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The median-voter hypothesis, income inequality, and income redistribution: an empirical test with the required data

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Abstract

The median-voter hypothesis has been central to an extensive literature on consequences of income redistribution. For example, it has been proposed that greater inequality is associated with lower growth, because of the greater redistribution that is sought by the median voter when income distribution is less equal. There have however been no proper tests of the median-voter hypothesis concerning redistribution, because of previous absence of data on factor-income distribution (that is, incomes before taxes and transfers) across households, and thus on the gains by poorer households from redistribution. The study reported in this paper is based on the required data, with 79 observations drawn from household budget surveys from 24 democracies. The results strongly support the conclusion that countries with greater inequality of factor income redistribute more to the poor. This is so even when we control for the share of the elderly in the population and for pension transfers. The evidence that the median-voter hypothesis adequately describes the collective-choice mechanism is however considerably weaker. Although middle-income groups gain more/or lose less through redistribution in countries where initial (factor) income distribution is more unequal, this regularity is all but lost when, by excluding pensions, we

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look only at explicit redistributive social transfers from which middle classes contemporaneously gain little. This leaves us searching for an alternative explanation: do middle-classes gain from transfers in the long run even if not contemporaneously?; or is the median-voter hypothesis, based on direct democracy, a proper representation of the mechanisms of collective decision making in representative democracy?

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1. Setting the problem: the link between inequality and redistribution

A key relationship in the literature on inequality and growth (see Perotti, 1992, 1993; Persson and Tabellini, 1994; Bertola, 1993; Alesina and Rodrik, 1994; Alesina and Perotti, 1994) concerns the link between market-generated income inequality and the extent of redistribution. In Perotti's (1996, pp. 151) extensive empirical review of the theories linking growth, income distribution, and democracy, this relationship appears under the title of an ''endogenous fiscal policy approach''. This approach includes two components or structural equations. The first component is a political mechanism through which greater income inequality leads to greater redistribution, and thus, more distortionary taxation. The second component is an economic mechanism through which the distortionary taxation reduces growth. The conclusion is that greater income inequality slows growth. In this paper, I will be concerned only with the first of these components involving the political mechanism.

When individuals are ordered according to their factor (or market) incomes,[1] the median voter (the individual with the median level of income) will be, in more unequal societies, relatively poorer. His or her income will be lower in relation to mean income. If net transfers (government cash transfers minus direct taxes) are progressive, the more unequal is the income distribution, the more the median voter has to gain through joint action of taxes and transfers, and the more likely he

[1] Factor income is income before government fiscal redistribution (via cash social transfers and personal income taxes). Factor (i.e. market) income includes wages and bonuses, property income, self-employment incomes, gifts and remittances, home consumption, etc. I will use the terms ''factor'' and ''market'' income interchangeably.