Inequality and Poverty: Analysis and Policy

14th lecture: Why redistribution fails in emerging democracies?

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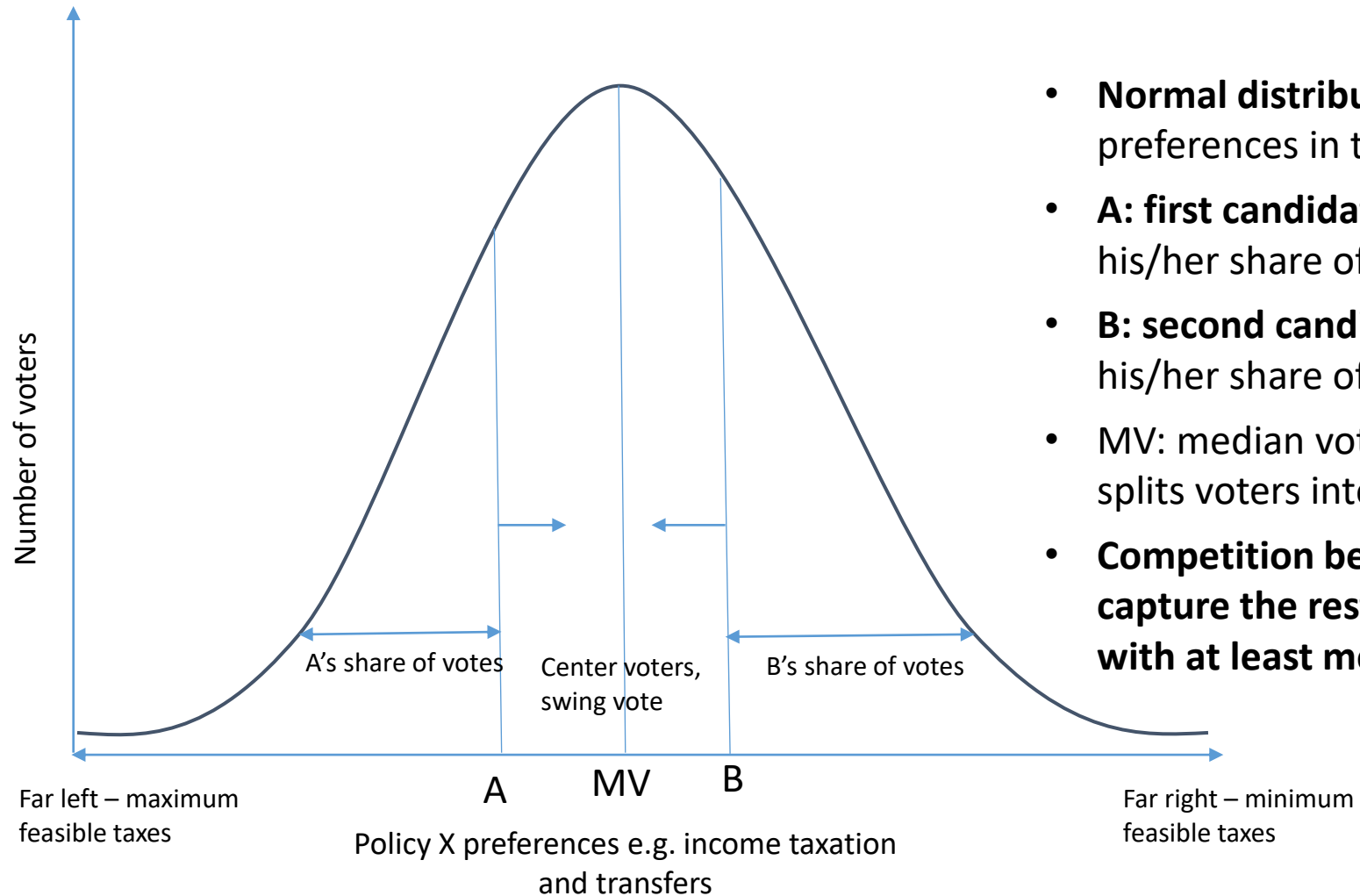**Course web page: http://rszarf.ips.uw.edu.pl/inequality/**

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Inequality as a driver of politics for redistribution in Median Voter Theorem framework

Median voter theorem (MVT) applied to redistribution

- MVT: the median voter in the <u>single dimension of policy preference spectrum</u> (e.g. from the left to the right) is the decisive voter in free <u>majoritarian elections with two candidates</u>

- Meltzer and Richard (1981) **applied MVT to simple redistributive policy by flat income tax and lump-sum transfer to all without making budget deficit (similar to UBI model)**

  - The policy dimension is the level of public expenditure (tax/transfer policy)

  - <u>A voter's preference is decided through income status (the poor are for maximum redistribution as they are net gainers; the rich are for zero redistribution as they are net losers)</u>

- They predicted that **government expenditure is decided by the mean to median income relationship (income inequality)**

  1. **If median income is lower than mean income**, the government would promote expenditures for the poor (understood as those below the median or the mean)

  2. **The larger the gap between mean and median income, the more redistributive the government policy is**

Allan H. Meltzer, Scott F. Richard, *A rational theory of the size of government*, Journal of Political Economy, 1981. For more details see Alex Tabarrok, *A Rational Theory of the Size of Government*

Median Voter Theorem (MVT) explained

- **Normal distribution** of policy X preferences in the society
- **A: first candidate** in election and his/her share of supporters
- **B: second candidate** in election and his/her share of supporters
- MV: median voter preference (median splits voters into two equal parts)
- **Competition between A and B to capture the rest of undecided voters with at least median voter**

Number of voters

A's share of votes

Center voters, swing vote

B's share of votes

Far left – maximum feasible taxes

A   MV   B

Far right – minimum feasible taxes

Policy X preferences e.g. income taxation and transfers

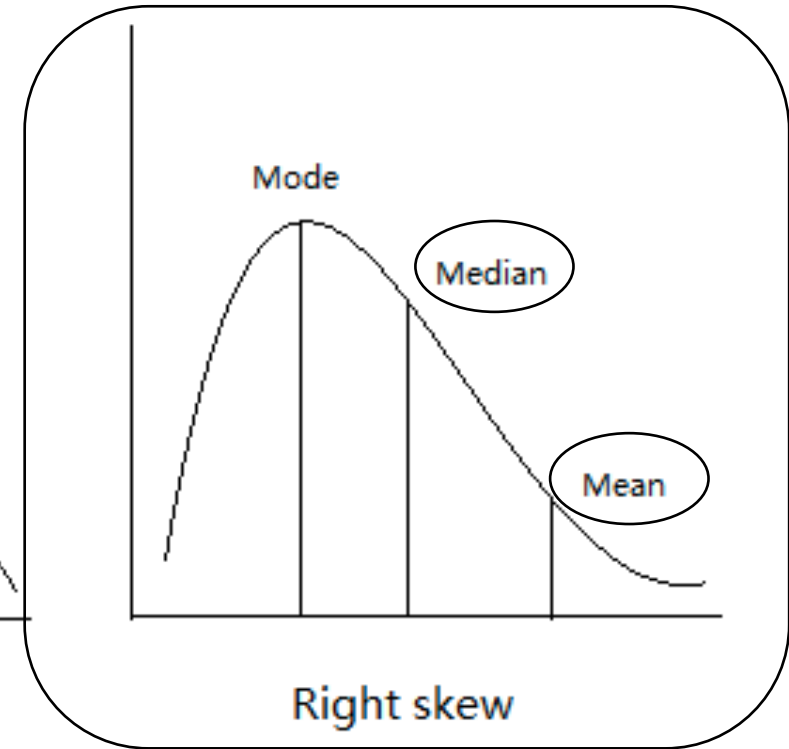# Median and mean relative position in distribution of income

Distribution of income are usually right skewed: median (it splits the distribution into two equal parts) is lower than mean
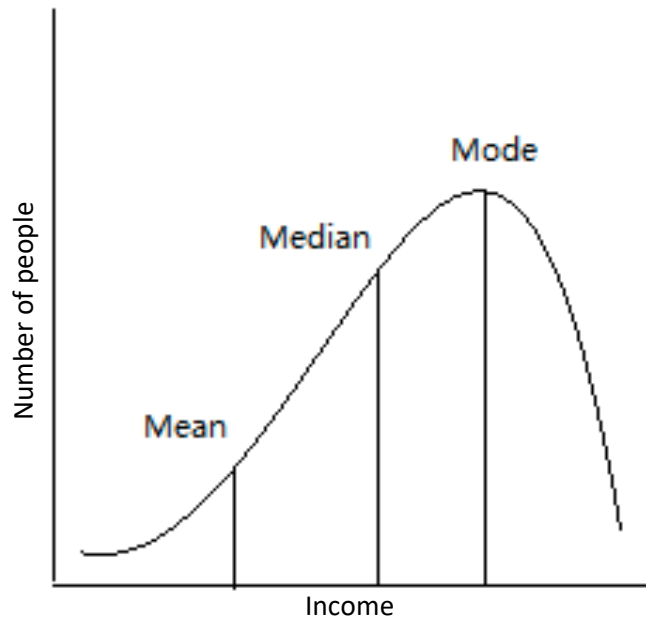
Left skew
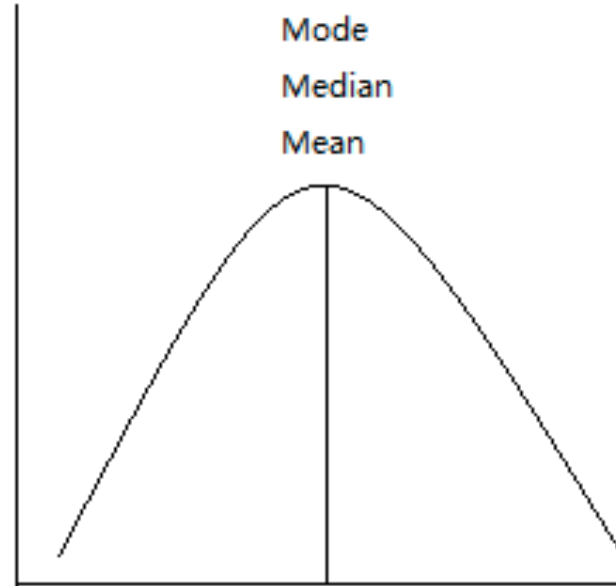
Normal Distribution

Right skew

If the median voter has income below the mean, she prefers higher redistribution. The conclusion is that **any party in two-party system (with MVT assumptions) wins with pro-redistribution agenda because majority (with those above median and below mean) prefers redistribution**

Numerical examples for the Meltzer-Richard model

A. Policy proposal to introduce 10% tax and equal transfer for all

	Gross income	10% income tax	Transfer	Net income	Gain/loss	Redistributive preference
	10	1	12,9	21,9	11,9	pro-redistribution
	20	2	12,9	30,9	10,9	pro-redistribution
	40	4	12,9	48,9	8,9	pro-redistribution
	80	8	12,9	84,9	4,9	pro-redistribution
	100	10	12,9	102,9	2,9	pro-redistribution
	150	15	12,9	147,9	-2,1	anti-redistribution
	500	50	12,9	462,9	-37,1	anti-redistribution
mean	128,6	90	12,86			
median	80					

B. Policy proposal to introduce 100% tax and equal transfer for all

	Gross income	100% income tax	Transfer	Net income	Gain/loss	Redistributive preference
	10	10	128,6	128,6	118,6	pro-redistribution
	20	20	128,6	128,6	108,6	pro-redistribution
	40	40	128,6	128,6	88,6	pro-redistribution
	80	80	128,6	128,6	48,6	pro-redistribution
	100	100	128,6	128,6	28,6	pro-redistribution
	150	150	128,6	128,6	-21,4	anti-redistribution
	500	500	128,6	128,6	-371,4	anti-redistribution
mean	128,6	900	128,57			
median	80					

Why policy proposal of 100% income tax is not politically possible in two issues and two party competition see:
John Roemer, *Why the poor do not expropriate the rich: an old argument in new garb*, 1998

- **The median is lower than the mean and in result there is a majority of net gainers from redistribution**

- Policy proposal is flat income tax and the lump-sum transfer for all which is the sum of tax revenue divided by the number of taxpayers

- The maximum gain for those below mean is when the income tax is 100% i.e. all income is taken and divided equally between all individuals

- **The party which proposes more redistribution i.e. higher income tax and higher transfer should be more popular than party with lower levels of tax and transfer**

Empirical confirmation that median is lower than mean in majority of countries in Europe

Figure 3.4: Ratio of mean to median equivalised income, EU-27, income year 2012
(Survey year 2013)
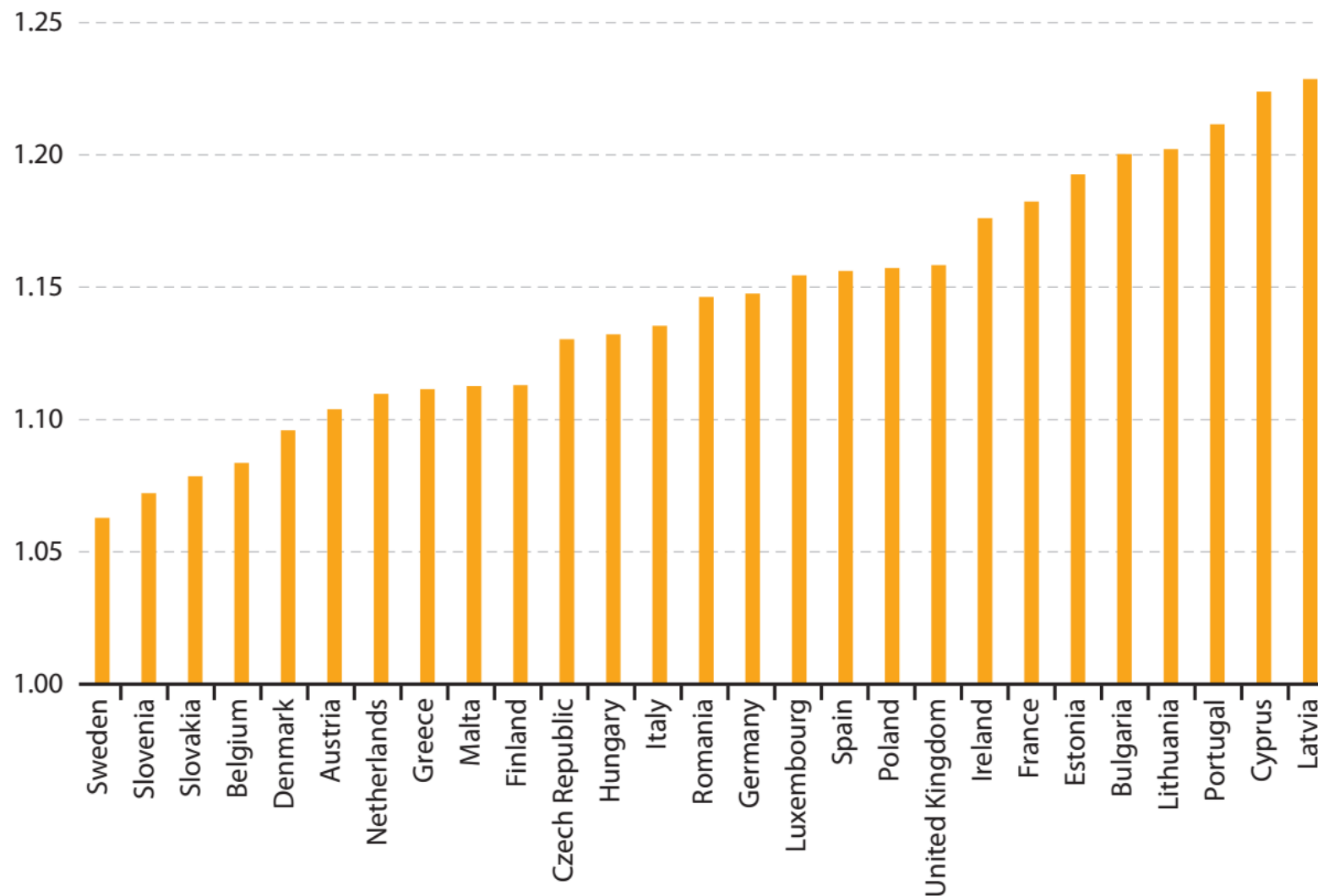
If mean to median income is greater than 1 it means that median is lower than mean

Monitoring social inclusion in Europe, 2017

Between country variability of preferences for redistribution and correlation between them and income inequality and its reduction

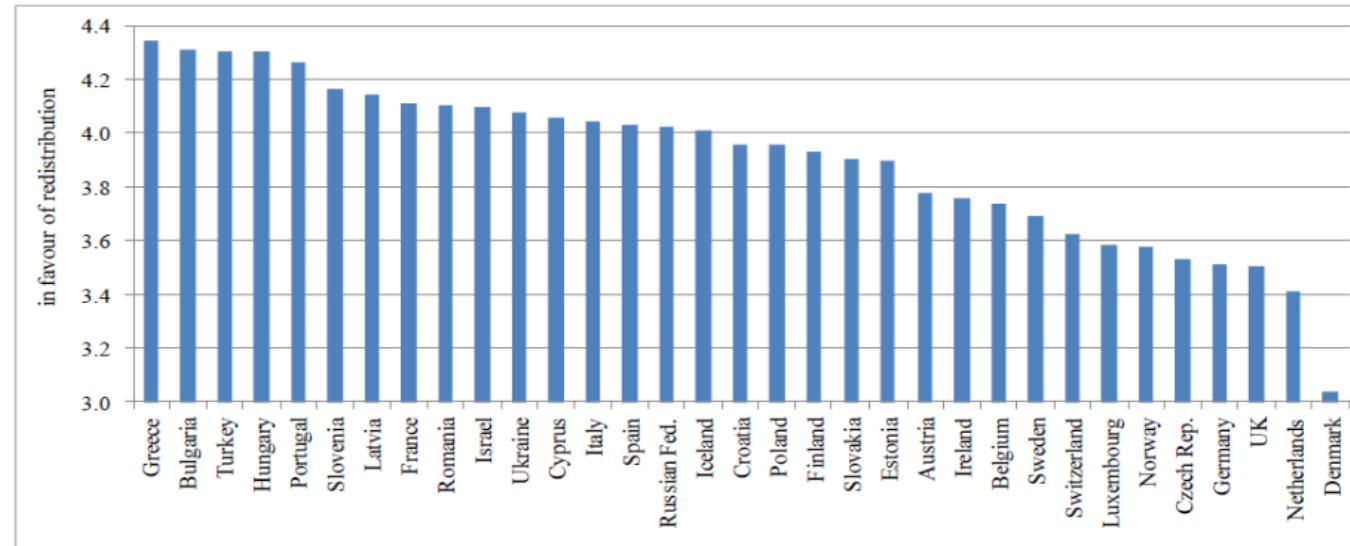Figure 1. Preferences for redistribution by country, 2002–2010

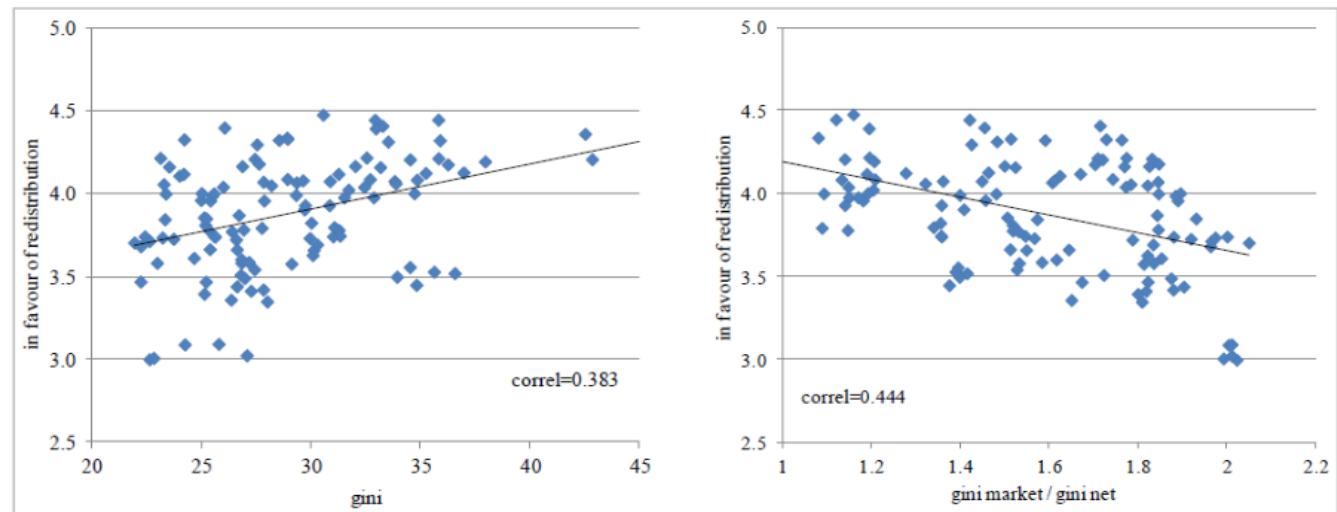Figure 2. Preferences for redistribution and income inequality

correl=0.383

correl=0.444

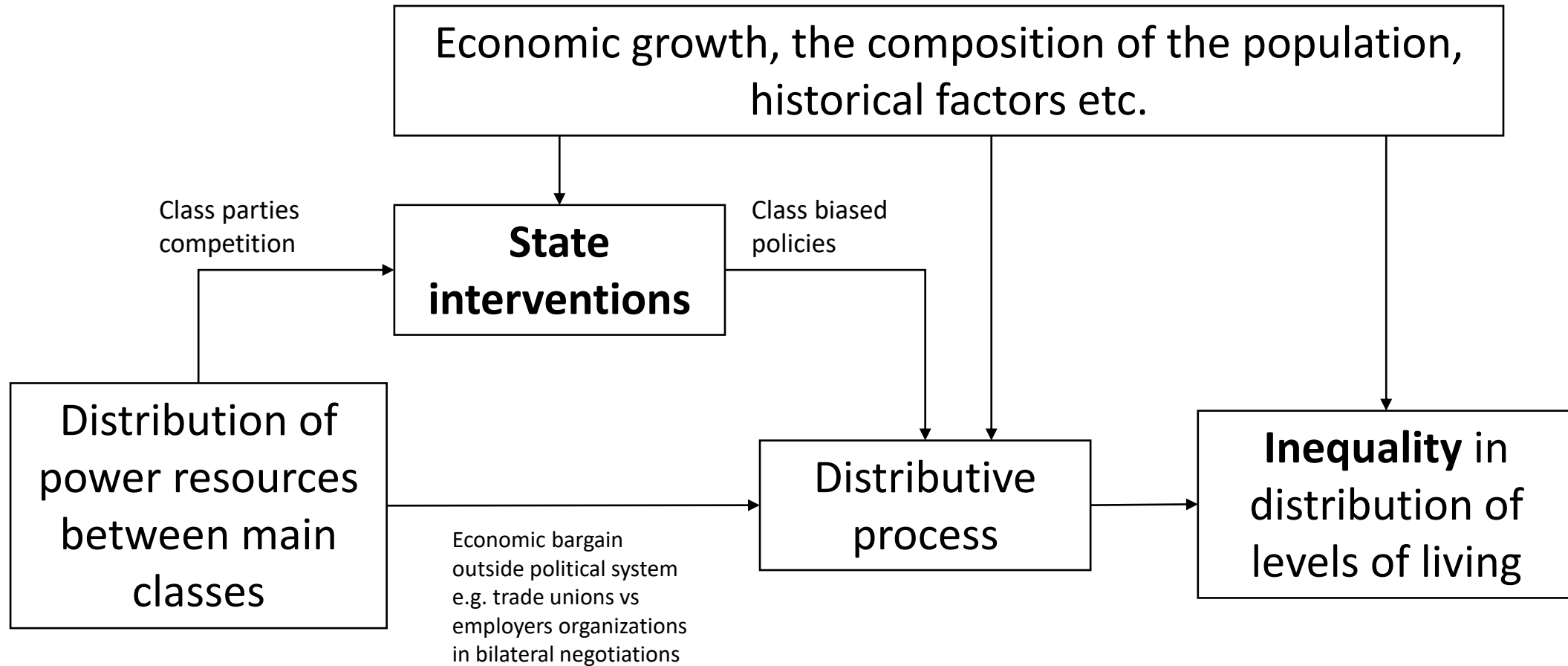Javier Oliviera, *Preferences for redistribution in Europe,* 2013

Alternative explanations to Median Voter Theorem: Power Resources Theory and Democratic Class Struggle

Alternatives to the Meltzer-Richard model in explanation of the redistribution

- M-R model is weak in explaining varieties of the level of public expenditures or redistributive policies in different countries (**Robin Hood paradox**: **countries with higher redistribution have lower inequality***)

- Two other theories were put forward to explain variability of the redistribution policies between countries

  - The **POWER RESOURCES THEORY** focuses on the strength of class organizations (e.g. trade unions) and their links with political parties (e.g. left wing). **The relative strength of certain class is considered as a determinant of social policy e.g. if working class relative to capitalist class is stronger, then social policy should be more redistributive and vice versa**

  - The **VARIETIES OF CAPITALISM** argument has departed from the perspective that considers class relations as confrontational, and claims that **strategic interactions between classes (e.g. alliances between argicultural and socialdemocratic parties) are the decisive factor of social policy**

* Countries with higher redistribution e.g. Sweden have more equal distribution of income than those which redistribute less e.g. USA. **Robin Hood should be more active in the second group not the first**. For more details see Alex Tabarrok, *A Rational Theory of the Size of Government*
The explanation could be **difference between perceived inequality and actual inequality,** e.g. Swedes can see their country as still very unequal, and US Americans see their society as equal in terms of opportunitties

Power Resources Theory: decisive role of distribution of power resources between working class and other classes

Economic growth, the composition of the population, historical factors etc.

Class parties competition

State interventions

Class biased policies

Distribution of power resources between main classes

Economic bargain outside political system e.g. trade unions vs employers organizations in bilateral negotiations

Distributive process

Inequality in distribution of levels of living

W. Korpi, *Democratic Class Struggle*, 1983, p. 187

Theory of democratic class struggle: summary

1. Within the industrial democracies, **universal adult suffrage has substantially reduced political inequalities by enfranchising low-income voters**, who constitute a majority of the electorate

2. **These voters tend to support parties of the left, which seek to redistribute income in favor of low-income voters**, and do so when in office

3. **Parties of the left compete with parties of the right, which draw the bulk of their support from higher-income voters**, and which protect the economic interests of their supporters when in office

4. **Failure of a party to pursue the class-defined economic interests of its constituents results in a loss of electoral support** for that party

Robert W. Jackman, *Elections and the Democratic Class Struggle*, World Politics, 1986, p. 131

Comment: But what about developments in the 1990s and beyond, e.g. Blair's (UK) or Shroeder's (DE) **Third Way ideology** and policies and politics? What about the rise of populist right parties? What about emerging **post-communist democracies with their specificity on the left ideological side** (new post-communist main left party was rather liberal in the case of Poland)?

Political theory explaining differences in redistribution between developed and emerging democracies

Non-political explanation of the inequality in countries in transformation process
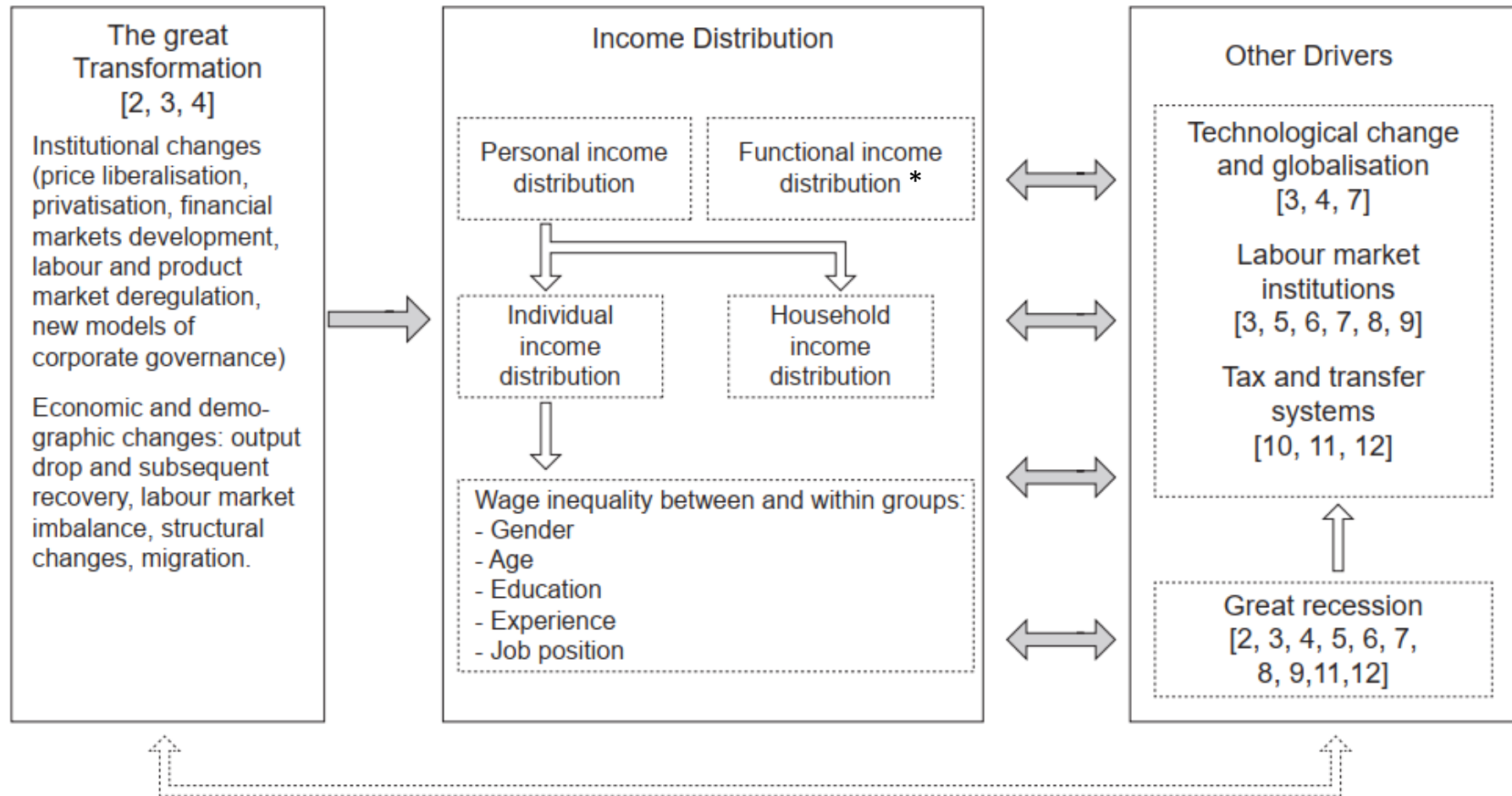

The great Transformation [2, 3, 4]	Income Distribution	Other Drivers
Institutional changes (price liberalisation, privatisation, financial markets development, labour and product market deregulation, new models of corporate governance)	Personal income distribution / Functional income distribution *	Technological change and globalisation [3, 4, 7]
	Individual income distribution / Household income distribution	Labour market institutions [3, 5, 6, 7, 8, 9]
Economic and demographic changes: output drop and subsequent recovery, labour market imbalance, structural changes, migration.	Wage inequality between and within groups: - Gender - Age - Education - Experience - Job position	Tax and transfer systems [10, 11, 12]
		Great recession [2, 3, 4, 5, 6, 7, 8, 9,11,12]

Figure 1.1   Income inequality in transition countries: a conceptual framework

Notes: In square brackets are the numbers of the chapters in this book that deal with the topic specified.

Cristiano Perugini, Fabrizio Pompei eds.
Inequalities During and After Transition in Central and Eastern Europe, 2015

* The functional distribution of income refers to how national income is divided among the factors of production - land, labor and capital. It looks at what share of national income goes to wages and salaries (labor's share), profits and interest (capital's share), and rent (land's share).

Politrical explanations: Who is voting and who is not voting (turnout) by income group in emerging democracies

„If we take into account the probability of voting by income groups, **the relevant population of likely voters will be wealthier**"

„Low political participation by the poor distorts public policies in new democracies"

Ekrem Karakoç, A Theory of Redistribution in New Democracies: Income Disparity in New Democracies in Europe, *Comparative Politics*, 2017

„our theory and findings show that **low political participation among the poor distorts public policies in favor of the middle class in new democracies**"
Conclusion: Even if the majority of voters are poor, they are less mobilised to vote for pro-redistributive parties, than rich voters to vote for anti-redistributive parties

Ekrem Karakoç, *Inequality After the Transition : Political Parties, Party Systems, and Social Policy in Southern and Postcommunist Europe*, 2018

TABLE 2.1 *Turnout among the poor across European democracies*

|	Year	Inequality	The poor (%)	Nonvoters among the poor (%)	The rich (%)	Nonvoters among the rich (%)
Austria	2002	0.26	20	30	14	9
Croatia	2008	0.34	26	33	22	16
Czech	2010	0.26	29	34	20	18
Republic	2012	0.26	21	27	20	15
Estonia	2008	0.31	24	28	22	18
France	2008	0.29	17	26	22	17
	2014	0.29	15	20	18	12
Hungary	2010	0.28	20	25	19	14
Germany	2002	0.27	13	25	24	9
	2006	0.29	16	29	21	9
Greece	2002	0.33	29	34	*16*	*17*
	2010	0.32	25	27	*21*	*19*
Latvia	2008	0.38	26	32	17	14
Lithuania	2012	0.32	20	24	16	13
Poland	2002	0.32	32	37	*13*	*12*
	2006	0.31	24	28	*15*	*14*
	2012	0.32	20	27	*15*	9
Portugal	2002	0.38	*15*	*15*	17	12
	2014	0.35	15	21	25	21
Romania	2008	0.36	23	26	*26*	*29*
Slovakia	2006	0.25	16	19	*11*	*11*
	2010	0.26	23	29	22	21
Slovenia	2002	0.23	24	28	21	21
	2006	0.25	14	18	*20*	*19*
	2014	0.27	23	31	*16*	*15*
Spain	2002	0.34	*19*	*22*	*16*	*14*
	2004	0.32	24	31	15	11
	2012	*0.34*	14	20	21	15
Turkey	2004	0.41	*23*	*25*	*9*	*11*
	2008	0.39	23	26	16	19
Ukraine	2008	0.27	*20*	*22*	*18*	*20*
	2012	0.25	*14*	*15*	*19*	*21*
UK	2002	0.34	22	24	15	15
	2006	0.34	*18*	*20*	20	17

Data come from European Social Survey (2002–2014). T-test indicates that italics are not statistically significant at p < 0.05.

Low turnout of the poor voters and political instability in explanation of inequality in post-transition countries

The theory posits that **low voter turnout and high electoral volatility (instability in party systems) lead to increased targeted social spending by governments**.

This **targeted spending favors certain groups like the middle class and organized interests, rather than the poor**.

As a result, despite the increase in spending, overall income inequality persists or worsens in new democracies.
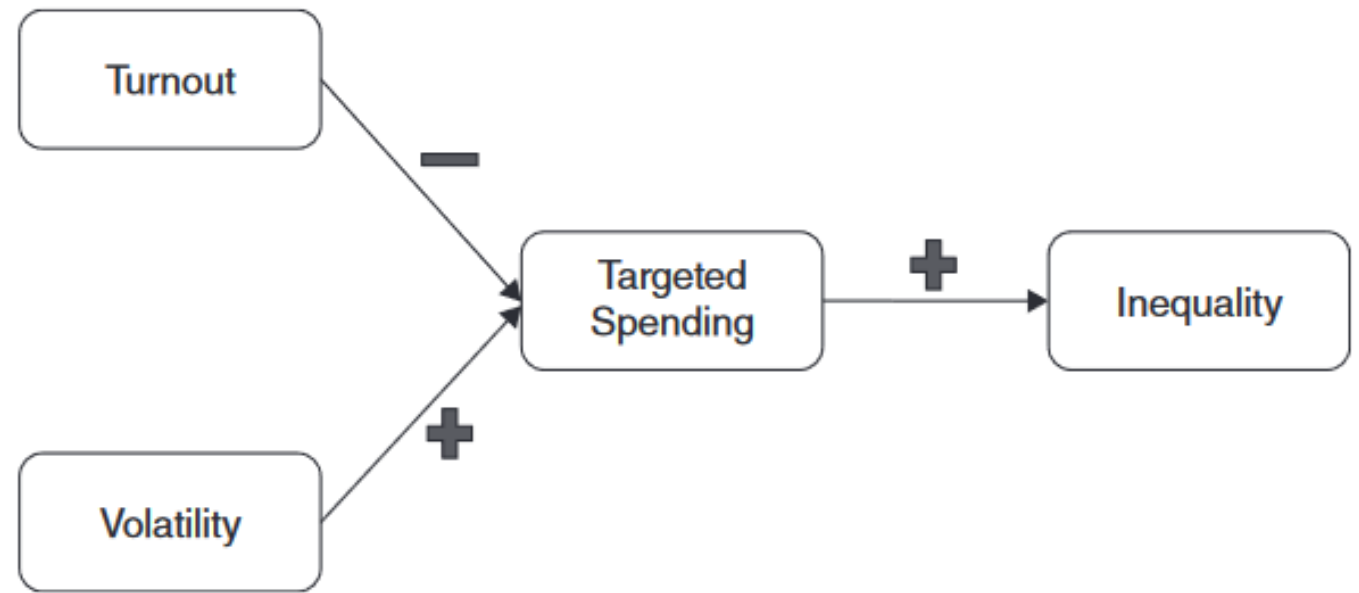
Ekrem Karakoc, *Inequality After the Transition: Political Parties, Party Systems, and Social Policy in Southern and Postcommunist Europe*, 2018

In summary, the causal chain is:
1. Low voter turnout, especially among the poor
2. High electoral volatility, meaning unstable party systems
3. Governments increase targeted social spending to appeal to likely voters and organized groups
4. **This targeted spending exacerbates income inequality instead of reducing it**

Emerging democracies and income class based politics

What are emerging democracies?

- **They were once autocracies** e.g. communist party system, military dictatorships, religious states

- **They have middle or low economic development**

- After democratization they are **not fully democratic by western standards**

In emerging democracies three **basic assumptions of income class based politics** DO NOT HOLD
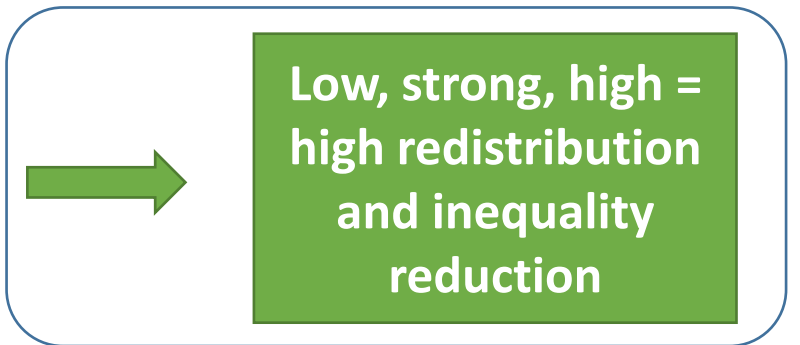
1. ECONOMIC VOTING: **Voters' preferences are strongly decided by individual income status**

2. PERFECT POLITICAL MARKET: **Politicians and voters have perfect knowledge about each other**, including their preferences, policy orientation, and credibility

3. STRONG POLICY CAPACITY OF THE STATE: The **state has always sufficient capacity to implement laws and policies**, including taxation and social policy

Stages of political process and main political variables in explaining redistribution in emerging democracies
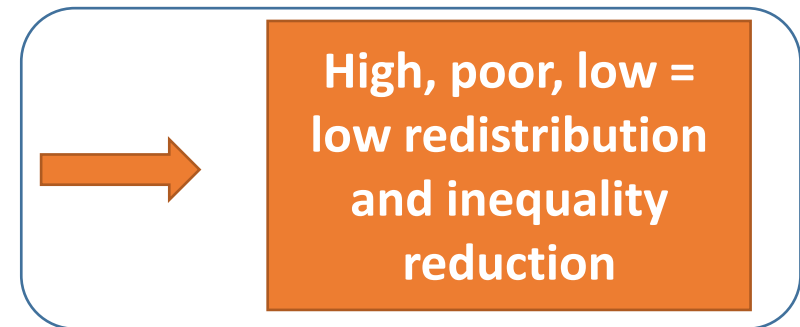
Stage of political process	Main political variable
1. Formation of individual preferences	Multidimensional preferences: low / high
2. Aggregation of preferences and representation	The state of political market: strong / poor
3. Implementation	The level of state capacity: high / low

Two predictions based on configuration of variables

In developed democracies

Low, strong, high = high redistribution and inequality reduction

IN EMERGING DEMOCRACIES

High, poor, low = low redistribution and inequality reduction

Based on Takeshi Kawanaka, Yasushi Hazama, *Political Determinants of Income Inequality in Emerging Democracies*, 2016

1. Formation of political preferences: income vs other factors

Stage of political process	Main political variable
1. Formation of individual preferences	**Multidimensional preferences: high**
2. Aggregation of preferences and representation	The state of political market: poor
3. Implementation	The level of state capacity: low

In emerging democracies

Low redistribution and inequality reduction
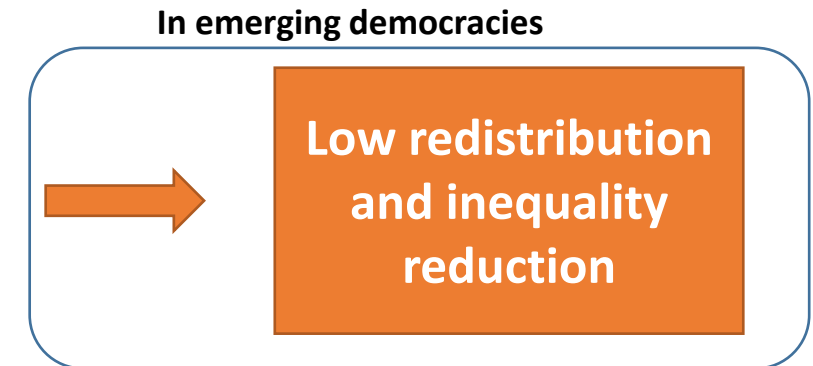
Income as determinant of political preferences: four assumptions of economic theory of voting (M-R model)

1. **NATURE OF REDISTRIBUTION**: An individual receives greater benefits under inequality reduction if one's income status is lower than the mean income

2. **REDISTRIBUTION AND ECONOMIC INTERESTS**: **The poor prefer greater redistribution, whereas the rich would prefer avoiding tax burden** to support inequality reduction, particularly redistribution

3. **RATIONALITY**: **A rational individual constructs his/her voting strategy to maximize benefits based on the payoff structure determined by his/her income status**

4. **RISK**: **Those who face a larger risk of losing their job or income reduction seem to support a larger welfare state**. Although risk is not about current income, it affects expected future income

# Beliefs as distraction for income based political preferences

- **Perception of fairness** (perception of importance of personal effort in obtaining higher income)
  - Those who **believe in personal effort in obtaining a better income tend not to support redistribution** even if they belong to the lower income group
  - Those who think that **luck or family background determines income levels are expected to have higher support for redistribution**
- **Individual expectations for social mobility**
  - Those who expect a higher future income with a greater subjective probability would not prefer as much inequality reduction even if their current income is not high
- **Political socialization**
  - **People born in highly redistributive countries and former socialist countries tend to support greater redistribution** (e.g. the case of Poland)

Group identities as distraction for income based political preferences

- **Different grounds for group identities** (not only income): nation, race, gender, **ethnicity**, religion, occupation, residential areas etc.
- **Groups made by income level (the rich, the middle, the poor) are different than groups with clear identity** e.g. member of the Polish nation identity vs member of the poor group identity
- Group identity argument: individual preferences for inequality reduction would be shaped by the collective benefits for the group to which voters feel they belong
- People could support a party that emphasizes the group identity even at the cost of individual benefits (policy bundling i.e. combining different policies in one electoral platform, could reinforce it)

2. The state of political market: limited knowledge about politicians and their values and agendas

Stage of political process	Main political variable
1. Formation of individual preferences	Multidimensional preferences: high
2. Aggregation of preferences and representation	**The state of political market: poor**
3. Implementation	The level of state capacity: low

In emerging democracies

➡ Low redistribution and inequality reduction
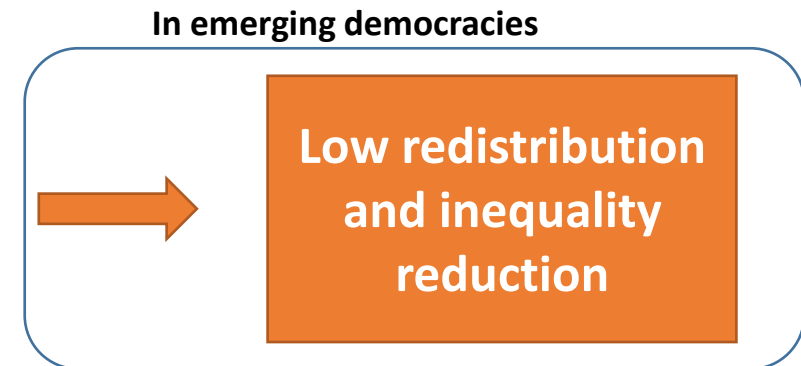
The idea of political market and redistribution

- Supply and demand side of political market*
  - Politicians offer policies (supply side)
  - Voters choosing between policies (demand side)

- Main product on the political market
  - Redistributive policies

- Main exchange unit
  - Votes in elections

- Main mechanism
  - If majority demands redistribution then they vote for politicians who offer redistributive policies (demand is driving supply)

* The other perspective is: „In the political marketplace, the "buyers" are politicians while the "sellers" are voters" (Kenny, *Why Populism*, 2023). In the first perspective, policies (here redistribution) are the goods being supplied and demanded, while in the second perspective, votes and political support are the goods being supplied and demanded. Both perspectives are using the concepts of supply and demand but applying them to different 'goods' within the political marketplace: policies in the first case, and votes/support in the second.

Political market failure in emerging democracies

- **Information constraints** (IC)
  - **Voters do not have sufficient information** about politicians
  - **Voters do not know** whether they can **trust politicians** to keep their preelection promises
  - **Voters do not know** politician's actual **policy orientations**
  - RESULT: Politicians have no incentives to secure public support by policy platforms
- Information constriants leads to **commitment problem**
- The **solution for commitment problem is political mobilization as patron-client networks**: personal networks based on the <u>exchange of private goods and political support</u> (**clientelism**)

# Three explanations why clientelism is bad for redistribution

1. **Concentration on private goods**: patron-client networks tended to concentrate on private goods thus limits more comprehensive redistributive approach with public goods

2. **Grassroots political leaders take their share**: maintenance of personal ties with voters-clients is crucial so grassroots political leaders are main distributors of benefits and take some of the resources from the common pool

3. **Distribution of benefits on political loyalty not income status**: clients of local politicians are not necessary the poor and redistribution is not effective in reaching those in poverty

Factors supporting clientelism in emerging democracies

- **Ethnic ties importance in clientelism**: patron-client networks could develop in line with ethnic ties and this is link to group identities

- **Deficiency in accountability**: voter capacity to penalize politicians who do not respond to their demands is lower for those in poverty, without education

- **Weak institutionalization of party system**: fluid and unstable political parties (e.g. frequent mergers and splits of parties, party control by individuals with strong personalities, vague names of parties) **are not a solution of the problem of information constraint**

3. State capacity to implement redistribution

Stage of political process	Main political variable
1. Formation of individual preferences	Multidimensional preferences: high
2. Aggregation of preferences and representation	The state of political market: poor
3. Implementation	**The level of state capacity: low**

In emerging democracies

Low redistribution and inequality reduction
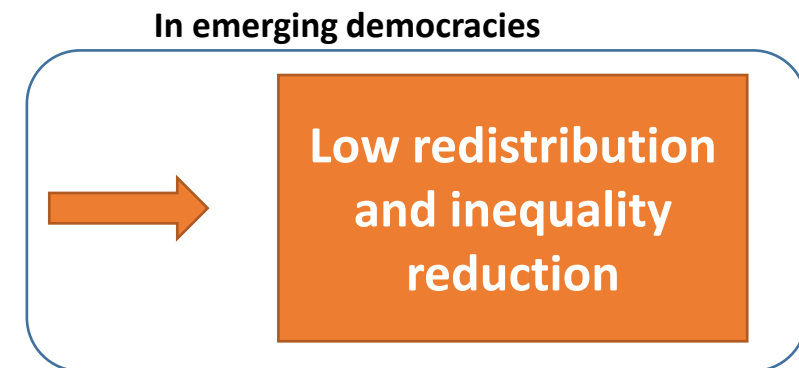
State capacity to implement redistributive policies in emerging democracies

- Social powers **(interest groups) are sufficiently strong to evade state control** in emerging democracies
- Consequences
  - **Financial resources**: weak capacity makes income monitoring difficult, **direct taxes are difficult to collect**, relying on indirect taxes
  - **Informal economy size**. When **informal economy share is large inequality reduction would not be even attempted**, because people know that the state lacks the capacity to implement public policy for inequality reduction
  - **Stagnation in social policy implementation**. Weak state capacity is represented by a **lack of skilled professional bureaucracy**
  - **Corruption**: bribing tax authorities, **lobbying for pro-rich policies**

Theory of redistribution and inequality reduction in emerging democracies: summary

Stage of political process	Main political variable
1. Formation of individual preferences	**Multidimensional preferences are high**
2. Aggregation of preferences and representation	**The state of political market is poor**
3. Implementation	**The level of state capacity is low**

In emerging democracies

→ Low redistribution and inequality reduction

Based on Takeshi Kawanaka, Yasushi Hazama, *Political Determinants of Income Inequality in Emerging Democracies*, 2016

What we have learnt? Summary

1. If we know that the redistributive welfare state developed substantially in 20th century, but differently in different countries (e.g. US vs France) then the question is how the size of the redistribution increased and those between countries differences emerged

2. Median Voter Theorem applied to simple redistributive policy (flat income tax and transfer equal for all) by Meltzer and Richard (MR) resulted in prediction that pro-redistributive party will win in countries with two-party majoritarian election and typical income distribution

3. MR model was criticized as not useful in explanation of the variability of redistributive policy in different countries (Robin Hood Paradox i.e. redistribution is higher in mor equal countries)

4. Power Resources Theory (working class mobilization) and Democratic Class Struggle are better in explanation of differences in redistributive policy in different countries

5. Emerging democracies have a weak redistributive policy, because of: 1) the poor have lower turnout than the middle class and the rich, 2) multidimensional political preferences (voters care not only about their economic self-interest), 3) weak and unstable political parties (party volatility) and 3) insufficient capacity of the state administration to resist powerful interest groups and corruption (clientelism)