"This is a pivotal moment for liberals to offer a radical agenda for equality..."

WEALTH OF OPPORTUNITY

Julia Margo
William Bradley

DEMOS

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Foreword

We live in one of the most unequal societies in the developed world. In the last two decades inequality appears to have worsened and social mobility has stalled.

For Liberal Democrats this is deeply troubling. If our goal is to create a fairer society in which everyone can fulfil their potential, such striking levels of inequality are a huge barrier. As Julia Margo and Will Bradley highlight, there is a clear link between inequality and poor social mobility. We know that access to resources affects equality of opportunity. With a poor child being only half as likely as a better-off classmate to leave school with five good GCSEs, we have an education system which too often perpetuates inequality and fails to tackle it.

The extent of inequality of outcomes and opportunities is only too evident. But what can be done, not least against a background of tough constraints on our public finances? Liberal Democrats have long believed in measures that tackle the root causes of poverty. That is why we have already made clear that in the coming election our priority and greatest spending commitment will be in education. Our plans to introduce a £2.5 billion pupil premium, guaranteeing schools taking the most disadvantaged pupils the extra the money they need to provide extra support, will make a real difference in raising the educational achievements of the poorest children. Julia Margo and Will Bradley's proposed life premium builds on our proposal by extending it into other services, outside schools. Creating an education system that tackles inequality and closes the shameful performance gap between rich and poor is vital if we are to provide an equality of opportunity ensuring all youngsters are equipped with the skills to fulfil their potential.

In the longer term, a fair education system will reduce wealth inequality. But the need to tackle wealth and income equality is also more immediate. Julia Margo and Will Bradley point towards worrying evidence about the impact that economic inequality can have. Children growing up in more affluent households are likely to benefit from parental spending on positive activities, but more disadvantaged children are more likely to suffer from anxiety and depression. The need for a fair tax system is therefore clear and that is why the Liberal Democrats have proposed a radical reform of the tax system with a much higher starting threshold on income tax, paid for by progressive reforms including of pensions and capital gains tax. This would mean over 3.5 million people would no longer have to pay any income tax at all. We are opposed to the Conservatives' plans to cut inheritance tax, which will do nothing to tackle wealth inequality in this country.

The Spirit Level sets the Liberal Democrats a challenge but also identifies areas of common ground.[1] Our commitment to extra investment in education to further greater equality of opportunity, coupled with improving income equality through fair taxation, sets us apart from the other parties. In *The Liberal Moment*, Nick Clegg appealed to all those who believe growing inequality is not inevitable.[2] Dismantling the barrier of inequality and building a fair society is what drives the Liberal Democrats, and will sit at the heart of our general election manifesto.

David Laws MP, Shadow Secretary of State for Children, Schools and Families

Introduction

A concern with inequality lies deep in liberal DNA; it was of course a liberal government under Lloyd George that laid the foundations of the welfare state a century ago. More than a century and a half ago, John Stuart Mill attacked the view of some of his Victorian contemporaries that inequality was somehow natural, or preordained: 'The distribution of wealth depends on the laws and customs of society,' he insisted. 'The rules by which it is determined, are what the opinions and feelings of the community make them, and are very different in different ages and countries: and might be made still more different, if mankind so chose.'[3] To facilitate a much greater spread of wealth, Mill proposed a financial cap on the amount any individual could receive in the form of inheritance: 'I see nothing objectionable,' he explained, 'in fixing a limit to what any one may acquire by mere favour of others, without any exercise of his faculties, and in requiring that if he desires any further accession of fortune, he shall work for it.' At the beginning of the twentieth century the writer and thinker Leonard Hobhouse founded the economic aspects of his 'new Liberalism' on a move towards progressive taxation and in particular a legitimate taxation of 'great sources of personal wealth', especially inheritance and 'financial speculation'.[4]

Jumping forward to the present day, the Liberal Democrats – self-proclaimed vanguard of the modern progressive left – face a unique opportunity to capture a zeitgeist: concern for economic inequality has never been more fashionable or higher in the public mind than immediately following recession and a scandal about MPs' expenses and tax evasion, and bankers' bonuses.

The seminal publication by Richard Wilkinson and Kate Pickett, *The Spirit Level*, has set the scene for a new political and academic concern for inequality by highlighting the links between income inequality and social ills.[5] Elsewhere in social science research, compelling evidence points to the role of access to resources in childhood in supporting the development of core 'capabilities' – the life skills that underpin success and social mobility. This research suggests that entrenched trends in inequality in British society – expressed through social immobility – can be explained by a 'capabilities gap' between children from richer and poorer families, which is passed on through generations.[6]

Resource inequality matters for a number of reasons. First, people need a certain amount of resource in order to lead a successful, fulfilling and secure life. Yet at the bottom end of the income distribution we still have 13.4 million people living in poverty (defined as below 60 per cent of median incomes), around 5 per cent of whom belong to fully-working families.[7] It is right that in exchange for support from the state there should be conditionality – so, for example, to expect someone on benefits who is capable of working to be jobseeking. But there are too many people who are in work but who do not earn a high enough wage to ensure an acceptable standard of living, and for people genuinely unable to work due to illness, the standard of living provided through benefits is not high enough. The goal for progressive government should be to provide financial security for all families – a real 'living wage' and opportunities to create sustainable and secure asset bases. In order to do this we need a better understanding of how many families in the UK live in financial insecurity; current poverty measures tell us only what they earn (living in poverty means earning below 60 per cent of the median income). We need a poverty measure that tells us about a family's ability to draw upon finances when times are tough and to provide a stable and secure economic environment for their children.

Second, growing up in a poor household has a profound impact on the development of capabilities and thus life chances and social mobility, and is self-perpetuating to some extent: it is harder to escape poverty having grown up in it. The story is not a simple one: some of the impacts of poverty make themselves felt through factors such as parenting style, parental aspirations and attitudes to education, others via the impact on quality of life and expectations – although the impacts of growing up in poverty cannot wholly be explained by this. What is not in doubt though is that growing up in a financially secure household improves a young person's life chances considerably.

Third, the above points relate to what is happening at the bottom of the income distribution – and the life chances of those who inhabit it (although poverty itself is a relative concept, in recognition of the fact that what we can do with the resources we have is partly determined by the resources that the rest of society has). But there is a third very important argument about inequality, which relates to the overall shape of the resource distribution within society. Societies made up of people who lead very different lives – because of very differing access to resources – tend to experience worse outcomes in aggregate, impacting on all of those in that society, including the very well off. The work of Richard Wilkinson has demonstrated that more unequal societies tend to have poorer health outcomes across the whole of society – including obesity and mental health, poorer levels of subjective well-being, a higher crime rate and greater inequality of political participation.[8] These are simple associations rather than causal links, but the hypothesis is that living in a more unequal society leads us all to think more about our status in relation to one another and that this has negative impacts for us all.

In this paper, we first consider where we are with respect to inequality in the UK. We then consider the relative strengths of each of the above three arguments about why inequality matters. We argue that all three provide a strong rationale for greater redistribution in the UK, but it is the argument about how lack of resource in childhood impacts on capabilities development which is most pressing and urgent if we are interested in equality of opportunity, and which has the potential to win most capital with the main political parties. Although our arguments are relevant to all political actors, the Liberal Democrats are arguably the party which has most to win if it is to adopt a radical and meaningful approach to improve life chances for the most disadvantaged.

Recommendations

We recommend:

- taxing wealth
- introducing a capabilities boost to benefits and services
- capitalising low income families.

Tax wealth

Although the politics of taxing wealth are tricky, an honest and open dialogue with the electorate, together with reform of a wealth tax system that is riddled with loopholes and avoidance-allowing provisions and thus is widely perceived as being unfair, could reap fruitful rewards.

1. There is more political capital in a gift tax than an inheritance tax – a tax the public despise and which is easily avoided by the very wealthy.
2. We also argue for the introduction of a land value tax and a Tobin tax on international transactions.

Introduce a capabilities boost to benefits and services

1. First, in exchange for firm conditionality for those who can make a contribution, benefit and tax credit levels should be increased to take more families with children out of resource poverty. It is an indictment on our society that families with adults in work can still be living below the poverty threshold.
2. Second, extra resource should be channelled into the services used by children from disadvantaged backgrounds and their families. So we suggest that extra resource should be available, to provide a 'capabilities boost' for children from disadvantaged backgrounds, for early years child care, parenting support, and throughout compulsory education for children from disadvantaged backgrounds. This would operate as a 'life premium' for these children in recognition of the disadvantage they face, and would help public service professionals to improve services for these children.

3 SureStart, which will benefit from a cash injection via the life premium, should be reformed to focus more on the programmes with a proven impact on child well-being, capability development and parenting.

Capitalise low income families

The measures above would address many of the concerns we identify about the impact of resource inequality and poor access to resources. However, the evidence also suggests that financial security is a key factor underpinning well-being and capability development in childhood. We therefore recommend the following long-term policy goals.

1 To improve the ability to save and draw on a reasonable level of resource, the living wage should replace the minimum wage. The starting point for this initiative should be £6.88 an hour, the level suggested by the Joseph Rowntree Foundation following consultation with the public on 'a minimum standard'.[9] This compares to the minimum wage, currently set at £5.52.

2 We recommend a system in which low-income families can draw a lump-sum grant of £500 on the birth of their child as part of the child benefit framework. The money could be used to cover some of the costs associated with having a child (clothes, a cot, a pram and so on). Child Trust Fund payments into the Child Trust Fund accounts of children not eligible for the means-tested grant would be abolished to pay for this initiative. It is the central claim of this paper that redistribution should occur as part of a political focus on early intervention. The Child Trust Fund, although a commendable and important initiative, being payable at age 18, does not fit with this approach.

3 We also recommend a more malleable system of paying child benefit to low income families with very young children, which recognises the importance of the early years. This would involve child benefit being paid at a higher rate for younger children – for example, the highest rate for 0–5-year-olds, with lower rates for 6–11-year-olds, 11–16-year-olds and 16–18-year-olds.

4 One long-term possibility would be to expand the Saving Gateway. This is a fixed-term saving scheme that provides a government match every month for a specific amount saved, up to a certain limit. Its aim is to provide support to people on low incomes to save – in the same way that Individual Savings Accounts (ISAs) provide savings support through tax relief for people who earn enough to pay basic rate tax. The scheme could be extended to low-income families in social housing or privately rented accommodation to help them save towards a deposit for a house. There would need to be several safeguards built in to make the scheme sustainable – for example, financial advice. The scheme could be designed so that families pay in the difference between what they pay in rent and what they would pay towards a mortgage into a matched saving scheme – helping them build up a deposit more quickly, and also to check the sustainability of higher monthly housing costs.

1 Resource inequality in the UK

What do we mean by resource inequality?

There are two main 'proxies' for measuring each individual's or household's level of resource: income and wealth. Income provides a snapshot at any one time of the amount an individual or household gets in a fixed time period (eg a week, a month or a year). It is not a measure of the total amount of resource an individual or family owns, but is a proxy in the sense that the more an individual earns, the more likely they are to have some accumulated resource or 'wealth'. The advantage of it as a measure is that it is relatively easy to determine. However, it doesn't take into account the fact that some individuals might choose to save more of their income than others as a lifestyle choice, or that for whatever reason some may be unable to save or use their income to ensure their financial security.

Wealth provides a snapshot of the *total* amount of resource an individual or a household owns. In some ways, it provides a more accurate indicator of resource inequality. However, it is much more difficult to measure accurately than income – and many household surveys in Britain do not even try to measure it, so the data on it compared to household income is very poor. A further (and important) complication is that there are different kinds of wealth with different amounts of liquidity – some forms of wealth can be accessed relatively quickly while others are locked away. Different forms of wealth include:

- cash savings, which tend to be very liquid
- savings and assets in the forms of stocks and shares
- property – because of the heavily mortgaged nature of the UK private housing market, many people are in debt on their properties – so they own some of their properties and have a loan to cover the portion that they don't own; however, although

most people will be in debt on their properties, they bring other benefits – for example the access to more resource through affordable loans

- pensions – pension wealth is a form of wealth that is locked up until retirement.

When discussing wealth inequality it is important to be clear which forms of wealth we are referring to, where possible. More liquid (accessible) forms of wealth have the advantage of giving people the flexibility to draw on extra resource to smooth their consumption in the short term should they require it. More illiquid (inaccessible) forms of wealth like housing and pensions do not carry this benefit, but offer people more security for the long term.

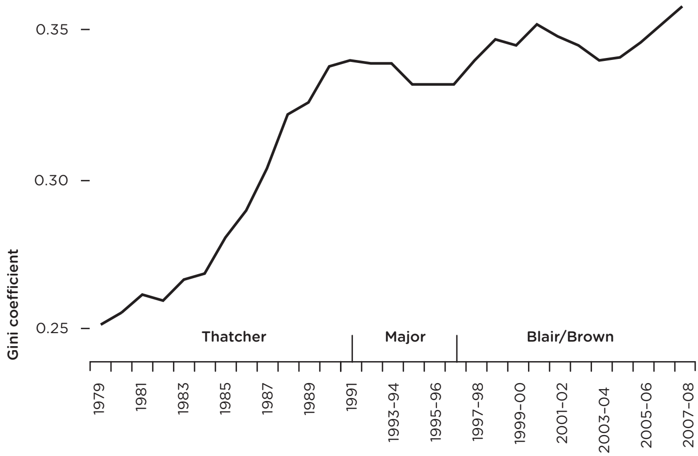
Trends in income and wealth inequality in the UK

Inequalities of both wealth and income in the UK are high and have not got much better over the last decade. We are at a point where inequality could be about to become greater due to the economic recession. This will depend on the extent to which different groups experience the recession in different ways, but it is still too early to determine the full effects of it. There are however some indications that recession is a tale of two Britains – while some people are losing their jobs, others are contributing to healthy sales figures.

Income inequality

Income inequality has risen in each of the last three decades, according to most indicators, and is currently at its highest level since the early 1960s.[10] The Gini coefficient is a good way to summarise trends in overall income inequality. The coefficient is calculated as a percentage: the higher the percentage, the greater the inequality of income. Income inequality rose dramatically over the 1980s with the coefficient rising from 31 in 1980 to 38 in 1990.[11] Income inequality has remained roughly unchanged since this period with a calculated coefficient of 38 for the year 2007–08 (Figure 1).

Figure 1 **The Gini coefficient, 1979 to 2007–08**



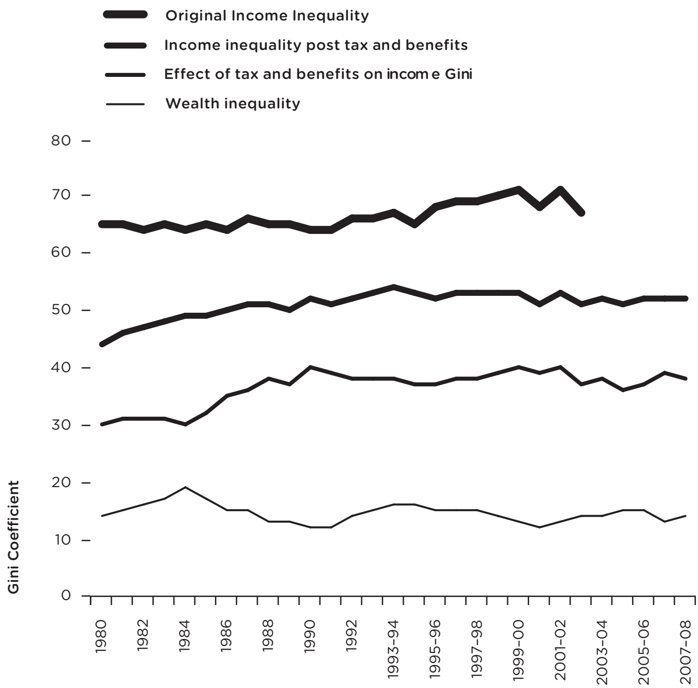
Note: The Gini coefficient has been calculated using incomes before housing costs have been deducted.

Source: Calculations using Family Expenditure Survey and Family Resources Survey, various years.

What underpins these trends? In 2007–08, original income (before taxes and benefits) of the top fifth households in the UK was £72,600, around 16 times the figure for the bottom fifth, £4,700.[12] Yet after all taxes and benefits, the top fifth had an average final income of £52,400 and the bottom fifth £14,300.[13] Tax and benefits have thus worked hard to reduce the inequality ratio from 16:1 to 4:1 (Figure 2).

Mike Brewer from the Institute of Fiscal Studies has characterised Labour's record as having three main stages:

Figure 2 **Income and wealth inequality in the UK, 1980 to 2007–08**



Source: HMRC (2006) 'Table 13.5: Distribution Amongst the Adult Population of Marketable Wealth' (Series C) [http://www.hmrc.gov.uk/stats/personal_wealth/table13_5.pd] and ONS (2009) The effects of taxes and benefits on household income, 2007/08. and London: Office for National Statistics

- Income inequality rose in the first term. But this was explained by incomes at the top rising quickly. Average income growth was strong and more fairly distributed because of rising employment, the minimum wage and tax credits. Overall, poverty fell and the gap between middle and bottom earners shrank.

- In the second term inequality fell as poverty continued to fall and the income growth at the top slowed (partly due to the bursting of the dot com bubble).
- In the third term, income inequality and poverty have risen: income growth has been virtually stagnant apart from for the very richest and there has been less to spend on redistribution.[14]

Another way of thinking about inequality and poverty is to ask how many resources people need to reach an acceptable standard of living. The Joseph Rowntree Foundation has carried out work to try to establish what a minimum income standard should be, based on consultation with social policy experts and the public. It suggested that in order to maintain a minimum, socially acceptable quality of life in 2008, a single working age adult needs a budget of £158 per week (after tax and benefits), and a couple with two children £370 per week.[15]

However, many people come nowhere close to this standard. For example, a single person on income support gets less than half of the income they need. A single adult working full time would need to earn £6.88 an hour to reach this standard – but the UK minimum wage in 2008 was only £5.52. Six in ten households in poverty (defined as with household income below 60 per cent of the national median) have someone in work, and over half of poor children live in working households in the UK.[16] A minimum income standard or 'living wage' would go some way in addressing the impact of resource inequality on child well-being and development. But a truly progressive and meaningful approach would require a definition of poverty that also captured assets and wealth, and debt and living costs, which measures one's genuine financial security.

Wealth inequality

Wealth is less evenly distributed than income and wealth inequality as a result is more severe than income inequality. In 2006–08 the Gini coefficient was 0.61 for total household wealth,[17] around double that of the post-tax income inequality coefficient.

In 2006–08 the least wealthy half of households in Britain owned just 9 per cent of total wealth while the wealthiest half owned 91 per cent.[18] Moreover, the wealthiest 20 per cent of the population owned 62 per cent of total wealth. This wealth is also unevenly distributed geographically. The median wealth of the South East in 2006–08 was £287,500 compared with the North West, where median wealth was £168,200.[19]

What has driven this increasing wealth inequality – and why is it much higher than income inequality? Sodha and Reed point to a number of different trends.[20]

Income inequality is one driver: the higher someone's income, the easier it is to save more, should they so wish. Differential saving rates will also act on top of income inequality to determine different rates of wealth accumulation, and the impacts of these two factors will increase over time.

Rising house prices are another strong driver of inequality.[21] House prices across England and Wales rose by approximately 300 per cent between 1995 and 2008 (before the recession) with the average house price rising from just over £60,000 to just over £180,000.[22] For home owners, this rise represents a vast growth in personal wealth over a relatively short period of time, with a house bought for £100,000 in 1995, for example, being worth over £300,000 in 2007.

These rises differ according to geographical area.[23] Looking at the same housing market figures but broken down to the regional scale, stark regional inequalities emerge. The average house price in the North East peaked at just over £130,000 in early 2008, compared to a peak of over £230,000 in the South East (Land Registry, 2009). This indicates a gross regional divide in wealth. Sub-regional variation is even more polarised: the average house price in Greater London peaked at over £350,000 in January 2008, more than two and a half times that of the North East.

As Sodha and Reed argue, the driving effect of increasing house prices on wealth inequality is further magnified by the leverage effect of mortgages.[24] The majority of homes are purchased using mortgages, hence the debt to equity ratio in homes is high. This means that losses, but more importantly gains that result from changing house prices, are high relative to the net amount invested in a home.

Not only does investing in housing through a mortgage tend to lead to huge gains for home owners, but the ability to invest in housing is also becoming confined to a smaller minority, or those who have some form of assistance. Every hike in house prices makes the step onto the property ladder progressively harder for those who cannot afford to buy. Statistics from the Council of Mortgage Lenders from 2006 showed that around 80,000 (20 per cent of total) first-time buyers received assistance. These 'assisted' buyers accounted for 38 per cent of first-time buyers under 30. More recent data shows that in 2008 nearly half of all first-time buyers under 30 were receiving help.[25] These statistics show that it is increasingly difficult to buy without help from parents or others.

Third, inheritance also drives wealth inequality.[26] Social class is a strong determinant of the likelihood of inheritance, with one survey finding that 70 per cent of social class A had inherited during their lifetimes compared with 30 per cent of social class E.[27] Large variation was also found between the amount of inheritance with 10 per cent of the highest two social classes having inherited at least £50,000 compared with just 2 per cent of the lowest social classes.

2 The case for tackling economic inequality

A debate about inequality has to start with the question: why does it matter? There are several different political and philosophical traditions that would place varying amounts of stress on the importance of inequality for different reasons. These are the most important ones (most people will hold a mix of the two rather than one of these over-caricatured views):

- *The social democratic 'outcomes' view*. Resource inequality matters for its own sake: it is not fair that some people enjoy better resource outcomes than others when those better outcomes are often due to luck (eg being born with higher innate ability, being born to wealthier parents) rather than due to effort (eg taking the time to develop your own talent, working hard).
- *The equality of opportunity or capability view*. Resource inequality matters for instrumental reasons: it gets in the way of people being able to fulfil their potential because everyone needs access to a certain amount of resources to be able to do this – particularly when they are growing up. The liberalism view (a subset of this) argues again that resource inequality matters for instrumental reasons because not having enough gets in the way of people being able to live fulfilled, autonomous lives and being able to achieve the life goals and ends that are important to them. It has often been argued that wealth gives extra capabilities. Evidence on this is weaker than for other capabilities though.
- *The social view*. There is evidence that equality underpins the well-being of societies as a whole. If Liberals care about social cohesion and mobility – as their political tradition dictates– then they must be concerned with equality.

We have taken a mixed view here, arguing that:

- To some extent, resource inequality matters for its own sake – in the sense that there is a certain standard below which we don't want people to fall as part of living in a humane society that values human life. However, it is fair to ask people for something back in order to guarantee this standard of living – for example, making welfare payments conditional on people looking for a job and taking it up when a suitable form of work comes along.
- But in the main, resource inequality matters for instrumental reasons: because of the negative impact financial insecurity has on life chances, in influencing the development of core life skills and capabilities and social mobility, and the negative impact it has on society in general (the Wilkinson thesis).

Inequality and individual life chances

For decades, the link between income (as represented by socio-economic background) and child outcomes, across a range of outcomes – education, well-being and health – has been documented. Children from poorer backgrounds tend to do worse, even when controlling for a range of other factors. In education, while the socio-economic gap has narrowed over time, the gaps remain significant,[28] with children eligible for free school meals (a good indicator of deprivation) being outperformed by their peers from more affluent backgrounds at every stage of the education system. Incidentally the link between socio-economic background and outcomes in education is stronger in the UK than in many other countries.

The role of income alone in life chances is significant enough to demonstrate the importance of tackling inequality. But when wealth is factored in too the story becomes compelling – in some cases wealth is even more powerful than income in explaining outcomes. Evidence from one of the largest longitudinal datasets in the USA suggests that wealth can be at least as powerful as income in predicting outcomes for children. Williams Shanks et al examined the Panel Study of Income Dynamics (PSID) and the accompanying Child Development Supplement, and found that assets could predict educational attainment and likelihood of attending university.[29] Mayer found that income from investments or inheritance were more important than income from the labour market in explaining differences in child attainment.[30] Further bodies of work that have also analysed large longitudinal data sets to explore the relative influence of assets and income on life chances include Hill and Duncan also using analysis of the PSID,[31] and Conley.[32] Conley's study showed that the role of assets were highly significant: a doubling of assets while controlling for other variables was associated with an 8.3 per cent increased probability of attending university, and a 5.6 per cent greater chance of graduating. Nearly all the authors mentioned found that the most important factor in explaining child outcomes was a family's level of financial security (income plus assets plus debts and living costs).

This association between family resources and outcomes is reflected in macro trends in social mobility. Social mobility is the likelihood that a child born to a poor family (or a family in a low social class) ends up being more affluent (or in a higher social class) later on. In a perfectly mobile society, everyone would have the same chance of being in the richest section of society (a 25 per cent chance for the top quartile) regardless of what kind of background they were born into. This points to the severely detrimental effect that resource inequality continues to have on British society as whole – undermining the Liberal commitment to meritocratic values.

The apparent stalling of social mobility in the UK has been a concern of policy makers for some time. Levels of intergenerational mobility – children doing better than their parents – rose until the 1970s, at which point mobility stagnated. A study that analysed birth cohorts from 1900 to 1960 found that the importance of family background on getting a better job declined through to the 1970s but since that time has remained relatively constant.[33] Using income as a measure confirms the overall picture with parental income becoming a more important determinant of the adult income of people born in 1970, compared with those born in 1958.[34]

Social mobility is an area of policy where there is considerable time lag – and it is too early to tell what social mobility will be like for the generation of children born since 1997 – although the early signs from data on the socio-economic gap in educational attainment certainly indicate that the problem is intractable and will remain in decades to come.

The international picture is also not encouraging: the USA is the only country with consistently lower levels of mobility than those in the UK. Perhaps unsurprisingly, countries with higher levels of inequality also tend to have poorer social mobility – it is harder to climb the social ladder in countries where there is further to go. Countries such as the UK and the USA, which are highly unequal in terms of the distribution of income and resources, are characterised by lower levels of social mobility. Countries such as Finland and Sweden, which are more equal in terms of wealth, are also characterised by higher levels of social mobility. This pattern holds across the world as demonstrated by Andrews and Leigh.[35] Their findings show that sons who grew up in more unequal countries in the 1970s were less likely to have experienced social mobility by 1999. Their estimates suggest that a 10-point rise in the Gini coefficient is associated with a 0.07–0.13 increase in intergenerational earnings correlation: moving from rags to riches is harder in more unequal countries.

What explains the link between resources and outcomes? The key route is likely to be via the impact of resources on early childhood experience and the development of character capabilities – the social, emotional and behavioural skills that young people need to succeed in life. Evidence shows that character capabilities have become more important in social mobility in recent decades. Margo et al compared longitudinal studies from 1958 and 1970 and found that 'in just over a decade, personal and social skills became 33 times more important in determining relative life chances'.[36] The same study reported that measured capability for application at the age of ten has a bigger impact on earnings by the age of 30 than ability in maths.

The development of character capabilities and life skills is strongly related to economic background. Over the past couple of generations, material deprivation has become a strong predictor of a deficit in social and emotional skills. Margo et al found that that although the development of character capabilities among children born in 1958 was not related to income, it was strongly associated with income among those born in 1970.[37] The suggestion is that the opportunities to develop character capabilities narrowed in lower-income households, just as those capabilities became more important to life chances.

Studies in the USA have found that for families living under the poverty level, work-based income supplements for working parents can boost the achievement of young children. One study, using data from evaluations of welfare to work initiatives, found that earnings supplements that increased family income by $1,000 to $1,500 per year were consistently associated with small, positive impacts on the achievement of pre-school-aged children.[38] (It should be noted that the same policies had negative effects on children entering adolescence.) A second study estimated the impacts of the Earned Income Tax Credit and also found small benefits for young children's achievement.[39]

More affluent parents are more likely to be able to afford access to services that are associated with better outcomes, for example, positive social activities. Margo et al show how trends in parental spending on activities for children increased in the last ten years in middle class families, creating a socialisation divide with poorer families unable to offer their children the same quality of structured sport, art or drama and music-based activities.[40] This impacts on capabilities since the study showed that participating in particular activities impacted on the development of social and emotional skills including application, locus of control and empathy.

As a result of the increasing commercialisation of society (more adverts aimed at children and young people, more TV consumption among the young), and the technological trends that have revolutionised life, particularly for children and young adults (internet, mobile phones and so on), children in the UK have been shown to be much more brand-aware than previous generations and, worryingly, more brand aware than their counterparts elsewhere in Europe.[41] This may or may not matter in itself, but of particular significance here is the finding that children attach an importance to the ability to buy and own products that impact on their self-esteem and confidence. Children from lower income groups are particularly affected and studies cited in Margo et al highlight a relationship between the status anxiety experienced by children who are unable to afford branded goods they feel they 'need' and an increased likelihood of anxiety and depression, stomach aches and nausea. The poorer the family the more likely the child is to be aware of branded goods and the more likely to attach significance to owning them. Children whose parents are unable to buy them the goods they want regularly are more likely to argue with parents and peers and to have a negative self-image.

This is unsurprising given that a wealth of material, including work by Richard Wilkinson which is highlighted below, illustrates the increased social tensions that exist in societies characterised by economic inequality. Although, for obvious reasons, the bulk of acute suffering is felt by children from poor families, the psycho-social impact of resource inequality is not confined to the poor. Rather, because of inequality's effect on perceived status and value assessment, families in the top bands are likely to be negatively affected by inequality too. The reality is that the whole of society is damaged by gross inequality.

Child development is also affected by the stress and strain related to financial insecurity. A large body of work shows that owning a home (particularly duration of home ownership) has a positive impact on emotional well-being including: less likelihood of teen pregnancy,[42] fewer behavioural problems,[43] and less likelihood of depression and conduct disorders. It should be stressed, however, that a causal link between home ownership and better outcomes has not been established – and this link may well be explained by underlying characteristics of parents who are more likely to be home owners. In fact, it appears that it is financial security (which home ownership is often a proxy for) that matters most and which appears to be the key driver of well-being and the development of capabilities.

In original analysis of the Millennium Cohort Study in 2009, Demos found that children who were parented by parents using warmth combined with discipline (a 'tough love' approach to parenting) were twice as likely to develop very good social, emotional and behavioural competencies – character capabilities – by age five as children with 'disengaged' parents (who display low warmth and low discipline).[44] The report found that parents from low income backgrounds were less likely to show the discipline element of the 'tough love' approach than parents from higher income backgrounds. It is very likely that the strain of parenting under financial stress and insecurity makes it more difficult for parents from low-income backgrounds to display the consistent approach to discipline and boundary-setting than parents from higher-income backgrounds. Thus we need to think about how to increase the financial security of low income families, and how to ensure access to positive social activities and services for their children.

Inequality and society

There is a growing body of evidence that more unequal societies tend to experience greater levels of social divergence.[45] It seems that increasing economic divergence pulls at our societal fabric, increasing social tensions.

Richard Wilkinson and Kate Pickett's work demonstrates that in countries typified by a big gap between the incomes of rich and poor, social problems including health, the welfare of younger generations and crime are more common; there are higher levels of teen conception; and life expectancy is shorter.[46] Children's educational attainment and literacy scores are also worse. The Scandinavian countries and Japan – which have the highest equity levels – consistently come at the top end of this spectrum. The countries with the widest gulf between rich and poor are Britain, the USA and Portugal. No surprise then that the UK also suffers more problems with our young, greater health and crime problems and a high teen pregnancy rate.[47]

The authors suggest that inequality increases stress across society, not just among the least advantaged, but among all of us. In unequal societies, the well-off suffer from fear of the poor, while the rest experience status anxiety, jealousy and bitterness.

In societies with greater income inequality, the policy approach tends to be more punitive, with more people being sent to prison, and less is spent on education and welfare. This certainly rings true given that the prison population in the UK has doubled since the 1990s and we have failed to make significant inroads into our youth crime 'problem', whereas in Finland, there are fewer than seven young offenders on the books. This evidence builds on a substantial research base. To cite just a few findings: levels of trust and civic cooperation are higher in countries with relatively low levels of income inequality,[48] and levels of violent crime are higher in countries and states where income inequality is greater[49] – this applies regionally within countries as well as internationally.[50] Numerous studies have shown that mortality rates are higher in more unequal cities and regions.[51] There is also evidence that economic growth is slower in more unequal countries.[52]

3 The UK policy context

Having established why we should care about resource inequality, in this section we turn to the political challenge. This paper aims to impact on the policy directions of the Liberal Democrat Party, as it bids to be the most progressive party on the left of British politics. To accomplish this it is important that we acknowledge the unique political position of the Liberal Democrats with respect to inequality – be it in their support for more redistributive taxation or in their radical ideas about land value taxation, the Liberal Democrats have a strong story to tell the electorate about their historic commitment to a progressive fiscal system.

It is also meaningful that Labour has failed to make a strong enough argument about why resource inequality matters. Although good work is being done to tackle the development of capabilities in the early years, more radical reform is needed to redistribute resources. This presents the Liberal Democrats with a strong political narrative as the *real* party of equality.

We argue, however, that the Liberal Democrats remain too cautious on resource distribution. Here we set out a Liberal agenda for 2010 and beyond.

Liberal Democratic solutions to resource inequality

Our central thesis is that we do have an issue with lack of resources at the bottom of the income distribution, and that there needs to be a greater emphasis on redistribution. However, this is not just a matter of *amount* – just as important is an emphasis on ensuring that a set amount of redistribution achieves the best value for money for taxpayers, and is as effective as possible in improving the lot of children born into disadvantage. We argue therefore that there needs to be a shift of emphasis in redistribution to providing financial security for families with children, particularly in the early years of a child's life, and that the Liberal Democrats ought to be at the forefront of that shift.

To whom – and how?

There is a need for further resource redistribution, given the impact that resources have on capabilities development. However, making the political case for more redistribution will, quite rightly, depend on being able to demonstrate that greater resource redistribution will lead to improved outcomes – both for people from disadvantaged backgrounds and for society as a whole. This requires intelligent and fair redistribution.

There are two main forms that redistribution can take. One is resource-based redistribution, in which resources (either income or assets) are redistributed to low-income families. The other is service-based redistribution, in which there is increased funding for services targeted at disadvantaged families (in other words, redistribution of a 'benefit in kind').

Resource-based redistribution: capitalising low-income families

We should, in the long term, be moving towards a system of resource-based redistribution in which everyone has access to the minimum standard of living deemed to be socially acceptable – for example, the standard arrived at by the Joseph Rowntree Foundation's Minimum Income Standard project. In this ideal system this living standard would be guaranteed for those who were genuinely unable to make any kind of economic contribution, but there would be heavy conditionality for those who were. In other words, there would be a more generous, but also stricter, system of benefits and welfare payments.

A living wage

In the long term we recommend the introduction of the living wage, set at the starting point of £6.88 an hour – although this would vary from geographic region to region depending on living costs in each local area. This is a long-term aspiration, and requires economic modelling to determine its feasibility – but the long-term goal should be that a person in full-time work should be able to earn an hourly wage that guarantees them an acceptable standard of living.

A birth grant

We recommend a system in which low-income families can draw a lump-sum grant of £500 on the birth of their child as part of the child benefit framework. This grant would be intended to help them meet the 'lumpy' costs associated with having a child (for example, the need to purchase items such as prams and cots), which without assistance can potentially trigger a downward spiral into poverty. This would be paid for by abolishing government payments into the Child Trust Fund. Although this is to be applauded as a policy that seeks to tackle wealth inequality by increasing saving, as a redistributive policy it is flawed: we argue here that redistribution has the greatest potential when targeted at families with children who are in poverty, particularly young children below the age of five. The research reviewed here shows the importance of financial security in childhood, and we believe that government payments into the Child Trust Fund would be better spent now on children in poverty, rather than sitting in accounts for 18 years. The CTF would continue to exist as a tax-privileged savings vehicle for parents, however, in the same way as ISAs.

Front-load child benefit

We also recommend that the Liberal Democrats investigate how popular and feasible it would be to frontload child benefit to families with younger children. This would involve child benefit being paid at a higher rate for younger children – for example, the highest rate for 0–5-year-olds, with lower rates for 6–11-year-olds, 11–16-year-olds and 16–18-year-olds.

Supporting home ownership

One long-term possibility would be to expand the government's matched saving scheme for people on a low income, the Saving Gateway. This is a fixed-term saving scheme that provides a government match every month for a specific amount saved, up to a certain limit. It aims to provide support to people on low incomes to save – in the same way that ISAs provide savings support through tax relief for people who earn enough to pay basic rate tax. The scheme could be extended to low-income families in social housing or privately rented accommodation to help them save towards a deposit for a house. There would need to be several safeguards built in to make the scheme sustainable – for example, financial advice. The scheme could be designed so that families pay in the difference between what they pay in rent and what they would pay towards a mortgage into a matched saving scheme – helping them build up a deposit more quickly, and also to check the sustainability of higher monthly housing costs.

Service-based redistribution

Given the limited amount that might be available for future redistribution, we argue that the best value for money in the short term is likely to come through increased service-based redistribution. There needs to be a 'capabilities boost' for children from disadvantaged backgrounds, which would in effect consist of extra resources for the evidence-based interventions that work in boosting skills – through parenting interventions, schools and community-based interventions such as structured extra-curricular activities.

The life premium

This capabilities boost should take the form of a 'life premium' for children from disadvantaged backgrounds. This would take the form of extra funding tracking children from age 0 to 18 that would follow children throughout their life course, and be paid directly to the services they use. This extra funding would be available for child care, Sure Start services, and through primary and secondary school, and further education. At each stage, it would need to be administered differently to cater for the differences in the way funding works of different services like child care, parenting and early years services, and school services. We would like to see a system in which the premium is spent on services and interventions that are evidence based with respect to their impact on outcomes and development for children from disadvantaged background, for example programmes such as Nurse Family Partnership (an intensive home-visiting programme for at-risk mothers from pregnancy until their children are age two) and Reading Recovery (a one-to-one tuition programme for six-year-old struggling readers). We set out further details of how this would work in the forthcoming Demos report on educational disengagement, *Ex Curricula*.[53]

Sure Start reform

Sure Start is an effective tool through which to deliver targeted interventions in the early years. The service should be reformed to ensure it focuses mainly on the interventions that best support child development and parenting, and focuses less on childcare. Our recommendations are again set out in more detail in *Ex Curricula*.

From whom?

The next important question is obviously from where should this extra resource come? A detailed assessment of how revenue is raised within the UK – and how fair the current system is – is beyond the scope of this paper. Here we focus on wealth taxation, because – relative to income – wealth is taxed very lightly. There is a significant imbalance between the taxation of income earned through labour, and the taxation of wealth – or the income stream that wealth provides through investment returns. Although these proposals should be used in order to finance the recommendations above, that is not the only reason to propose them. If Liberal Democrats are serious about bearing the mantle of 'the progressive left' they must actively attempt to reduce the inequalities of resource that pervade British society. This does mean providing further support to lift people out of unacceptable poverty but it also means reducing unearned advantages for the very wealthy.

Wealth in the UK is mainly taxed through two taxes: inheritance tax (IHT) and capital gains tax (CGT). Inheritance tax is a tax on estates, levied when owners die. The first £325,000 of an estate can be passed on tax free, and wealth above this threshold is subject to a 40 per cent tax. There are exemptions, including transfers to spouses, charities and small gifts, and reliefs for agricultural property, and family and private business. People can also make gifts tax-free so long as they live for seven years after they are made. It is a tax paid by around 6 per cent of estates.[54]

Capital gains tax is a tax on gains to people's wealth over a period of time – in other words, a tax on unearned income. It is a transactions tax: people pay the tax at the point of sale of assets that have appreciated in value. People pay a tax rate of 18 per cent, and each person has a CGT tax-free allowance (£10,100 in 2009–10). However, there are significant exemptions. People's homes are completely exempted – meaning that any increases in the value of their homes go untaxed during their lifetime – a tax bonus of around £14.5 billion in 2007–08.[55] Second, the amount of gain that is taxable on other assets decreases over time to just 60 per cent after ten years for non-business assets, and 25 per cent after two years for business assets – this represents a tax bonus of £6.8 billion a year in 2007–08.[56]

There are issues with both of these taxes. First, IHT is very easy for the wealthy to avoid – because they can afford to pay for expensive tax-avoidance advice. Although the government has attempted to close some of these loopholes, for example ones on trusts, in recent years, the biggest loophole is impossible to close without reforming the system entirely. If they are wealthy enough, people can avoid IHT by choosing to give their wealth away to their beneficiaries while they are still living, rather than pass it on after death. So long as they live for seven years after making their gift, this intergenerational transmission of wealth goes entirely untaxed. Thus it is the moderately affluent who disproportionately are affected by the tax because their wealth tends to be locked up in their homes and is harder to gift; one estimate is that income tax receipts are only 16 per cent of what they would be were IHT not so easy to avoid.[57]

As a result these taxes capture only a very small fraction of the total increase in wealth in the UK each year. For example, the

UK property market alone increased in value by over £400 billion in 2006,[58] but IHT and stamp duty taxes in that same year raised only £14 billion – capturing about 4 per cent of the increase in value.[59] This is obviously a much lower rate than the rate at which income is taxed.

Moreover, the principal residence exemption in CGT mean that windfall gains to housing value – which simply represent a transfer of wealth from non-owners to owners, and derive in the main from restraints on house building and area-based infrastructure investment – are not taxed at all until death. This is in contrast to earned income – which is taxed annually. Many would justify IHT on the basis of the fact that it helps tax these windfall gains, but because it is much more distanced from the principle of taxing gains to wealth than CGT, it is difficult to make the case for it as a wealth tax on this basis.

Land value tax

There is a good case, therefore, for fundamentally reforming the system of wealth.[60] The first way of doing this would be by bringing housing wealth more fully into the tax system, for example through an annual tax on land value, levied by owners, set at a percentage of land value (say 0.5–1 per cent). This tax:

- would capture some of the huge gains in property value that derive from increases in land value, without the distortionary impacts that making people's homes eligible for CGT would have on buying and selling decisions.[61]
- would be difficult to avoid – as land cannot be moved offshore!
- could potentially have macroeconomic benefits by helping to stabilise property prices in high-demand areas, and increase investment on low-demand ones.[62]

A gift tax

A second reform should be to change the system of taxing intergenerational transmissions of resource so the very affluent cannot avoid tax by gifting their wealth during their lifetimes. We propose a tax on gifts rather than inheritance. If the starting point is that transmission of financial wealth between adult generations should be taxed to some degree, this should apply to all transmission of financial wealth between adult generations, not just those at death. Such a tax could either take the form of a tax on the gifts that donors make, or a tax on the recipients of gifts above an annual limit as was proposed by the Fabian Tax Commission.[63] This would see an increase in the number of bequests and gifts that would become taxable – and if introduced in conjunction with a land tax could see a significant reduction in the rate applied: it could be much lower than the 40 per cent IHT rate applied at the moment.

A Tobin tax

Third, we recommend a financial transaction tax, or Tobin tax. This would be a small tax (current suggestions are for 0.05 per cent) on the trillions of dollars that change hands each day. This would include currency, but also other types of financial trades. At 0.05 per cent this could raise $700 billion annually. There is currently momentum gathering behind the idea of such a tax, with a broad coalition forming to support a campaign from January to April 2010.

Redefining poverty

All of these are radical and long-term ideas for reform, and require much practical work on how they would be implemented. But together they could tackle some of the current unfairness in the system of wealth taxation, and could raise extra resources for the reforms recommended above.

Finally, the research here has relevance for the way in which Liberals, and policy makers more generally, currently conceive of both poverty and inequality. In this paper, we have shown that financial security appears to be the key factor underpinning good life chances, a broader issue than straightforward poverty, and we have argued that the primary reason for undertaking a more distributive agenda is to improve the opportunities for children from poorer families to develop the life skills and character capabilities required for social mobility and a good life.

Ultimately, it is equality of capability that matters most, but if this approach is to sustain a political agenda, we need to update the way in which we measure and conceive of poverty. In the UK the conventional definition of poverty is based on income: those households whose income is below 60 per cent of median income are considered to be in poverty. But this measure tells us nothing about a family's level of financial security – their ability to draw upon assets which provide stability and help to override the stresses and sudden shocks of daily life. The first step for a truly progressive agenda on equality must be to broaden our official definitions of poverty and equality to capture the centrality of financial security to our understanding of poverty and the role of resource equality in equality of capabilities.

The shape of the challenge

Writing in a recent Demos pamphlet, Nick Clegg pointed to the 'fairer dispersal and distribution of power' as the very 'starting point' of liberalism.[64] Making sure everyone – and particularly the wealthy – pays their fair share is vital to empowering society's most vulnerable.[65] In pursuit of this aim, the party's plans to 'radically rebalance' the tax system – for example by raising the income tax threshold and pledging to close tax loopholes – can be considered progressive. But our proposals present a crucial challenge to the Liberal Democrats. This is especially evident in the following two policy areas:

- *Plans for a 1 per cent levy on the value of properties over £2 million*.[66]

This is a much fairer scheme than council tax, as the latter allows for multimillionaires to pay the same as those owning a band H family home (despite their properties being worth up to 50 times as much).[67] However, the introduction of an annual land value tax would not only be fairer, in that it is harder to avoid; it would result in key macroeconomic benefits by stabilising property prices, preventing property bubbles from emerging.

- *The abolition of the Child Trust Fund*. Instead of paying out a lump sum of money to a child once they become 18 (at which stage their life changes are 'already all but determined'), the Liberal

Democrats propose to invest the money into smaller classroom sizes for primary schoolchildren.[68] In light of recent research revealing the early years to be the most critical in a child's life,[69] the premise of this policy is sound; but the revenue it generates is wasted as smaller class sizes in primary and pre-primary schools result in few real benefits for the children themselves.[70]

The party's plans to cut income tax for low- and middle-earners by closing prevailing loopholes and targeting the relatively wealthy[71] is certainly redistributive – but not yet radically so. The fact remains that inequality of wealth continues to be much higher than income inequality,[72] and is at its highest level for almost 50 years.[73] If the Liberal Democrats are to become the dominant progressive force in British politics that Clegg so wishes, if they are to realise their vision of a 'good society', then resource inequality is a challenge that needs to be confronted. Adopting the recommendations presented in this paper would, we believe, constitute a positive and definitive step towards achieving this aim.

Conclusion

The Spirit Level presents a challenge to policy makers because it demonstrates the holistic damage caused by inequality.[74] Its findings, that inequality impacts profoundly on the well-being of societies, is supplemented by the evidence of the impact that lack of access to resources has on individual life chances. There is therefore a double challenge for politicians to contend with, and this challenge is especially pertinent for the Liberal Democrats, who have long positioned themselves as the party of both fairness and progressive taxation. First, the Liberal Democrats should not allow the argument about redistribution simply to become one about taxing the rich for taxing the rich's own sake: the argument is about developing a society with greater mobility and broader opportunity. Second, greater redistribution needs to be justified by a more instrumental narrative: it is about finding the resource as a society to invest in programmes that will genuinely make the difference for people who are a long way off the liberal ideal of 'achieving their vision of the good life'.

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Julia Margo is director of research at Demos. William Bradley is a junior associate at Demos.

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