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**Understanding the Links between Inequalities and
Poverty (LIP)**

Lin Yang

**The relationship between
poverty and inequality:
Resource constraint
mechanisms**

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The relationship between poverty and inequality: Resource constraint mechanisms

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Editorial note

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Abstract

This paper reviews the evidence of how the welfare state can shape the relationship between economic inequality and poverty through the channels of taxes, transfers and public good provision. In particular, we examine how the quantity, and to some extent the quality, of resources that can be raised to tackle poverty may be influenced or constrained by high levels of inequality.

Key words: Poverty, inequality, redistribution, perceptions, wealth

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Summary

This paper reviews the evidence of how the welfare state can shape the relationship between economic inequality and poverty through the channels of taxes, transfers and public good provision. In particular, we examine how the quantity, and to some extent the quality, of resources that can be raised to tackle poverty may be influenced or constrained by high levels of inequality.

Through raising taxes for the government to spend, the welfare state is by definition redistributive. However, social and political pressures can constrain the extent to which it reduces poverty and inequality. In particular, a variety of channels exist through which economic inequality may generate pressures on the resources available to tackle poverty. Some of these channels have a subjective basis, such as subconscious biases in how people perceive the economic distribution and their place in it, and conscious beliefs and attitudes towards the poor and towards redistribution. Redistributive policies rely on public support from the electorate, and if public support is low then this can constrain the effective amount of resources available for redistribution and social expenditure available to tackle poverty. Some of these attitudinal channels also stem from objective circumstances, such as social and geographical segregation.

Other channels work through observed decisions and behaviour, in particular those of governments and wealthy individuals. The level of inequality is reflected in the power of those at the top of the economic distribution to influence these government decisions in ways that constrain its capacity to redistribute. This could be directly through funding particular political agendas, and indirectly through withholding government revenue through tax evasion. In this way, the political economy effects of high levels of inequality in society can influence the resource constraints on government decisions regarding welfare targeting, decentralisation, budget cuts, and representation of voter interests. These in turn can all impact on the effectiveness of poverty alleviation.

While the net effect of these channels on efforts to tackle poverty are not clear-cut, it seems on balance that high inequality tips many of these channels in a direction that constrains the redistributive powers of governments and their poverty alleviation efforts.

1 Introduction

This paper forms part of a series of papers reviewing the evidence of mechanisms that can shape the relationship between economic inequality and poverty. In this paper we focus on the welfare state through the channels of taxes, transfers and public good provision, and in particular how the quantity, and to some extent the quality, of resources that can be raised to tackle poverty may be influenced or constrained by high levels of inequality.

The functions of a country's welfare state include providing social protection, health, education and training, housing, social services, pensions, and policies that affect earnings capacity and the structure of the labour market (Esping-Andersen and Myles, 2009). Through raising taxes for the government to spend, the welfare state is by definition redistributive. However, not all of this redistributive activity reduces poverty and inequality. Following Barr (2001), the first function of the welfare state is to act as a collective "piggy bank", helping individuals insure against various risks over their lifetimes through alternate periods of want and plenty (Rowntree, 1902). Through this function, wealthier households can receive a similar amount of support over their lifetimes as the less well-off, benefitting to a greater extent from, for example, higher education spending, tax breaks on savings and the NHS over longer life expectancies of the wealthy (Hills, 2014). The second function of the welfare state is to reduce welfare disparities over the economic distribution and reduce poverty by supporting low-income families through, for example, income support, tax credits and unemployment benefits. It is the progressivity of the tax and transfer system that largely shapes the degree of this vertical redistribution to the least well-off.

While a progressive tax system attempts to reduce poverty by limiting the tax incidence of people who are less able to pay, this does not guarantee that the poor are always better off than in a less progressive system (Higgins and Lustig, 2016). For example, a more progressive system generates stronger incentives among the rich to evade income and wealth taxes, reducing the ability of the government to raise tax revenue for welfare state spending (Slemrod and Yitzhaki, 2002). In an unequal society with high concentrations of wealth at the top, this incentive is even greater among the wealthiest since these individuals stand to gain disproportionately from reducing their tax liabilities.

This, and other types of incentives, behaviours and perceptions can serve to constrain the capacity of governments to redistribute in a way that

effectively tackles poverty. This paper provides a discussion of how high levels of inequality can lead to such constraints, what these constraints might be and how they provide mechanisms through which income inequality may influence levels of poverty in a society. In section 2 we look at how misperceptions, and specifically underestimations, of inequality can constrain the level of demand for redistribution and consequently the resources available to help the less well-off. Section 3 discusses how inequality tends to be accompanied by different types of segregation, which can in turn generate hostile attitudes towards the poor and towards redistribution. Section 4 investigates the decentralisation of tax-setting powers to local government, and how this can limit the ability of poorer areas to raise resources to tackle poverty. Finally, in section 5 we look at how the effectiveness of welfare state policies aimed at reducing poverty and increasing social mobility are dependent on the political power and economic behaviours of the wealthy.

2 Underestimating inequality

Studies of public support and preferences for redistributive policies have traditionally focused on how such preferences depend on the actual level of inequality or social mobility in society. More recently, however, the literature has emphasised the role of perceived inequality, rather than actual inequality, on shaping attitudes towards and demand for redistribution. This section examines the importance of this distinction for generating the resources necessary to tackle poverty in an unequal society.

Redistributive policies rely on public support from the electorate, and if public support is low then this can constrain the effective amount of resources available for redistribution and social expenditure available to tackle poverty. Several theoretical papers have explored this dependence of redistributive parameters on social beliefs linked to attitudes towards redistribution (Alesina and Angeletos, 2005; Bénabou and Tirole, 2006; Alesina et al., 2012). For example, the dependence of marginal tax rates on beliefs about the importance of non-meritocratic factors in determining individual wages (Kuhn, 2016). Empirically, among OECD countries, preferences for more redistribution are significantly positively correlated with higher levels of observed public social expenditure, and significantly negatively correlated with income inequality after taxes and transfers (Kuhn, 2012). In the UK, social security and related policies have largely been in line with public attitudes (Hills, 2002). Influencing preferences and mobilising support for redistribution therefore appear essential in generating the resources needed to tackle poverty through the tax and transfer system. However, in order to use this relationship to understand the potential mechanism linking the level of inequality with poverty, we

must ask whether, and how, the prevailing level of inequality itself affects these public preferences for redistribution.

The standard median voter theorem in relation to democracies would predict that income inequality and redistribution should be positively related (Romer, 1975; Meltzer and Richard, 1981). If inequality is high such that the pivotal median voter is below the mean level of income in society, then since this voter would benefit from a more progressive tax and transfer system, the pivotal vote would be in favour of greater redistribution. Through this mechanism, more resources would also be expected to be available for tackling poverty. Empirical evidence supporting this theorem has been mixed, however. Using cross-sectional data for 56 countries in the post-war period, Perotti (1996) finds that inequality (measured by the combined share of the third and fourth quintiles, or the "middle class share") was not significantly correlated to redistribution proxied by the maximum marginal tax rate. However, in democracies, inequality was positively correlated to greater social transfers as measured by social security and welfare expenditure. Milanovic (2000) finds using a longitudinal sample of 24 countries, that more unequal countries (measured by the Gini coefficient of market incomes) do redistribute more to the poor as measured by the income share gain of the lower half ("the poor") and lowest quintile ("the very poor").

An empirical example to the contrary is that income inequality is higher in the US than in continental Western European countries, yet redistributive policies and legislation are much more extensive in Europe. Niehues (2014) points to the importance of beliefs and perceptions of inequality, rather than the actual level of inequality, as a way of understanding this empirical deviation from the median voter theorem's predicted outcome. The author shows that a large proportion of Europeans, especially in former socialist countries, perceive inequality to be higher than actual inequality in their countries, justifying the need for redistributive policies. On the other hand, those in the US substantially underestimate the extent of inequality and are more likely to believe they live in a middle-class society (a distribution with most people in the middle, few at the bottom and a long tail at the top) than many European countries, even though income inequality in the US is significantly higher. In this study, perceived inequality explains 56% of the cross-country variation in redistributive preferences.

Further studies show that perceptions of inequality do not in general tend to align with the true level of inequality. In the UK, Hills (2005) and Pahl et al. (2007) have shown that the extent of wage inequality at the top is much greater than perceived. In the US, people's perceptions also tend

to be biased downwards, so that there is a systematic underestimation of the true level of inequality (Norton and Ariely, 2011). As mentioned, Niehues (2014) shows that opposite is true in continental Europe, with perceptions tending to be biased towards overestimating rather than underestimating inequality. According to an Indonesian survey by the World Bank (Indrakesuma et al., 2015), on average Indonesians believed the country's richest 20 percent of people earned 38 percent of all income, roughly equal to what they believed the bottom 60 percent earned. This equates to a Gini coefficient of around 0.3 – lower than most other countries in the world. The actual Indonesian Gini coefficient is significantly higher at 0.4, which is similar to the United States and higher than most countries. The study also showed that on average, Indonesians would have preferred the level of inequality to be even lower than the perceived level. Preferences for lower levels of inequality were associated with support for increasing social protection, and this provides additional support to the small number of other studies that currently exist on the effect of correcting people's misperceptions of inequality.

This recent stream of research shows that what matters in shaping people's attitudes and levels of support for redistribution is not necessarily the prevailing level of inequality in a society, but *perceptions* of the level of inequality. This is important, as the decisions of policy-makers are strongly influenced by public opinion and the level of public support for certain policy options. If people are unaware of how unequal their society is, then it is likely that public support for redistributive policies is reduced as people perceive policy-makers to be addressing a smaller issue than really exists. In the extreme, if inequality rises but people think that inequality has decreased, then people may in fact seek less redistribution than before (Windsteiger, 2017). With less redistribution, fewer poor households would receive the support they need to maintain an acceptable standard of living. The weight of the evidence shows that correcting people's underestimations of inequality leads to greater support for redistribution and greater support for taxing the wealth of the richest in society (Cruces et al., 2013; Kuziemko et al., 2015). Individuals who perceive inequality to be high are more likely to support redistributive policies and progressive taxation (Kuhn, 2016).

The bias in perceived inequality may in part be generated through two other biases (Engelhardt and Wagener, 2014). The first is that people tend to think they are closer to the middle of the income distribution than they really are (Runciman, 1966). The second is that people tend to overestimate the degree of upward social mobility in society (Bjørnskov et al., 2013). On the first point, evidence suggests that there is only a weak correlation between people's actual place in the income distribution and where they perceived themselves to be, since individuals tend to place

themselves subjectively in the middle of the income distribution despite coming from the full range of socioeconomic backgrounds (Evans and Kelley, 2004; Bamfield and Horton, 2009; Indrakesuma et al., 2015). On the second point, the Prospect of Upward Mobility (POUM) hypothesis predicts that people with current incomes below average may not support redistribution if social mobility is high because they believe that they or their children will move up the distribution in the future, when progressive taxation will hurt them (Piketty, 1995; Bénabou and Ok, 2001). With overoptimistic perceptions of upward social mobility, individuals may fail to support redistributive policies that would be beneficial to them. As an example, low support for inheritance tax may stem from overestimations of the fortunes that individuals may leave to their children, whereas in reality few people are wealthy enough to pay inheritance tax but many would benefit from it (Maxwell, 2004).

If people in low-income households perceive themselves to better off than they really are, and similarly if the rich do not perceive themselves to be as well off, then neither will view inequality to be as urgent an issue as the actual situation might warrant. A study of attitudes in the UK from 1983-2011 for the Joseph Rowntree Foundation found that "Attitudes to welfare spending bear little relation to economic circumstances, even among those groups most likely to be affected by them and to require welfare provision as a result" (Clery et al., 2013). If inequality increases but this has no effect on people's perceptions of their own personal positions, then the poor do not realise the scale and direction of changing disparity and are therefore less motivated to push for greater redistribution to address it. Likewise, the rich and political elite fail to notice this increase in inequality – or the extent of it – meaning their support for redistributive policies doesn't increase accordingly, and neither are they held to account by those lower down the income distribution who are in poverty. Effectively communicating the true state of inequality to members of the public as well as policy-makers, and correcting misconceived underestimates of inequality would act as an important counteracting force to this mechanism linking inequality to constraints on support for redistribution.

3 Segregation and beliefs about the causes of poverty and inequality

A further underlying mechanism for the biases discussed in the previous section may be that greater inequality leads to greater social segregation and polarisation, so that people with similar circumstances tend to associate only with one another. In the UK, growing income inequality in the latter part of the twentieth century was accompanied by increasing social and geographical segregation (Dorling and Rees, 2003; Dorling et al., 2007). Figures 1 and 2 are taken from Dorling et al. (2007). Figure 1 shows graphically how poverty clustering, especially in urban areas, has increased from 1970 to 2000, as measured by the Breadline Britain (Gordon et al., 2000) deprivation index. Meanwhile Figure 2 shows that wealthy households, as measured by households with sufficient total wealth to be liable to Inheritance Tax, have tended to concentrate in already wealthy areas on the outskirts of major cities. The evidence therefore points towards increasing polarisation, where rich and poor now live further apart. Bailey et al. (2013) find that in England, this rising spatial segregation appears to have eroded support for redistribution, which may in turn further increase levels of inequality in a feedback loop.

Figure 1. Geographical patterns of poverty 1970-2000, as measured by the Breadline Britain (Gordon et al., 2000) deprivation index

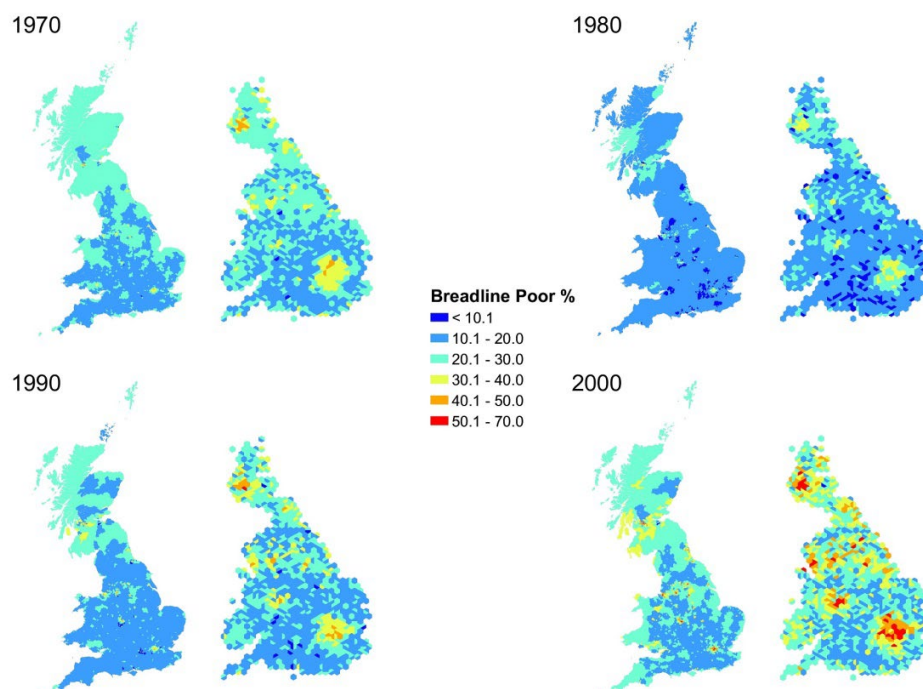
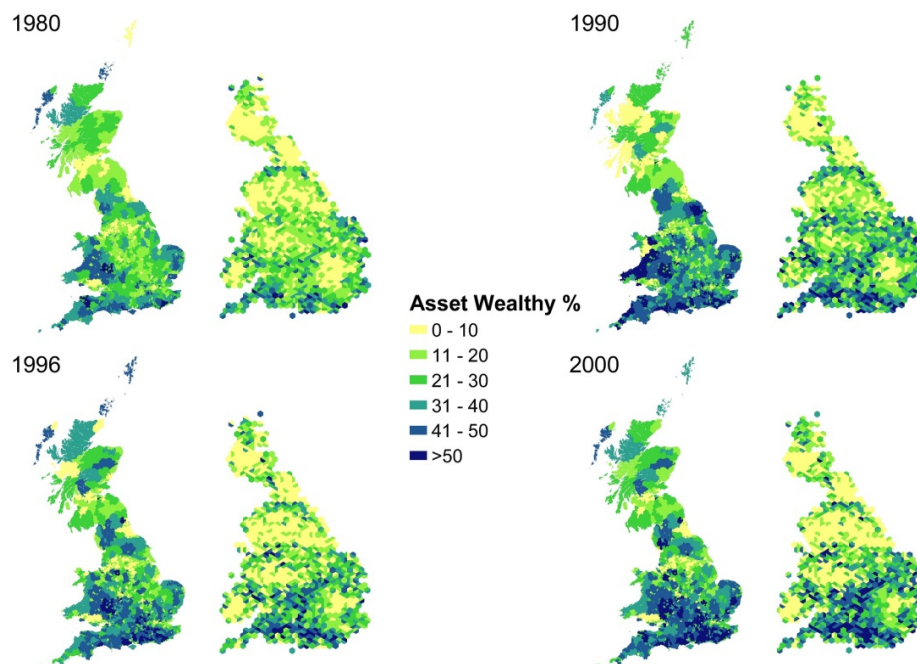


Figure 2. Geographical patterns of asset-wealthy households 1980-2000, as measured by households with sufficient total wealth to be liable to Inheritance Tax



Evidence from the US and many other developed countries has also shown that changes in social segregation are strongly positively associated with changes in inequality (OECD, 1998; Watson, 2009; Reardon and Bischoff, 2011). As Bailey et al. (2013) note, the two are linked through the operation of the housing market – the rise in geographical segregation reflects the increased ability of higher income groups to outbid lower income groups to compete for more 'desirable' neighbourhoods as the income differential between these groups increases with increasing inequality (Cheshire et al., 2003).

The advent of social media has seen this segregation take on not only physical form in terms of neighbourhood and occupational segregation by income and social class, for example, but increasingly segregation in terms of who we interact with online (Bakshy et al., 2015). This has been particularly pronounced for segregation by political engagement, with social media users becoming digitally siloed into interactions with others who share the same political views (Garrett, 2009; Krasodonski-Jones, 2016). Misjudgements within large portions of society of the Brexit outcome in the UK and Trump's presidential election in the US have become often-cited examples of this social media "echo chamber effect" (Quattrociocchi et al., 2016).

Importantly for mobilising support for redistribution and tackling poverty, increased polarisation of political attitudes through high inequality leads to misunderstanding and erosion of awareness of those who live in very different circumstances from one another (Bailey et al., 2013). If growing segregation between rich and poor erodes the empathy and reciprocity that underpins redistribution through tax and transfer systems, then social segregation may act as a feedback mechanism, undermining support for redistributive policies and further reinforcing high levels of inequality. Conversely, such a feedback mechanism means that societies with smaller pre-tax income differences may be characterised by a less segregated structure, making it more likely that larger transfers will be supported by voters valuing redistribution for its insurance value and regard for the welfare of others (Bowles and Gintis, 2000; Bjorvatn and Cappelen, 2003).

In addition to reducing support for redistribution by biasing perceptions of the level of inequality, social segregation can generate a more direct animosity effect that influences people's attitudes to redistribution and poverty (Hills, 2014). People become more susceptible to portrayals in the popular media and by politicians of a population "divided into those who benefit from the welfare state and those who pay into it, despite the evidence painting a rather different picture" (Hills, 2017). Even among the poor, Luttmer (2001) shows that people are less likely to support redistribution if they live around poor people of a different race. This might suggest an additional dimension of resource constraints generated through not only economic and social segregation but also racial segregation.

Evidence shows that the view that welfare generosity encourages dependence became more prevalent under New Labour (Clery et al., 2013), which positioned itself as less pro-welfare during the late-1990s. It has been argued that the attitudes of Labour supporters in particular followed in response to Labour's stance to this and other issues (Curtice, 2010). Georgiadis and Manning (2012) argue that the main change in attitudes that can account for the falling demand for redistribution in the UK from 1983 to 2004 is a greater belief in the importance of incentives as proxied by attitudes about the disincentives to work associated with the welfare state. This divisive sense of "them" and "us" allows the political ruling class to be more willing to make spending cuts that are detrimental to "them" – the income-poor and politically vulnerable portion of society (Hills, 2014).

4 Fiscal decentralisation and local governance

In addition to generating redistributive constraints through geographical and social segregation, inequality may generate additional impacts on poverty reduction efforts when control over tax-setting and expenditure decisions are decentralised. In theory, more freedom to make spending decisions locally may help to reduce poverty by bringing decisions regarding public expenditures "closer to the people" (Oates, 1999, p. 1123), and therefore result in a more efficient allocation of resources to the needy. There is evidence that shares of health and education services in total government expenditures increase with fiscal decentralisation (Arze del Granado et al., 2005), which might be expected to have a positive effect on the welfare of the poor (Martinez-Vazquez, 2001). However, in terms of poverty reduction there is evidence suggesting that higher fiscal decentralisation, measured as the share of subnational expenditures over total government expenditures, is not in general associated with lower poverty, and is even associated with higher poverty (Sepulveda and Martinez-Vazquez, 2011). One of the reasons for this may be due to the movement of individuals between areas when inequality and geographical disparities in affluence are high. This mechanism will now be discussed in greater detail.

According to the classic "Decentralisation Theorem" proposed by Oates (1972), fiscal decentralisation improves social welfare. The argument is that local decisions over taxation and public expenditures allow for a better fit of the preferences of constituents, and therefore for efficiency gains to society. This literature argues that the larger the share of local expenditures that is financed through local revenue collections, the more accountable local authorities will become to their constituents to make responsible and efficient tax and spending decisions. However, in the presence of high inequality within an area, attempts to redistribute locally by increasing tax rates for the rich may eventually lead to these individuals migrating outwards to areas with lower taxes while less well-off individuals from neighbouring jurisdictions migrate inwards. As a result, the costs of redistributive programmes may increase while the local tax base, making poverty reduction through such redistributive policies unsustainable.

To avoid this, local governments may engage in tax competition, leading to a 'race to the bottom' as local governments reduce their tax rates to avoid further erosion of the tax base (Wildasin, 2003; Wilson, 1999). If more affluent areas cut local taxes in this way to retain or attract wealthy households to the area, then this could displace less well-off households and produce a negative cycle of further geographical segregation and concentrations of poverty and wealth. Additionally, when inequality is high,

decentralised decision-making over business and council tax rates may further entrench poverty because more deprived areas typically have less ability to attract wealthy tax-payers and businesses to raise local tax revenue. For example, local income taxes are used in US cities such as New York and Philadelphia. Yet for deprived cities, such as Detroit, economic stagnation and high levels of deprivation mean that tax revenues decline further and local government faces financial crisis (Davey and Walsh, 2013).

By international standards, the UK has a highly centralised system of taxation and expenditure, with the exception of business and council tax. As of 2011 the proportion of tax set at a local or regional level was less than 2.5 percent of GDP, compared with 15.9 percent in Sweden, 15.3 percent in Canada, 10.9 percent in Germany, and 5.8 percent in France (Parliament. House of Commons, 2014). Nevertheless, the distribution of income, poverty and wealth has consistently shown an unequal geographical distribution across the UK (refer back to Figure 1 (Dorling et al., 2007)). While local councils currently keep up to half of local business rates, full devolution planned for the year 2020 means that councils will receive full control of this revenue stream. With this move towards greater fiscal decentralisation, the risk of local authorities engaging in competitive cutting of taxes to attract companies increases. As the chancellor George Osborne has said: "Any local area will be able to cut business rates as much as they like to win new jobs and generate wealth. It's up to them to judge whether they can afford it." (Wintour, 2015). If the implication of this for the unequal economic landscape of the UK is that those areas least able to afford it are least able to compete under decentralised setting of business rates, then this will have negative impacts on poverty and geographical segregation.

It has also been argued that decentralisation may serve as a vehicle for making cuts to public service provision, since devolved spending cuts tend to happen faster than ones administered centrally (Neville, 2015). In the period of ongoing austerity in the UK following the 2008 recession, the greatest percentage cuts in real levels of spending resources have been to the lowest-income district councils as measured by the government's 2010 Index of Multiple Deprivation (Hastings et al., 2015). On the opposite end of the spectrum, the smallest cuts have been to the most affluent district councils. Analysing 50 countries in the years 2007, 2009 and 2011, Aizenman and Jinjark (2012) provide evidence that countries with higher levels of economic inequality tend to adjust to economic crises by decreasing public expenditure to minimise their adjustment burden rather than by raising taxes. This shifts cuts onto an already vulnerable portion of society (MacLeavy, 2011).

To sum up, there exist channels through which decentralisation may interact with spatial inequalities to help or hinder poverty reduction. While greater freedom over local spending decisions means that resources may be allocated more efficiently to where it is most needed in a community, this is countered by the risk that inequalities manifested in geographical disparities create tax competition. If lower tax rates are used to attract higher income households and businesses to an area while the most deprived areas are unable to afford such behaviour, then these areas are placed at a further disadvantage. For decentralisation mechanisms to work in favour of poverty reduction, decision-makers in local government need to be made responsive to the demands of their constituents. As we will explore in the next section, however, the political influence of wealthier constituents is often greater than that of the poor, and so the demands of the economically vulnerable may not ultimately be met.

5 Interdependence of the state and the wealthy

The discussion in Sections 2 and 3 focused on the role of people's attitudes, beliefs and perceptions in shaping resource constraints on redistribution – these stem from subjective views of inequality and poverty that may or may not align with reality. Equally as important for considering such resource constraints are people's actual observed behaviour in response to the design of the tax and transfer system itself. Examples include the rich using financial power to buy better education, shape political or public views through buying media outlets and think tanks (Reich, 2012), or responding to more progressive taxation by shifting income flows and assets to less taxable vehicles (Allingham and Sandmo, 1972; Cowell and P. F. Gordon, 1988; Alstadsaeter et al., 2017). While those at the top of the income distribution are particularly well-placed to respond to tax changes to circumvent any personal loss, poverty alleviation through the tax and transfer system must work within the constraints of the available resources – which depends on tax revenue and by extension the behaviour of the wealthy. This section focuses on the interaction between the state and the wealthy at different levels of inequality, and how the behaviour of one depends on the other in ways that shape the amount of resources available and how effectively they can be used to address poverty.

It may be possible that higher market inequality can mean that the size of the redistributive budget from income tax is larger, since larger tax revenues can in principle be extracted from the higher concentrations of income and wealth at the top of the distribution. This could point to an argument that greater inequality could in fact be beneficial for poverty reduction if transfers are funded progressively. But equally, taxes can be designed to raise just as much revenue from a more equal distribution of market incomes. Furthermore, this depends on whether the incentives and disincentives provided by the tax and transfer system affect people's behaviour further up the income distribution, and whether these people mobilise their political influence to shape policies that are attractive to them to the detriment of the less well-off.

5.1 Inequality, targeting and poverty reduction

For a given degree of inequality, efforts to change the level of income poverty by changing the degree of redistribution through taxes and transfers can be achieved in different ways, requiring differing amounts of resources. A key debate over how resources can best be used for poverty alleviation and redistribution concerns universal versus targeted welfare systems (Titmuss, 1968). Targeted systems select beneficiaries for cash

transfers or in-kind services based on economic status or resources, such as labour market status or income level. On the other hand, universalistic cash transfers or services are available to all or to large categories of citizens or residents, such as children or pensioners, without the requirement of economic means-testing. In practice, however, the design of some categories can result in these universal transfers being concentrated in low income households.

The effectiveness of universalistic compared to targeted redistribution in tackling poverty has been a strongly contested issue in the literature (Marx et al., 2013). Poverty reduction policies could in theory be very narrowly targeted – for instance, raising the incomes of those below the poverty line, but doing so in a way that has little or no impact on inequalities amongst those above it. In a mechanical sense, this targeted approach would be the most efficient way of tackling poverty in an unequal society through redistribution in the short term. However, a targeted system is more likely to cultivate the politically unattractive perception that the non-poor contributors to such a system are excluded from its benefits, notwithstanding the fact that these groups are not mutually exclusive at different points in time as poverty risk changes over the lifetime. A more universalistic cash transfer system with a wider set of beneficiaries may attract more support and a more generous tax base, emphasising the role of redistribution as insurance required by everyone at different stages of life against periods of income vulnerability (Esping-Anderson and Myles, 2009; Kenworthy, 2011). Particularly in highly unequal societies where public attitudes may be divided into "them" and "us" (Hills, 2014), this emphasis on the "piggy bank" rather than the "Robin Hood" role of redistribution implies that a universal cash transfer system may attract greater electoral support and therefore generosity. However, the more diffused spread of transfer payments means that the degree of poverty alleviation is constrained. A trade-off may therefore exist between the proportion of funding going to the worst-off and the overall level of funding available.

Gelbach and Pritchett (1995) use a theoretical model to investigate this trade-off, asking the question "is more for the poor less for the poor?". They find that when the budget is taken as fixed, full use of targeted transfers is optimal for poverty alleviation and overall social welfare and equality. However, when the budget is determined through majority voting with the policymaker choosing the share of the budget to be spent on targeted and non-targeted transfers, the optimal degree of targeting is zero. The seminal empirical study by Korpi and Palme (1998) supports the theory that such a trade-off in budget size exists in a "paradox of targeting". They find that universalistic approaches to redistribution are associated with

greater levels of public spending and higher degrees of redistribution and poverty reduction compared to targeted approaches. Later studies have challenged Korpi and Palme's finding, however (Kenworthy, 2011; Marx et al., 2013; Van Lancker et al., 2015), and yet further studies find support for Korpi and Palme's original conclusion (McKnight, 2015). Despite a considerable amount of up-to-date research around targeted and universalistic approaches, the evidence does not clearly point to the advantages of one approach outweighing the other.

In targeted approaches, an additional issue arises regarding the efficient use of resources in tackling poverty. In more unequal and segregated societies, the social stigma attached to claiming means-tested cash transfers may be amplified in comparison to more equal societies. This means that the poor face an additional barrier of indignity, over and above the means-testing process itself, in order to receive the transfers necessary for an acceptable standard of living. If the barrier of social stigma results in benefits being left unclaimed, then the ability of targeted programmes to reduce poverty is hampered for any given level of available resources (Mkandawire, 2007; Sen, 1995). Such stigma and the picture commonly painted in public discourse of the "underserving poor" may stem from the negative political rhetoric that can often accompany policies targeting the poor (Katz, 1989). In addition to lowering benefit take-up, the additional effect on wider society may be to reduce taxpayer support and generosity, further constraining poverty reduction efforts by limiting the amount of resources available for redistribution as discussed in the previous paragraph.

Beyond cash transfers, resources are also required for driving poverty reduction through social investment and in-kind provision of education, for example. These types of policies aim at equalising opportunities and are therefore designed to affect the pre-distribution of income, as opposed to cash transfers which aim at changing the distribution of income and poverty post-taxes and transfers. The extent to which policy can reduce poverty through funding education and promoting long run social mobility is, again, limited by the amount of resources required. Such policies need to reduce the link between household resources and educational attainment. However, expansion in higher education and increases in average attainment do not necessarily reduce poverty or increase social mobility (McKnight, forthcoming). As McKnight observes:

"As average levels of educational attainment increase and governments strive to reduce education inequalities at secondary and undergraduate levels, better-off families will seek to ensure that their children continue to secure the best jobs and highest incomes. They do this

by maximising their children's chance of achieving the highest level of qualifications and acquiring non-cognitive/character skills which are rewarded in the labour market. This can involve ensuring that their children attend the highest performing schools, possibly attend private fee-paying schools, or paying for additional tuition. Parents also play an important role in assisting with homework, organisation, examination preparation, guidance and by creating a conducive home learning environment, and providing education enrichment activities and experiences. The outcome becomes a 'race' both between families, and between wealthy parents and the state, with government seeking to narrow gaps in educational attainment and financially advantaged parents trying to maintain them." (McKnight, forthcoming)

Empirical evidence supports the key importance of parental background and resources on children's outcomes (Ermisch et al., 2012). In the UK, the wealthiest parents are positioned to secure not only the highest quality education and levels of attainment, but also connections and job opportunities are not open to the children of poorer families (Lindley and Machin, 2012). This effect is likely to be magnified with higher economic inequality and greater concentrations of wealth. While evidence shows that public provision of, in particular, early childhood education can reduce the gradient between parental socio-economic status and child achievement (Ludwig and Miller, 2007; Heckman, 2008; Almond and Currie, 2010), private resources often far outstrip what the public sector can offer in societies with high economic and social inequality (McKnight et al., 2016). Figure 3, taken from (Heckman, 2008), shows the return to a marginal increase in investment at different stages of the life cycle, from the perspective of the beginning of life. The vast majority of children of poor families rely on state provision at each stage of education, which is limited in the extent to which it can compete with the private financial resources of the wealthy. With the government constrained in their ability to equalise opportunities and increase social mobility through educational attainment, such inequalities can mean that poverty is entrenched over time.

On the other side of the same issue, the cost of not intervening early when young people experience difficulties in life can be most costly for the most deprived portions of society. These costs manifest themselves indirectly through school absence, children's social care, youth economic inactivity, crime and anti-social behaviour, child injuries and mental health problems, and youth substance misuse. It is estimated that the total UK budget dedicated to dealing with these issues is £16.6 billion annually (Chowdry and Fitzsimons, 2016).

Figure 3. Return to a dollar invested at different ages (Heckman, 2008)

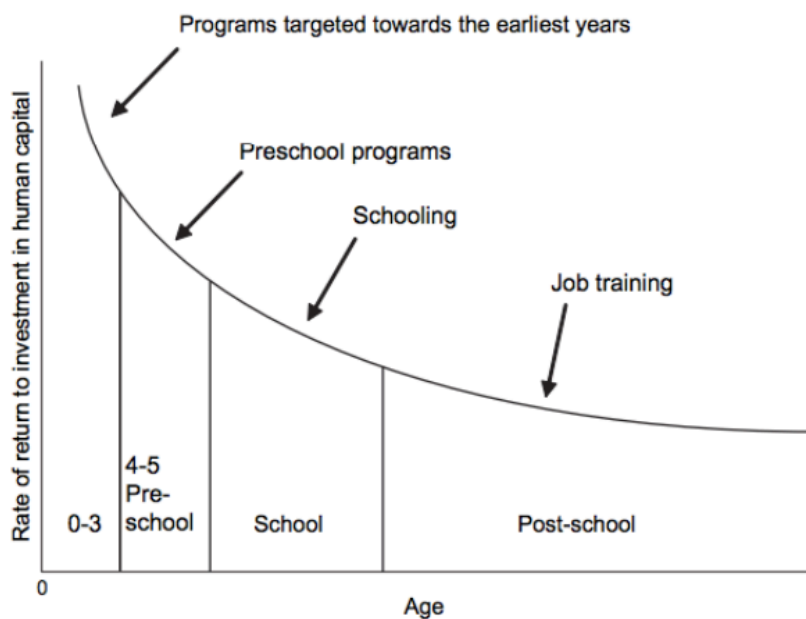
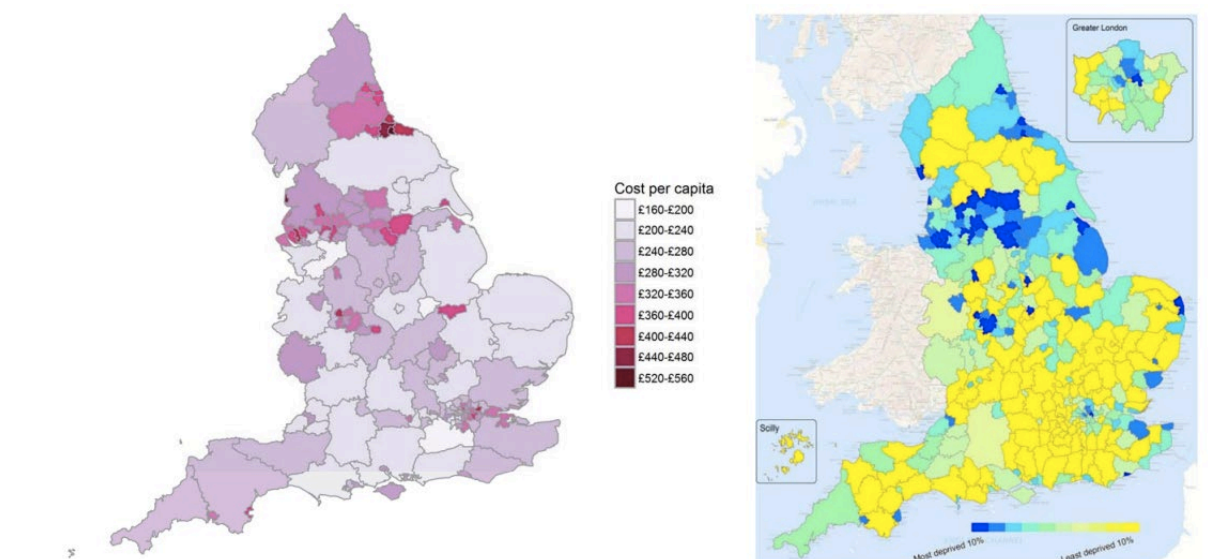


Figure 4. Heat maps of late intervention spend per person and local indices of multiple deprivation (Chowdry and Fitzsimons, 2016)



In addition to the general problem of requiring a huge quantity of resources overall, Figure 4 (Chowdry and Fitzsimons, 2016) shows that the amount spent on late intervention per capita is linked to the level of deprivation in that area. The heat maps show a tendency for the same local areas to appear in a darker colour on both maps. In this unequal landscape,

constraints on government resources may mean that high costs of late intervention in the most deprived areas risks neglecting preventative early intervention approaches, which have strong evidence of reducing the likelihood of poor long-term outcomes for vulnerable children.

A similar argument can be made for the provision of private versus public healthcare. For public health services such as the NHS, resource constraints mean that many treatments cannot be funded, while delays for popular treatments can impair long-term recovery. For people who rely solely on the NHS and cannot afford alternative private treatment, this can result in more lost work days that cannot be afforded, and increased personal cost and financial risk for the individual. In the long-run, this can also generate further costs to the state. Economic inequality allows for a dual healthcare system, where the less well-off rely on the funding-constrained NHS and the rich can pay for swift access to private treatments either domestically or abroad. A report by Breast Cancer Now and Prostate Cancer UK (2016) finds that thousands of NHS cancer patients in the UK are unable to access innovative treatments being made available in five countries with similar wealth but lower disposable Gini income inequality (Germany, France, Australia, Canada and Sweden). With some cancer patients turning to crowdfunding to pay for private medical treatment not available on the NHS (The Telegraph, 2017), inequalities in healthcare access clearly seem to place financial burdens on those who cannot afford it. Wide disparities in income and wealth mean that public health services are less able to keep up with the quality and extent of privately-purchased equivalents. Combined with the other constraints already discussed, this provides an additional dimension to the limitations faced by the government in their ability to equalise outcomes and achieve poverty reduction.

5.2 Wealth, political power and tax evasion

We have seen that inequality propagates the concentration and accumulation of financial and human capital through a divided education and health system, in a way that constrains upward social mobility for the poor. Furthermore, high inequality can generate concentrations of political power among the well-off, influencing the political agenda in ways that disregard the interests of the poor and provide a double standard for the wealthy elite. Christiano (2012) identifies four mechanisms that turn money into political power. These are: (1) the ultra-wealthy buying support for self-interested causes by funding political parties and individuals through campaign financing; (2) political agendas representing upper-middle and upper-class interests who are more likely to be donors to political candidates; (3) influencing opinion through buying media outlets

and providing financial backing for lobbyists and ideology-driven think tank research; and (4) using financial power to influence the behaviour of corporations to circumvent policies of democratically elected government. As pointed out by Robeyns (2016), wealthier individuals who have "excess money" are able, and more likely, to spend money on these various mechanisms that translate money into political power. In contrast, the poor necessarily spend the majority of their available resources on food or basic utilities, and hence have no surplus to spend on acquiring political influence. Robeyns argues that through these mechanisms, wealth undermines the political equality of citizens, resulting in the erosion of the political position of the least well-off.

With greater inequality and higher concentrations of top incomes and wealth, the rich also gain greater means of concealing their assets, reducing the potential for governments to tackle poverty due to their impact on government revenues. The recent leaks of micro-data from offshore financial institutions HSBC Switzerland ("Swiss leaks") and Mossack Fonseca ("Panama Papers") have sparked much coverage in the popular media on the issue of tax evasion (The Guardian, 2017). There is evidence that the probability of hiding wealth offshore rises very steeply within the top 1% of the income distribution, with the ultra-wealthy evading on average nearly a third of their due tax (Alstadsaeter et al., 2017). The richest 0.01 percent of households, including those who hold over £31 million in assets, evade paying 30 percent of their taxes on average. Zucman (2015) estimates that 80 percent of assets are undeclared globally, and that the annual losses to governments from uncollected income, inheritance and wealth taxes are close to \$200 billion. The expectation of a larger redistributive budget to tackle poverty may therefore not materialise in comparison to a counterfactual scenario with the same redistributive system but lower concentrations of wealth and evasive power at the top of the distribution.

There is an argument that individuals are more likely to increase evasion after a tax rise when they feel that public goods and services are under-provided (Cowell and P. F. Gordon, 1988). The explanation for this is that if the tax rise is used to fund government provision, then this may make individuals feel better off and therefore more willing to gamble with higher tax evasion (Cowell and P. F. Gordon, 1988). This argument would predict that if government provision begins from a low baseline, then attempts to fund expansions in services through tax increases will be hampered by higher tax evasion, to the detriment of the poor who rely more on such services. Individuals may also be more likely to increase evasion if these goods and services are not seen as representing good value for tax contributions. When inequality is such that there are very high

concentrations of wealth, as is currently the case in the UK, the ultra-wealthy are unlikely to take account of the provision of public goods and services in their tax evasion decisions if they prefer to use private alternatives. Therefore, while quality of public service provision matters for tackling poverty, it is unlikely to affect the constraints on financing from tax evasion by the ultra-wealthy.

Wealth inequality is higher than income inequality, yet most OECD countries either do not have or have abolished wealth taxes due to the risk of wealth and capital flight to low-tax countries (Joumard et al., 2012). With low taxes on wealth, the wealth and asset accumulation of the ultra-wealthy are protected and unavailable for redistributive purposes. This not only limits the resources available to the government for tackling poverty, but also encourages unsustainable spending patterns and the taking on of excessive debt by those who cannot afford it. This so-called "Hello magazine effect" arises from growing inequality that makes the lifestyles of the rich ever more visible and desirable in the mass media, encouraging emulation of the living standards and consumption patterns of the wealthy (OECD, 2008). The resulting "trickle-down consumption" effect (Bertrand and Morse, 2013) amplifies the negative implications of high wealth inequality – not only does low wealth taxation limit the size redistributive budgets to help those on low incomes, but this inequality also encourages those people to further weaken their economic positions by taking on debt. This hidden component of poverty, which standard measures of income poverty underestimate (Scott and Pressman, 2013), introduces a dynamic component to poverty and requires further resources to tackle in the future.

6 Conclusion

In summary, we have seen that there are a variety of channels through which economic inequality may generate pressures on the resources available to tackle poverty. Some of these channels have a subjective basis, such as subconscious biases in how people perceive the economic distribution and their place in it, and conscious beliefs and attitudes towards the poor and towards redistribution. Some of these subjective channels stem from objective circumstances, such as social and geographical segregation. Yet further channels work through observed decisions and behaviour, in particular those of governments and wealthy individuals. The level of inequality in society affects the resource constraints on government decisions regarding welfare targeting, decentralisation, budget cuts, and representation of voter interests. These in turn can all impact on the effectiveness of poverty alleviation. The level of inequality is also reflected in the power of those at the top of the economic distribution to influence these government decisions in ways that constrain its capacity to redistribute. This could be directly through funding particular political agendas, and indirectly through withholding government revenue through tax evasion. While the net effect of these channels on efforts to tackle poverty are not clear-cut, it seems on balance that high inequality tips many of these channels in a direction that constrains the redistributive powers of governments and their poverty alleviation efforts.

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