The Coalition Government and income inequality

THE HALF TERM REPORT

ONE SOCIETY better for all

About One Society

We work to share the knowledge that reduced income inequality means a healthier economy and a healthier society for everyone.

We work to support those with power and influence to make the change necessary to reduce income inequality in the UK.

One Society was established as an Equality Trust project in 2009. The Equality Trust is working to build a movement for change to reduce the income gap and improve the health of society. The Equality Trust does this by analysing and sharing the latest research and supporting a dynamic network of local campaign groups to lobby their local politicians, across the UK and beyond.

The Equality Trust, established in 2009, was inspired by findings set out in the internationally best-selling book, The Spirit Level, which looks at the link between income inequality and the health of society.

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The half term report

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Our address:
One Society, 32 – 36 Loman Street, London SE1 0EH
onesociety.org.uk

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Introduction

The Coalition Government has reached the halfway point of its planned five-year term. Pronouncements on the importance of fairness and equity, commonly heard from both the Liberal Democrats and the Conservatives during the 2010 election campaign, continued beyond the General Election. Early statements from David Cameron that not only are 'we are all in this together'[1] but that 'those with broader shoulders should bear a greater load',[2] suggested that inequality would be a top priority for the Coalition Government. Its record in office, however, is mixed. As the Coalition Government approaches half-term, this collection of essays brings together academics, commentators and leading practitioners to assess government policy and practice on fairness and equity so far. It asks whether Government has acted to reduce or limit the UK's level of income inequality and if so, how.

Our opening piece from Professor Kate Pickett of York University sets out how the UK's unusually high level of income inequality impacts upon the health and wellbeing of individuals and society. She looks at the consequences of the associated wide disparities in social status and their relevance for the issues right at the top of the government's political agenda – stronger families, stronger communities and a stable economy. Pickett's piece is complemented by that of Stewart Lansley, visiting fellow at Bristol University, which explores how 'excessive' levels of income inequality are holding back economic growth. Lansley discusses how the upward redistribution of income in favour of a small elite has restricted consumer spending, encouraged debt and created an economy more vulnerable to financial crises. He concludes that continuing income inequality can only have the consequence of long-term constriction of our productive economy.

1 www.britishpoliticalspeech.org/speech-archive.htm?speech=321

2 www.britishpoliticalspeech.org/speech-archive.htm?speech=214

Deborah Hargreaves of the High Pay Centre assesses the efforts of the Business Secretary to curb rising top pay in the private sector. Whilst acknowledging tentative steps in the right direction, Hargreaves concludes that the action taken is not sufficient to achieve meaningful change. This is particularly so in the context of too great an emphasis being placed on the willingness and ability of investors to reduce income inequality. At the other end of the pay spectrum, the Joseph Rowntree Foundation's Chris Goulden and One Society's Sue Christoforou look at action Government have taken on low pay. Some positive moves have been made with the National Minimum Wage (NMW) being extended to apprentices and the adult rate of NMW being paid to those aged 21 for the first time. However, policies that focus on the public sector have had, and will have, a less positive effect on the lowest paid, with constriction of public sector pay and proposals for regionalisation of pay both impacting negatively on public sector workers at the bottom of the pay scale.

Duncan Exley, also of One Society, finds that Government has made some clear statements about pay in the public sector, with Eric Pickles, the Communities and Local Government Secretary, advocating curbs to the highest public sector salaries.[3] As a consequence of the requirement on local authorities to publish information on the pay policies, set out in the Localism Act, government policy is beginning to have a moderating effect on high pay in local government. Yet, there is little evidence of benefit for those at the lower end of the pay scale and some of the starkest examples of taxpayer-funded pay inequality, particularly in the Public Services Industry, remain unaddressed.

In his piece, Ben Baumberg, lecturer in social policy and sociology at the University of Kent, assesses the impact of Government's welfare reform agenda on income inequality. He concludes that on first examination, Government welfare policies appear progressive: the poorest tenth of households with children will lose slightly more in 2011-2014 than households that are marginally richer. However, the richest tenth of households lose the least. Also, this is only the case if changes implemented by the Coalition Government, but proposed by the preceding Labour administration, are taken into account. Coalition-only policies, including next year's introduction of Universal Credit, present a notably different picture, in

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[3] Eric Pickles (June 2010) 'Time to halt council chiefs' gravy train' **Telegraph** accessed 08 October 2012 www.telegraph.co.uk/news/politics/conservative/7805372/Time-to-halt-council-chiefs-gravy-train.html

which the poorest tenth of households with children lose over five per cent of their income, while the richest tenth lose only two per cent.

Moving from welfare benefits to tax issues, John Cullinane, past President of the Chartered Institute of Taxation, finds the impact of tax-rate changes to be a mixed picture. He concludes that the 'bottom end of the top decile' (i.e not the very richest) have fared worst, for example through the loss of tax allowances for high earners and that those at the lower end of the pay scale may have fared worse than those in the middle of the spectrum. In Cullinane's analysis, this is in part due to measures which sought to help low earners – such as the increased income tax threshold – benefiting many people higher up the income scale, whilst having little impact on very low earners.

Gary Ashford of accountancy firm RSM Tenon and Kelly Sizer of the Chartered Institute of Taxation, find that Government is taking steps towards 'following through on their commitments to tackle tax avoidance and evasion'. This includes initiatives such as new rules on tax avoidance to tackle disguised remuneration, aimed at those on the highest salaries. Yet, in terms of the amount of income generated – which might be used to mitigate the most severe austerity actions – it is policy implemented by the preceding Labour government that is having the most positive effect. However, as Ashford and Sizer point out, action to address tax evasion and avoidance is not intended to be redistributional, making it difficult to draw a straight line from policies on tax avoidance and tax evasion and any impact they may have on income inequality.

Particularly if Coalition-only, as opposed to Labour-devised, policies are considered, our half term report suggests that the current government has done little to meaningfully address the UK's vast income inequality since gaining office in May 2010. This relative inaction is in the face of the electorate's growing frustration with unjust income inequality.[4, 5] As austerity belts are ever tightened, proposed policy on income inequality is an issue on which the two government parties – and the opposition – will be judged in the second half of the term and the run-up to the next election. All parties would do well to pay close attention to electorate anger and set out effective policies that will have a real and lasting impact on the UK's current levels of vast income inequality.

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4 Park A & Clery E (December 2010) **British Social Attitudes 27th Report** NatCen

5 Heath A et al (2010) 'How Fair is the Route to the Top: perceptions of social mobility' **British Social Attitudes 27th Report** NatCen

Why inequality matters

Kate Pickett

How are we doing? How are we as a nation, as a society, doing? Are we as healthy, wealthy, and wise as we ought to be? Are we as healthy, wealthy and wise as other nations and other societies? And how would we know this, what comparisons would we need to make, what evidence would we need?

For a long time, we've judged our national success almost entirely by economic growth and development. As long as our GDP kept on growing and GDP per capita kept rising, we thought we were doing OK – as one of the rich, developed market democracies all we needed to do was to keep on growing and we would see the benefits of that growth flow throughout society.

But it didn't work. Among researchers in public health, it's been known for some time that when we compare different rich countries, there is no association between average levels of income (GDP per capita) and measures of population health, such as life expectancy or mortality rates. Citizens of the wealthy USA and UK, for example, don't live longer on average than citizens of the considerably less well-off Spain, or Greece. Beyond a certain level of economic development, more money doesn't buy more health. And the same is true for happiness – beyond a certain level of development there is no association between average incomes and the proportion of the population that are happy with their lives.

Yet within each of those rich, developed countries there are stark inequalities and social gradients in health and wellbeing by income. In the UK, you can expect to live about eight years longer if you live in one of the wealthiest neighbourhoods rather than in the most deprived. Income seems to be important within societies, but meaningless between them.

What this tells us is that it is relative social status that is important for health and wellbeing. When we look at population health or happiness in relation to the gap between the rich and the poor, rather than average levels of GDP per capita, we can see clearly that societies with greater income inequality have worse health than those where incomes are less unequal.

It isn't just death rates and life expectancy that are affected by income inequality. A wide range of health and social problems are much worse in more unequal societies, including higher rates of infant mortality, obesity and mental illness, more teenage births, lower levels of child wellbeing and educational achievement, higher levels of violence, more people in prison and less social mobility. But let's stick with the health example for a while.

Not only is the average life expectancy for both men and women lower in more unequal societies, the social gradient in health is affected too – the gap between the life expectancies of the rich and the poor gets bigger. And the impact of inequality isn't only experienced by those lower down the social scale, even a well-educated middle class person is likely to die sooner in a more unequal country than their exact counterpart living in a more equal one.

To summarise then, research shows that rates of health and social problems are higher in more unequal societies. The disparity in these problems between the rich and the poor is greater in more unequal societies – there is more social injustice. But rates of problems are higher even among the better off – the vast majority of the population do better in more equal societies. Even those near the top of the social ladder will be likely to live longer, be more involved in community life and less likely to suffer violence, while their children are likely to do better at school, less likely to take drugs and less likely to become teenage parents.

Alongside this growing body of evidence on the impact of inequality, there is also a growing scientific understanding of the pathways from income inequality to a number of health and social problems – of the ways in which status competition, or feeling devalued, disrespected, insecure and worried about how you are seen and judged by others, affects human health and behaviour. The processes which produce a social class gradient in each problem are intensified by greater inequality. Status competition makes it feel more important to have money and so leads people to work longer hours in more unequal societies. Inequality also increases the strains on family life and parenting. And greater inequality leads to more violence because, as status matters more, people become more sensitive to common triggers to violence such as being disrespected and looked down on.

How unequal societies are, also has major implications for reducing carbon emissions and moving towards environmental sustainability. More equal societies recycle more of their waste, and their business leaders place a higher priority on environmental protection. The difference seems to be that in more equal societies, with higher levels of trust and stronger community life, people are more aware of the common good and more public-spirited. In contrast, greater inequality increases anti-social tendencies; reciprocity and cooperation give way to a feeling that people have to fend for themselves.

As well as these broad effects of income inequality, economists are increasingly drawing attention to the central role played by inequality in the financial crashes of 1929 and of 2008. There is a very close correlation between increasing debt and increasing inequality within the USA and among other OECD countries. As the share of income going to the rich rose, they had more and more money to invest and lend, but everybody else found it increasingly difficult to maintain their incomes or realise their aspirations. Both for speculators and ordinary people rising house prices made investment in property look like a band wagon everyone should climb onto. People bought into the housing market wherever they could and re-mortgaged perilously as prices rose.

Speculation on these debts grew bigger and bigger until the bubble inevitably burst. So in terms of health, happiness and wellbeing, the environment and the economy, an ever-expanding body of research suggests that rich countries have got to the end of the social benefits of economic growth and rising material standards, but are deeply damaged by rising inequality. Further improvements in the real quality of life now depend more on the quality of social relations in society than on higher levels of consumption. By narrowing income differences we can improve the social and psychological wellbeing of the whole population, and set the stage for a more balanced and greener economy; this is an exciting and hopeful prospect.

Kate Pickett is Professor of Epidemiology at the University of York, and a National Institute for Health Research Career scientist. She co-founded the Equality Trust, a non-profit organisation seeking to explain the benefits of a more equal society, and is the co-author of The Spirit Level: Why More Equal Societies Almost Always Do Better.

Inequality and instability: why more equal societies have more stable economies

Stewart Lansley

Most critiques of the deepening income and wealth gulf of the last thirty years have concentrated on issues of injustice and fairness and on the damaging social consequences of an excessive divide. An equally important issue, but one that has been much less debated, is the impact of surging inequality on the way economies function.

The economic orthodoxy of the last thirty years holds that a stiff dose of inequality is a necessary condition for economic progress. Higher rewards and lower taxes at the top, it is claimed, boost enterprise and deliver a larger economic pie.

It is a theory – for theory it is – that emerged in the post-war teachings of a small group of pro-market thinkers and was then taken up more widely. As the influential American economist, Arthur Okun, put it in 1975, you could have more equal societies or more efficient ones, but not both.[6] Attempts to close the gap would reduce incentives and lead to slower growth.

This theory has been put to the test over the last thirty years in both the UK and the US. Both countries have allowed the concentration of income and wealth to return to levels last seen in the inter-war years. Moreover, although it was a theory that originated with the new right, it came to be embraced across most of the political spectrum, including by the leaders of New Labour in the UK and of the Democratic Party in the US.

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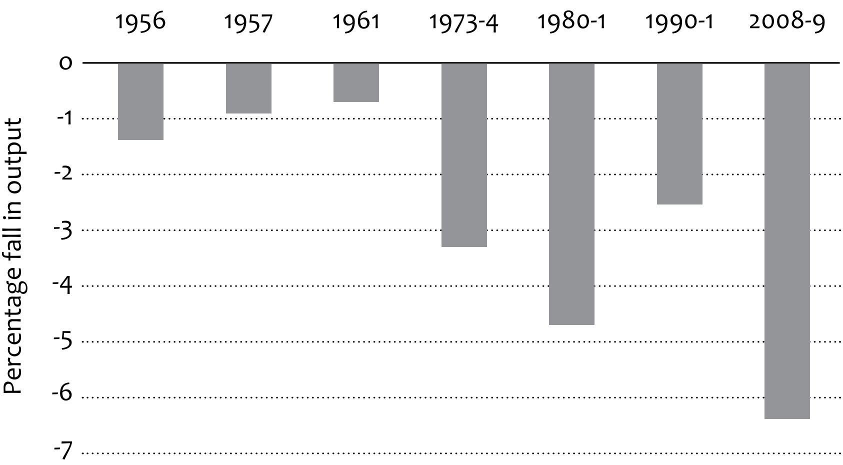
6 Okun A (1975) **Equality and Efficiency: The Big Tradeoff** Brookings Institute Press

So has the experiment in 'unequal market capitalism' worked in the way predicted by the theory? The answer appears to be no. The income gap has surged but without the promised pay-off of wider economic progress.

On all measures of economic success bar inflation, the post-1980 era of rising inequality has a much poorer record than the egalitarian post-war decades. The UK's growth and productivity rates have been about a third lower since 1980 than in the post-war era, while unemployment has been consistently higher. A recent IMF study shows that the 'efficiency/inequality trade-off theory' has failed to stand up to real world application: "When growth is looked at over the long term, the trade-off may not exist. In fact equality appears to be an important ingredient in promoting and sustaining growth."[7]

Not only has rising inequality failed to deliver faster growth, there is growing evidence that it is also associated with greater instability and played a critical role in both the 2008 crash and the persistence of the current slump. Since 1979 there have been three deep-seated recessions compared with only two shallow and short-lived ones in the two post-war decades (see chart 1). The main outcome for the countries that have embraced the post-1980 model of market capitalism most fully has been economies that are both much more polarised and much more fragile.

Chart 1: Post-war recessions, UK (percentage fall in output)



[7] Berg AG & Ostry JD (Sept 2011) 'Equality and Efficiency' **Finance and Development** IMF

Indeed, history shows a strong association between rising inequality and economic breakdown. The Great Depression of the 1930s and the Great Crash of 2008 were both preceded by sharp rises in inequality. In contrast, the most prolonged period of economic success and stability – from 1950 to the early 1970s – was one in which inequality was falling and the proceeds of growth were evenly shared between wages and profits and across earnings groups.

Association is one thing, causation is another. To establish cause and effect, it is necessary to consider the impact of changing 'factor shares' (the way the output of the economy is divided between wages and profits) on the way economies work. Throughout the 1950s and 1960s the division remained roughly constant with wages in the UK settling at between 58 and 60 per cent of output, a higher rate than achieved in the pre-war era. It was this steady and elevated wage share that helped drive the 'great levelling' of the post-war decades. After rising sharply, but briefly, to a historic peak of 64.5 per cent in 1975, it then fell steadily to reach 53 per cent by 2007, below its post-war average, and a level last seen before the First World War. The United States has followed a very similar pattern, with its economy experiencing an even deeper fall in its wage share over this period.

In search of greater efficiency, successive UK and US governments from 1979 allowed, indeed encouraged, the fruits of growth to be colonised largely by a small business, financial and corporate elite, leaving the workforce with a continually shrinking share of the nation's output. According to market theorists, this shift in the division of output in favour of business and the very rich would trigger a sustained investment boom and deliver more robust economies. Instead, it appears, concentrating the gains of economic progress in this way has created a dangerous structural imbalance that has made nations much more prone to instability and crisis.

There are four main mechanisms that link growing inequality to economic crisis. First, reducing the relative incomes of large sections of the workforce stifles purchasing power and prevents economic output being sold. In the build-up to 2007, rising inequality set a number of economies on a sustained course of deflation. The political solution to this problem of shrinking consumer power was to pump economies full of private debt. In the UK, levels of personal debt rose from 45 per cent of incomes in 1981 to 157 per cent in 2008. In the US, debt also rose sharply to reach a third more than national income by 2008. None of this prevented recession, it just delayed it. The same factors were at work in the 1920s, when the growing demand gap was filled by another explosion in private debt.

Secondly, the swollen corporate and personal wealth surpluses that were the flipside of these shrinking wage shares were used in ways which greatly damaged the real productive economy. Instead of boosting investment, these surpluses led to a giant mountain of footloose global capital that ended up fuelling financial engineering and hostile corporate raids, activity geared to transferring existing rather than creating new wealth and reinforcing the shift towards greater inequality. By contributing to the creation of asset bubbles, the same process greatly amplified the risk of financial crisis. Again there are striking parallels with the 1920s when swelling surpluses were poured into real estate and the stock market creating the bubbles that triggered the 1929 Crash.

Thirdly, the effect of these trends has been to intensify the concentration of power. In both the UK and the US, key economic decision-making is now heavily concentrated in the hands of a tiny minority. A new business and financial elite has been able to ensure economic policies characterized by inaction on tax havens, a blind-eye approach to tax avoidance and the scaling back of regulations on the City and Wall Street, policies that have simultaneously accentuated the risk of economic failure.

Fourth, a number of academic studies – covering large and small firms in both North America and Europe – have shown a strong correlation between narrower pay dispersion within an organisation and improved organisation performance.[8] This research suggests that wide gaps between top and bottom pay harms performance overall, and can also have particularly strong negative effects in certain circumstances. In firms with a high degree of interdependence in work tasks requiring a greater degree of interaction between employees, for example, pay compression is associated with improved performance. Large pay gaps are also especially detrimental in R&D-intensive firms.

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[8] Cowherd D & Levine D (1992) 'Product Quality and Pay Equity Between Lower-Level Employees and Top Management: An Investigation of Distributive Justice Theory' **Administrative Science Quarterly**

Bloom M (1999) 'The Performance Effects of Pay Dispersion on Individuals and Organizations' **Academy of Management Journal**

Shaw J, Gupta N & Delery J (2002) 'Pay Dispersion and Workforce Performance: Moderating Effects of Incentives and Interdependence' **Strategic Management Journal**

Martins P (2008) 'Dispersion in wage premiums and firm performance' **Economics Letters**

Faleye O, Reis E & Venkateswaran A (2010) 'The Effect of Executive-Employee Pay Disparity on Labor Productivity' unpublished

Not only did the growing income divide help to drive the global economy over the cliff in 1929 and 2008 it is now helping to prolong the crisis. UK wage-earners today have around £100 billion less in their pockets (roughly equivalent to the size of the nation's health budget) than if the cake was shared as it was in the late 1970s. In the bigger economy of the United States the sum stands at £500 billion. In contrast, the winners from the process of upward redistribution – big business and the top one per cent – are sitting on growing corporate surpluses and soaring private fortunes that are mostly sitting idle. This imbalance is a central explanation of the lack of recovery.

The evidence is that, on every count, the impact of rising inequality has been bad news for the economy. It has brought slower growth and greater turbulence and inflamed the highs and lows of the business cycle. The key lesson of the last thirty years is that economies that allow the richest members of society to accumulate a larger and larger share of the cake merely brings a dangerous mix of demand deflation, asset appreciation and a long squeeze on the productive economy that will end in economic turmoil.

Stewart Lansley is Visiting Fellow at Bristol University and author of The Cost of Inequality: Why Economic Equality is Essential for Recovery.

Half-term report on government initiatives to curb directors' pay

Deborah Hargreaves

A half-term score card for Vince Cable, Business Secretary, might award a B- for effort in addressing the issue of burgeoning executive pay, but a D for outcome. Cable has worked diligently towards a consensus on reforming top pay, but has been forced to water down some of his original proposals under pressure from business and some partners in the coalition.

Cable's tub-thumping rhetoric about the 'dysfunctional' nature of the market for directors' remuneration has given way to a package of reforms that are a step in the right direction, but unlikely on their own to reverse the trend for stratospheric awards to leading bosses.

Public anger at the behaviour of business leaders and bankers has seen politicians from all parties denouncing so-called 'rewards for failure,' this year. Shareholders have also recently found a voice, voting in increasing numbers against excessive rewards for mediocre company performance.

This year's outbreak of activism, dubbed the 'shareholder spring', saw the departure of a handful of chief executives where investors expressed anger at lack of corporate strategy or poor financial performance. Protest votes were also recorded at successful companies such as WPP, where shareholders were annoyed at the lack of consultation over big pay rises for the board.

However, even amid the rise in shareholder disapproval, top pay still continued to increase much faster than average wages. Awards for top bosses rose on average by ten per cent in 2011 according to MM&K and Manifest when average earnings barely shifted and did not keep up with the cost of living. A FTSE 100 chief executive now earns £4.8 million – 185 times average wages.

Top pay in the private sector is a key factor in the issue of rising inequality in Britain. While the top 0.1 per cent of Britain's income scale – those earning more than £500,000 – amounts to only 47,000 people, some 65 per cent of them are company directors and bankers. This group is highly influential and sets a comparison for pay in the public sector and other areas, dragging salaries up at the top level and opening up a widening gap with the rest of the workforce.

In 1979, the top 0.1 per cent of the income scale took home 1.3 per cent of national earnings. This has now risen to more than seven per cent and looks set to breach ten per cent in the next 20 years if current trends continue unchecked. That would take us back to Victorian levels of inequality. Cable's BIS department (Department for Business Innovation & Skills) points out that over the past decade, directors' pay in the UK's largest listed companies has quadrupled with no clear link to corporate performance.

The final report from the High Pay Commission of which I was chair, has put pressure on the government to curb excessive rewards. The report called for widespread simplification of pay, more powers for shareholders and employees to be elected to the remuneration committees of big companies.

After a consultation on reforming top pay in January 2012, Cable announced he would take action to give investors more say over pay and better information on which to take action. However, as yet, nothing has actually been enshrined in law.

Cable's reforms have been included in the Business and Enterprise Regulatory Reform Bill which is currently going through parliament. He has beefed up the current shareholder vote which is purely advisory and can be ignored by companies, to a binding vote. But rather than take place every year, this binding vote will be a say on remuneration policy put in place every three years. The advisory vote will continue to take place annually on the implementation of the pay policy.

The government is keen to place the sole responsibility for action on pay onto shareholders, citing this year's outbreak of investor activism as a positive sign that shareholder groups will become more engaged on the issue. That is why Cable's reforms are focused almost solely on giving more powers to shareholders.

However, this year's 'shareholder spring' needs to be seen in context. Even at the height of the outcry over pay, only six companies saw substantial protest votes, which is hardly a revolution. There have been only 15 votes against pay at big companies since the shareholder advisory vote was introduced in 2002.

Many shareholders also believe that this year's protests were unusual, were associated with a period of particularly poor returns for investors, and are unlikely to herald a new period of activism. In fact, the opposite could be the case as investors cut back on their governance teams due to cost pressures.

The BIS proposals also fail to take account of other stakeholders such as employees and their interest in company pay policy. The workforce has arguably more to lose from a board that is allocating resources incorrectly, since jobs are at stake in any cost-cutting exercise to pay for the bosses' packages. BIS has included guidance on what should be in the remuneration policy on which shareholders will vote every three years. This includes significant factors taken into account when setting pay such as employee wages, but only appears to require a glancing reference to this rather than a more meaningful consideration.

The government says the new binding vote will put downward pressure on pay as it means that if directors want to change the company's policy, they will need shareholder approval. However, it does not provide details of how this might happen.

Binding pay votes are in place in some other countries, notably the Netherlands. But they have failed to achieve much impact on rising pay at some of the large Dutch multinationals. This is because the pay policy on which investors get to vote, can often be quite broad-brush and very bland. Cable was initially pressing for a binding vote annually, but has bowed to business pressure to move this to a three-year say. This is disappointing as a vote on a longer term remuneration policy is unlikely to contain as much detail as an annual vote on what will be paid in the forthcoming year.

In order to be effective, the binding vote will have to cover a policy that is detailed and contains as much nitty gritty as possible. There is a concern that companies will seek to water this down further and that investors will be consulted about vague pay policy.

An additional concern is that this vote preserves much about the status quo and that Cable has given up the chance to take more radical action, for example, to ban cash bonuses altogether or dramatically simplify pay packages. He has also ducked the issue of electing an employee to the remuneration committee which could have provided some challenge to pay decisions.

Cable says he does not want to micro-manage companies, but to create a robust framework to ensure that active shareholder engagement is sustained over the longer term. However, the government's reluctance to take stronger action on pay, means that inequality is likely to continue its inexorable rise.

As the economy remains stuck in the doldrums, it is unlikely that workforce pay will increase much in the next few years. With executive pay on an ever steeper upwards trajectory, Britain will have returned to Victorian levels of inequality by 2025. The top one per cent of the income scale already takes home 15 per cent of national income compared to six per cent in 1979. And that is set to rise to 20 per cent in coming years, exacerbating the gap between those at the very top and everyone else in the workforce.

Shareholders have had an advisory vote on pay since 2002 and seldom exercised it in great numbers. The key to the success of Cable's reforms is that investors sustain their current level of action and they insist on voting on real policy, not just broad rhetoric.

The High Pay Centre has been sceptical that shareholders can hold companies to account on their own. There is a growing recognition that companies should have regard to the social interest as well as the wellbeing of their own employees and that pay decisions should reflect this.

Cable's reforms are a good first step, but there is much further to go to achieve meaningful change. His current set of reforms will do little to reverse the growth of inequality in Britain.

Deborah Hargreaves is Director of the High Pay Centre, successor to the High Pay Commission.

Low pay policy

Chris Goulden and Sue Christoforou

The last two and a half years have witnessed some positives on low pay, with the Coalition Government policy on low pay very much a continuation of the previous government strategy, largely focused on the National Minimum Wage (NMW) as a statutory pay floor. Building on what was already in place, the current government implemented NMW protection for all apprentices with a new hourly rate of £2.50 for those who were previously exempt, shortly after gaining office. At the same time, government reduced the age threshold for paying the adult rate of NMW from 22 to age 21, which will gave the 50,000 21-year-olds who were paid below the adult rate a pay increase of 20.3 per cent.

This was not bound to happen, given Conservative opposition in the 1990s, and represents a huge turn around. The Coalition Government continues to support the NMW and the Low Pay Commission, which regularly delivers relatively modest but welcome increases to around a million low paid workers, around 60 per cent of whom are women. However, the NNW may not always keep pace with inflation with, for example, the adult rate increasing by 1.8 per cent in October 2012 at a time when RPI stood at 2.9 per cent.

Government also offered some protection to low paid public sector workers when it exempted those earning £21,000 pa or less from its two year public sector pay freeze announced in the June 2010 Budget. And on the eve of the 2010 general election, the Prime Minister called the living wage 'an idea whose time has come', although has taken no action on the issue.

Less positively, the Government plans to abolish the Agricultural Wages Board (AWB), which sets detailed pay rates in the sector, as part of its bonfire of the quangos. The AWB sets a range of rates above the NMW, including overtime rates, for farm workers. Once the AWB is abolished, the only pay protection farm workers will have will be that provided by the NMW.

Further still, last autumn saw the Chancellor announce that once the two year pay freeze for public sector workers has passed, public sector pay increases will average at one per cent for the following two years. This policy will take effect over a period during which analysts expect inflation to significantly exceed one per cent, with the average of independent RPI forecasts ranging from 2.9 to 4.0 per cent for the period running to 2016.[9]

In addition, Government is exploring the option of regionalising public sector pay. In their report on the issue, the New Economics Foundation (NEF) identified the positive role of public sector wage bargaining on reducing socio-economic inequality[10], and concluded that any policy to localise pay will affect low income earners most.[11]

On the current figures then, those in the public sector will not receive pay increases which keep pace with inflation. Therefore, low paid public sector staff will, along with their higher paid colleagues, experience a real terms pay cut in the forthcoming years. If Government implements its policy to localise public sector pay, there will be further downward pressure on already low public sector salaries, particularly outside of London and the south east of England. It is probable then, that, over time, the pay levels of the lowest paid in the public sector will be eroded. For those in the private sector the welcome continuing government commitment to the NMW has to be viewed in the context of there being no guarantee that the NMW will keep pace with inflation. The lowest paid in the private sector are also at risk of experiencing real term pay cuts over time.

What this means in terms of impact upon living standards is an issue examined by the Joseph Rowntree Foundation (JRF), which publishes an annual on a 'Minimum Income Standard for the UK'. This shows what members of the public think people living in the UK need for an acceptable standard of living and how, since 2008, this has altered over time.

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9 p25 Jamei M (February 2012) **Forecasts for the UK economy: a comparison of independent forecasts** HMT

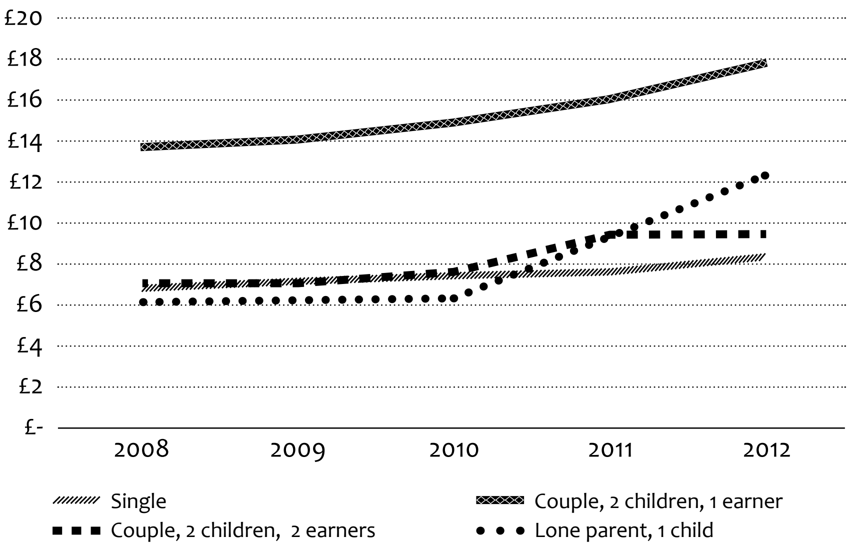
10 p7 Vardakoulias O et al (July 2012) **The economic impact of local and regional pay in the public sector** NEF for TUC

11 p26 Vardakoulias O et al (July 2012) **The economic impact of local and regional pay in the public sector** NEF for TUC

The research calculates the cost of minimum baskets of items and activities for different family types – from single adults to families with children and for pensioners. These budgets are then run through the JRF Minimum Income Calculator, which works out the gross wage needed, taking into account income tax, National Insurance and in-work welfare benefits (Child Benefit, Child Tax Credit, Housing Benefit and Council Tax Benefit).

Chart 1 shows how the wage required to meet the minimum standard of living has changed since 2008, in £ per hour, across four sample family types.

Chart 1: Hourly wage needed to meet the minimum income standard 2008-12



There are several things worth noting:

- All of the wages required for different family types have increased since 2008 but unevenly so – the rise for a single adult is small but is quite pronounced for the family of four with one worker.
- The wage required for a lone parent was flat up to 2010 but has virtually doubled since then (this is in part due to the high marginal effective tax rates, where lone parents in particular have to earn a huge amount more to increase their net incomes as benefits are withdrawn).

- For the two-earner couple with two children, the average wage needed per worker fell in 2012 compared with 2011 (the only fall on record).

The reasons for these changes are not straightforward because the headline hourly wage figures hide a lot of complexity. Some of the rise is caused by a general increase in prices, some by changes to taxes and benefits and some by changes in what people who took part in the research think makes up a minimum living standard. Changes in the price of goods and in societal norms are in turn caused by further complex drivers. But we can isolate some particular changes in services, attitudes and policy that have had an effect over the last few years.

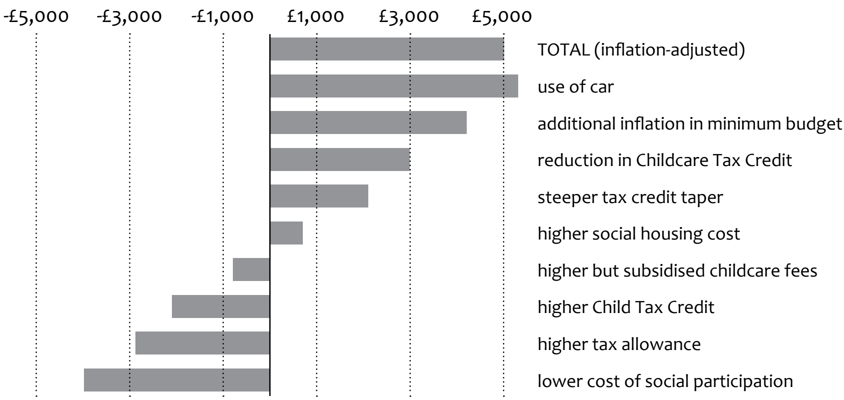
Childcare: has risen by nearly a third. In 2008, child minders outside London charged on average £2.70 an hour; now they charge £3.50. Full-time childcare is families' single biggest weekly outgoing at nearly £150 per week.

Transport: bus travel has doubled in price since the late 1990s which, combined with cuts to public transport, means families with children now deem a (second-hand) car as essential.

Tax Credits: cuts to Tax Credits – particularly Childcare Tax Credits – have increased earning requirements substantially, more than wiping out the benefit of higher income tax thresholds.

Chart 2 shows some of the 'swings and roundabouts' that led to an overall rise of £5,000 (inflation-adjusted) in the minimum budget for a family of four.

Chart 2: Components of change in the minimum income standard 2008-12



This highlights the importance of looking at incomes, costs and tax/benefit changes in the round. It isn't feasible to rely on a single policy (increases in Tax Credits or the income tax threshold for instance) to be effective against the problems of low income.

It is true to say that some – apprentices and those workers aged 21 – have benefited from Coalition Government policy on low pay. But, at the same time, the level of pay protection afforded to agricultural workers is to be reduced, the lowest paid in the public sector will experience multiple downward pressures on wages and the lowest paid in the private sector have no protection against real term cuts in pay over time. And that real risk of real terms pay erosion, threatens in the context of the increasing cost of maintaining an acceptable standard of living. Between now and the general election, for many of the lowest paid, income will effectively go down as living costs actually go up and reduced incomes will be stretched tighter and tighter.

Chris Goulden is Head of the Joseph Rowntree Foundation Poverty Team and
Sue Christoforou is Policy and Research Manager at One Society.

Pay inequality in the public sector

Duncan Exley

Levels of pay inequality in the public sector are nowhere near as stark as those in the private sector. As Will Hutton has pointed out 'the sharp increase in executive pay over the last decade, and the wider trend of growing income inequality, has been largely a private sector phenomenon'.[12] Nevertheless, it is important that the public sector, as a large employer and procurer, should be at the vanguard of ensuring that taxpayers' money is spent in a way that delivers good value and fairness.

Government has made a promising early start on this issue. During the 2010 general election campaign, David Cameron wrote that "The government plays an important role in helping to shape society, so if we win the election we will set up a fair pay review to investigate pay inequality in the public sector […] I am confident it will not only help tackle unfair pay policies, it will improve cohesion and morale in the public sector too."[13]

When elected, Mr Cameron kept this promise and commissioned Will Hutton to carry out a review of fair pay in the public sector. The review, which reported in March 2011, recommended a number of measures, including the publication of organisations' top to median pay multiples and other pay data, a fair pay code, and measures to prevent 'rewards for failure'. The review also said "it is important that the Fair Pay Code and as far as possible the other recommendations of this Review are extended into the public services industry."[14]

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[12] p10 Hutton W (March 2011) **Hutton Review of Fair Pay in the public sector: Final Report**

[13] David Cameron (8 April 2010) **'Labour are now the reactionaries, we the radicals' The Guardian**

[14] p12 Hutton W (March 2011) **Hutton Review of Fair Pay in the public sector: Final Report**

The Government has implemented some of the recommendations of the fair pay review, most systematically for local authorities, which are now required to report information including the salaries of senior employees, top to median pay ratios and policies relating to the pay of chief officers and the lowest-paid employees. Similar, but less comprehensive policies have been applied to other parts of the public sector, such as NHS organisations, which are now also required to report on pay ratios.

Government therefore deserves some credit for taking the positive step of requiring a large number of large employers to report on their levels of pay inequality and for the recognition of the value of moderate pay dispersion which this implies. Research from One Society suggests that over a third of local authorities are now monitoring (and some reducing or limiting) their pay ratios.

There is also evidence that government statements about fair pay in the public sector, together with reporting requirements and painfully reduced budgets, have prompted some organisations and/or their senior staff to reduce or moderate top-end pay inequality. Public sector pay freezes in recent years have included those at the top, and there have been moves by some public sector employers to reduce levels of top pay in absolute terms. For example, our research suggests that at least one in eight local authorities have taken steps to cut top pay in recent years.

The steps taken to reduce pay at the top end will come as cold comfort for low-paid public sector workers shivering through a pay freeze as costs of living rise. There have been fewer moves to address pay inequality at the low end of the pay spectrum than there have been to restrain pay at the top. Public sector employees paid less than £21,000 pa were promised by the Chancellor that they would be protected from the pay freeze (i.e the real terms pay cut) with a £250 pay supplement, but unions have complained that some public sector employers have not paid this to their employees.[15] Research by the New Policy Institute found that "High inflation coupled with a pay freeze that began in April 2010 slashed the real value of earnings in local government by 13 per cent between April 2009 and February 2012. A fall this big is unprecedented. Continuing high inflation means that earnings will fall further still."[16]

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15 'Enough is enough' on Local Government pay' (22 March 2012) Unison

16 Kenway P, Parekh A & Aldridge H (2012) **Living on the EDGE: Pay in Local Government** Unison

It is also likely that the move towards regional pay bargaining in the public sector, currently being considered by the government, would increase inequality, by lowering pay for already low-paid public sector employees, whilst also increasing pay inequality between genders and regions.

It is disappointing that Government's requirements to at least report on levels of pay inequality have not been applied to all sections of the public sector. For example, universities, which were identified in the Fair Pay Review as having higher pay ratios than local authorities, are regarded by the government as independent employers, which are responsible for developing their own pay polices and determining whether these are disclosed, despite receiving substantial taxpayer funding.[17]

But the most worrying gap in policy is that the recommendations of the fair pay review have not, as the review strongly urged, been extended into the Public Services Industry. This gap has serious implications, because the government's objectives to increase transparency about how taxpayers' money is used and promote 'fairness in the setting of local pay' are undermined if the substantial proportion of public sector services, which are delivered by private-sector companies are beyond taxpayer accountability.[18] This is a matter of substantial legitimate public interest, particularly given the hidden costs of private-sector delivery which are met by the taxpayer, most obviously the cost of supplementing low pay through the benefits system. The Public Services Industry typically has substantially higher levels of pay inequality than are found in the public sector. It aids neither fairness nor transparency about how taxpayers' money is used to allow public sector organisations to merely move their worst manifestations of pay inequality off the books.

Overall, Government has taken some steps – through a combination of policy and public pressure – which have had the effect of limiting and in some cases reducing the inequality at the top of the pay scale in the public sector. This is not the major contributor to pay inequality in the UK, but it does set an important precedent. The risk is that this will be more than offset if regional pay bargaining increases inequality by pushing down pay at the bottom of the income scale, and if taxpayer-funded pay inequality in the private sector is allowed to grow without control nor scrutiny.

Duncan Exley is Campaign Director at One Society.

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[17] Lords Hansard, 24 Apr 2012 : Column WA392

[18] Paras 9 & 11 **Openness and accountability in local pay: Guidance under section 40 of the Localism Act** DCLG

Benefit cuts, welfare reform and inequality

Ben Baumberg

On one level, the question of whether benefit cuts lead to higher income inequality is simple to answer. Poorer people are more likely to claim benefits, ergo cutting benefits has less effect on people with high incomes – and from the 2010 Emergency Budget to the 2012 Budget, there were £19bn of net cuts due by 2014-15.[19] Prof John Hills, the former chair of the National Equality Panel, calculates that £1000 of deficit reduction spread equally over all benefits and services will cut incomes of the poorest fifth by 12 per cent, but less than one per cent for the richest fifth.[20] In contrast, deficit reduction through equal rises across all taxes has roughly the same effect (a three and a half per cent reduction) on all.

However, the answer becomes more complex when we see the different ways that deficit reduction can be enacted. Both benefit cuts and tax rises can be particularly targeted on the poor or rich; the Coalition can point to greater means-testing of Child Benefit as a benefits cut that is not targeting poorer people. (This ignores the long-term political impacts of cutting universal benefits.[21]) David Cameron has therefore argued (back in March 2009) that "fiscal responsibility needs a social conscience, or it is not responsible at all."[22]

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19 Updated with Budget 2012 from Annexes to (Welsh Government 2012)

20 Presentation to the Social Policy Association conference, July 2012

21 Baumberg B (2012) 'Three ways to defend social security in Britain' **Journal of Poverty and Social Justice**

22 www.conservatives.com/News/Speeches/2009/03/David_Cameron_Fiscal_Responsibility_with_a_Social_Conscience.aspx

In this short piece I review the likely impact of the Coalition's benefits policy on income inequality – firstly looking at the 'next day' impact of the changes, and then (more speculatively) how this will influence inequality by changing people's behaviour. (To make this task manageable I do not look at the impact of social care or public service cuts.)

Who has lost what?

In the light of a bewildering array of different reforms, we can see the broader picture using modelling from the Institute of Fiscal Studies (IFS) – noting that this includes tax changes as well as benefit cuts. At first glance this seems to support Cameron's claim that 'we are all in this together'; the poorest tenth of households with children will lose slightly more 2011-2014 than slightly richer households, but this is still less than the richest tenth, and we are all reasonably similarly affected (a reduction in income of five to seven per cent[23]).

Yet we only come to this conclusion if we include changes that came into effect during the Coalition but due to policies already announced by Labour in April 2010.[24] This argument came to a head at the time of the 2010 Comprehensive Spending Review, where the Coalition added another £7bn of benefit cuts to £11bn of cuts in the emergency budget earlier in 2010.[25] The Coalition argued that they should take credit for Labour's (pro-poor) changes, but sceptics may feel it is slightly generous to credit governments with responsibility for every action in train that they do not disrupt.

This is still not the full picture. The coming years (2013-2018) will also see the introduction of Universal Credit (UC) – an amalgam of several means-tested benefits and tax credits intended to simplify an undoubtedly complex benefits system. Well over 1m people will see their entitlements reduced under UC

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23 Fig 3.2b Browne J (2012) **The Impact of Austerity Measures on Households with Children** Family & Parenting Institute

24 This includes a one per cent increase in both employer and employee National Insurance contributions (as well as an increase in the threshold at which employers start to pay NICs), real reductions in the threshold for paying higher rate tax, restricting tax relief on pension contributions for those earning over £130,000, the expiry of some 'one-off giveaways' (in benefits and the personal allowance), and some restrictions on local housing allowance – see www.ifs.org.uk/publications/5246

25 www.bbc.co.uk/blogs/thereporters/stephanieflanders/2010/10/fairness_and_the_recovery_two.html

(though there is transitional protection), but over 2m will receive more, at an estimated initial cost of £2bn.[26] And UC taken on its own – without the highly regressive changes announced by the Coalition in 2010 – is progressive; an early IFS estimate put the net gains as five per cent of income for the poorest tenth, with negligible effects on the richest four deciles.[27, 28]

So what happens if we put UC together with the earlier, regressive cuts, and separate these out from the policies previously announced by Labour? The latest picture available is only for households with children; it excludes the changes in the 2012 Budget and transitional protections, and is clearly not the final word on the matter.[29, 30] Still, Chart 1 on page 27 gives us the best overview of how the different sets of policies combine. The policies implemented in 2011 (including those announced by Labour) reduce inequality – but later changes are regressive, the poorest tenth of households with children lose over five per cent of their income, while the richest tenth lose two per cent.

Benefits and behavioural change

So far these numbers all refer to the 'next day' change in people's finances, but people's behaviour may also change. The Work and Pensions Secretary, Iain Duncan Smith hopes that people will move into work, and recently claimed that "Universal Credit will ensure the vast majority of children will be lifted out of poverty if at least one parent works 35 hours a week at the minimum wage."[31]

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26 Brewer M, Browne J & Wenchao J (2011) **Universal Credit: a preliminary analysis IFS Briefing Note 116** Institute of Fiscal Studies

27 This over-estimates the progressivity of Universal Credit as it predates some of the later cuts announced in Universal Credit, such as the reductions in disability premiums (Royston & Royston, 2012).

28 Brewer M, Browne J & Wenchao J (2011) **Universal Credit: a preliminary analysis IFS Briefing Note 116** Institute of Fiscal Studies

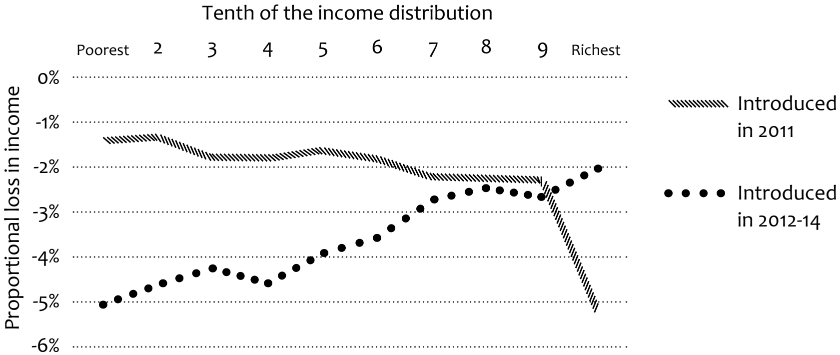
29 Primarily the reduction of the 50% top tax rate to 45%, an increase in the tax Personal Allowance, the abolition of age-related tax allowances and the tapered rather than cliff-edge removal of Child Benefit.

30 It takes no account of several decisions yet to be taken (e.g. over passported benefits), nor a possible increase in sanctioning that would have considerable impacts on inequality on the ground.

31 www.dwp.gov.uk/newsroom/ministers-speeches/2012/14-06-12a.shtml

Chart 1: Effect of all benefit/tax changes under the Coalition (including UC) on estimated net income in 2014-2015

(Adapted from Figure 3.2 in Browne, 2012[32]; figures kindly supplied by Robert Joyce)



Early estimates suggested that UC genuinely does increase the incentive to work, particularly at low earning levels, and despite reduced work incentives for second earners.[33]

There are, however, reasons to be less optimistic. Firstly, IFS modelling (strangely) suggests that employment impacts will have small impacts on poverty levels, partly because this will in turn raise the poverty line, and partly due to continuing in-work poverty.[34] Secondly, the simplification and improved incentives from UC are damaged by increasing complexity and means-testing in other parts of the system. Council Tax Benefit is being transferred to local authorities, while the proliferation of different means-tested fee/bursary schemes across different universities leads to small patches of disincentives to earn more.[35]

32 Browne J (2012) **The Impact of Austerity Measures on Households with Children** Family & Parenting Institute

33 Brewer M, Brown, J & Wenchao J (2011) **Universal Credit: a preliminary analysis IFS Briefing Note 116** Institute of Fiscal Studies

34 Brewer M, Browne J, & Joyce R (2011) **Child and Working-Age Poverty from 2010 to 2020 IFS Commentary C12** Institute of Fiscal Studies

35 www.guardian.co.uk/commentisfree/2012/may/02/students-poverty-trap-means-testing

It is therefore plausible that more people are encouraged to work, but the extent of both (i) employment changes and (ii) impacts on inequality are likely to be more limited than some suggest – and this is even without considering Housing Benefit changes which might force people to move further away from jobs, the possible rise of low-paid 'mini-jobs', and doubts that the IT systems underlying UC will work effectively.[36]

Another unknown impact is whether more eligible people will take up UC than the benefits that preceded it. The expectation is that they will be; indeed, the IFS assume that take-up will be at least the level of current Tax Credits, and tests the impact of even higher levels given that UC "is likely to be easier and less confusing to claim" and the less stigmatising nature of tax credits may also rub off on UC.[37] If non-take-up in UC is half the level that of IFS baseline assumption, a further 1m people will be taken out of poverty in 2020. However, tax credits may instead become tarred with the greater stigma associated with benefits, particularly given some of UC's more stringent requirements: in-work conditionality is being introduced, and people with savings above £16,000 are disbarred from the system.

In both cases, then, behavioural change may reduce inequality – but we will only know by how much after the policies have been introduced (and even then, disentangling such effects will be a challenge).

Conclusion

Two years into the Coalition, the already-announced benefit cuts and tax changes are likely to increase income inequality – as we would expect them to. The Coalition did follow through with progressive policies announced by Labour in 2010, but it takes a charitable observer to attribute full credit for this to the Coalition (although it should equally be noted that Labour has also said that they would have introduced unspecified cuts).

The remaining changes are broadly regressive: the introduction of Universal Credit in itself may reduce inequality (through its short-term impacts and improved work incentives), but this is largely outweighed by the scale of the benefit cuts announced in 2010. And this is not the end of the matter; not only is

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36 www.telegraph.co.uk/news/politics/conservative/9524683/Iain-Duncan-Smith-benefits-shake-up-proving-a-challenge-minister-warns.html

37 Brewer M, Browne J, & Joyce R (2011) **Child and Working-Age Poverty from 2010 to 2020 IFS Commentary C121** Institute of Fiscal Studies

the largest cut a change to benefit uprating that multiplies year-on-year, but there is the threat of a further £8bn of benefit cuts later in 2012.[38] As we continue our path through austerity, we will continue to face choices that have greater and lesser impacts on income inequality in Britain.

Ben Baumberg is Lecturer in Sociology and Social Policy, University of Kent, LSE CASE Associate and co-founder of the Inequalities blog.

[38] Sutherland H, Evans M, Hancock R, Hills J, & Zantomio F (2008) **The impact of benefit and tax uprating on incomes and poverty** Joseph Rowntree Foundation

Income tax and inequality

John Cullinane

Caesar divided all of Gaul into three parts, I cannot shoehorn our complex income tax system into less than seven.

The first is personal allowances – the amount of income an individual can earn before paying tax. Driving the basic allowance up to £10,000 pa is the flagship 'equalising' policy of the Coalition and at half time they are more than 50 per cent of the way there. Taking the bottom incomes out of tax is a simplifying move, reducing administration, and arguably there is no change that could be implemented through income tax reductions alone (an important caveat) that addresses human need as much, pound for pound. Certainly it beats the old ten per cent rate, the focus of so much sound and fury, on that score.

Unfortunately personal allowances are not that efficiently targeted at need, even so. The benefit of any increase is spread across almost the entire working population, and even if clawed back from higher rate taxpayers, by reducing the threshold at which that rate applies, the basic rate taxpayers still amount to a very large group (suggesting maybe this is more of an electorally than poverty driven policy?). The very neediest have less taxable income than the allowance so do not benefit from its increase, and those with only marginally higher incomes may only see a fraction of the benefit after taking into account the withdrawal of means-tested benefits on the corresponding increase in net income. And of course, the biggest most common driver of need is having children, which is (and is best) addressed through the benefit and tax credit systems. It is hard to avoid the conclusion that the priority given to the personal allowance is diverting resources from these. A defence of sorts is that favouring allowances helps 'make work pay' – but that is also achievable with tax credits.

Ironically the main political downside of this policy to date arose not from all this, but from the so-called 'granny tax' – paring down the means-tested age allowance alongside the recent increases in universal personal allowances. No-one actually lost out after taking these increases into account, and complexity and administration were reduced, but the benefit of the personal allowance increase was targeted away from some not particularly well off, and previously quite well protected pensioners. You can debate the merits rationally – but not in the tabloids.

Secondly, basic rate – the Coalition have left it at the 20 per cent they inherited. This rate now may prove to be sticky – financially hard to reduce, politically hard to increase. Ditto part three, the old, 1988 vintage, 40 per cent higher rate.

Till the credit crunch you could, materially speaking, stop there – and arguably a tax free allowance and two tax rates give you all the structural flexibility you need, without much complexity, to do as much as an income tax system can to arrive at any post-tax distribution of income desired by political taste. But fuelled by the crisis, public and political opinion have sought more ways of making the (guilty?) rich pay. The results have been confused as the politicians cannot decide whether they want to boast about these changes to get political credit from the less affluent majority, or hide them for fear of damaging competitiveness or excessively upsetting the target population itself. There is also a partially unwarranted but almost universally accepted assumption that people who have high earnings for maybe a limited period of their lives are 'rich' – even if there is some correlation, wealth is not the same as income and, in the UK at least is much more lightly taxed.

Our fourth part, availability of universal tax allowances and similar benefits to the better paid – since the crisis there has been a fear of allowing high earners to get excessive benefit from these. So personal allowances are being clawed back from those earning over £100,000 pa, resulting in an effective marginal tax rate of 60 per cent on the next £16,210 pa of income. This is a higher rate of tax than that faced by those with higher incomes, though a lower rate than that imposed on those on lower incomes who face withdrawal of credits or benefits as their income rises. There seems no reason in equity or anything else why people at a given income level should face higher marginal rates than those with even higher incomes. But on this, as on leaving the 20 per cent/40 per cent rates alone, there has been a curious continuity of policy between the last days of Labour and the Coalition. However the Coalition plan to take things further by clawing back child benefit from households where one member has income of £50,000 pa or more, which carries additional disadvantages of complexity and potentially to taxpayer confidentiality.

Number five is the flagship response to the credit crunch, Labour's 50 per cent tax rate for incomes over £150,000, initially retained by the Coalition but now to be reduced to 45 per cent. There is much debate over how much these rates raise, after avoidance and other taxpayer behavioural responses are considered, and on wider economic issues. It seems that the top rate is popular, and has at least a symbolic significance in these days of allegedly unavoidable austerity. The political reaction to the reduction to 45 per cent perhaps makes further reduction unlikely this side of an election.

Sixth, loss and other targeted reliefs – many people with very high incomes shelter these from tax by charitable donations, claiming loss reliefs from such activities as film partnerships, and other legitimate opportunities within the tax code. Labour reduced the generous limits for tax deductible pension contributions which it had previously introduced, and the Coalition confirmed and simplified the new limit at a straight £50,000 pa. Now the Coalition is imposing tight limits on the amount of income that can be sheltered at the higher end (and the proportion of income lower down) by a range of other reliefs. The inclusion of charitable donations within these limits was yet another cause of the 'omnishambles' verdict on the last Budget – and indeed, hitting all charities in this way as distinct from targeting bogus or more marginal charities specifically was a 'bridge too far'. Nevertheless, the limitation of loss and other reliefs does seem likely to collect more tax from the higher paid than will be lost through the five per cent reduction in the top rate to 45 per cent. Fans of simplification and flat tax proposals will ask, why not abolish many of these reliefs altogether?

Last but never least, part seven, the UK's curious 'non-dom' rules. Labour's ill-fated assault on them in 2008 ironically seems to have guaranteed them a further lease of life, albeit those staying beyond seven years have to pay a toll charge to continue on the 'remittance basis'. The Coalition have basically tweaked, increasing the maximum charge from £30,000 pa to £50,000 pa and simplifying some of Labour's more detailed but themselves ultimately minor changes. Totally abolishing these rules would be very challenging – why would anyone with significant investment income and no previous connection with the UK come here if we imposed full worldwide taxation from day one? – but allowing well advised and very wealthy people in this category who stay for generations to pass on non-dom status as a kind of fiscal heirloom seems oddly excessive.

So who has won, and who has lost? Income tax has come down, for all except the top decile of income distribution. But other taxes have gone up and benefits reduced. What do you count, and when do you take as the starting point? In 2010, some of Labour's changes were still just coming in, and how do you deal with the fact that the Coalition broadly reaffirmed them?

The top decile, on any count, have fared worst – but given some aspects of earlier points above (such as the 60 per cent marginal rate and limits to pension contributions), I suspect it is the bottom end of the top decile that have suffered most – a sort of 'squeezed higher upper middle' perhaps or SHUMs for short.

On most ways of looking at things, if you take the impact of the changes on people as a proportion of their incomes, people toward the bottom of the income scale have come off relatively worse than people in the middle. This probably reflects the fact that higher personal allowances are something of a false idol – though (looking beyond income tax) the introduction of Universal Credit might change that picture.

It's hard to summarise such a complex picture. Perhaps it's a 'curate's egg sandwich' – better in the middle than near the top or underneath.

John Cullinane is a past President of the Chartered Institute of Taxation. The views expressed are personal.

Tax enforcement: half-term report on the government's record

Gary Ashford and Kelly Sizer

The context for the Coalition Government's tax enforcement agenda comes from two things. First, the Government's commitment to eliminate the structural deficit, with a significant share of the work being done by the tax take. Second, a report published five months before the election by HM Revenue and Customs (HMRC) estimating the total 'tax gap' (that is, the difference between the tax actually collected and the tax the Revenue think they should be collecting, comprising tax evaded, avoided, disputed and otherwise not paid) at £40bn a year (since updated to £35bn). This highlighted the potential for squeezing more out of existing tax rates by toughening up on tax enforcement rather than the less politically palatable alternative of increasing these rates.

The framework for the Government's enforcement activity was set by the announcement in the 2010 Spending Review of an extra £900m for HMRC over the course of the Parliament to reduce tax fraud, evasion and avoidance, projected to raise an additional £7bn a year by 2014-15.

A number of initiatives have flowed from this announcement. One is a new 200-strong 'Affluent Team' within HMRC, supplementing the work of HMRC's existing High Net Worth Unit (HNWU). The new team's early focus is wealthy individuals who own land and property abroad, with commodity traders reportedly next on the list. HMRC anticipate the team will bring in additional revenues of £560m by 2014-15, while the HNWU saw its tax take increase by nearly a quarter to £200m in 2011-12.

The Government have promised a five-fold increase in the number of criminal prosecutions for serious tax offences. Additionally, HMRC have made some significant changes to the way they undertake serious civil tax investigations to give them greater teeth.

HMRC have also stepped up their programme of 'campaigns'. These are opportunities for tax evaders within a targeted group to come forward and pay the tax due with a limited penalty under a more lenient regime. Those who fail to come forward are targeted for further investigation and can ultimately face criminal charges. This approach was introduced by the previous government, but has been greatly expanded by the Coalition. Plumbers, electricians, professional tutors and coaches and online sellers have all been placed in HMRC's sights so far, as well as those who should have registered for VAT or completed self-assessment forms but failed to do so.

These campaigns have so far yielded nearly £630m but £595m of this has come from two schemes set up under Labour, targeting UK citizens holding undeclared assets offshore. The domestic campaigns have as yet raised only a small fraction of this amount.

Similar to 'campaigns', but more narrowly targeted, are HMRC taskforces, which were begun by the Coalition Government in May 2011. These target perceived high-risk industries in a particular part of the country. Early taskforces targeted restaurants and takeaways, landlords, property transactions and the construction and scrap metal trades. HMRC expects to collect over £50m as a result of the 12 taskforces launched in 2011-12. A further 30 taskforces will launch this year.

The Coalition has continued the work of the previous administration on information exchange with other jurisdictions, to make it harder for tax evaders (and criminals more widely) to hide their money in overseas accounts. A new 'Offshore Co-Ordination Unit' of 100 investigators has been launched. A deal has been signed with the Swiss government to allow Britons holding untaxed offshore assets in Switzerland to regularise those assets (that is, declare them and pay the tax owed), with a hefty withholding tax applying if they do not. HMRC believes this agreement will raise £4-7bn. Another regularisation opportunity, the Liechtenstein Disclosure Facility, was inherited from the previous government but has been extended.

Although UK citizens with offshore accounts will commonly (though by no means universally) be well-off, the range of HMRC's other campaigns and taskforces makes it hard to describe these elements of HMRC's work as targeting any particular socio-economic group. Rather they are aimed at those sections of the population who HMRC either judge as especially prone to evasion because of the nature of their work, or about whom HMRC have obtained data which can help identify lawbreakers (or preferably both).

While the Coalition's anti-evasion policies target a range of disparate groups, the Government's anti-avoidance agenda is more clearly aimed at the top end – wealthy individuals and larger companies; broadly those in a position to pay the high fees demanded by those who design and promote such schemes, famously condemned by the Chancellor as 'morally repugnant'. The steady flow of targeted anti-avoidance rules begun by the last government, to close down loopholes in tax law, one or two retrospectively, has continued apace. Probably the most significant measure so far passed by the Coalition was 2011's disguised remuneration legislation, which is expected to bring in over £700m a year, by preventing the avoidance of tax by paying someone via a third party. Most of those affected are expected to be higher or additional rate taxpayers.

A number of the Government's most substantial tax proposals have been designed to tackle behaviour which, while clearly legal, was widely felt to be unfair, by enabling high earning individuals to gain tax advantages not open to the average person. An increase in capital gains tax in 2010 was in part a response to indignation about hedge fund magnates paying lower tax rates than their cleaners. Changes to stamp duty land tax in this year's Budget came after media stories about Russian oligarchs and others 'enveloping' their high value residential properties in tax-efficient structures before a sale. While those affected by these measures are, of course, far wider than just magnates and oligarchs they are still primarily those at the higher end of the wealth and income scale.

A number of further anti-avoidance measures are likely to be implemented in 2013. A crackdown on the use of 'personal service companies' by those, especially but not only in the public sector, who are really disguised employees (and especially where they help run the organisation) will cover a wider range of people but again may have the greatest impact on those getting generous rewards. A proposal for a cap on the amount of tax relief that an individual can use will also target high earners though it could hit much less wealthy self-employed people too. Most significantly of all, a 'general anti-abuse rule' covering the main direct taxes and national insurance is slated to appear in next year's Finance Bill. Again this is targeted at aggressive tax planning, probably mainly by higher earners and businesses.

There is one area of enforcement activity where those targeted are disproportionately on below average incomes: the joint HMRC and DWP strategy to tackle fraud and error in the benefit and tax credits systems. Worryingly, the anti-fraud element of this project has dominated to the extent that vulnerable taxpayers, mostly on low to moderate incomes, making genuine mistakes have been caught in the anti-fraud net. About a sixth of the 'tax gap' is attributed by HMRC to taxpayer error and carelessness, but insufficient focus on research on where errors occur means that HMRC has failed to reduce rates of inadvertent taxpayer error by, for example, improving guidance and helpline advice.

A key driver for the Government around fraud and error is the need to reduce debt owed by taxpayers to the Government. The spotlight on tax debt increased enormously over the first half of the Government's term, due to widespread PAYE problems. Impacts of measures to enforce these debts have meant that those with the lowest incomes, such as pensioners, have often been hit hardest.

The Government's activities focus, understandably, on people who have not paid enough tax but there are also many people over paying tax (for example, not claiming the ten per cent savings rate or not claiming enough allowances). Some might say that HMRC should be focusing harder on making sure everyone pays the 'right tax' rather than just the most tax.

In conclusion, measured by the amount of activity, the Government are following through on their commitments to tackle tax avoidance and evasion, though it is still early days in terms of judging how successful many of the initiatives will ultimately prove and in some cases there are regrettable side-effects.

The overall income distribution effects of the Coalition's tax enforcement policies are difficult to assess as the incomes of those affected are not tracked. The intentions behind the programme are, of course, not redistributional, beyond ensuring that the tax burden is distributed as the law intended. HMRC's accounts show that total yield from their compliance activities in 2011-12 was a record £16.7 billion, up £2.8 billion on 2010-11. Changes to the top rate of income tax and the personal allowance, to the VAT rate, and to the extent and rates of tax credits and social security, are likely to have a rather greater impact on inequality.

Gary Ashford represents the Chartered Institute of Taxation on HMRC's Compliance Reform Forum, and is National Head of Tax Investigations and Dispute Resolution at RSM Tenon.

Kelly Sizer is a Technical Officer for the Low Incomes Tax Reform Group, an initiative of the Chartered Institute of Taxation.

As the Coalition Government reaches the halfway point of its planned five-year term, this pamphlet investigates whether or not it has acted to address the UK's high level of income inequality. Presenting eight expert opinions which explore themes from economy to welfare reform, low pay to executive pay, these essays find the government's record wanting.

This pamphlet argues that, as austerity belts tighten, proposed policy on income inequality is an issue on which the two government parties – and the opposition – will be judged in the second half of the term and the run-up to the next election. These essays send out a warning signal to all parties to pay close attention to electorate anger and set out effective policies that will have a real and lasting impact on the UK's current levels of vast income inequality.