

# Skill distributions and the compatibility between mobility and redistribution

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## Abstract

We study the extent to which, in a Tiebout economy, the exogenous distribution of skill across agents affects the compatibility between the redistributive policy and the residential decision. We propose a two-region economy where (i) each region's redistributive policy is elected by majority rule (where both cases, myopic and sophisticated voters, are considered), and (ii) each region's wage is endogenously determined by separated labor markets. We find that mobility and redistribution are compatible when either there is a low-skilled region where the median skilled agent is below the mean skill of the region, and/or when there is a high-skilled region where the median skilled agent is above the mean skill of the region. We provide examples of commonly used distribution functions that satisfy, or that fail to satisfy, the above properties. © 2006 Elsevier B.V. All rights reserved.

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## 1. Introduction

Along with the development of economic unions, the globalization process has improved the mobility of agents across different regions or states, such as the United States, Canada and Germany. Labor market trends, as well as welfare policies, are two basic determinants of the in- and out-flows of citizens across neighboring regions or countries. Depending on the individual characteristics, the residential decisions are motivated by different incentives. Thus, whereas high-skilled (or highly-educated) individuals are more interested in higher wages and lower

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taxation rates, low-skilled (or less-educated) individuals are more interested in large welfare programs financed by substantial income taxation.

While citizens make the residential decisions, the composition of the electorate is affected by the migration flows which, in turn, alter policy decisions. Thus, in-flows of high-skilled individuals alter political decisions by reducing income taxation, and in-flows of low-skilled individuals modify political decisions towards larger welfare programs.

In this paper, we investigate the labor market forces as a basic determinant of location and, via composition of the electorate, its influence on redistributive policies. The paper draws on previous contributions which are based on the novel paper of [Tiebout \(1956\)](#). See, for instance, [Westhoff \(1977\)](#), and [Epple et al. \(1984\)](#) where location is determined by the elected provision of local public good, and, see, also, the more related contributions of [Epple and Romer \(1991\)](#), and [Hansen and Kessler \(2001\)](#), where location is also based on the elected redistributive policy, as well as on the housing market prices.

We present a two-region economy with a continuum of individuals who differ in their skill level. In each region there is a labor market. The in-flows of individuals increase labor supply, and, as a consequence, wages decrease. On the other hand, the out-flows of individuals increase wages. Each region's redistributive policy is decided by majority voting among the residents of the region.<sup>1</sup> Thus, individuals make two decisions: what region they join, and what taxation policy they vote for.

In a previous paper ([Puy, 2003](#)), we characterize the set of redistributive policies that guarantee that mobility and redistribution are compatible. As a counterbalance effect, regions with higher wages require higher redistribution, and regions with lower wages require lower redistribution.

[Epple and Romer \(1991\)](#) and [Hansen and Kessler \(2001\)](#) also analyze the interaction between mobility and redistribution. Their models assume an exogenous distribution of income across agents. While these authors analyze the housing market effect, we analyze the labor market effect. The housing market, as well as the labor market, induces an equivalent implicit cost since the in-flows of individuals affects negatively the residents' income (increasing housing prices or decreasing wages). [Epple and Romer \(1991\)](#) provide an example to illustrate equilibrium existence, but they also find non-existence examples, i.e., examples where the elected level of redistribution is not compatible with the residential decision. [Hansen and Kessler \(2001\)](#) show equilibrium existence under the assumption of a unimodal distribution of income, where the median income of the overall population is lower than the mean.<sup>2</sup>

From the above mentioned contributions, we find that the shape of the exogenous distribution, of either income or skill, may be crucial to guarantee existence of equilibrium in those economies where the redistributive policies are elected by majority rule. Thus, the main objective of this paper is to study what type of skill distributions guarantee that the redistributive policies elected by majority rule are compatible with the residential decisions.

Following [Caplin and Nalebuff \(1997\)](#), when analyzing the political decisions, we consider two different types of voting behavior: myopic voters and sophisticated voters. When voters are myopic, they take the population of their region as fixed and they vote simply for the most

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<sup>1</sup> As [Konishi \(1996\)](#) claims: "Majority voting is one of the most plausible candidates to describe a jurisdiction's decision mechanism in the actual economy."

<sup>2</sup> As we show in this paper, [Hansen and Kessler's \(2001\)](#) assumption on land restriction is crucial to guarantee existence of equilibrium.

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