

Dynamic Political Agency with Adverse Selection and Moral Hazard

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- This opportunity is very useful for us, maybe not so useful for you.

Outline of this Talk

- I. Introduction, Motivation and Related Literature
- II. The Model
- III. The Result
- IV. Conclusions & Conjectures

Don't worry, each section is short!

Questions

- What role does asymmetric information play in the interaction between voters and politicians?

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- Moral Hazard - Voters generally cannot observe the actions of incumbents, but only their consequences.
- Adverse Selection - Voters generally do not observe the costs, competence and policy preferences of candidates or incumbents, but only their consequences.

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- The tool that voters can use is rather crude - elections. Keep them in office or throw them out and get a new draw.
- Due to the size of the electorate and conflicts of interest among voters, not plausible that voters could design and commit to a socially optimal incentive contract with a politician.

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- Even though the game and information structure appear complex, can equilibrium strategies be simple?
- What is your favorite color?

Applications to Other Literatures

- Political budget cycles

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- Career Concerns

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- Many dimension issue space fine

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- In a rather general model, existence of a particularly simple kind of equilibrium in pure strategies.
- *A belief stationary equilibrium features strategies of voters and politicians that depend on the past only through voters' current beliefs about the current officeholder's type.*

Literature

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- But our model is much more general, whereas we prove that a simple equilibrium in pure strategies exists.

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- Finite set of voters (finite types)
- Finite set of states
- Countably infinite number of elections

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- Separate preference shocks perturb the stage utilities of voters
- **Key Assumption: Noisy signal to voters about current officeholder's type that is independent of incumbent's actions**

Game Timeline

Begin with an incumbent in place. We discuss what happens during one period of the game with discrete but infinite time.

- The type and preference shock (over actions) are given and privately known to the politicians. The state and the preference shocks for voters (over politician types) are given and observed by all players, and the prior beliefs of voters about the incumbent are known to all entering into this period.



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- An incumbent is matched with a challenger, randomly drawn from the pool of politicians. The two candidates compete in an election. The prior on the challenger is a function only of the state.



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- The (winning) officeholder takes an action that is both type and state dependent, unobserved by voters.
⇓
- Before a policy outcome is realized as a consequence of incumbent action, voters observe an exogenous signal about the officeholder's type. News story about the politician's conduct in prior office, or a news story about personality that is independent of actions in office. Voters update their beliefs about the incumbent type.



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- Voters and politicians receive stage payoffs.
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- Next period begins... A new state is drawn (the distribution from which it is drawn can depend on the previous period state as well as the incumbent action). Preference shocks for voters and politicians are drawn.

Assumptions

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- Keys: Sufficient noise in preference shock to incumbent, sufficient noise independent of action. Noise can have arbitrarily small support. Smoothing.

Main Result

Theorem

Under some technical assumptions on distributions and with sufficient noise, there exists a belief stationary equilibrium in pure strategies.

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Theorem

For X a separable metric space and $Q \subset \mathbb{R}^n$ an open set, suppose that $F : X \times Q \rightarrow \mathbb{R}$ is a continuous function such that $\partial_q F(x, q)$ exists and is continuous for all $(x, q) \in X \times Q$. If whenever $x \neq x'$ and $F(x, q) = F(x', q)$ we have $\partial_q [F(x, q) - F(x', q)] \neq 0$ then, for a.e. $\bar{q} \in Q$, $F(x, \bar{q})$ has at most one maximizer.

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- Difficult in general, need more structure.
- Conjecture, it's similar to Banks and Duggan (2008a,b), a model of pure adverse selection.
- In that paper, "Win Set" containing policies sufficient to ensure reelection of incumbent.

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- Some with ideal points outside win set compromise by choosing policies best for them but in win set.
- Others with ideal points outside win set shirk by choosing their ideal points, sacrificing reelection.