UNIVERSITY OF BIRMINGHAM

SHARING OUR GOOD FORTUNE: UNDERSTANDING AND RESPONDING TO WEALTH INEQUALITY

Birmingham Policy Commission on the Distribution of Wealth

Executive Summary
2013

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Introduction

- In October 2012, the University of Birmingham launched the Policy Commission on the Distribution of Wealth. The Commission had three main aims: to review existing knowledge on wealth inequality; to question the extent to which wealth inequality is a problem; and to consider appropriate policy responses to wealth inequality. A broader aim of the Commission was to promote debate around the issue of wealth inequality.

- Competing ideas of wealth were at the heart of the work of this Commission when we set out. The balance of wealth, some argued, appeared to have shifted in a fundamental way, both in terms of a less even distribution of people who were able to share in prosperity and also in terms of a perceived decline of the quality or sustainability of the social, civic and natural environment, just as the reach of financial factors in decision-making was larger than ever.

- There are more forms of wealth/capital than those that are measured in traditional economic terms. One model presents four forms of capital – environmental capital, human capital (including knowledge, skills and health), physical capital and social/organisational capital (including legal, political, community, family, organisational and corporate). Our focus, however, was on personal wealth in the form of housing wealth, pension wealth and savings.

- The distribution of personal wealth is highly unequal with the overall share of the top tenth of the population in 2008/10 being more than 850 times the share of the bottom tenth. The distribution of wealth is much more unequal than the distribution of income. Whereas those at the (top) ninetieth percentile for income or earnings receive four times as much as those at the (bottom) tenth percentile, the ratio for wealth is 77 times.

- Wealth inequalities occur through a number of mechanisms. Some people have higher incomes than others and so have the opportunity to accumulate more wealth. Some people have similar amounts of income but choose to accumulate wealth rather than spend. Some people have wealthy parents and receive higher levels of inheritance/lifetime gifts. And some people have the wisdom or good luck to invest in housing and financial assets just before they increase substantially in value. We may wish to treat these different forms of wealth accumulation differently when designing policy instruments.

- There are many gaps in our knowledge about wealth inequality. Some of these

are empirical: for example we know very little about the 'super rich' as the Office for National Statistics no longer publishes data on this group using the estate multiplier method. And international comparative data is still rather limited. But there are also gaps in our theorising around wealth. What is wealth? How might we distinguish between groups with different levels of wealth? And why does wealth matter?

Does wealth inequality matter?

- Personal wealth has become increasingly important in recent years and will continue to be so as we experience the longest and deepest slump in a century, with social security benefits being cut. Unemployment remains high and average incomes are stagnating, if not falling, while prices rise. Precautionary savings are therefore particularly important as a financial cushion to meet unexpected expenses; yet many people lack even a small cushion of this kind.

- Wealth affects health. There is strong evidence that people with wealth have higher levels of physical and mental well-being than those without, after controlling for other factors. People with debts are likely to have lower levels of mental well-being.

- Wealth affects education and employment opportunities. There is a strong link between parental wealth and children's educational attainment, independent of any income effect. Young people with wealth also do better later in life (eg, in terms of employment).

- The impact of wealth inequality on society and politics more generally are difficult to pin down as accurately as the impact on individuals. But it has been argued that the wealthy become insulated from the lives of others, leading to social fractures. The ability of the wealthy to gain greater influence in the corridors of power is also a potential threat to democratic processes.

- Wealth and income inequalities are sometimes defended as being important in relation to economic growth, as the opportunity to accumulate high levels of income and wealth may provide incentives for entrepreneurship or high levels of effort and performance. But there is a lack of strong evidence for this.

- Wealth can be accumulated in different ways and these may relate to notions of fairness. Some of them (eg, through hard work and efforts to save from income) may be seen as more 'worthy' than others (eg, receiving a large inheritance).

- Wealth clearly matters. But there is still much more thinking and empirical research to be done on what it is that matters, and for whom. Our report concentrates on three groups: those with very little, no or negative wealth; those 'in the middle' with some assets; and those 'at the top'.

Those with very little, no or negative wealth

- Low levels of income are a concern as they reduce the ability to avoid debt and/or accumulate saving. Ways of raising incomes, for example through a living wage policy, greater worker representation in companies and/or training to raise skill levels need consideration.

- Levels of problem debt have been increasing in recent years and look set to increase still further with the introduction of welfare reforms which will both reduce the amount of benefit received by various groups and also change the ways in which people receive it. The impact of benefit reform needs careful scrutiny.

- Debt advice is crucial here but there has been a reduction in funding for some forms of debt advice (eg, through Law Centres). Continued, and indeed increasing, support for debt advice is essential to support people, particularly through these difficult economic times.

- Credit Unions are, potentially, an ideal vehicle for supporting people in terms of: money advice; affordable credit; transactional banking services; and savings schemes. Credit Unions are receiving government investment but they need much higher levels, not least because of the low level of interest they (are constrained to) charge.

- The financial services sector also needs to play its part here. Payday lending is currently under the scrutiny of the Competition Commission; and the Parliamentary Commission on Banking Standards has warned the banks to improve the services they provide to people on low incomes. The development of new technologies (mobile banking etc) could also be used to help people manage and save their money.

- People on low incomes receive much less support for saving than those on middle and high incomes. For example, those who are below the income tax thresholds do not benefit from tax-free savings products like Individual Savings Accounts (ISAs). And higher rate tax payers benefit more than standard rate tax payers. The Saving Gateway was a policy designed to provide incentives/rewards to those on low incomes who nevertheless managed to save by providing a match (50p for every pound saved up to a threshold). Further thought needs to be given to how such a scheme can be funded.

- Other ways of encouraging saving should also be developed including auto-enrolment into savings accounts when people start a new job and 'save the change' savings accounts linked to credit and debit cards. Means tests on savings for workers receiving Universal Credit should also be reviewed as a possible disincentive to save for such groups.

- There is currently no organisation which solely represents the interests of savers and this is something which could be established, for example, using the fees which savers pay to the financial services industry and which are currently used to fund trade bodies and regulators.

Those 'in the middle' with some assets

- Those 'in the middle' of the wealth distribution tend have some housing and pension wealth or the ability to accumulate some. But there are a number of difficulties facing these groups, not least getting a foot on the housing ladder and the ability of owner-occupiers to access some of their housing wealth to maintain or increase their living standards, particularly in retirement.

- Since the credit crunch it has become much more difficult for people to get a foot on the housing ladder. The government's 'Funding for Lending Scheme' does, more recently, appear to have helped here with mortgage lending increasing in 2012/2013 (though finance to small and medium-sized enterprises is still an issue). However, government support for lending props up the relatively high house prices which are also part of the problem. Prices, ideally, need to come down, not least by increasing supply. But those with housing wealth may not be enthusiastic about such policies.

- Younger people are increasingly relying on the 'Bank of Mum and Dad' but this reinforces inequalities based on whether or not young people have been born into wealthy families.

- One interesting idea to consider here is to separate – for all forms of accommodation – the cost of housing services from the returns on residential property investment, potentially removing some affordability barriers from owner occupation while enabling renters to benefit from house price appreciation (much as they benefit from savings linked to interest rates) if they wish. This would pave the way for housing policy to focus on providing people with secure and affordable homes of a high standard rather than promoting particular tenure types.

- For those who have accumulated housing wealth, often as the centrepiece of their wealth portfolio, ways of helping them access their equity safely (without adding to unsustainable debts) and cost-effectively (especially in older age) should also be explored. In particular, there is interest in equity release among consumers and the financial services industry but very few people take advantage of such mechanisms, possibly due to the costs and risks involved in such products (on both sides). Some ways to share the risks, perhaps involving government, might be helpful here.

- Pensions are vital to provide decent incomes in later life. In recent decades, governments have sought to encourage private pension provision rather than reliance on state pensions, but this strategy has not, so far, proved successful for a number of reasons and inequalities in private pension provision are significant.

- Auto enrolment appears to be working well in terms of low opt-out rates and this policy, alongside the single tier pension, has the potential to increase living standards in retirement as the population ages. But small businesses are likely to need more support as the policy is rolled out among them and savers will need to save more than the default rate in order to reach the kind of income levels in retirement that most people aspire to.

- The decline of Defined Benefit pension schemes in favour of Defined Contribution schemes is a particular concern here as savers have little idea of how much money they will receive in retirement. The development of Defined Ambition schemes, which share the risk between saver, employer (and potentially state) could help here but there have been few concrete advances here and employers and the pensions industry appear lukewarm about the idea.

Those 'at the top'

- This Commission is focusing on wealth but a key way in which wealth is accumulated is through saving from earned income. Over the last 30 years income inequality has grown dramatically and those at the very top of the income distribution have seen huge increases in their incomes which have subsequently fed through into wealth inequalities. Those on high incomes are also much more likely to receive an inheritance and/or lifetime gift and much more likely to receive one of high value.

- The 2013 Parliamentary Commission on Banking Standards has proposed *'a radical re-shaping of remuneration'* in the finance sector and, more broadly, the UK is giving shareholders a binding say on pay policy and the powers to consider the differentials between the lowest and median paid workers but greater transparency and power for shareholders is vital for ensuring fairer rewards for work.

- Ensuring fair rewards for work, not just 'at the top' but also for those on lower wages, will create a fairer distribution of 'original income' thus reducing any need for redistribution.

- There is often great disagreement about the overall level of income and wealth taxation but, whatever the level, there is then a question about the balance between these two types of taxation (and the balance between these and other forms of taxation). The Mirrlees Review called for a range of reforms of wealth taxation and these should be considered by the government.

- The UK does not currently have an annual wealth tax but council tax plays part of a role here. This tax is over-ripe for reform either whole-sale or through incremental change (eg, the introduction of new bands at the top). The scope for a mansion tax and a land tax also needs more public consideration.

- If earned wealth is generally considered more worthy than unearned wealth, then reform of inheritance tax should be seriously reviewed. Turning this into a capital receipts tax rather than an estate tax, and capturing lifetime gifts in a more comprehensive way would make this a fairer tax though the practical and political challenges should not be underestimated. Further study of Ireland's tax system in this regard could be very fruitful.

- Further reform of Capital Gains Tax (CGT) is called for, potentially including a return to its application at marginal rates of income to reflect the nature of capital gains as an alternative form of income that is available to those with assets to call on when needed.

- Alongside wealth taxation, the wealthy could be encouraged to make increased charitable donations. One way of achieving this could be through further tax incentives but this runs the risk of encouraging tax avoidance. A government review of ways to support philanthropy would be welcome.

Policy recommendations

For those on the lowest incomes

- Funding for debt advice and Credit Unions should be increased
- Regulation of payday lending should be enforced and toughened
- 'Saving Gateway', a matched-savings scheme devised to encourage/reward saving by people on low incomes, should be revived
- Automatic enrolment into a saving account for people starting a new job should be considered
- Means-testing on savings for workers receiving Universal Credit should be reviewed
- A not-for-profit organisation to represent the interests of savers should be established
- Low incomes of those on benefits and in work are at the root of many of the issues raised in this report. Ways of increasing these incomes need to be implemented

For those 'in the middle', with some assets

- Housing policy needs to be reviewed to ensure supply meets demand and avoids merely propping up house prices
- Innovation in housing finance should be explored to boost affordability and help renters benefit from housing investment returns, though with suitable regulation
- Measures to help people access the equity in their homes should be reviewed to find ways to share the risk between home-owners, lenders and, potentially, government
- Incentives to increase the amount saved in occupational pensions should be investigated for those on low and middle incomes
- Ways of putting into practice the principles of a 'Defined Ambition' pension, which shares the risk between saver, employer and the state, should be identified

For those 'at the top'

- Inheritance tax should be transformed into a capital receipts tax that also captures lifetime gifts
- Shareholders should be given a binding say on pay policy and the power to consider the differentials between the lowest and median paid workers
- Council Tax needs to be reformed – either by a wholesale review or the introduction of new bands at the top
- Fresh consideration should be given to proposals for a mansion tax and/or a land tax
- Parity across the tenure divide in the treatment of returns on savings/investment should be reviewed
- Further reform of Capital Gains Tax is needed to reflect the nature of capital gains as an alternative form of income
- Measures to encourage philanthropic giving (without encouraging tax avoidance) should be brought forward

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