

Essays on Political Agency Problems in Dynamic Environments

(動学的環境下における政治的エージェンシー問題に関する研究)

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1 Backgrounds

In representative democracy, voters delegate decisions on policymaking to elected politicians. Ideally, voters appropriately elect politicians, who choose the policy desirable for the electorate based on their expertise. However, politicians are self-interested, and their policy preferences are usually not aligned with those of voters. That is, conflicts of interest exist between politicians and voters, which induce agency problems. Hence, whether the ideal of representative democracy is achievable is not obvious. This is one of the central questions in the political economics literature.

The most seminal study that tackles this question is that by Downs (1957). He considers a static environment in which two parties (or equivalently two politicians) compete with each other. Each party simultaneously announces its own platform in a one-dimensional policy space, and voters then decide which one to vote for. Voters' preferences are assumed to be single-peaked. In this simple framework, it is shown that each party commits to the median voter's ideal policy. Since Downs (1957)'s work, the literature on electoral competition in such a static environment has been developed.

Although this static electoral competition approach gives us rich insights on representative democracy, there is a shortcoming. In this approach, parties and politicians are assumed to commit to policy platforms before an election. However, in politics, politicians do not sign a legal contract with voters. That is, the commitment to policy platforms is not necessarily binding. Hence, we need to understand how representative democracy works when politicians cannot commit to policies. Nonetheless, the static electoral competition models overlook this issue.

The purpose of the present thesis is to fill this gap. To this end, we emphasize the possibility of replacement (equivalently, the possibility of reelection). The real environment in politics is not static rather dynamic. In the dynamic environment where future elections exist, voters can select a good politician by replacing bad politicians through repeated elections. In addition, voters can discipline the incumbent by using the possibility of reelection as an incentive device. Hence, even if politicians cannot fully commit to the future policies, the responsiveness of democracy is partially maintained through the possibility of reelection. As such, the reelection possibility plays a key role in representative democracy.

The analysis of reelection possibilities, by its nature, requires us to consider a dynamic rather than a static environment in which the following game is repeated: (i) the incumbent politician implements a policy, and (ii) voters then decide whether to reelect the incumbent or elect a challenger.

In this environment, each politician chooses the current policy taking the effect on the reelection probability in the future into account, and voters decide whether to reelect the incumbent by forming the expectation about the future performance of the incumbent based on the politician's past performance. In this thesis, we analyze under what conditions representative democracy works by exploring dynamic environments.

Clearly, the question about the role of the reelection possibilities on the performance of representative democracy in dynamic environments is not my original one at all. Though the history is relatively new compared with the literature on the static electoral competition models, it has been explored in the literature since Barro (1973) and Ferejohn (1986). The models analyzing this issue are called *the electoral accountability models* (see Ashworth (2012) and Duggan and Martinelli (2017) for a literature review). We tackle three remaining challenges that have not been explored enough in the existing literature on electoral accountability models: (i) the effect of ambiguity (Knightian uncertainty), (ii) the dynamic interaction between public opinions and policies, and (iii) political economy of economic policymaking. Through such attempts, this thesis aims to extend our understanding of political agency problems in dynamic environments.

2 Overview of the Thesis

The thesis consists of four chapters:

Chapter 1. Overall Introduction

Chapter 2. (Not) Delegating Decisions to Experts: The Effect of Uncertainty

Chapter 3. Cotagion of Populist Extremism: Social Learning with Agency Problems

Chapter 4. Does High Labor Mobility Always Promote Trade Liberalization?

Chapter 1 reviews the existing literature of electoral accountability models and provides the overview of the thesis. The subsequent three chapters are the original researches. Chapter 3 is based on the work joint with Atsushi Yamagishi, while the other two chapters are based on my single author articles.

In various principal-agent relationships, a principal decides the agent to whom to delegate decisions among multiple agents. In this decision, the principal typically faces the choice between informed experts with uncertain bias and uninformed non-experts with no bias. One example is electoral competition wherein both elite and non-elite politicians are running for an election. Having the application to political economics in mind, in Chapter 2, we construct a delegation model that contains two unique features: the possibility of replacement in a dynamic environment and the distinction between experts and non-experts. We then investigate whether the principal delegates to experts by focusing on the effect of uncertainty regarding preference heterogeneity among experts. To this end, we distinguish two types of uncertainty: *risk* – the probability distribution is known – and *ambiguity* (*Knightian uncertainty*) – even the probability distribution is unknown. Ambiguity-averse preferences are modeled by adopting Choquet/Maximin expected utility theory

(Schmeidler 1989; Gilboa and Schmeidler 1989). We show that an increase in risk and in ambiguity work in opposite directions with higher ambiguity rather than risk being a source of the delegation to non-experts. This analysis sheds new lights on the sources of anti-elitism in politics.

Chapter 3 is about populist extremism. In academic literature as well as the real politics, it has been pointed out that populism might spread across countries like falling dominoes. The purpose of Chapter 3 is to explore the long-run dynamics of the propagation of populist extremism across countries. For this purpose, we construct a multi-country model in which each country's politician sequentially implements a policy. Voters learn the incumbent politician's type as well as the desirable policy by observing foreign policies on top of the domestic one. We first establish a preliminary result that populist extremism, wherein undesirably extreme policies are supported by voters, arises when the public opinion is sufficiently radical. This is a simple extension of the result by Acemoglu, Egorov, and Sonin (2013). We then show that populist extremism is contagious across countries through the novel mechanism: the dynamic interaction between the public opinion and implemented policies. This structure yields novel long-run dynamics, which are not obtained in canonical social learning models (Banerjee 1992; Bikhchandani, Hirshleifer, and Welch 1992). First, a single moderate policy could be always enough to stop the domino effect. Second, the persistence of the domino effect depends on the correlation of the desirable policy across countries. In particular, while extremism eventually ends under the perfect correlation, either the convergence towards extremism or cycles of extremism hold when the state of the world follows a Markov process without absorbing states. These results indicate the importance to take into account agency problems when we analyze policy diffusion across countries.

Chapter 4 is devoted to the analysis of the political economy of economic policies (especially trade policies) in the framework of an electoral accountability model. Labor immobility (high adjustment cost) has been regarded as a major obstacle to trade liberalization, and it has been argued that higher labor mobility promotes trade liberalization. Indeed, we straightforwardly obtain this monotonic relationship so long as the median voter theorem holds. However, this is not the case when we take into account conflicts of interests between politicians and voters that are inevitable in representative democracy. To show this, we construct a simple two-period model including both elections and sectoral adjustment, where sectoral adjustment is described by using Blanchard and Willmann (2011)'s model. We then show the non-monotonic relationship between labor mobility and the equilibrium degree of trade liberalization. Higher labor mobility prevents trade liberalization in some cases. This is because the degree of labor mobility endogenously changes whether the partial trade liberalization by the incumbent prevents the reelection. The result highlights the importance to take into account politicians' reelection motives and the associated dynamic structure in the analysis of politics on trade liberalization.