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## **Special-Interest Policies and Redistribution**

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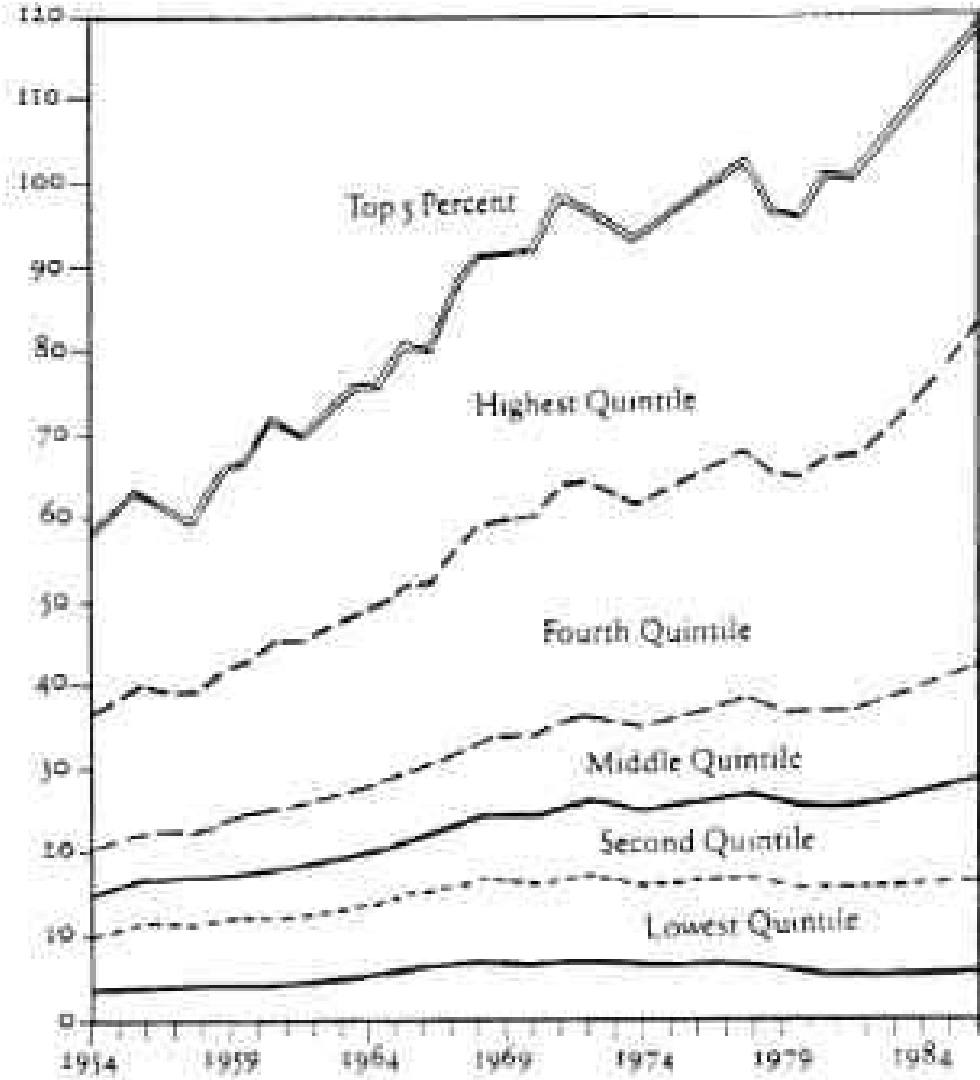
## Why do governments redistribute income?

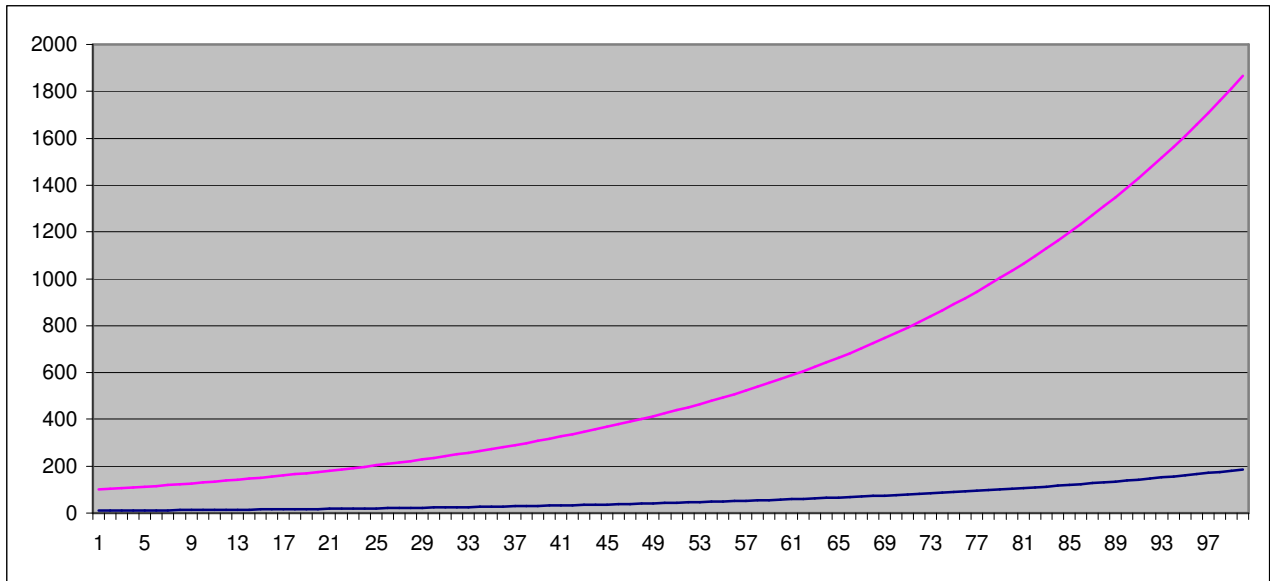
- to achieve an optimal level of income inequality (optimal might mean: growth maximizing)
- to provide benefits for important groups of voters (swing voters, median-voters)
- to achieve second order goals, such as environmental protection
- else?

# Some remarks on the development of income inequality in the USA

(An Example on how to lie with statistics)

**Figure 2: Mean Incomes of Population Quintiles, 1954-86**  
Thousands of US dollars





Both functions grow with a rate of 3%.

Income Inequality in the US

<http://www.census.gov/prod/2000pubs/p60-204.pdf>

## Major Policy Instruments to Redirect Income

- tax policy
- subsidies
- social transfers
- monetary policy
- regulation
- trade policy
- cultural policy
- ..

Is there any policy that does not redirect income?  
NO.

## Simple Models of Income Redistribution

Meltzer-Richard

pre-tax income: productivity times hours worked

individuals maximize utility, which is an increasing concave function of consumption (=productivity\*hours worked – taxes) and leisure  $z$

$$c = (1 - \tau)l\kappa + v$$

where  $c$  is consumption,  $\tau$  the tax rate,  $l$  is times worked ( $1-l$  is thus leisure) and  $v$  are government transfer to the individual,  $\kappa$  is productivity.

Government's transfers cannot exceed the tax rate times the taxed income (no deficits).

This model suggests that poorer individuals prefer higher taxes.

The model's predictions are often interpreted as

The lower the median voter's income relative to the mean income, the higher the degree of redistribution c.p.

DISCUSS!

## Dixit-Londregan Model

In this model, two parties with different policy preferences compete for the votes of the electorate.

The utility of voters depend on two factors:

the distance between his policy position and the position of the party in power, and on his consumption, which is a function of his/her pre-tax income and transfers s/he receives.

Transfers are directed to 'groups' (rather than to the population or to the individual).

The model is non-trivial, but its main results are the following:

In equilibrium, each party offers a vector of transfers which maximize its total votes, taking the other parties vector of transfers into consideration (subject to a balanced budget constraint).

The basic model has been used to derive predictions on the parties' response to different reaction function of voters.

Most importantly, it can be shown that BOTH parties are more likely to target swing voters to direct transfers to voters that can be targeted more efficiently.

These are two different, even competing predictions:

if parties now core voters better, they can target them more efficiently, however, the matter much less for the electoral outcome than swing voters.

**DISCUSS!**

## **Pork-Barrel Politics**

Pork Barrel refers to a situation in which a collectively financed program is directed to a small group though the social costs exceed the social benefits.

In the US context, Pork Barrel is explained by the decision-making mechanism in the US congress.

The Weingast, Shepsle, Johnson model suggest that there are  $J$  legislative district, and each congressman has an incentive to provide goodies to his district's electorate.

Projects are financed by tax revenues, which have a unspecific origin, that is: tax income from California might be used to finance a bridge in Delaware.

Btw. the same logic applies to decision-making in the EU.

Buchanan and Tullock argue that congressmen exchange support, that is, they support each others projects. This behavior is called logrolling.

Fiorina and Baron model legislative processes based on logrolling. In short, they suggest that the congress should decide firstly on the size of budget, then on its distribution.

## Lobbying and Redistribution

The standard model of lobbying for special interests is by Grossman and Helpman.

They assume opportunistic governments, voters with mean interest  $v$  and interest groups with interest  $c$ .

In the absence of organized special-interests, the government would implement a policy according to the mean (median) voters' interest. With organized interests, the interest group might pull the government away from this policy.

In doing so, the interest group commands over two instruments:

it can transfer 'resources' and 'information' to the government.

The equilibrium of the game depends on the reaction function of the voters, the heterogeneity of interests among organized interests, and the resources/information over which the interest-group commands.