Learning about the prospects for mobility: Economic and political dynamics following fundamental policy reform[☆]

John Morrow[a,*], Michael R. Carter[b]

[a] Birkbeck University of London, CEP and CEPR, United Kingdom
[b] University of California, Davis and NBER, United States

ABSTRACT

The political left turn in Latin America, which lagged its transition to liberalized market economies by a decade or more, challenges conventional economic explanations of voting behavior. This paper generalizes the forward-looking voter model to a broad range of dynamic, possibly non-concave income processes. Under full information, the model implies support for redistributive policies materializes rapidly if few prospects of upward mobility are present. In contrast, modeling voters' evolving beliefs about an unknown income dynamic process shows a slow and polarizing shift toward redistributive preferences. Simulation using fitted income dynamics suggests that this imperfect information perspective accounts for Latin America's right-to-left political shift, and offers additional insights about political dynamics in the face of economic polarization.

1. Introduction

Most Latin American countries had transitioned to market economies by the early 1990's. The largely center-right political leadership that instituted these transitions continued to win national elections and persisted in into the early 2000's. After that, electoral politics turned sharply left. Presidential elections saw left-leaning candidates defeat more conservative opponents in Brazil, Bolivia, Chile, Ecuador, El Salvador, Honduras, Nicaragua, Paraguay, Peru and Venezuela.[1] Not only did these elections usher in a political shift, but in many instances they were tightly contested between candidates offering fundamentally different economic visions. The goal of this paper is to provide a theoretical framework to help us understand the economic forces that underlie this political dynamic.

We start from the perspective that by the early 1990s, Latin America and other, what are now called, transitional economies, experienced the exhaustion of (left) political alternatives. In Peru, for example, the 1980s ended with hyper-inflation and a general economic malaise that

had been overseen by a left-of-center government. Our goal in this paper is not to explain the rightward shift from the interventionist, putatively left-wing policies of the 1980s, but instead to explain the subsequent return to left-leaning governments following a decade or more of conservative, economically liberal rule.

The influential body of political economy literature that focuses on economic inequality as a force that determines both political institutions and voting patterns would seem to offer a window into this right to left shift (Acemoglu and Robinson, 2006; Boix, 2003). However, the fact that inequality measures tend to be remarkably stable over time makes it unlikely that inequality can explain Latin America's right-left voting dynamics. Robert Kaufman (2009) confirms the inconvenient empirical fact that contemporaneous measures of economic inequality do a very poor job of explaining political institutions and voting patterns in Latin America.[2]

Although we could abandon the search for economic explanations of contemporary voting patterns, we instead take our cue from Benabou and Ok (2001) and Moene and Wallerstein (2001) who model voters as

[1] While the contemporary Latin American left cannot be defined by a single, shared economic model, this new left does share an impulse and desire to shift resources and opportunity to those at the bottom of the income distribution. For instance, Greene and Baker (2011) construct vote revealed leftism (VRL) from ideological ratings of presidents and parliamentary parties in Latin America from 1996 to 2008, showing that the left has an economic policy mandate to halt or partially reverse neoliberal economic policies.

[2] Fields (2007) makes this point even more strongly by showing how inequality can increase during the early stages of a period of upward mobility that would dampen political preferences for redistribution.

forward-looking agents who look beyond current income inequality and focus on how policies will influence their future economic prospects. From this starting point, we offer the following contributions:

- We analyze forward-looking political preferences under a variety of income dynamics, including dynamics that offer prospects for upward mobility ('POUM' as in Benabou and Ok), as well as empirically based dynamics which are neither concave or convex that offer no prospects of upward mobility ('No-POUM').
- We also consider political dynamics when voters lack full information and must live and learn about the income dynamics that characterize their economy. This is particularly relevant to transition countries that have fundamentally altered their economic model, as happened across Latin America circa 1990.
- We show that not only does the incorporation of learning provide a richer suite of possible political dynamics, it also reveals that perceptions of the dead weight loss associated with redistribution can, in surprising ways, further fuel political instability.
- To draw out the implications of our model, we estimate income distribution dynamics for two Latin American countries, Chile and Peru, and show that the learning, forward-looking voter model is broadly consistent with the recent political histories of both countries.

In their seminal paper, Benabou and Ok show that concave income distribution dynamics that offer the prospect of upward mobility can account for surprising conservatism by voters below the mean income who would benefit in the short run from redistributive policies.[3] While this POUM model has little to say about the right-left political dynamics observed in contemporary Latin America, we show here that the income transition functions suggested by poverty trap theory, which offer limited or no prospects of upward mobility can result in a surprisingly and increasingly pro-redistribution electorate.[4] Specifically, we show that forward-looking political preferences are determined by the smoothed envelopes drawn around income transition functions, where the transitions themselves need not be concave or convex. This finding generalizes the connection between redistribution and income beyond the usual concepts in the literature.

In an effort to corroborate this theoretical intuition, we calibrate income dynamics for Latin American countries. These reveal for some countries the sort of No-POUM dynamics that would be expected to generate an increasingly pro-redistribution electorate. Applying these dynamics to a full information, forward-looking voting model indicates that the demand for redistribution should have been stronger and should have occurred well in advance of the suite of Latin American presidential elections that moved governments to the left in the early 2000's. This result presents a puzzle that questions fundamental assumptions about how economic voters perceive and react to their material prospects.

We argue it is the assumption that voters have full information about their economy's income distribution dynamics that is most problematic, especially in transition economies where the electorates have had little prior experience with liberalized market economies (e.g. Przeworski, 1991).[5] In such circumstances, voters have little choice but

to fall back on priors about how such an economy might work.[6] Edwards (1995), for example, largely credits the origins of the switch to liberal economic policies within Latin America to the failure of all other alternatives, although he notes that multilateral institutions influenced the "convergence of doctrinal views" through research, analysis, lending practices and conditionalities.

In Latin America, the shift to the liberal economic model was put forward on the grounds that it would boost incomes and well being for all, including the lower half of the income distribution.[7] Assuming that voters begin with this "POUM prior," we go on to model voters as Bayesian learners who experientially update their expectations based on their own stochastic income experience. Leveraging the POUM and No-POUM distinction, we characterize "right" vs "left" Bayesian beliefs about income dynamics. We show that this model of forward-looking, Bayesian voters offers an empirically tenable explanation of the recent right to left political evolution in Latin America. We further show – under more restrictive assumptions – that taking into consideration the dead weight losses of redistribution amplifies this result and implies even stronger political volatility. While increased dead weight loss reduces support for redistribution for both right and left voters, the effect is proportionately stronger for right voters. This asymmetry then amplifies political volatility in which learning is moving some fraction of the electorate left.

The general tenor of this explanation is corroborated by public opinion survey data from Peru, a country whose politics mirror the right to left electoral pattern that motivates this paper. The Latinobarómetro Corporation began annual surveys of the Peruvian electorate in 1995, the year in which liberal candidate Alberto Fujimori was elected with a strong two-thirds majority.[8] The 1995 data reveal that 55% of Peruvian expressed prospects of upward mobility, expecting their personal economic circumstances to improve in the next 12 months.[9] At the same time, only 11% of survey respondents positioned themselves as left of center on a political scale, while another 23% said that they were either uncertain of their political position, or refused to reveal it. In the ensuing 5 years, the fraction of the electorate expressing positive prospects of upward mobility steadily declined from 55%, reaching a low of 27% in 1998, before rebounding to 36% in the months before the 2000 presidential election. Over this same time period, the fraction of the electorate who self-identified as left of center doubled to 22%, a trend that continued another 5 years when the self-identified left reached 33% of the electorate. Fujimori won the 2000 election, which was widely criticized as fraudulent, and then exiled himself from Peru later that year, to be replaced in 2001 by the more progressive candidate he had ostensibly defeated in the 2000 election.

While Peru fits the pattern whereby diminished expectations of upward mobility accompany a leftward shift in the electorate, observers

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[3] Complementary endogenous explanations for anti-redistributive positions include disincentives for labor supply (Meltzer and Richards, 1981), asset formation (Persson and Tabellini, 1994), inefficient levels of public goods (Alesina and Rodrik, 1994), and multidimensional policy spaces in which non-economic preferences conflict with pocketbook voting (Roemer, 2001). To highlight the roles of income dynamics and learning, we ignore the incentive effects of taxation (see Piketty, 1995), but do account for the role of dead weight loss.

[4] Tucker (2006) shows that voting in the post-Soviet bloc reflects economic experiences: areas with poor outcomes support "Old Regime" parties while good outcomes provide support for liberal "New Regime" parties.

[5] Fernandez and Rodrik (1991) point out the importance of uncertainty in policy reform, although they explain why policies might increase in popularity after