Effects of Tax-benefit Changes on Income Distribution:
A Decomposition Approach*

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Abstract

Tax-benefit reforms could well explain some of the observed trend in inequality and poverty. There is no agreement, however, on the best way to assess the impact of policy changes on income distribution over time, both in absolute terms and compared to other explanatory factors (e.g. change in pre-tax income distribution and composition, change in demographic structure). In this note, we suggest a decomposition methodology which helps on both accounts. First, it provides a measure of the absolute impact of policy changes when compared to a distributionally-neutral situation, i.e. a benchmark where monetary parameters (benefit amounts, tax bands, etc.) are nominally adjusted in line with income growth. We apply this measure to analyze the effect of recent policy changes in twelve European countries. Second, we focus on France and Ireland to assess the relative role of policy changes compared to other factors. We check the sensitivity of the results to the decomposition order.

Key Words: Tax-benefit systems, inequality, relative income poverty, microsimulation.

JEL Classification: H23, H53, I32

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