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Social capital, household income, and preferences for income redistribution

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ABSTRACT

This paper explores how social capital influences individual preferences for income redistribution. Social capital is measured by participation in community activities. After controlling for individual characteristics, I find that people are more likely to express preferences for income redistribution in areas with higher rates of community participation. This is more clearly so in high-income groups than in low-income groups. I infer that individuals' preferences for income redistribution are influenced by psychological externalities. Because the data is from surveys, I also consider the role of expressive behavior. I also consider the hypothesis that behavior is influenced by social distance.

1. Introduction

A major activity of governments is to redistribute income. In principle, although income redistribution is more complex and subject to political calculations (Tullock, 2005), in western democracies, redistribution increases the welfare of the poor, while decreasing that of the wealthy (Milanovic, 2000). Income inequality also has several indirect effects—it can lead to a decrease in trust among people (Alesina and La Ferrara, 2002) and impede levels of community involvement (Alesina and La Ferrara, 2000; La Ferrara, 2002). Social capital, which is defined as trust or participation within a community, is considered to play a critical role in increasing social welfare (Putnam, 1993; 2000). Hence, income redistribution is thought to increase social welfare, in part through social capital formation. However, the reverse causality that social capital influences political redistribution has not been investigated to date, with the exception of Bergh and Bjørnskov (2011).[1]

Since 2000, a growing number of studies have attempted to explore how and why people prefer income redistribution (e.g., Ravallion and Lokshin, 2000; Corneo and Grüner, 2002; Alesina and La Ferrara, 2005; Rainer and Siedler, 2008; Alesina and Giuliano, 2009; Klor and Shayo, 2010). Theoretical models suggest that expectations of upward and downward mobility play an important role in determining individual attitudes toward redistribution (Piketty, 1995). The “prospect of upward mobility” hypothesis supposes that people who expect to move up the income scale will not favor a distributive policy even if they are currently poor (Bénabou and Ok, 2001). This hypothesis is empirically supported by prior works (Alesina and La Ferrara, 2005; Rainer and Siedler, 2008). In contrast, it has also been found that people with current wealth tend to support redistribution if they expect their welfare to fall (Ravallion and Lokshin, 2000).

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[1] Using cross-country data, Bergh and Bjørnskov (2011) found that trust aids the creation of welfare states, reducing inequality. Algan and Cahuc (2010) also addressed a similar question.

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The existing literature that explores the determinants of preference for redistribution does not sufficiently consider the effect of interaction among people. However, an individual's perception and behavior are thought to be influenced by the people around them and the neighboring community structure (e.g., Alesina and La Ferrara, 2000, 2002; La Ferrara, 2002; Jensen and Harris, 2008; Shields et al., 2009). There are empirical works that support the hypothesis that it is "relative" income rather than "absolute income" that has an effect on the degree of happiness (e.g., Clark and Oswald, 1996; Neumark and Postlewaite, 1998; McBride, 2001; Stutzer, 2004; Luttmer, 2005). Veblen (1899) argued that "conspicuous consumption" by rich people serves to impress other people. However, it seems plausible that poor people envy rich people, and therefore hope that the rich will become poor. Owing to such externalities, rich people are likely to be unhappy. In this case, rich people tend to support income redistribution, thereby reducing the externality, and achieving increased levels of happiness.[2] This possibility seems to be more likely when the rich and poor meet and interact more frequently. In other words, rich people are more likely to support income redistribution when people are more inclined to participate in social activities. However, little is known regarding the interaction mechanism for redistribution. Thus, it is worthwhile to examine how and the extent to which the preference for redistribution is affected by interactions among people. Furthermore, preference appears to be significantly affected by structure and traditional societal values (Alesina et al., 2004; Chang, 2010). However, existing literature on redistribution preferences has focused largely on Western countries, with the exception of Ohtake and Tomioka (2004) and Chang (2010). Asian countries are characterized by the fact that their cultures and societies are different from those of Western countries, and as such it would be a valuable and necessary exercise to consider the preference for income redistribution in Asian countries. To this end, this paper attempts to compare the effect of social capital on preferences for redistribution between poor and rich groups using Japanese General Social Surveys (JGSS), which include more than 10,000 observations. I found that people are more inclined to prefer income redistribution in areas where residents are more actively involved in community activities. This tendency was more clearly observed for people from high-income groups than with people in low-income groups. This paper is in line with Alesina et al. (2004), which marks the crossroad for the determinants of happiness and preferences for redistribution.

The remainder of this paper is organized as follows. In Section 2, the testable hypotheses are discussed. Section 3 provides an explanation regarding data and the empirical method used. Section 4 presents the estimation results and their interpretation. The final section offers some conclusions.

2. Hypotheses

The seminal work of Becker (1974) stated that social interaction is defined in terms of a consumption externality or as the utility function of a person to include the reactions of others in his/her actions. Along similar lines, there is an argument that relative income is related to happiness (e.g., Clark and Oswald, 1996; Neumark and Postlewaite, 1998; McBride, 2001; Luttmer, 2005). Luttmer concluded "that the negative effect of a neighbor's earnings on well-being is real and that it is most likely caused by a psychological externality" (Luttmer, 2005, 990). It follows from this that an individual's preference depends, in part, on those that surround them (Luttmer, 2001). Furthermore, frequency of contact with neighboring people reinforces this effect (Stutzer, 2004). Luttmer provided the evidence that "increased neighbors' earnings have the strongest negative effect on happiness for those who socialize more in their neighborhood" (Luttmer, 2005, 989–990).

If one's household income is higher than the average household income within a residential area, they are considered as relatively wealthy. The remainder of the people are regarded as relatively poor. Rich people are more likely to meet people with lower household income than to meet higher-income people within their residential area. In contrast, poorer people are more likely to meet people with higher household incomes than people with lower incomes within their residential area. As suggested in previous works, people tend to consider the extent to which their income is higher (or lower) than the income of others. That is, people are believed to care about their relative position. Because of interpersonal preferences, higher earnings of neighbors are related with lower levels of happiness (e.g., Frank, 1985; Luttmer, 2005; Layard, 1980). "An envious or malicious person presumably would feel better off if some other persons become worse off in certain respects. He could "harm" himself (i.e., spend his own resources) in order to harm others" (Becker, 1996, 190). Further, envy possibly causes poorer people to engage in criminal behaviors such as theft or vandalism, not only to increase their "wealth" but also to reduce rich people's wealth (Skaperdas, 1992; Mitsopoulos, 2009). Thus, such criminal behavior caused by envy is considered to result in "illegal" income redistribution.

When there is greater societal interaction among residents (i.e., more frequent contact between rich and poor), there is also an increase in the degree of envy felt by poorer residents toward the richer ones, leading to an increase in negative effects (crimes committed against them by the poor) on the wealthy. Hence, I advance Hypothesis 1[3]:

Hypothesis 1. Poor people are more inclined to prefer income redistribution when they live in areas where residents are more likely to interact with each other.

This effect gives poorer people an incentive to support a "legal" redistribution policy. In contrast, richer people are more averse to redistribution simply because redistribution policies transfer their income to the poor. For example, a rich person's welfare depends not only on his/her own income and consumption levels but also on how the neighboring poorer people view his/her income and consumption. If a rich person enjoys the goodwill of those neighboring him/her or fears their envy, that rich person may

[2] Social capital possibly influences the fairness of people, leading to change the equilibrium level of redistribution (Galasso, 2003).

[3] It should be noted that Hypothesis 1 will only hold if comparison effects actually exist. This is because comparison effects are difficult to separate from purely individual aspiration effects at the individual level (Stutzer, 2004).