

1-page Summary (Verena Rebecca Fetscher)  
*Equalizing Incomes over Time: Why Structural Differences in Social Insurance Matter for Redistribution Preferences.*

Income inequality is on the rise, even in the advanced European welfare states. Policy-makers are seeking for solutions to distribute the benefits of economic growth more equally. The task is a thorny one. If politicians propose policies that go against the interests of the rich, a group that turns out to be politically more important than the poor, they might be playing with their own political survival. Additionally, if conflict over redistributive policies leads to socioeconomic class-conflict, society as a whole would be negatively affected. The central question I ask in this article is what explains support for redistribution among the rich. More specifically, why do the rich support more income redistribution in some Western European welfare states than in others?

The article builds on structural differences in the governing principle of social insurance. Flat-rate systems provide social benefits in equal amounts to everyone in need, while earnings-related systems provide benefits in relation to previous earnings. These differences have implications for future income equalization. Given that people are exposed to the same labor market risk, the rich stand to lose proportionally more from becoming unemployed than the poor. Income differences are equalized between the rich and the poor during out-of-work periods, and between the unemployed rich and the employed poor. Earnings-related systems like Germany or France, in contrast, hand out social benefits during out-of-work periods in relation to previous earnings. Social insurance smooths life-cycle income but has no redistributive impact, and the unemployed rich are still better-off than the employed poor. Assuming that individual incomes are composed of fair (earned) and unfair (luck) components, earnings-related systems perpetuate the fair and the unfair component over time. Flat-rate systems, in contrast, equalize both, fair and unfair income differences in future periods.

If it is true that people are concerned about the well-being of others, with other-regarding concerns driven by fairness considerations (e.g. Konow (2000) and Cappelen et al. (2007) for experimental evidence), and if it is also true that these individuals take into account the future when forming preferences for redistribution, then structural differences in the governing principle of social insurance, at least in parts, explain why the rich support higher levels of redistribution in some countries than in others. The hypothesis that I test in this article is that support for redistribution among the other-regarding rich is, on average, higher in welfare states that maintain a given income distribution over time than in welfare states that equalize income differences between the rich and the poor in the future.

I combine observational and experimental approaches for empirical testing of the stated hypothesis. First, I analyze data from the European Social Survey (ESS) and find that average support for redistribution is lower in flat-rate systems than in earnings-related systems. I use OECD simulation models which incorporate complex policy rules of benefit entitlement and tax obligations and construct a benefit concentration indicator based on the distribution of replacement rates (percentage of in-work income being replaced during periods of unemployment) over a range of incomes (50% to 200% of the average wage). The indicator captures the underlying governing principle of social insurance, which in turn reveals information on future income equalization. Second, I conduct modified dictator games to test whether other-regarding preferences are more prevalent in situations where benefits are handed out on an earnings-related basis. Endowments are based on luck and redistribution never provides social insurance for the future self. The evidence is in line with the observational finding and further reveals that concerns for fairness and future income equalization are different from income inequality aversion more generally. Taken together, this article provides observational and experimental evidence which shows that individuals are more in support of income redistribution if unfair income differences are maintained over time (as is the case in earnings-related systems).

## References

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- Konow, James. 2000. “Fair Shares: Accountability and Cognitive Dissonance in Allocation Decisions.” *American Economic Review* 90 (4): 1072–1091.