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Success, survive or escape? Aspirations and poverty traps☆

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ABSTRACT

I present a model of occupational choice where an agent decides whether to invest in a project that yields risky returns or a project that yields safe returns. An agent's utility is affected by the presence of an aspiration level which will only be satisfied if their final income is above the poverty line. I show that agents who are sufficiently above the poverty line will invest in the risky project and are able to aspire for success. An agent, however, who is just above the poverty line, may be so concerned about falling into poverty that they choose to invest in the safe project. These individuals aspire only to survive. Alternatively, if an agent is sufficiently below the poverty line, then they will invest in the risky project even if expected returns are lower than the safe project. These individuals have "nothing left to lose" and therefore aspire to escape. Two forms of poverty traps emerge from the resulting equilibria: one above the poverty line, and one below the poverty line. Finally, I offer empirical support for the model based on individual level survey data across a large number of countries.

1. Introduction

What does it mean to have aspirations? We tend to think of an aspiration as above and beyond the position in life we are in now: to achieve great things, to become rich, to be a success. However, for some individuals, the aim is simply to survive, to maintain the status quo. This is born out of a fear that falling below their status quo is far worse than the current state they are in. For others, the fear of the status quo is already being felt, and will take any chance to escape their current situation. What aspirations have in common, however, is that they are formed in the present about the kind of future we want and the kind of future we hope will never happen. As a consequence, an aspiration is defined by the relative weights we attach to the overall probability of success and failure for a desired objective.

The natural question one turns to is how we form our aspirations. One could argue that our aspirations are heterogenous and innate, shaped by our parents, or perhaps our culture. Despite our own, idiosyncratic aspirations, we may also share a common aspiration, to be free from poverty, for example. If this is the case, the effect of this common aspiration will differ

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depending on our own proximity to the poverty line. This will have important implications for wealth-enhancing investment decisions.

For example, starting a business can make individuals extremely rich or leave them desperately poor. Faced with the decision either to start a business or obtain a safer form of income, someone who is relatively wealthy can aspire for success, and may see this as a risk worth taking. Someone who is just above the poverty line, however, may view this business opportunity as a risk too far. This desire to maintain the status quo is born out of a fear that if their business failed they would fall into poverty. Someone who is already below the poverty line will have “nothing left to lose” and may view starting a business as the only way to escape poverty. This paper will show how individual aspirations to avoid poverty can result in poverty traps.

Within the theoretical poverty trap literature, many of the results are driven by moves away from the standard neoclassical paradigm, in order to create multiple equilibria and path-dependence (i.e., long-run outcomes are dependent on initial conditions). These include non-convexities in technologies, market incompleteness (often in the form of credit constraints) and imperfect functioning of institutions (see Azariadis, 1996; Azariadis and Stachurski, 2005 for surveys).

More recently there has been a focus on the role of aspirations in the creation and persistence of poverty traps (see Ray, 2006 for an introduction). Aspirations may be conditioned by relative economic status, as in Moav and Neeman (2010) and Ray and Robson (2012), or by parents’ aspirations for their children’s education, as in Mookherjee et al. (2010). For example, Genicot and Ray (2017) develop a model in which there is an endogenous relationship between economic outcomes and individual aspirations, and hence income and the distribution of income are jointly determined.

Dalton et al. (2016) show how a poverty trap can occur when effort affects final wealth. The optimal amount of effort chosen will be based on whether an individual believes they can meet their aspiration level. As a result, aspiration failure will be self-fulfilling. Blackburn and Chivers (2015) show how the effects of aspirationally-induced loss aversion can result in persistent inequality due to the fear or falling below a certain level of income. However, all of these models treat aspirations as unidirectional: either success (as in Genicot and Ray, 2017; Dalton et al., 2016) or survival (as in Blackburn and Chivers, 2015).

The key insight of this paper is that aspirations should be thought of as multidirectional. That is to say, the effect of aspirations will differ depending on the situation an individual faces. The model developed within this paper will show that an individual’s aspiration to avoid poverty will result in different behaviour depending on how far away the individual is from experiencing poverty, or how close the individual is from escaping poverty. The result of this model is that two poverty traps emerge: one below the poverty line and one just above the poverty line.

The notion that aspirations of the poor may differ, can be traced back to Banerjee (2000), who suggests that there are two distinct and competing views of poverty: “poverty as desperation” and “poverty as vulnerability”. Banerjee (2000) argues that, if we view poverty as a form of desperation, the poor would wish to invest in wealth-enhancing projects, but may be denied credit. However, if one views poverty as vulnerable individuals facing the possibility of falling further into poverty, then the poor may forgo investment in a risky project. This paper differs to Banerjee’s (2000), as it shows how both these types of behaviours can stem from aspirations alone, without the need of appealing to non-convexities in technologies.

The approach of this paper is driven by recent advancements in decision theory – specifically, aspiration levels. Aspiration levels occur when individuals are faced with a risky prospect. The individual evaluates the project based on their weighted preferences of the overall probability of success or failure. What individuals deem to be a success or failure is judged with respect to some aspirational outcome (see Diecidue and van de Ven, 2008).

Aspiration levels are similar to reference points that occur in loss-averse preferences developed by Kahneman and Tversky (1979) in their seminal work on prospect theory. Loss aversion is the notion that individuals have a stronger preference to avoid losses than to obtain gains, relative to a particular reference point. Although there is a subtle difference between aspiration levels and reference points, the two are linked (see Lopes and Oden, 1999, for a comparison). Aspiration levels are based on probabilities and view outcomes as final states. Conversely, reference points are a behavioural concept linked to changes in wealth. These features give rise to a discontinuity in the utility function for aspiration levels and a kinked utility function under loss aversion.

The presence of aspirational levels in risky projects has been found in a number of experimental and empirical studies (see e.g., Holthausen, 1981; Mezias, 1988; Langer and Weber, 2001; Mezias et al., 2002). There is also a growing literature examining aspirations in developing countries. Pasquier-Doumer and Risso Brandon (2015) examine educational investment among indigenous and non-indigenous children in Peru. They find that although indigenous children have lower aspirations than non-indigenous children, this is mostly explained by the effects of socioeconomic status. Aspirations have also been the subject of a number of randomised control trials (see Bogliacino and González-Gallo, 2015; Macours and Vakis, 2014). Bernard and Seyoum Taffesse (2014) conducted an experiment in order to examine peer effects in the formation of aspirations in rural Ethiopia. The treatment group of individuals were invited to watch a documentary about successful entrepreneurs from similar communities. A first control group watched an entertainment programme, while a second control group were simply surveyed. They found that aspirations were higher among the treated, but unchanged amongst the control groups.

The purpose of this paper is to highlight the importance of aspirations for the development process, as risky, wealth-enhancing investment decisions are key to understanding the creation and persistence of poverty traps.

The remainder of the paper is outlined as follows. In Section 2, I examine the effect of aspirations on wealth-enhancing investment decisions in a stochastic overlapping generation model. In Section 3, I test the implications of this model by using