The Politics of Economic Inequality
Lecture 24 (May 9, 2013)
Outline

1. Democracy and Economic Inequality
2. Economic Inequality in the United States
3. Explanations for Economic Inequality
Outline

1 Democracy and Economic Inequality

2 Economic Inequality in the United States

3 Explanations for Economic Inequality
Are democracy and capitalism compatible, even mutually reinforcing, or are they fundamentally in conflict?

**Compatible:**

- Intuitively, they are similar in that they are based on choice among competing alternatives:
  - elections as “markets” for policies
- Theoretically, some argue that government control over the economy inevitably threatens democracy:
  - e.g., Friedrich Hayek’s “The Road to Serfdom”
- Empirically, capitalism and democracy are tightly correlated.
Democracy & Capitalism: In Conflict?

- **Conflicting:**
  - Democracy is based on political equality, whereas capitalism requires distributing economic goods unequally, in accordance with their market value.
  - Capitalism requires limiting the power of democratic majorities (e.g., protection of property rights)
    → “automatic punishment” (Lindblom)
  - Economic inequality undermines political equality.

- Freedom vs. (in)equality
How should we expect democratic electorates to respond to economic inequality? Consider a median voter model of redistribution (Meltzer & Richard):

- $N$ voters with pre-tax income $y_i$ subject to flat (proportional) tax rate $t$, the proceeds from which are distributed evenly to all voters in the form of an income transfer $r = t \times \sum_i \frac{y_i}{N}$
- The post-tax, post-transfer income of voter $i$ is thus:

$$\text{income}_i = y_i(1 - t) + r$$

- Assume that higher taxes discourage voters from working.
- Assume that suffrage is universal and that the tax rate $t$ is the only thing that influences citizens’ vote choices.
Implications of Median Voter Models of Redistribution

- The higher voters’ income, the lower their preferred tax rate and demand for redistribution.

- Policy will reflect the preferences of the median voter, who will be the voter with the median income.

- In equilibrium, the tax rate will be redistributive but fall short of complete economic equality (because voters anticipate that taxation reduces incentives to work).

- As economic inequality grows, the ratio of the mean to the median income will increase and so will median voter’s demand for redistribution.
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Increasing Economic Inequality in the U.S.

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The Role of Politics and Policy in Economic Inequality

Taxes:
- Flat or progressive?
- Income vs. investments vs. sales
- Deductions

Transfers:
- Social Security
- Food stamps

Services:
- Health care

Pre-Tax Income:
- Minimum wage
- Unions
- Corporate governance
Contrary to the predictions of the median voter model, economic policy has (at least until very recently) become less redistributive as economic inequality has grown. WHY?
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Explanations Derived from Median Voter Models

- Technological and other economic changes have driven economic inequality, so no political response needed.
- Immigration has added non-voting citizens at the bottom of the income distribution, so the median voter hasn’t fallen in relative terms (probably not true.).
Unequal Representation

- Government officials are less (or not at all) responsive to the policy preferences of lower-income citizens.
  - **Bartels**: No correlation between senators’ voting patterns and the opinions of their low-income constituents.
  - **Gilens**: Policy changes favored by low-income citizens almost never occur if not favored by upper-income citizens.

- **Critiques**:
  - Different income groups tend to vary little and to move in parallel, so responsiveness to upper-income indirectly represents lower-income citizens.
The Problem of Preferences

- Lower-income citizens tend to have less informed, less coherent preferences → measurement error.
- In addition, Bartels’s other work suggests that their preferences do not rationally reflect their true interests.
- Possibility of changing values or tolerance for inequality?
Hacker & Pierson: In addition to ignoring the concentration of income growth at the top and advancing a simplistic view of policy, scholars focused on public opinion and electoral behavior ignore the fact that policy outcomes are often determined by organized groups.

- Mobilization of business interests since the 1970s.
- Collapse of labor unions in the U.S. → double blow (political and economic).
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