A Reform Dilemma in polarized democracies☆

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A B S T R A C T

We study the feasibility and efficiency of policy reforms in democracies. We develop a simple election model where (i) reforms are costly for voters and politicians and these costs increase with the extent of policy change, and (ii) politicians differ in their ability to carry out reforms efficiently. We identify a so-called *Reform Dilemma*, which manifests itself in two variants. From a static perspective, low-reform-ability politicians are elected when political parties are polarized, who then impose high costs on citizens for each reform step. This property of elections arises as low reform ability is a substitute for policy commitment. From a dynamic perspective, incumbents may choose socially undesirable policies to align the social need for reform with their own reform ability and are thus re-elected regardless of their reform ability.

1. Introduction

1.1. Motivation

Within any democracy, changes in the environment, in technologies, in the delivery of services, and in demography demand continuous policy changes. Well-known examples can be found in most policy areas: (i) the adjustment of retirement and social care systems whenever a society is aging; (ii) the necessity for new financial regulation once it has become apparent that banking systems are too fragile; (iii) heightened security after a terrorist attack such as 9/11; (iv) a phase-out of nuclear energy, as the one decided in Germany after the Fukushima incident; (v) investments in information security once the use of the internet has spread and become crucial to modern societies; (vi) winding down the Iraq War after it became clear that the benefits for the US were lower than predicted.

Policy changes may be desirable because they bring about significant benefits for the citizenry. Unlike maintaining the status quo, however, undertaking policy reforms typically also entails so-called *costs of change.*[1] Policy reforms may involve substantial investments in physical and human capital from the public sector, which is financed by the taxes paid by all citizens. The government may have to invest

substantial time and resources to implement the reform, thereby creating opportunity costs for the citizens because politicians cannot spend time on other governmental tasks. Lastly, regulating industries may generate higher wages and prices.

As a general rule, the larger the reforms, the higher the costs of change. What is more, such costs are not typically exogenous, as able politicians may engineer policy changes more efficiently than less able ones. Able office-holders may be more influential and achievement-oriented, make fewer mistakes, need fewer resources to implement policies, and/or impose lower costs on the private sector.[2]

1.2. Model and results

We augment a standard two-period election model with no possibility for politicians to commit to policies before elections take place by introducing two features. First, the ideal point of the median voter shifts over time, and adjusting or reforming policies is costly. Second, the costs of reform depend on the office-holder's ability to engineer such changes.

Our main finding is the identification of two sources of inefficiency in democracy. On the one hand, candidates with low reform ability may be elected if the candidates' desire for reform differs from the median

voter's and a majority of voters fears that high-reform-ability candidates will undertake excessively large reforms. Low-reform-ability office-holders will nonetheless impose high costs on citizens, even for smaller reforms, as they will carry out these reforms inefficiently. This inefficiency arises because politicians lack the power to commit to policies before election, low reform ability emerging then as a substitute for such commitment. On the other hand, once high-reform-ability candidates have succeeded in entering office, they will choose cost-generating polar policies that make future reform needs particularly large, thereby making it attractive to re-elect them. This strong incumbency advantage originates in the possibility for office-holders to choose policies in anticipation of the voters' behavior in the subsequent election, and is more pronounced when political parties are more polarized. Accordingly, we call these two properties of elections the *Reform Dilemma of Polarized Democracies*.

We present the Reform Dilemma in the simplest set-up, where the politicians' reform ability is common knowledge. This is not a critical assumption, as the existence of the Reform Dilemma is independent of the exact point in time when the abilities of candidates reveal themselves to become common knowledge. In our analysis, we take both a static and dynamic perspective. In the static version of the model, in particular, the chances for a low-reform-ability candidate to be elected are high whenever there is party polarization, no matter whether his ability is already common knowledge at the first election campaign stage, only becomes common knowledge after he has entered office, or is only revealed towards the end of his first term. Similarly, in the dynamic version of the model, an office-holder's incentives to align the social need for reform with his own ability by choosing more or less extreme policies arise independently of the moment when the politicians' reform ability reveals itself.

Our analysis provides further insights. First, we find that earlier revelation of the candidate's reform ability may not enhance welfare measured in utilitarian terms. Especially in polarized societies, early knowledge about reform ability may be socially undesirable. Second, we show that incumbents may have incentives to deliberately and irrevocably reduce their reform ability in order to obtain re-election, even if by doing so they incur private costs. In a similar vein, parties may want to nominate less competent candidates. Third and last, *ceteris paribus*, ideological moderation increases the election chances.

1.3. The Reform Dilemma in practice

Although we focus on the conceptual understanding of the two manifestations of the Reform Dilemma, empirical observations can be related to the predictions of our results. One such prediction is that more able candidates are elected when the economy performs badly, and thus when large reforms may be needed. Based on several studies, Simonton (2006) estimated the so-called *intellectual brilliance (IB)* of all the Presidents of the US, which can serve as a proxy for their reform ability. Since 1928, the correlation between the Presidents' intellectual brilliance and the unemployment rate when each President was elected for his first term is 0.38.[3] Moreover, when the challenger was able to defeat the incumbent, the latter's IB was lower than the former's. For example, in 1992, when Bill Clinton (IB = 1.0) defeated George H. Bush (IB = −0.3), the unemployment rate was relatively high, namely 7.4%.[4]

A second prediction of our model is that office-holders may take decisions that are disliked by a majority of their own supporters,

let alone by a majority of the entire electorate, in order to present themselves as the remedy to a self-created problem. There is a variety of examples. For the US, it can be argued that the escalation of the Vietnam and Iraq wars driven by the Republican party, and pro-affirmative actions driven by the Democrats fall into this category (see Glazer et al., 1998). Chancellor Kohl initiated the introduction of the Euro, a decision that was opposed by a majority of Germans at that time. In the subsequent elections, he presented himself as the candidate most able to guarantee that the new currency would remain stable.[5]

1.4. Organization of the paper

The remainder of the paper is organized as follows: In Section 2 we review the research connected to our article. In Section 3 we outline our baseline set-up. In Section 4 we study a static model of elections. In Section 5 we study a dynamic model of elections. In Section 6 we analyze some extensions of our baseline set-up. Section 7 concludes. All proofs are contained in Appendices A, B, C, and D (see Supplementary Material).

2. Relation to the literature

Our paper is related to several strands of the literature, which enables us to put our results into a broader perspective.

2.1. Electoral competition

Our model of candidate competition for winner-take-all elections has many features in common with the standard literature on electoral competition, and particularly with models of political competition without policy commitment (see e.g. Persson and Tabellini, 2002). Beyond having standard quadratic preferences over the policies chosen in each of the two periods, as a key ingredient, voters and candidates also care in our model about the difference between the policies chosen in two consecutive periods, due to the existence of costs of change.[6] Our results show that competition between candidates by means of elections may be insufficient to ensure that socially efficient policies are implemented.

2.2. Costs of reform in policies

To date, few models have considered the costs associated with changes in policies. Glazer et al. (1998) show that when any policy change generates the same large fixed cost, the incumbent will obtain an electoral advantage by choosing a policy beyond his own ideal policy, thereby outcompeting the challenger. Gersbach et al. (2015) consider costs that increase with the extent of the policy change and where, contrary to the present paper, all politicians are alike in terms of reform ability. Our paper adds to this literature on costly reforms by focusing on how differences in politicians' reform ability might lead to inefficiencies in elections.

2.3. Policy persistence

It has frequently been observed that in democracies, the status quo will prevail, even if changes are desired by a majority of voters. Beyond the costs of such changes, other frictions in the electoral process might explain this phenomenon: the dynamics of internal party politics (Miller

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