

A Second Chance at Success: A Political Economy Perspective*

Ryo Arawatari[†] and Tetsuo Ono[‡]

Graduate School of Economics, Osaka University

January 18, 2008

Abstract

This paper characterizes a stationary Markov perfect political equilibrium where agents vote over income taxation that distorts their educational investment. Agents become rich or poor through educational investment, and the poor have a second chance at success. The results show the following concerning the costs of a second chance. First, when the cost is low, the economy is characterized by high levels of upward mobility and inequality, and a low tax burden supported by the poor with prospects for upward mobility. Second, when the cost is high, there are multiple equilibria: one is characterized by high levels of upward mobility and inequality and a low tax burden supported by the rich, the other is characterized by low levels of upward mobility and inequality and a high tax burden supported by the poor. Numerical examples show that the low-cost economy is inferior to the high-cost economy in terms of social welfare.

Key words: Second chance; Political economy; Stationary Markov perfect equilibrium; Redistribution; Inequality; Upward mobility; Intragenerational mobility.

JEL Classification: D30; D63; D72; H20; H55; I38.

*We would like to thank John Hassler and seminar participants at Osaka University, University of Groningen and University of Graz for their useful comments and suggestions. Arawatari acknowledges financial support from the Research Fellowships for Young Scientists of the Japan Society for the Promotion of Science (JSPS). Ono acknowledges financial support from the 21st Century COE Program (Osaka University). All remaining errors are ours.

[†]Corresponding Author: Graduate School of Economics, Osaka University, 1-7, Machikaneyama, Toyonaka, Osaka 560-0043, Japan. E-mail address: tono@econ.osaka-u.ac.jp

[‡]Graduate School of Economics, Osaka University, 1-7, Machikaneyama, Toyonaka, Osaka 560-0043, Japan. E-mail address: ege001ar@mail2.econ.osaka-u.ac.jp