Inequality and Redistribution:

From Classical to Behavioral Approaches

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Who Wants To Redistribute?

- Once upon a time, this question had a simple answer: Meltzer-Richard model

- Voters poorer than average want to redistribute (say, linearly), trade off gain versus incentive distortions $\Rightarrow$ Three important predictions

  A Income is main determinant of individual demand for redistribution

  B Countries with more inequality (poorer median) will redistribute more

  C As inequality rises, equilibrium policies become more redistributive

- Over time, facts have shown all three predictions to be largely false.

  1. Poor often vote for the Right, don't want to "expropriate the rich" although perceive little incentive distortions. Income very imperfect predictor

  2. Countries with more inequality redistribute less, not more: US/Europe, Scandinavia/Continental Europe, Korea/Philippines or Latin America

  3. As inequality rises, voters bring to power "populists" (often millionaires) who implement regressive rather than progressive policies: Reagan, Bush's, Berlusconi, Trump, Bolsonaro, Orban,.. Frequent link to religious interests.

Answer 1: wealth-bias & efficient redistribution I

Bénabou (AER 2000) "Unequal Societies: Income Distribution and Social Contract

- Influence (participation, contributions) rises with income, education $\Rightarrow$ pivotal voter richer than median, and even average.

  - On its own, answers why the poor do not expropriate the rich, but leaves comparative-statics puzzles (A), (B), (C) unchanged.

- Add key ingredient: some forms of progressive redistribution generate efficiency or growth gains rather than losses: public education, health insurance, relaxing wealth constraints $\Rightarrow$

- New picture, set of predictions emerge:

  1. Pivotal rich trades off self-interest vs. aggregate / ex-ante benefits of progressive policies (or: costs of regressive policies) $\Rightarrow$ as inequality Δ rises, wants less redistribution $\Rightarrow$ Solves (B,C): $\partial \tau_t / \partial \Delta_t < 0$ over some range

  2. Dynamics: capital market imperfections (relating to efficiency benefits): more redistribution today, less inequality in the next generation: $\partial \Delta_{t+1} / \partial \tau_t < 0$

Answer 1: wealth-bias & efficient redistribution II
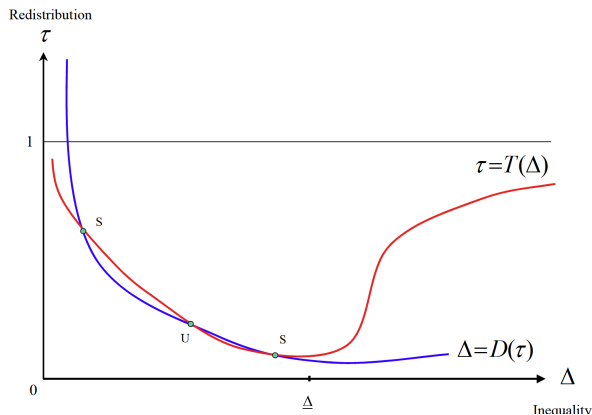
- ③ Multiple steady-states in $(\Delta, \tau) =$ *(Inequality, Policies or Institutions)*
- ④ Across societies/ steady -states: Corr(*Inequality*, *Mobility*) $< 0 \Rightarrow$

  Model already predicts the "Great Gatsby Curve" (Krueger 2012)

Answer 1: wealth-bias & efficient redistribution III

Redistribution τ

S_{WS}

$\tau = T(\Delta)$

S'_{LF}

$\Delta = D(\tau)$

S_{LF}

$\underline{\Delta}$

Δ
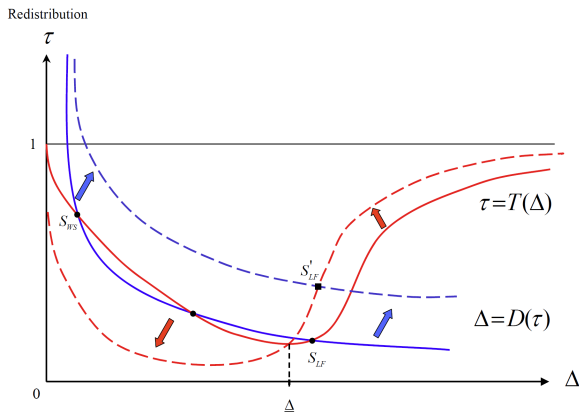
⑤ Inequality shocks: an increase in inequality due to SBTC can cause the Welfare-State equilibrium to unravel ⇒ society transitions to higher inequality, less progressive redistribution, more stagnant mobility

- Overall: helps solve (B,C), but not (A); several novel predictions

Answer 2: POUM

Bénabou-Ok "Social Mobility and the Demand for Redistribution: the POUM Hypothesis" (QJE 2001)

- The poor expect that they, or their children will become richer $\Rightarrow$ oppose (too much) redistribution for that reason, on income and inheritance. But does this proposed explanation even make sense?

  - Mobility process must be (empirically, is) rank-preserving in expectation: i may expect $E\left[y_{t+1}^i\right] > y_t^i$, but if $y_t^j > y_t^i$, still have $E[y_{t+1}^j] > E[y_{t+1}^i]$

  - How could large majority of population (say 2/3) simultaneously be poorer than average today and rationally expect to be richer than average tomorrow? In steady-state, fractions above/below mean are time-invariant

- Surprising positive answer, natural property of social mobility processes:

$$E\left[y_{t+1}^i | y_t^i\right] \text{ is a concave function } f(y_t^i),$$

e.g. standard $\ln y_{t+1}^i = \alpha \ln y_t^i + \varepsilon_t^i$. Thus $f(\bar{y}_t) > \int f(\bar{y}_t^i)di = \bar{y}_{t+1}$: agent with mean income today (and some below it) has expected income above tomorrow' mean income, will oppose lasting redistributions
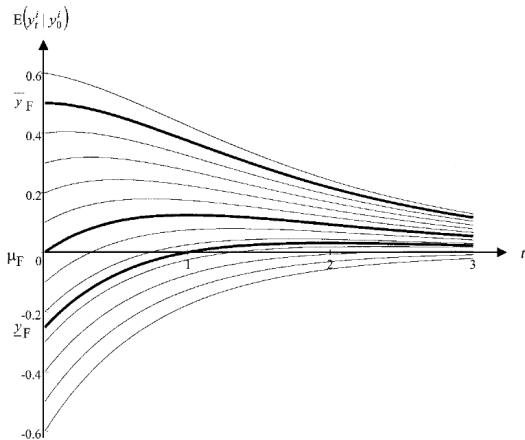
- Combined with skewed shocks, $y_{t+1}^i = f(y_t^i) + \varepsilon_t^i \Rightarrow$ skewed steady-state distribution of realized, actual incomes

- Simulations reasonably well calibrated to US, such that: 65% of population has income below the mean, and yet 77% have expected income above that mean, period after period. Integenerational mobility $\rho \approx 0.5$.

Overall:

1. Explains in (A) why poor do not even want to expropriate the rich, even when unconcerned about distortions. POUM hypothesis theoretically valid, can be quantitatively significant.

2. Still leaves (B,C), i.e. $\partial\tau/\partial\Delta > 0$ largely unchanged

3. With plausible risk aversion (fearing downward mobility more than liking upward mobility) the range of the poor opposing redistribution shrinks, becomes insufficient for a majority

4. Identifies beliefs about the social-mobility process as significant predictor of attitudes toward redistribution, alongside current income (as in Piketty QJE 1995, but different channel and implications).

5. Points to fact that actual redistributive attitudes must involve agents holding more optimistic beliefs about mobility prospects than warranted in reality

Answer 3: Motivated Beliefs - Ideology

Bénabou-Tirole "Belief in a Just World and Redistributive Politics" (QJE 2006)

- Digging deeper into beliefs about mobility process, sources of inequality: findings from political psychology and sociology provide evidence that:

  - ▸ Many people, esp. in the US, overestimate the role of effort, willpower, as determinants of success in life –the extent to which society is meritocratic .

  - ▸ Do so not just as imperfect statisticians, but stubbornly maintain these beliefs in the face of contrary evidence, pass them on to their children. Conversely, blame the victim, e.g., "lazy poor".

  - ▸ At individual level, these "Just-World" beliefs are a key determinant of attitudes toward redistribution, at least as much as income.

- Links to: locus of control, fundamental attribution error, cognitive dissonance, rationalization, "false consciousness". Desire to believe that people get what they deserve, and deserve what they get (Lerner 1982).

  - ▸ Extent of these shared belief distortions varies significantly across countries. Why are people differently receptive to ideologies of the Right vs. the Left (both in ample supply) in different places, times?

Enter Behavioral Political Economy

1. **Psychological mechanism:** beliefs about rewards to effort, perseverance (and others) are endogenous: functionally or/and hedonically adaptive to nature of society in which individuals must operate.

   ▸ Where limited social-safety net, low redistribution: crucial to motivate individual effort ⇒ beliefs about its effectiveness, internal locus of control, have high functional (also, hedonic) value ⇒ actively maintained, passed on.

   ▸ Where strong social safety net, egalitarian redistribution from successful to unsuccessful: investment in such beliefs has much lower value.

2. **Political mechanism:** agents vote based on their beliefs, as usual

- Feedback between the two ⇒

   Beliefs, attitudes, ideologies, coevolve with policies and institutions

   ▸ Very general: motivated-cognition models for beliefs about consumerism vs. leisure as source of happiness; religion; effectiveness of Market vs. State (Bénabou JEEA 2009); stereotypes and discrimination (McGee 2022).

Main Implications I
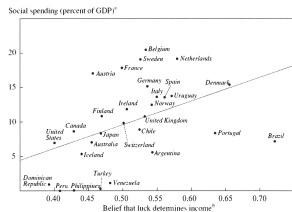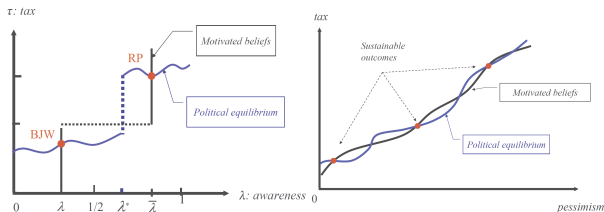
1. Multiple steady-states, history dependence, now in *(Ideology, Policy)* space

   - American-Dream equilibrium with overestimation of role of effort, laziness of the poor, etc., mutually sustaining with low redistribution

   - European Pessimism equilibrium, with beliefs about predominance of luck (incl. birth), together with extensive social-safety net / high taxes

   - Pattern across steady-states matches Alesina-Glaeser-Sacerdote (2001) finding

Main Implications II

② Predicts that in US, should see significant overestimation of role of effort vs. luck. In continental Europe, not so (even slight pessimistic bias if transmitting beliefs is costly). Indeed: Alesina-Stantcheva-Teso (AER 2018)
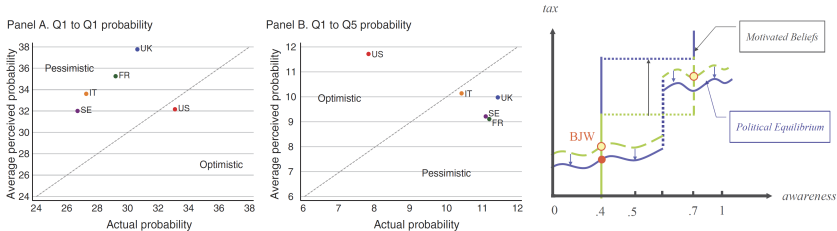

③ Ideological shifts: increases in inequality, such as SBTC, can move society from a Realistic Pessimism equilibrium to a Meritocracy-Myth one ⇒ As inequality rises, redistribution falls, ideology shifts to justify it

  ▸ Model now helps solve (A,B,C).

  ▸ Ideology-Policy shifts can also result from changes in collective action, memorable events (Great Depression), propaganda effectiveness, education,...

Inequality, Religion, and Redistribution

1. Scheve-Stastavage (QJPS 2006): as (national) religiosity increases, social spending decreases. Model in which religion is "club good" that substitutes for social insurance, providing both material and spiritual benefits.

2. Benabou-Ticchi-Vindigni (ReStud 2022):

   1. Higher religiosity facilitates a "Religious Right" coalition between the Rich and the Religious Poor against the Secular Poor: lower taxes, while public goods / tax exemptions / societal laws become more favorable to religious interests

   2. Religiosity itself is endogenous: as inequality rises, the Rich become more willing to impede diffusion of scientific and other forms of knowledge (sources of TFP), to strategically preserve the religiosity of the Poor from erosion

      ⇒ Higher Δ leads not only to lower τ, but also to obscurantism.

3. Alternative / complement: religion as "consolation": helping to see the world as more just (B-T QJE 2006)

- Some suggestive correlations (ongoing work with Davide Ticchi):
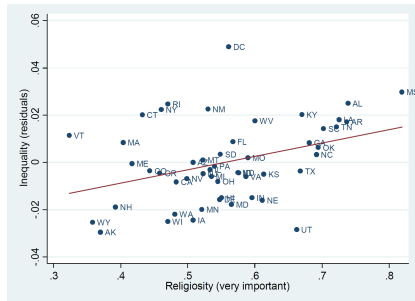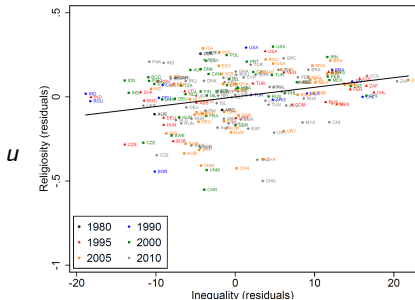
- Controls for GDP/GSP per capita, population, tertiary education, predominant religion, year f.e.'s (WVS)

- Another potential source of persistence in both beliefs and redistribution: higher $\Delta_t \rightarrow$ higher $relig_t \rightarrow$ lower $\tau_t \rightarrow$ higher $\Delta_{+1} \rightarrow$ higher $relig_{t+1}$, etc.

New Questions, Puzzles and Directions

- Recent empirical / experimental research has been digging deeper into the role of beliefs about luck / effort, vs that of "pure" preferences
  - Almas et al. (2021): subjects know whether (experimental) income differences are determined by luck or by task performance $\Rightarrow$ Substantial differences in extent to which people consider luck unfair, want to redistribute it
    –e.g., China, India, do not seem to share West's "meritocratic" preferences.

- Puzzle: goes against standard "veil of ignorance" principle, insurance, core of Mirleesian optimal taxation

- Conjecture: roles, at societal and individual level, of:
  - Fatalism: who am I to "play god", interfere with how the dice fell; randomness is just the way the world works; luck has a purpose, must be seized by those with the right talent, effort
  - Superstition: interfering with what is "meant to be" can be dangerous hubris China and India seem like high-superstition countries

  Relates to and broadens the religion aspect

Meritocracy I

Ongoing work with Jean Tirole

- Behavioral Economics II: besides material rewards, utility depends importantly on symbolic ones: prestige/shame, pride/guilt ⇒

- Should enter positive and normative analyses of inequality, redistribution, and attitudes toward them. Need appropriate models

- Links to: (i) beliefs about effort, talent, luck, but now these matter *per se* as well; (ii) literature on social / self image as motivators, incentives (e.g., Bénabou-Tirole AER 2006, QJE 2011)

- Meritocracy under attack, though sometimes with confused arguments:

    1. "It is not real, people overattribute effort, talent relative to luck". True in some places, not others. Is an argument for more real meritocracy, not less.

    2. "It creates an inefficient rate race, especially at the top". But depends on what achievements attract prestige or stigma: private enrichement / rent seeking, or public goods, knowledge, prosocial behavior. Reallocating "merit", esteem incentives, to socially useful but market-under-rewarded activities.

Meritocracy II

What matters is utility inequality $\Rightarrow$ if the most successful exhaust themselves in competitive pursuit of prestige, perhaps we should not cry too much over their (chosen) fate. Learn to opt out, pursue intrinsic rather then extrinsic goals, vanities. And if not, this reduces inequality of wellbeing with the losers.

3. "Double dividend / penalty": the losers of the race get low income and stigma, the winners high income and social/self esteem. But not true if taxes set optimally: will correct for the (excessive, or perhaps insufficient, see #2) pursuit of esteem and recognition as a negative, zero or positive sum game.

4. If frictions in the setting of taxes cause them to be:
   - Too low: deadweight losses, tax avoidance/competition, unequal political power
   - Too high: poor median, unmeasured knowledge externalities

   relative to first best, then there is room for public arguments / persuasion that there should be less, or more, reverence for "merit".

▸ Build on models combining image + material rewards, and optimal policy along both dimensions (Bénabou-Tirole 2011, Ali-Bénabou 2020).

Optimal taxation with prestige / stigma: simple case

- Effort $a = 0, 1$ cost $(c - v)$, where v is talent, $v \sim F(v)$
- If $a = 1 \rightsquigarrow$ market income w, taxes t, social externality e
- Social / self-esteem payoff: $\mu E\,[talent\,|income]$

1. Equilibrium: talent cutoff $v^*(t)$ above which $a = 1$.

$$w - t + \mu(\underbrace{E\,[v\,|v \geq v^*(t)] - E\,[v\,|v < v^*(t)]}_{\Delta(v^*(t)): \text{ net esteem payoff}}) = c - v^*(t)$$

2. Social optimum: includes reputation tax

$$t^{FB} = w - e + \mu\Delta(v^*(t^{FB}))$$

$\Rightarrow$ Achieves efficiency (Samuelson condition), no "double dividend":

$$e = c - v^*(t^{FB}),$$
$$U(v \geq v^*) - U(v' < v^*) = v - v^*(t^{FB}).$$

Conclusions

1. Theory and empirics / experiments go hand in hand in generating progress:

   - Contra a certain tendency to dismiss theory as useless, now that we have so much data, RCT's. etc.

   - And conversely, "pure" theorists taking refuge in more ethereal spheres

   - Initially "theory ahead of measurement". Now becoming the opposite, need back and forth iterations.

2. Insights from psychology, sociology, anthropology:

   - In the 80's, at the time of MRR paper, political economy had its "rational choice" revolution.

   - Today, in economics if not yet in political-science departments, we are firmly in the realm of Behavioral Political Economy.