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Learning, political attitudes and crises: Lessons from transition countries



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ABSTRACT

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This paper illustrates the sensitivity of political attitudes to the business cycle. It shows how the 2008 economic crisis has reshaped individual support for democracy and market liberalization in post-transition countries. Pro-reform attitudes have lost ground between 2006 and 2010 in Central and Eastern European countries that were hit by a negative economic shock. By contrast, they have increased in the CIS. Although on average, individual exposure to the crisis is associated with lower support to democracy and markets, it drives the demand for liberal reforms among groups of the population that were most excluded from the political-economic system in place, the youth particularly, in countries that lag behind in terms of liberalization and, where institutions are corrupt. We propose an interpretation of these evolutions in terms of learning and updating of beliefs. *Journal of Comparative Economics* 41 (2) (2013) 490–505. The School of Economics, Australian School of Business, The University of New South Wales, Australia; European Bank for Reconstruction and Development, Office of the Chief Economist, One, Exchange Square, London, EC2A 2JN, United Kingdom; Paris School of Economics, 48 bd Jourdan, 75014 Paris, France.

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1. Introduction

How cyclical are political attitudes, and what can mitigate the extent of their variation? In the context of the 2008 economic crisis, these questions bear important implications, especially in countries, where democracy is still fragile and market institutions are not full-fledged. In Central and Eastern Europe, the very momentum of Transition from communism was triggered by popular aspirations to democracy and free competition and the belief that these institutions were superior to authoritarianism and state regulation in terms of welfare and performance. Twenty years after the start of the Transition process, how have these beliefs and aspirations evolved? Have they been influenced by the adverse shock of the recent economic crisis? Are new members of the European Union, the most advanced transition economies, more supportive of democracy and free markets?

This paper adopts the view that political attitudes are driven by a process of slow and home-biased formation and updating of beliefs about the relative performance of different institutions. Imperfect learning is at the origin of a “cyclicality” of political attitudes, i.e. the sensitivity of political opinions to the short run state of affairs and business cycle of the country.

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Within this frame of analysis, this paper scrutinizes the political attitudes in Central and Eastern Europe and in the Commonwealth of Independent States in 2010 and their evolution since 2006 using the *Life in Transition Survey (LiTS)*. The LiTS is a nationally representative survey of socio-economic attitudes and conditions. It is a repeated cross-section, first conducted in 2006 in 29 post-transition countries and Turkey and repeated in 2011, with the addition of five “benchmark” Western European countries: France, Germany, Great-Britain, Italy and Sweden.

At first sight, it appears that, surprisingly, the more democratic and market-friendly the institutions of a country, the stronger the set back of popular support for these institutions. This intriguing result could suggest that citizens of transition countries have been disappointed by the evolution of their country, perhaps because of reform fatigue and disenchantment with the once idealized Western-type societies. However, this interpretation rests on a spurious correlation hiding the effect of the business cycle.¹ Indeed, support for democracy and market liberalization have fallen in Central and Eastern Europe, in contrast with the Commonwealth of Independent States (CIS), mostly because of the deeper integration of the former group in global financial markets and international trade. At the individual level, people seem to blame the negative consequences of the business cycle on the system in place that they reject all the more as they are hit personally. This explains the greater rejection of liberal institutions in more advanced economies, which were both further down the path of reforms and hit harder by the crisis.

We also explore the institutional features that may underlie the increase in popular support for liberal policies within the CIS and their decrease in Central and Eastern Europe. We consider two main hypotheses. The first one has to do with the influence of state corruption as a magnifying factor in the relationship between economic outlook and political attitudes. Because corruption is not only perceived as illegal or inefficient, but also as unfair, we expect that when hit by the crisis, people will turn against the political and economic system in place all the more as they perceive corruption to be high. In line with theoretical interpretations of regulation as a rent-seeking instrument benefiting a restricted group of insiders (Tullock, 1967; Stigler, 1971), people may perceive the inefficiencies associated with regulation when state corruption is high, and demand more liberal policies as a result. This implies that the effect should be particularly strong in countries with low institutional quality and high degree of state capture, and among groups that are most excluded from the beneficiaries of regulation policies. Our estimates confirm this prediction. Where institutions are corrupt, economic hardship leads people to demand more market and democracy. The effect is particularly strong among the youth and in countries with low quality institutions, in particular in the CIS. This observation is conducive to a parallel with Arab revolutions of Spring 2011, where the role of the youth was particularly important in the expression of social discontent and in the political upheaval. The second hypothesis relates to the mitigating effect of social policy. We do observe that social safety nets lessen the effect of economic downturns on people's political preferences, provided that they are adequately targeted to those who most need it and are affected by the crisis.

Identification of the causal effects of the crisis on support for reforms supposes that crisis exposure is exogenous to political preferences. We employ several strategies to deal with the issue of potential endogeneity. First, our approach relies on individual level analysis, thereby controlling for country-level characteristics that could be correlated both with the country's exposure to the economic crisis and with average political preferences. Second, we control for observable individual circumstances, such as education, age, gender, occupation and ownership structure of companies in which people are employed, that could be correlated both with exposure to the crisis and with attitudes towards the political-economic system. However, because there may still be other unobserved variables that jointly influence exposure to the crisis and political preferences, we assess the size of the omitted variable bias that would explain away the observed effect of crisis exposure on political preferences. We find that the influence of unobservable factors would need to be between 3 and 5 times that of all combined observable individual characteristics.

The issue of endogeneity is of particular concern concerning the relationship between people's perception of corruption, exposure to the crisis and attitudes to the political system. One may worry that perceptions of corruption are determined by unobservable variables that may also be correlated with preferences for democracy and free markets. In order to deal with this issue, we instrument perceived corruption in public services by the number of time individuals have actually used public services during the past 12 months. We also check that our results are robust to using different measures of exposure to the economic crisis.

1.1. Literature

This paper draws on a large literature dedicated to popular beliefs and preferences concerning political and economic institutions, regimes and economic policy. An important strand of the literature has endeavored to measure how much these attitudes depend on past outcomes through the formation of beliefs about the relative performance of different institutions. It points to the crucial importance of the process of learning and updating beliefs and to the potential multiple politico-economic equilibria generated by imperfect learning (see Piketty, 1995; Kremer et al., 2001, or Di Tella and MacCulloch, 2009). Because of imperfect learning, political attitudes of the inhabitants of a country may depend on the current state of affairs and on the business cycle in that country. Landier et al. (2008) indeed argue that beliefs are slowly moving,

¹ As shown by Transition Report (EBRD, 2011, Chapter 3), controlling for the level of economic activity or the extent of the crisis, it appears that it is not institutional quality but the business cycle that is the main driver of the change in political attitudes.

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