Thoughts on the Political Economy of Inequality

Tim Besley
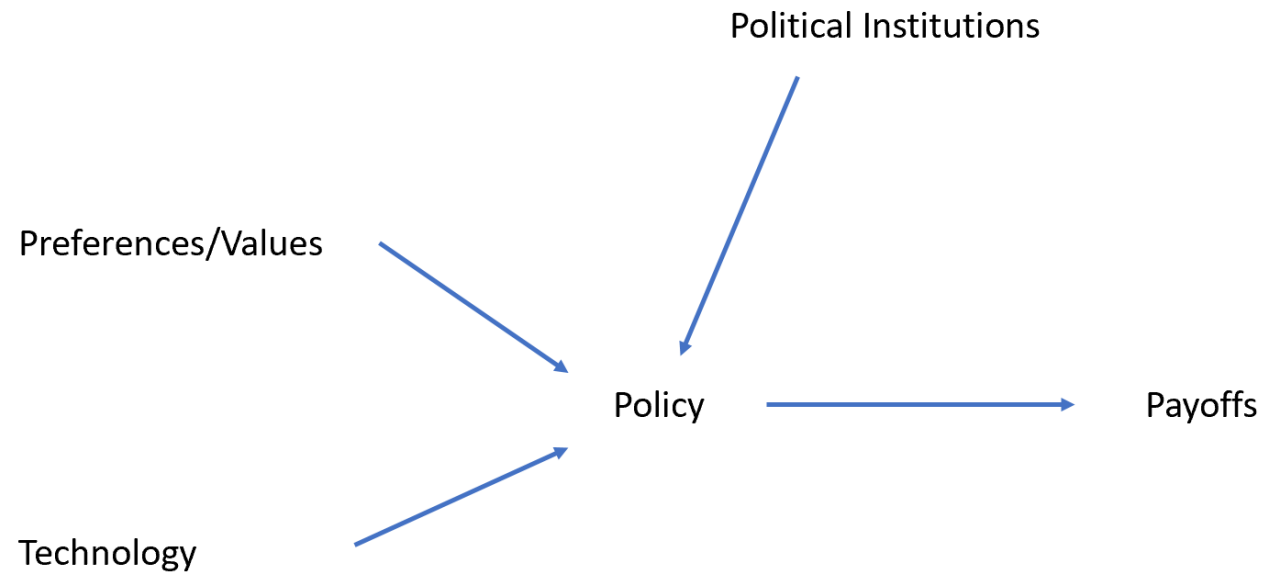
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Outline

- The standard approach
- Assumptions worth questioning
- Directions of "bias"
- Deeper issues
- Concluding Comments

Schematic Approach

Political Institutions

Preferences/Values

Technology

Policy

Payoffs

The Standard Approach

- Developed by Romer, Roberts, Meltzler and Richards
  - Individuals care only about their own consumption and heterogeneous earnings capacities
  - They use a negative income tax to redistribute
  - Parties compete for their votes and with suitable assumptions (hierarchical adherence) the median voter's preferred outcome prevails
  - The income tax rate depends on the mean-median difference
- **Main conclusion:** more (exogenously driven) inequality by reasonable definitions means more redistribution

Issues

- Some have used this to say that democratic policy making will be responsive to inequality

- But, although this is a great model to teach and gives a flavour of some of the things that might matter.
    - But as a guide for thinking about policy, it is pretty useless.

- Pretty much every assumption that it makes is questionable
    - Although that does not stop it being a useful benchmark
    - By exploring why it is not useful, we might get some insight into what would be.
    - BUT: I will argue that this will still leave too much out that we should be thinking about.

- And to be clear, there are many people in economics and elsewhere who are thinking about a range of important issues.

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Missing Elements

- Preferences for redistribution
- Richness of the policy space
- Nature of political representation

Preferences for redistribution

- Preferences for redistribution entirely derived by their implications for personal consumption
  - It is apparent that people have preferences for redistribution and it would be heroic to say that this are just a proxy for their personal consumption
  - More interesting is to try to unpack these and then think about their implications
- People care a lot about redistributive dimensions other than income
  - E.g.
    - Region
    - Gender
    - Identity
- They can also care about process based criteria
  - Notions of fairness or reciprocity
- And we should think about how well-informed citizens are

The Policy Space

- Pretty much every policy has some redistributive impact

- But key missing dimensions
    - Education
    - Health
    - Social insurance
    - Targeted transfers
    - Capital taxes

- Real question is about how these work together to affect life chances in different dimensions
    - No simple sufficient statistic to summarize their impact
    - And objectives are multi-dimensional

Political Representation

- Which issues are paid attention to?
  - When will income redistribution be a priority?
  - A mixture of convergence and divergence
    - Which can change over time
- Does it matter who is elected?
  - Politics cannot commit
  - Much political activity unobservable
  - so political selection, i.e. "types" matter
- Architectural issues
  - What should be determined locally and centrally?

Directions of bias?

- Impossible to say a priori which forms of inequality get attention
- And it does not make a lot of sense to think of there being any kind of predictable relationship between inequality and policy "in general"
- Example of gender equalities
  - Range of political factors at work
    - Voting and representation
    - But also courts
  - Rich array of policy instruments
  - What is the equality criterion?
  - Trade-offs?

Open Issues

- Where does preference come from?
    - Inherited egalitarian and fairness ideals
    - Cultural influence
        - Requires a dynamic model of two-way causality
- The nature of markets
    - What is fair about the market?
    - Challenges to competition and new sources of market power
- The nature of government
    - Is the liberal democracy under pressure
    - Good or bad for different forms of inequality?
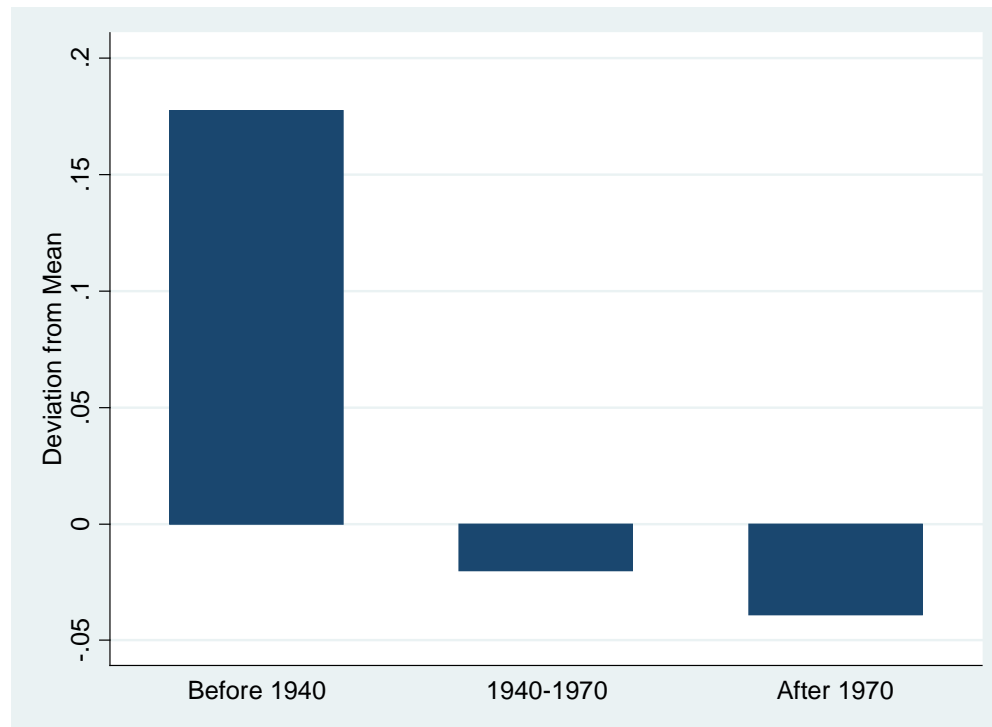   - The inevitability of hierarchy: but of what form?

Preference Heterogeneity

- Evidence from combined WVS/EVS

- Asks respondent "Do you think that incomes should be made more equal" on 10 points scale.

- Data on 440,000 respondents in 103 countries in waves from 1981 to 2014

- Strongly correlated with individual characteristics

- Significant cross-country differences

- Are these data or interesting endogenous variation?
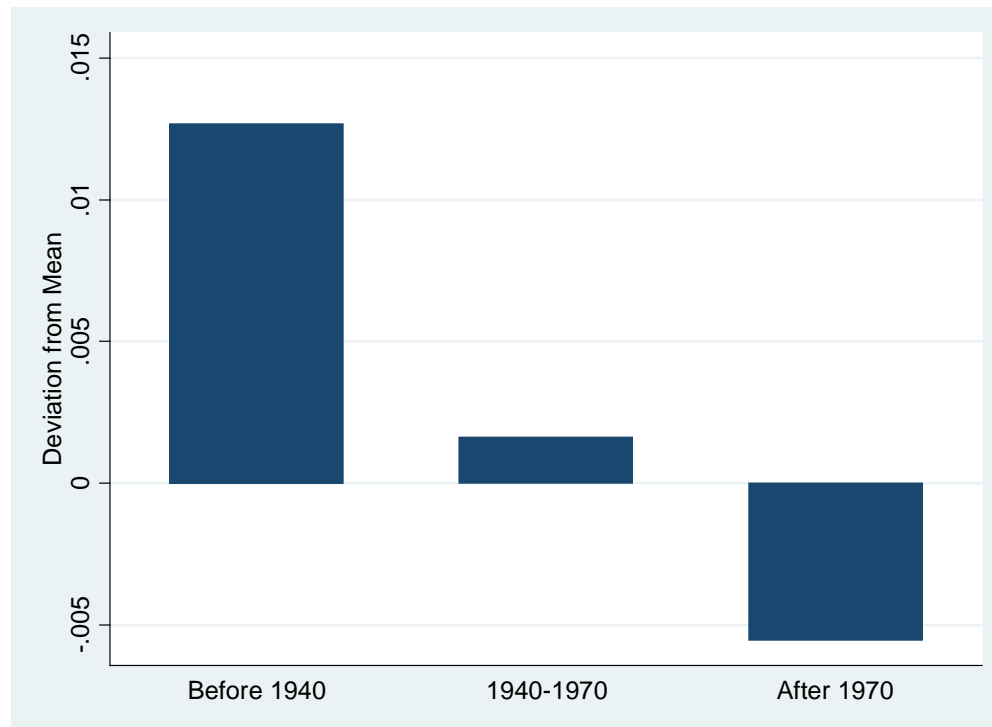 - Are they codetermined with policy or exogenous to it?

Preference Heterogeneity:

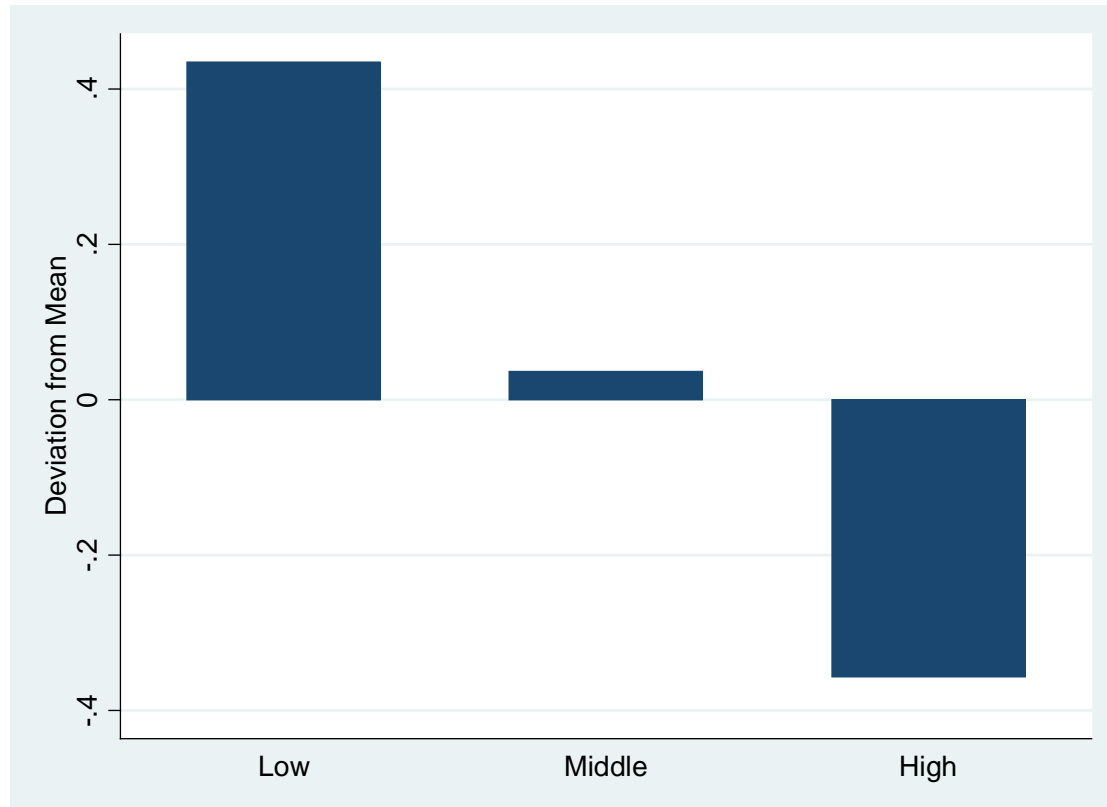by generation

Preference Heterogeneity

by generation
(background characteristics + within country variation)
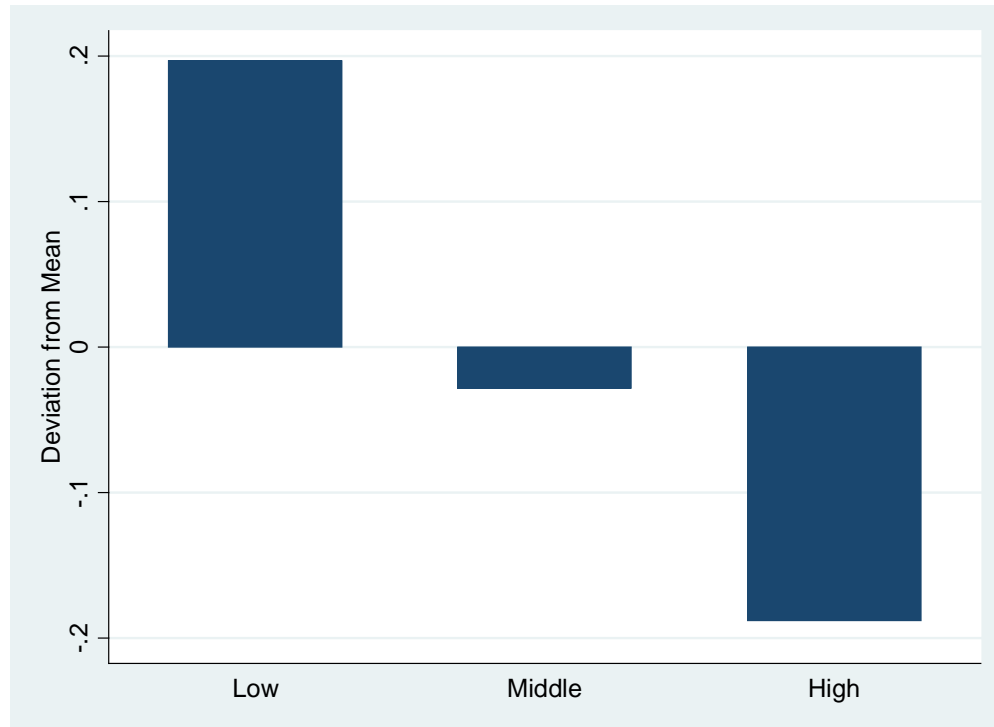
Preference Heterogeneity

by education group

Preference Heterogeneity
by education grouping
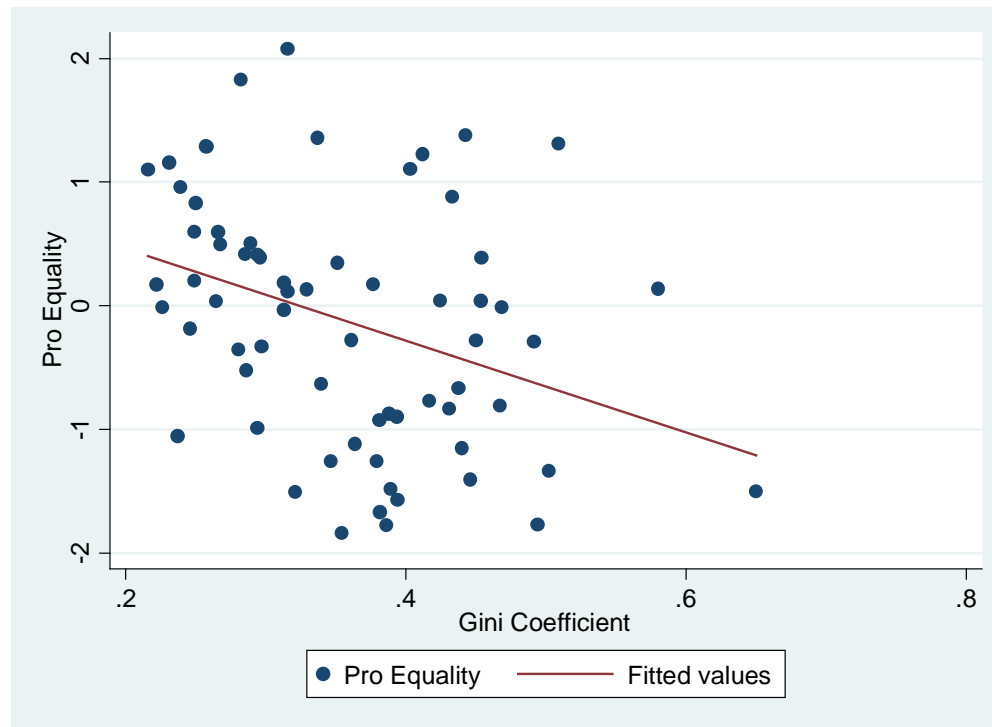 (background characteristics + within country variation)

Preference Heterogeneity
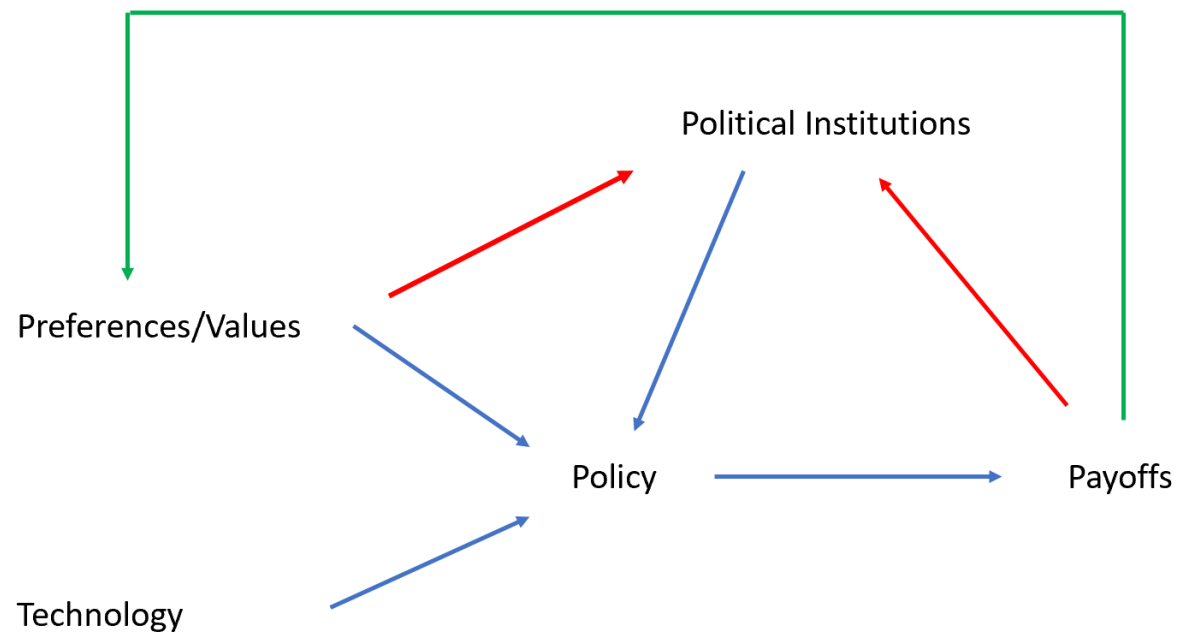
Intergenerational persistence

Preference Heterogeneity

plotted against gini coefficient

Schematic Approach

Open Issues

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  - Cultural influence
    - Requires a dynamic model of two-way causality
- The nature of markets
  - What is fair about the market?
  - Challenges to competition and new sources of market power
- The nature of government
  - Is the liberal democracy under pressure
  - Good or bad for different forms of inequality?
  - The inevitability of hierarchy: but of what form?

The Role of Economists

- Strategy 1: Stick to what we know
  - albeit doing it better with available methods and data
  - certainly we can widen the set of inequalities that we think about

- Strategy 2: Widen our competence
  - But expose ourselves to risk
    - Where are tools fit for purpose?
    - Do we want to "work with" or "educate" other disciplines?

- Either way: we have to be policy-relevant
  - But recognizing that the world of policy is full of "motivated beliefs"