Chapter 8

Social Beliefs and Redistributive Politics

With uncertainty about the relative weighting of the income determinants, different beliefs regarding, for example, the role of effort significantly affect incentives to work, the demand for redistribution, and the income distribution in society. These individual beliefs emerge from personal experiences of intergenerational income mobility.

The aim of this chapter is to study (i) how the real and socially believed economic conditions influence long-term equilibrium in society and (ii) whether policy measures that reduce inequality of opportunity also increase intergenerational income mobility. For this purpose, this chapter exhibits a model enabling us to investigate the link between social beliefs and redistributive politics.\(^1\) Regarding cross-national differences, the study takes into account that societies may differ in their degree of dynastic altruism and their social value judgments.

8.1 Incentives to Work and the Demand for Redistribution

Individuals know that both predetermined factors and effort to some extent are important for personal economic success, but not the relative weighting of these factors. Assuming uncertainty about the crucial factor for personal economic success, in this section incentives to work and the demand for redistribution are determined. For this purpose, in section 8.1.1 initially the optimal effort level and the individually preferred tax rate are illustrated assuming the society knows the income determinants with certainty.

\(^1\)This model is an extended version of the model in Piketty (1995), including the possibility of dynastic altruism and varying social value judgments. In contrast to Piketty (1995), this study goes one step further investigating the impact of social beliefs on society in the long run including the effect on income mobility.
8.1.1 Optimal Decision under Certainty

A non-overlapping generations model is considered with a discrete and infinite time horizon \((t = 1, 2, \ldots)\). Each time period \(t\) can be seen as one generation. In each generation \(t\), society consists of a continuum of agents \(i \in [0; 1]\). Assuming that each agent in each generation has exactly one offspring, the general public is constant over time. Below, index \(t\) marks the generation considered and index \(i\) a representative family dynasty.

Individual life-time income is either high \((y_H)\) or low \((y_L)\) with:

\[
\Delta y = y_H - y_L > 0.
\]

In the following, life-time income is referred to as income. In generation \(t\), the share of agents born into low-income families (high-income families) is denoted by \(L_t\) (\(H_t\)). For all generations, the sum of children born into low-income families and those born into high-income families is one, that is:

\[
L_t + H_t = 1 \quad \forall t \in T.
\]

Whether receiving high income or not depends on an agent’s social origins, individual effort, and luck. An agent born into a low-income family receives income \(y_H\) with probability:

\[
\rho_L := \rho_L(y_{it} = y_{H,t} | e_{it} = e, y_{it-1} = y_L) = \pi_L + \theta e
\]

with \(\rho_L < 1\). Analogously, the probability of success for agents born into a high-income family is:

\[
\rho_H := \rho_H(y_{it} = y_{H,t} | e_{it} = e, y_{it-1} = y_H) = \pi_H + \theta e
\]

with \(\rho_H < 1\). In both cases (8.1) and (8.2), the first term describes the influence of the predetermined factor on personal economic success. For \(\pi_L \neq \pi_H\), prospects of success vary with parents’ income level. Assuming that \(\pi_H > \pi_L\), the probability of success is greater for children born into high-income families than for children born into low-income families. Here \(\Delta\pi \equiv \pi_H - \pi_L\) states the extent of inequality of opportunity. The second term, \(\theta e\), identifies the