

Mobility and Redistribution

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Mobility and redistribution

- Meltzer Richards model is static
- Growth applications do not allow for social mobility and changes in the rankings of endowments
- Rankings do not change in the growth path

Mobility

- If redistributive policies are long lasting future income prospects and future positions in the income ladder matter in determining current preferences, not only current income.
- Prospect of upward mobility should make someone relatively poor today less averse to redistribution.

POUM Hypothesis

- Assumptions:
 - 1) Long lasting redistributive policies
 - 2) Tomorrow's expected income a concave function of today's income
 - 3) Limited risk aversion
 - 4) Skewenes in the distribution of random shocks to income

Discussion

- 1) Obvious
- 2) This imply that some of the families that are poorer than average today expect to become richer than average tomorrow but this effect is declining at an increasing rate with initial income
- 3) Implies that the risk of loosing out does not have an overwhelming effect on individuals' utility

Discussion

- 4) without skewedness in the distribution of random shocks the income distribution over time would not remain constant given the concavity of the function linking today's income to tomorrow expected income; in particular it would become less skewed. Skewed shocks maintain the skewness.

Do we believe in POUM?

- As an explanation for why we don't observe expropriatory policies for the rich in democracies?
- No.
- What really matter is that the median voter model does not hold; various ways in which the rich count more than one person one vote, various other characteristics of the political system.

Do we believe in POUM?

- As a reminder that social mobility interacts with preferences for redistributions definitively yes.
- Are people rational in their assessment of POUM?
- Very hard to test: US versus Europe evidence. Over optimism in US and over pessimism in Europe? More on this later

Learning

- Piketty 1996 learning about social mobility form past personal experience and experience of friends
- Is learning rational? Indoctrination?

Mobility and Preferences for redistribution

- Alesina and La Ferrara (2005) test on US data
- Determinants of preference for redistributions:
- Current income (Meltzer Richards) expected future income, risk aversion, perception of fairness, individual characteristics.

Measurement of income mobility

- **Past mobility:** educational attainment relative to father or occupational prestige index relative to father
- **Subjective mobility:** self assessment of prospects of the future

Measurement of mobility

- **Objective measure:** based on transition matrix for US economy for various income deciles from PSID
- Mobility within one to five years time horizon from PSID

Objective mobility

$$EXPINC_{d,(t-1)} = \sum_{i=j}^{10} pd_j \bar{y}_{j,t}$$

Measurement

- From GSS views about the role of government as a redistributive machine
- Various individual characteristics
- Dependent variable :” the government should reduce income differences between rich and poor by raising taxes on wealthy families or by giving income assistance to the poor”

Results

- More favorable to redistribution if you are:
- Black, Woman, Poor, low expected future income, less educated.
- Huge racial effect (black versus white) after controlling for income education and everything else.

Multiple equilibria models

- Alesina and Angeletos (2005) Luck and sense of justice
- Benabou and Tirole (2006) Self imposed belief in a just world.

Alesina Angeletos AER 2005

- Static economy infinite number of agents (continuum 0-1).
- Work en ante and ex post, i.e. before and after taxation.
- Meltzer Richard redistributive scheme
- Total income depends on work effort and luck

Alesina and Angeletos

$$y_i = A_i [\alpha k_i + (1 - \alpha) e_i] + \eta_i$$

$$c_i = (1 - \tau) y_i + G$$

$$U_i = u_i - \gamma \Omega$$

$$u_i = V_i(c_i, k_i, e_i) = c_i - \frac{1}{2\beta_i} [\alpha k_i^2 + (1 - \alpha) e_i^2]$$

$$\Omega = \int_i (u_i - \hat{u}_i)^2$$

$$\hat{c}_i = \hat{y}_i = A_i [\alpha k_i + (1 - \alpha) e_i]$$

DEFINITION: An equilibrium is a tax rate τ and a collection of individuals $\{k_i, e_i\}_{i \in [0,1]}$ such that (i) the plan (k_i, e_i) maximizes the utility of agent i for every i , and (ii) the tax rate maximizes the utility of the median agent.

$$\Omega = \tau^2 \text{Var}(\hat{y}_i) + (1 - \tau)^2 \text{Var}(y_i - \hat{y}_i)$$

$$\frac{1 - \tau}{\tau} = \frac{\text{Var}(\hat{y}_i)}{\text{Var}(y_i - \hat{y}_i)}$$

$$\frac{\text{Var}(\hat{y}_i)}{\text{Var}(y_i - \hat{y}_i)} = [1 - \alpha\tau_e - (1 - \alpha)\tau]^2 \frac{\sigma_\delta^2}{\sigma_\eta^2}$$

$$\sigma_\delta^2 \equiv \text{Var}(\delta_i) \equiv \text{Var}(\beta_i A_i^2) \quad \sigma_\eta^2 \equiv \text{Var}(\eta)$$

Equilibrium

- With no demand for justice a unique Meltzer Richard type equilibrium
- With a sufficiently high level of gamma multiple equilibria can exist.
- US equilibrium: low taxes, high effort, low incidence of luck, low tax desired.
- EU equilibrium high taxes, high incidence of luck, and low effort, high tax desired.

Benabou and Tirole Qje 2006

- Different perceptions of the same reality.
- EU equilibrium: effort does not pay off, I do not work hard, I need social insurance and high taxes, rational not to work hard because of disincentive effects of taxation
- US equilibrium: self inducement to think that efforts create success, work hard, less demand for social insurance, lower taxation, rational to work hard.