# An Analysis of the Meltzer-Richard-Roberts Assumption

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*Rising inequality is an issue that has plagued modern society for generations. In this paper, Navika Mehta provides a comprehensive critical analysis of the Meltzer – Richard – Roberts Assumption, that rising inequality will lead to greater redistribution of social spending. This has been widely used to explain the rise in social spending in the 20th century. However, the paper argues that voting behaviours, elite influence, concepts of social mobility and fairness, and the irrational human nature disproves the real-world application of the assumption. In doing so she shows that social spending is impacted by a myriad of factors that cannot simply be reduced to rising inequalities.*

## INTRODUCTION

In an interview with the Rolling Stone Magazine on his book The Price of Inequality, Nobel Laureate economist, Joseph Stiglitz explained that "High levels of economic inequality leads to imbalances in political power as those at the top use their economic weight to shape our politics in ways that give them more economic power." (Bernstein, 2012). He asserts that in the United States, outcomes of political processes seldom reflect the interests of citizens. The problem of 'asymmetric information' and disillusioned citizens is also highlighted as a contributing factor that enables the use of economics for political agendas. Having said that, equality is a pillar of democracy but inequality is a fact of life. Democracies help in providing equal opportunities to all citizens; including equality in the form of universal suffrage, in front of the law and through the absence of discrimination based on race, religions, sexual orientation, gender, class etc. Essentially, democracies across the world have seen rising inequalities and in particular, income inequality. In short, the rich are getting richer and the poor, poorer. Through recessions and depressions, social movements like the Occupy Wallstreet have attempted to highlight this inequality with slogans like – "we are the 99%".

That said, the idea of inequality and demand for support from the state is a contemporary issue. Meltzer, Richard and Roberts give the assumption that rising inequalities will lead to greater redistribution or social spending (Meltzer and Richard, 1981 & Roberts, 1977). This essay attempts to refute this assumption and show that although this makes sense in theory, in reality, it does not apply. It begins with explaining the Meltzer-Richard-Roberts assumption in detail and evaluates how it is used to explain the rise in social spending during the 20th century. It then gives three main arguments against this theory. Firstly, it highlights the importance of turnout in an election and elite control influencing who the median voter is and thus the outcome of the elections. Secondly, it shows that the idea that economic growth will lead to increased redistribution because of high inequalities does not apply in the developing world. Finally, it evaluates the role of the concept of social mobility and individual beliefs about 'fairness' that go beyond economic interests and influence people's choices. Hence proving that the Meltzer-Richard-Roberts hypothesis is, essentially, flawed in reality.

## The Meltzer-Richard-Roberts Assumption

A highly influential prediction about income inequality and redistribution, based on the Median Voter Theorem was given by Meltzer and Richard. The model, known as the Meltzer-Richard Model emphasizes how elections are important in ensuring social and economic equality (Meltzer & Richard, 1981). They use the Median Voter Theorem, which shows that with universal suffrage and majority rule, the median voter is the decisive voter (Roberts, 1977). They also use studies regarding the distribution of income to show that the income distribution is skewed to the right, i.e., the mean income lies above the median income, in order to prove their argument. The assumptions are that there is a unidimensional policy space, that is redistribution, and all citizens are paying a flat tax rate that is used to finance this redistribution. Moreover, all citizens receive the same tax transfer and they are voting for their preferred tax rate. The implication of their hypothesis is that the distance between the mean income and the income of the decisive voter (median voter) is what determines the size of the government. With a skewed income distribution as mentioned above, there are more people earning income lower than the mean income, which incentivises greater redistribution of income financed by incomes of higher earning citizens. This implies that higher taxes and redistribution lead to a reduction in the incentive to work in the first place, thereby lowering income and increasing inequality (Meltzer & Richard, 1981).

They set out a static model, that individuals chose between consumption and leisure and this choice is dependent on the tax rate and the size of transfer payments. This tax rate and the size transfer payments further depend on the voting rule and income distribution. Essentially, their argument follows two main assertions. First, income inequality determines the amount of redistribution. Second, the greater the inequality or distance between the median and mean income, the greater will be the redistribution or social spending. This implies that in a general equilibrium model, the government has only two functions of redistribution and taxation (Meltzer & Richard, 1981). If the budget is balanced and voters are fully informed, the decisive median voters' choice is what determines the size of the government. They explain that voters earning below the median voter will prefer higher taxes and greater redistribution while those earning above the median voter will prefer the opposite. Thus, as mean income rises relative to the median voter income, taxes will also rise. Roberts gives an argument that is similar in essence. He explains that the marginal tax rate chosen by majority voting will be the highest possible due to the fact that if the median voter earns less than the voter with the mean income and income distribution is skewed, then people with low income will prefer a high tax rate (Roberts, 1977). The overall argument is used to explain the rise in social spending in the 20th century.

## An Explanation for the Rise in Social Spending

Meltzer and Richard use their argument to explain the rise of social spending in the 19th and 20th century with the rationale that as the number of voters earning below the mean income increased, it shifted the median voter position and increased redistribution and taxation. They also connect this to economic growth leading to greater inequality and therefore to greater redistribution (Meltzer & Richard, 1981). In the introduction of their paper, they mention that the share of redistribution and income tax has increased in western European countries in North America, and specifically in the US and Britain and that this rate of tax proportional to income has existed for over a century. However, they do not claim that this theory is limited to these countries, in their view, it is largely universal. That said, the rise in social spending in the 20th century mainly occurred in the democratic countries of Western Europe and North America. Meltzer and Richard use the spread of the franchise to argue that in the 19th and 20th century, this led to an increase in voters with low income and it sh ifted the median voter down to a lower income bracket and so taxes rose and as a result, social spending increased. Lindert argues that Meltzer and Richard fail to explain two facts about this rise. First, the differences in the share of GDP between countries is not explained. Second, there is ambiguity whether countries with higher redistribution and low incomes will glow slower than countries with lower redistribution and high incomes (Lindert, 1996). He offers 'competing hypothesis' that give alternative explanations for the rise in social spending and its eventual decline. He presents the argument that the dispersion of income below the median voter matters in determining redistribution. He highlights the influence of socialism, socialist democratic parties and labour union as a factor that led to the rise in social spending in the 20th century. Moreover, he argues that the age distribution of voters can also influence the government's redistribution policies, as the elderly are more likely to be in favour of contributions to health and pension. He uses the deadweight costs theories to argue that high social spending in the long run and the rising costs of increasing the size of government will eventually limit social spending (Lindert, 1996). This is because the rising deadweight costs will reach a point where it will eventually stop income growth. Dispersion of income is another factor that influences social spending. The increase in inequality below the median voter will lead to greater redistribution. After testing these hypotheses on a sample of 19 countries between 1960 and 1981, Lindert finds that although the Meltzer-Richard model seems theoretically plausible, there is little empirical evidence for it having an impact in the 20th century. He explains that growth in social spending is impacted by various factors like the diminishing age or income effect. He predicts an end to this growth in the 21st century (Lindert, 1996).

## CRITIQUE OF MELTZER- RICHARD – ROBERTS ASSUMPTION

### VOTING BEHAVIOUR AND TURNOUT

The following section gives three further arguments to counter the Meltzer-Richard-Roberts Model. Firstly, the importance of turnout and the reality of elite control influencing voting decisions and outcomes. An important argument countering the claims made by the Meltzer- Richard and Roberts Model is given by Larcinese (2007). He explains two opposite effects of the rise in inequality. First, increased inequality would lead to the median voters' preference for greater redistribution. Second, increased inequality would mean differences in turnout, wherein the rich and privileged citizens are more likely to vote than those living in extreme poverty. This could be due to illiteracy, work restrictions, lack of interest or awareness. Thus, the overall impact is that inequality would not actually lead to more redistribution (Larcinese, 2007). He argues that although it seems theoretically logical to say that countries that are poor and have greater inequality are not growing due to excessive social spending, it is misleading in reality. Meltzer and Richard do highlight the extension of voting rights as leading to an increase in voters below the median voter, however, they do not take into account that the turnout is not 100% (Meltzer & Richard, 1981). Larcinese studies 41 countries between 1972 and 1998 and does not find a clear correlation between redistribution and inequality; explaining that country-specific factors are influencing this relationship (Larcinese, 2007).

### Elite Control of Democracy

This argument is supporting Acemoglu and Robinsons' idea of 'captured democracy', which describes elite control of the political system after democratization. The elites use their economic power to invest in their de facto power, they influence parties through lobbying and control political ideology through the media. Acemoglu and Robinson explained that the elites must contribute to the collective de facto power that must be larger than the de jure power of poor voters (Acemoglu & Robinson, 2008). For example, in a study on Clientelism in India, Anderson et al. (2015) find that in the state of Maharashtra in areas where Maratha landlords have power in the form of landholdings, democratic decisions are pro-landlords and opposed to the poor because of their elite clientelist ties to political parties. Furthermore, Luebker (2014) conducts an empirical analysis of 110 observations from 26 countries and found no relationship between inequality and redistribution. He explains that factors such as unemployment rates, an increase in an ageing population are more effective in explaining the rise in social spending. Further critiquing, that the Meltzer-Richard-Roberts model uses rational choice and portrays humans as rational which is indifferent to the argument in behavioural economics that humans take into account society, shared values, ideas of social justice and fairness that further influence their economic decisions (ibid).

### Evidence from Developing Countries

Secondly, the Meltzer-Richard-Roberts model has been critiqued widely in relation to the developing world. Keefer and Khemani (2005) argue that the Meltzer-Richard-Roberts model does not hold in low income countries. Here, the median voter is extremely poor and evidently, social services are lacking. They highlight three market imperfection causing this outcome – "lack of information about the performance of politicians, social fragmentation and identity-based voting, and absence of credibility of promises made by politicians" (ibid). They provide evidence that in developing countries, governments tend to prefer investing in infrastructure and government jobs rather than social services. For example, in India, when disadvantaged groups comprise of the vote bank more emphasis is laid on increasing access to government jobs and welfare transfers to gain support in the short term rather than investing in education and healthcare, which would not cost as much and would be beneficial in the long term (ibid). However, if politicians are concerned with only winning elections, short-term appeasement is the chosen strategy.

### AFFINITY-BASED VOTING AND THE RIGHT TO VOTE

Moreover, Keefer and Khemani (2005) state that countries like India and Nigeria experience 'affinity-based voting' which means that people are more likely to vote on caste, religious, tribal or racial lines. This is not evidenced in the United States or Western Europe. In order to explain their critique, they refer to a study conducted to examine the disparity in outcomes of health and education in two states in India – Kerala and Uttar Pradesh (UP). Between the 1960s and 1995, in each decade the average per capita public expenditure spending in Kerala was more than two times that of UP. UP allocated a large amount of resources to state administration and very little to health and education while Kerala did the opposite. They argue that these differences are due to the market imperfections mentioned above. Moreover, citizens in Kerala are better informed and parties compete on offering social services. UP, on the other hand, relies on clientelist influence. High literacy rates in Kerala and relatively lower caste-based discrimination compared to UP affected the outcome. Essentially, the Communist Party in Kerala influenced and increased party competition for the dominant Indian National Congress Party (INC), while in UP, the INC did not have a strong competitor. In UP social services remain weak and people tend to vote on caste-based lines. Thus, in a democracy, several different forms of electoral competition can impact the outcomes of redistribution. Keefer and Khemani (2005) conclude that although poor voters are highly active, the credibility of politicians in providing basic social services without pursuing clientelist agendas is needed to ensure greater redistribution. Ahuja and Chhibber (2012) validate this by questioning the reasons for the large turnout of the poor in elections in India. They conduct a series of focus groups and open-ended interviews to find that although the poor are not the ones gaining from elections, they see voting as a right more so than a civic duty or a way to get economic benefits. They find that voting is an affirmation of citizenship (Ahuja & Chhibber, 2012). Thus, there are several factors influencing turnout and income inequalities in developing countries. Even with high turnout, social spending is still very low.

### The concept of Social mobility

Finally, another criticism of the Meltzer-Richard-Roberts Model comes from the perspective of political sociology in the form of the concept of social mobility and fairness. People with income below the average, do still hope that in future they will move up on the income scale. In a democracy, this is a valid possibility. This idea of upward mobility is constructed in the form of expectation that in the future their children may be the high-income earners and will lose from high taxes. Benabou and Ok reflect (2001) on the "prospect of upward mobility" (POUM) hypothesis. If citizens have low-risk aversion and they expect to have higher income in future, then they would be less inclined to vote for higher social spending. Alesina and Angeletos (2005) go a step further and question the idea of the statement – "people get what they deserve and deserve what they get". The idea of fairness in the level of distribution is questioned. They focus on the differences between Europe and the United States. While European countries tend to have more effective redistribution policy, possibly due to the history of class struggle, in the United States, the perception is that the wealthy have earned their place. They also talk about the racial struggle in the US after the end of slavery, they highlight that the reason for "poor deserves to be poor" idea is that the median income voter is white and the low-income voter is black (Alesina & Angeletos, 2005).

### Fairness and irrational human behaviour

Piketty (1995) further explains the social mobility argument in shaping political attitudes and electoral outcomes. The argument follows that people have varied experiences and they learn and believe differently about how taxation impacts the society. He argues that it is important to look at these different beliefs and ideas about the role of the government in the economy (Piketty, 1995). The exposure to different information based on their socio-economic background can highly impact the outcome, even if they are fully informed. It is important to go beyond the economic interests of the citizens (Piketty, 1995). A study conducted in the Slums of New Delhi by Banerjee et al. (2011) offers evidence for this argument. The level of awareness and information that voters have are limited. They divided areas into treatment and control groups. The treatment groups were given newspapers along with report cards that gave information about the performance of the legislators running for elections (Banerjee, et al., 2011). Public readings of the report card were conducted in the treatment areas. They found that providing this information influenced the perception of the benefits from voting and led to changes in turnout relative to the performance of the legislator.

## Conclusion

In conclusion, the claim that greater inequality will lead to greater redistribution because the Median voter will have a low income and so will vote for higher taxes is not convincing. This assumption is flawed on several grounds. Voter turnout is not taken into consideration, which is especially important as for the majority of the 20th century, several low-income groups and women did not have voting rights. Today, in developing countries, even if the poor are coming out to vote in large numbers, social services are still lacking. Elites control the economic power used for campaigning in elections, they influence voters through the media, use lobbying and clientelism to influence the government. Developing countries have large income inequalities that are not addressed with large social spending, even if there is a high turnout. Governments are more interested in spending on infrastructure than education and health. Moreover, Identity-based voting is rampant. Factors including social mobility or expectations of having higher income in future prevent people from voting for politicians who promise higher taxation and greater redistribution. The culture of a country and perceptions of 'fairness' influence citizens voting decisions. Finally, human beings must not be looked at as rational profit maximising agents, because they typically are not. Humans are influenced by the social fabrics of their society and the information that form their beliefs and ideologies. These highly influence their voting behaviour. Hence as Stiglitz explained, political and economic power go hand in hand and till the time a few influential high-income earners exist in a capitalist system, social spending can never be a priority for governments.

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