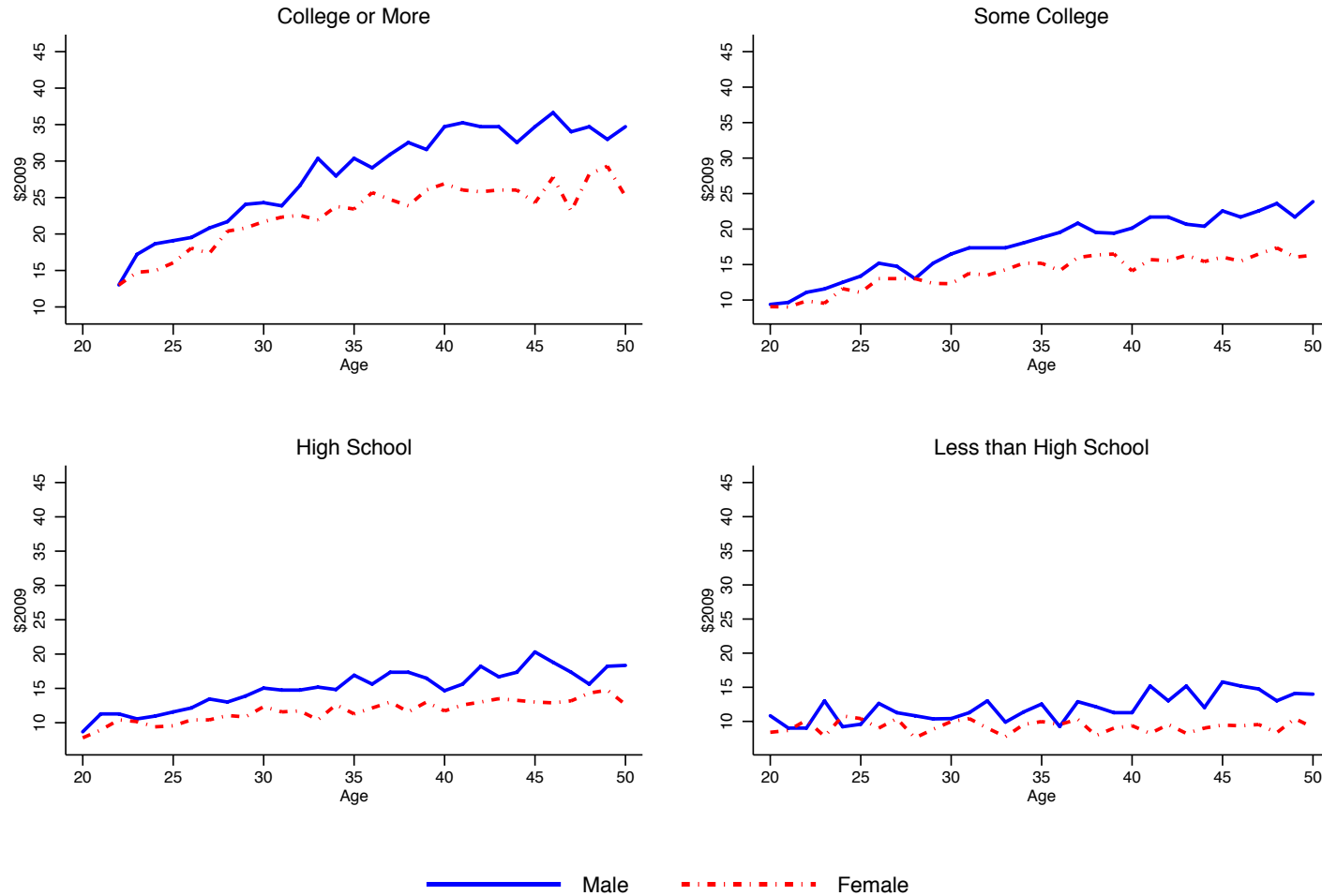
Source: Blundell, Dias, Meghir and Shaw (2016),

Notes: Women, UK BHPS. See similar for UK men and for recent cohorts in the US.

Similar wage progression age profiles in the US

Life-cycle growth in real median wages

Real Median Hourly Wage–Age Profile of Male and Female Workers in the U.S., 2016



Notes: CPS, Includes self employment income and self-employed households.

Source: Blundell, Joyce, Norris Keiller and Ziliak (2018)

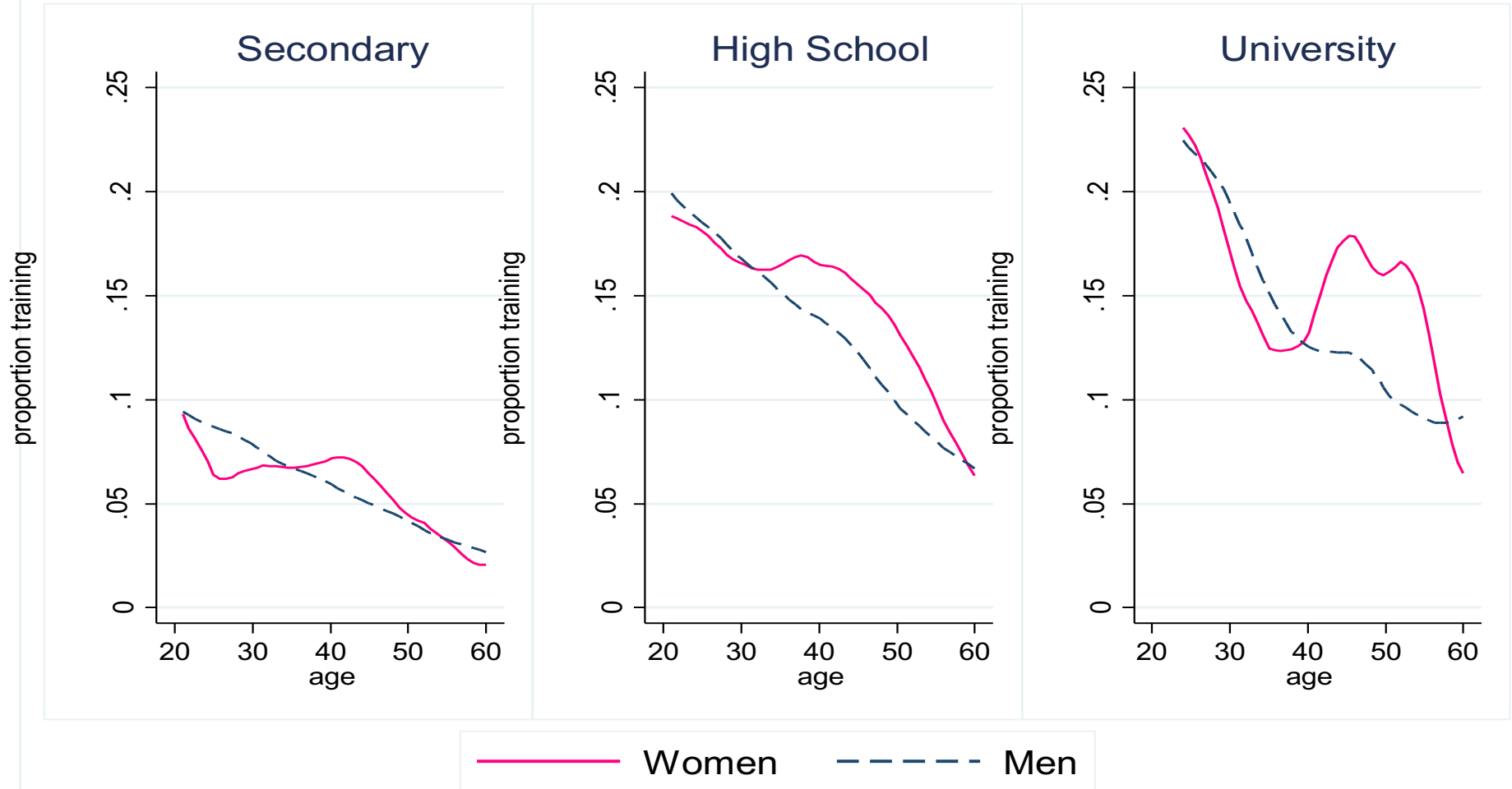
Understanding wage progression: summary results

- The returns to work experience show strong complementarity with education,
 - much lower returns for low educated,
 - much lower returns for part-time work.
- These effects seem to be getting stronger over time.
- We find reduced work experience and the part-time penalty explain around 60% of the gender wage gap,
 - note too the growth of younger men in part-time work.
- What about the role of on-the-job training?

2. Training also appears complementary with education

Prevalence of training over past year

All training, 50+ hours



Source: Blundell, Costa-Dias, Goll and Meghir (2019), Notes: UK BHPS

Wage progression and training: empirical results

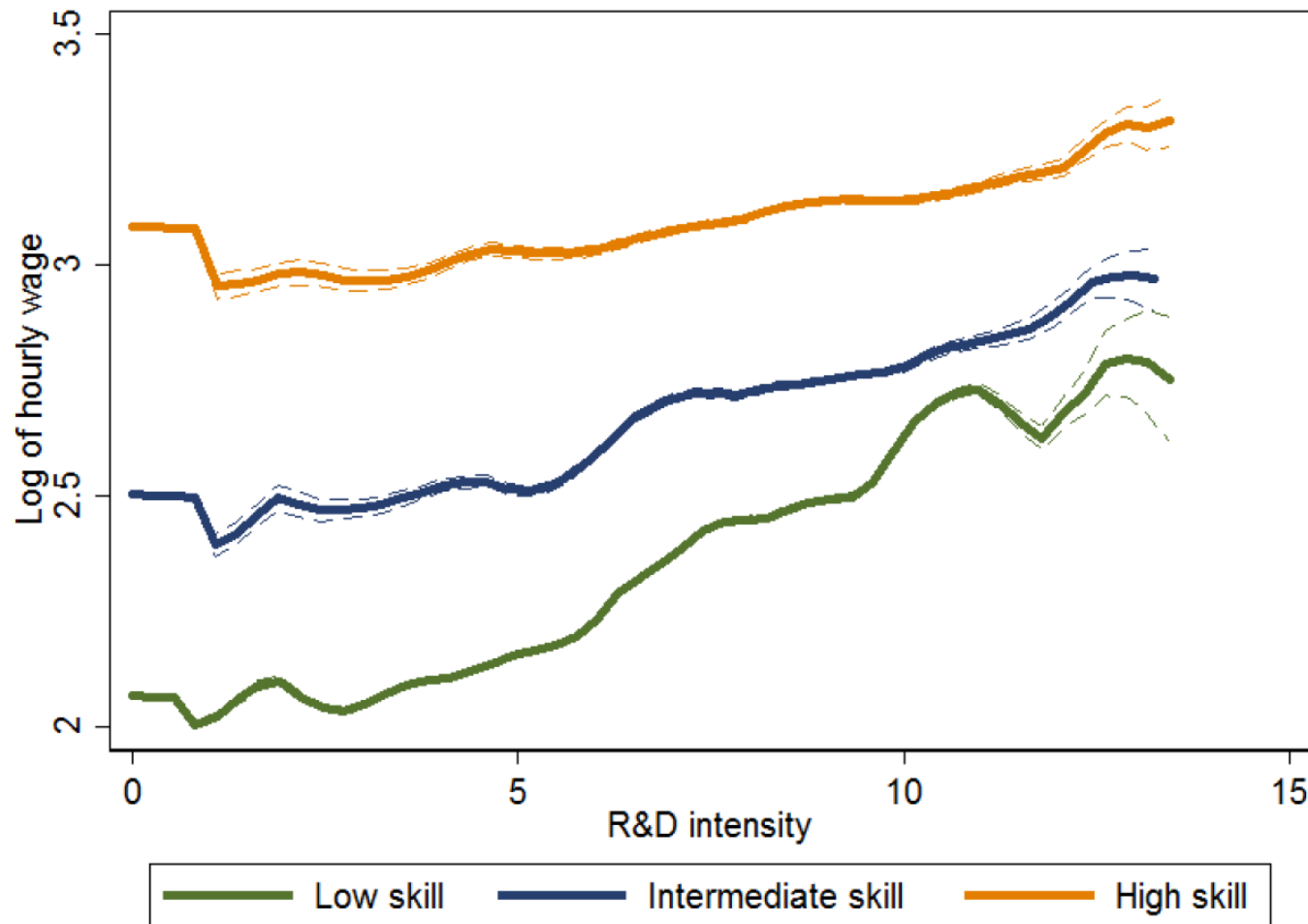
- Add training to the determination of wage progression as an additional human capital investment
 - offsetting the depreciation of experience capital,
 - allow for job-induction training.
- The training impact on wages is significant, conditional on education, experience, family background, heterogeneity,
- Firm-based qualification training is key ,
 - with return equivalent to that in formal education.
- Particularly strong effects for middle education group

3. Wage progression and firms

- Do firms matter?
- Why and when do some low education workers do well?
- What are 'good' firms?

Low skilled workers and 'good' firms: not all bad at the bottom

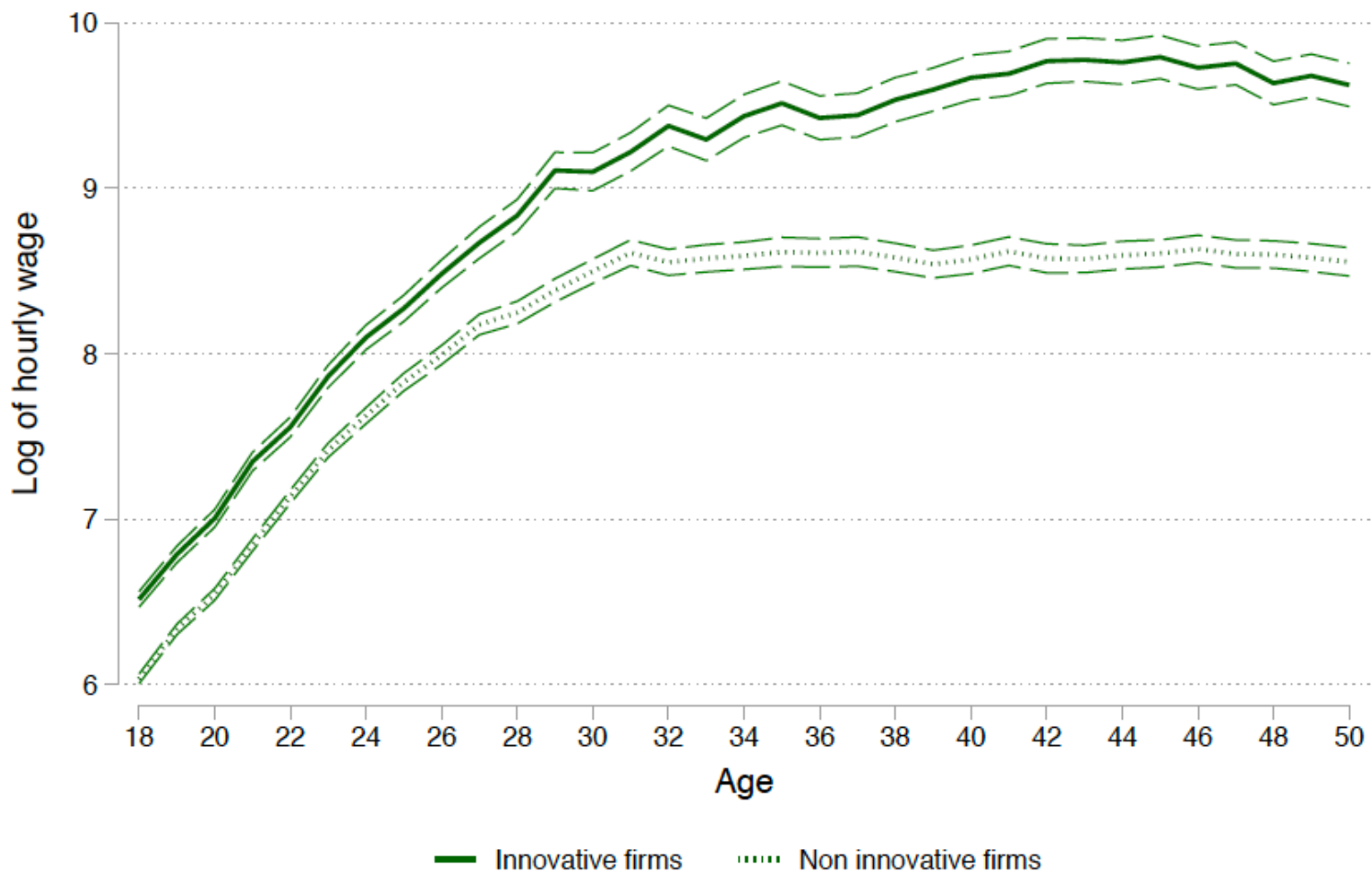
log hourly wage rate and R&D intensity: by skill group



Not all selection, some 'skills' of low educated are complementary with technology, they get training and the jobs are not outsourced....

Notes: Skill allocated by occupations in ASHE.
Source: Aghion, Bergeaud, Blundell and Griffith (2019)

Wage progression for workers in low-skilled occupations



Notes: matched employer-employee data for UK 2004-2016; average hourly wage for workers in low-skilled occupation in innovative and non-innovative firms

Source: Aghion, Bergeaud, Blundell and Griffith (2019)

Firms and wage progression: empirical findings

Implications of using new employee-employer matched data,

- workers in innovative firms earn higher wages on average than workers in non-innovative firms,
- some workers in low skilled occupations attract higher wages in innovative firms and see wage progression with tenure.

The idea: workers who perform tasks *complementary* to high skilled workers, capture a higher share of the surplus than equivalent workers in low innovation/R&D firms.

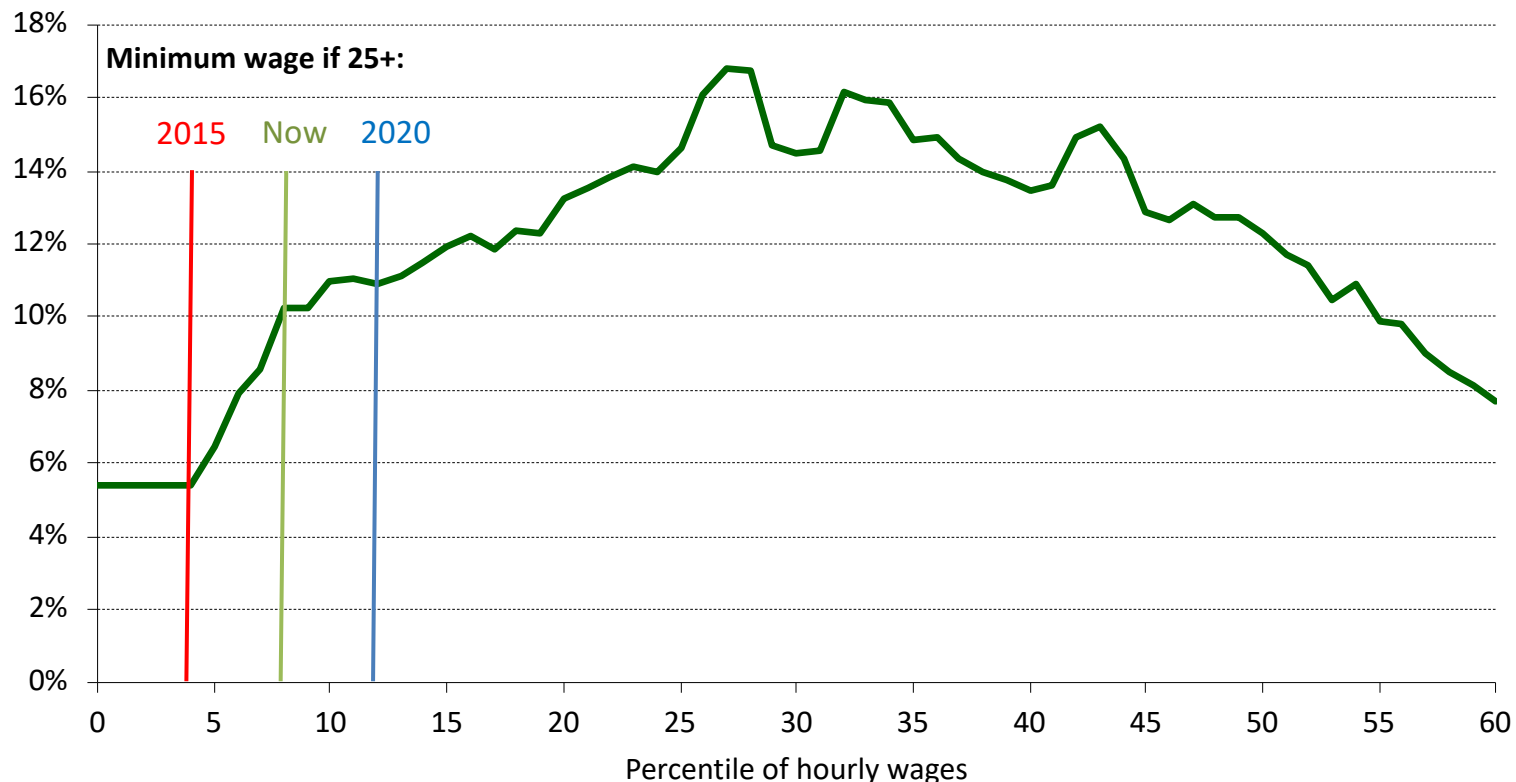
- Show this reflects 'soft skills' for low educated workers,
- Find workers with these skills are less likely to be out-sourced and more likely to receive training.

Some take-aways:

- Little wage progression for low educated & those in part-time work
 - employment is not enough to escape poverty or for self-sufficiency;
 - diverging profiles with education? US and UK evidence; IRL?
- Increased female labour supply
 - has not overcome family earnings inequality;
 - assortativeness and low earnings share.
- In-work tax-credits/benefits well targeted to low earning families
 - offset means-testing at the extensive margin for parents;
 - but earnings progression and incidence?
- Minimum wage has lifted *hourly* wages at the bottom
 - but not well-targeted to low earning families, due to secondary workers and falling male hours -> *complementary* to tax credits;
 - increasingly affecting workers vulnerable to automation?

Jobs affected by higher minimum are not the same as those previously affected

Proportion of employees aged 25+ in the most “automatable” jobs (top 10% of routine task intensity”)



Source: Cribb, Joyce and Norris Keiller (2018): www.ifs.org.uk/publications/10287. Data used is ASHE, 2015.

Designing a policy mix

- What limits wage progression?
 - less training and networking, constraints on build-up of skill in low-hours jobs, labour market for part-time workers less competitive;
 - avoid part-time incentives & incorporate training incentives in part-time work.
- What skills among those with lower education are valued by 'good /growing' firms?
 - skills that complement innovation are less likely to be out-sourced;
 - 'soft skills' seem key => re-think qualification firm-based training and the role of technology.
- Do we need stronger competition policy and contract regulation alongside redistributive tax credit and min wage policies?
 - increasing mark-ups, solo self-employment and the gig economy may signal declining bargaining power of lower educated workers..
 - improve access to training, non-wage benefits and job search information.

Summary

- A depressing finding – *little wage progression for low skill.*
- Employment is *increasingly* not enough to move out of poverty or for longer run self-sufficiency – *diverging profiles by education and part-time work.*
- Female employment and family earnings inequality – *assortativeness.*
- Policy options:
 1. *Earned income tax credits?* - encourage employment, well-targeted to low earning families, but preserve low progression, & adverse incidence.
 2. *Minimum wage?* - not so well-targeted, due to family earnings and falling male hours/attachment. Should be a *complement* to tax credits.
 3. *Basic income?* - difficult to square once families are brought in.
 4. *Human capital/training incentives/tax credits for low educated?* – focus on soft skills and training for women returning after children....
- *Challenge: finding the appropriate balance between tax policy & min wage, human capital, and competition policies that impact earnings inequality.*