

Equilibrium social insurance with policy-motivated parties

Philippe De Donder^{a,*}, Jean Hindriks^b

^a *University of Toulouse, GREMAQ-CNRS and IDEI, 21 allée de Brienne, 31 000 Toulouse, France*

^b *CORE and Department of Economics, Université catholique de Louvain, 34 Voie du Roman Pays,
1348 Louvain-la-Neuve, Belgium*

Received 23 February 2006; received in revised form 26 February 2007; accepted 26 February 2007
Available online 3 April 2007

Abstract

We study the political economy of social insurance with voters' heterogeneity on two dimensions: income and risk levels. Individuals vote over the extent of social insurance, which they can complement on the private market. We model political competition à la Wittman, with two parties maximizing the utility of their members. We obtain equilibrium policy differentiation with the Left party proposing more social insurance than the Right party. The Right party attracts the less risky and richer individuals, and the Left party attracts the more risky and poorer individuals. In equilibrium, each party is tying for winning. Unlike the median voter outcome, our equilibrium outcome depends on the whole income and risk distribution. Conditional on the risk distribution, more income inequality does not necessarily lead to higher demand for social insurance. In fact we find that more income polarization leads both parties to propose *less* social insurance. We also contrast our political equilibrium with the Rawlsian and utilitarian outcomes. Finally, we provide in the Appendix a first try at calibrating the model with real data, using U.S. data from the PSID survey.

© 2007 Elsevier B.V. All rights reserved.

JEL classification: H23; H50

Keywords: Electoral competition; Endogenous parties; Wittman equilibrium; Social insurance; Adverse selection

1. Introduction

The Downsian model of two-party competition over a single dimension predicts party convergence to the median voter's most-preferred policy if parties are motivated solely by

* Corresponding author. Tel.: +33 561 128 603; fax: +33 561 128 637.

E-mail address: dedonder@cict.fr (P. De Donder).

winning the election and voters' preferences satisfy certain properties (single-peakedness or single-crossing mainly). While Downs (1951) has inspired a very fruitful literature on spatial competition, the Downsian model fails to predict the persistent party divergence we observe. Divergence between party positions is well documented in Alesina and Rosenthal (1995) and Poole and Rosenthal (1984a,b) for the US, Hofferbert and Budge (1992) for the UK and Hofferbert and Klingemann (1990) for Germany. Also, MacDonald et al. (1991) show that Western European political parties exhibit a tendency toward polarized politics, with the absence of party position in the center of the distribution of voters' ideal points.

In this paper, we use a political economy model that results in party divergence. Following Wittman, we modify the standard Downsian model to permit parties to care both about winning elections and about policy. More precisely, political parties have policy preferences and adopt policy positions which trade off those preferences against their chance of winning the election. Unlike many other models that generate centrifugal forces, this approach generates divergence simply by making realistic assumptions about the nature of political parties and voters motivations. In particular, as Roemer (in press) points out, parties are inevitably associated with ideologies and their members have an influence in shaping policies.

In his seminal paper, Wittman (1973) assumes that parties are uncertain about the election results when choosing their platform and that they choose policies in order to maximize expected utility. However, Wittman (1973) does not explain where the party preferences come from, and makes no attempt to relate them to voters preferences. Later, Ortuño-Ortín and Roemer (2000) assume that parties maximize the expected utility of their members which consist of all the citizens who vote for this party (i.e., who prefer the policy proposed by this party to the one proposed by the other party). This was coined the endogenous Wittman equilibrium. Therefore, what political parties offer depends on who they attract and who they attract depends on what they offer. This is akin to the idea that citizens vote with their feet as well as in the voting booth.¹ In their model, individuals with different income endowments vote over a proportional income tax rate to finance a public good. In stark contrast with the Downsian results, they obtain that the expected equilibrium tax rate does not coincide with the median voter outcome. Moreover, the expected tax rate is not increasing with income inequality (as defined by the difference between mean and median income levels).

Our objective in this paper is to develop a political model where endogenously formed policy-motivated parties compete over the size of social insurance when there exists a possibility of substitution with private insurance. The reason for concentrating on social insurance is that it is a central source of disagreement among political parties in many countries. In our model, there are two reasons for supporting social insurance. The first reason is redistribution. Social insurance financing is usually income-related, which implies redistribution from rich to poor. Social insurance is also pooling different risk levels which implies redistribution from low risk to high risk individuals. In contrast, private insurance premia are not related to income but are related to risk, which eliminates either form of redistribution.

The second reason to support social insurance is efficiency. Contrary to many papers in the literature which assume perfect private insurance,² we introduce adverse selection in the private insurance market. This generates insurance rationing and provides an efficiency argument for social insurance.

¹ See Baron (1993) and Caplin and Nalebuff (1997) for similar ideas.

² See e.g., Blomqvist and Horn (1984), Rochet (1991), Cremer and Pestieau (1996), Gouveia (1997), and Petretto (1999).

Download English Version:

<https://daneshyari.com/en/article/5068527>

Download Persian Version:

<https://daneshyari.com/article/5068527>

[Daneshyari.com](https://daneshyari.com)