Term limits and bounds on policy responsiveness in dynamic elections ☆

John Duggan

Department of Political Science and Department of Economics, University of Rochester, United States

Abstract

I analyze equilibria of a dynamic political agency model of elections with a two-period term limit in the presence of adverse selection and moral hazard. In equilibrium, office holders' policy choices are ordered by type; politicians exert positive effort in the first term of office; and as politicians become highly office motivated, the highest politician type mixes with positive probability between shirking and choosing arbitrarily high policies. Nevertheless, the commitment problem of voters imposes a bound on equilibrium expected effort exerted by politicians that holds uniformly across the level of office benefit and the rate of time discounting. In particular, when politicians are highly office motivated, voters are too demanding in equilibrium, and voter welfare would increase if it were possible to commit to a lower cutoff for re-election. © 2016 Elsevier Inc. All rights reserved.

1. Introduction

An essential feature of representative democracy is the periodic reconsideration of political agents by their principal, the electorate. Elections allow voters to express approval or disapproval

of their elected delegates, and at the same time they provide politicians with incentives to shun parochial interests in favor of the public good. The operation of these incentives is complicated by informational asymmetries—in the form of adverse selection and moral hazard—and by the extended time horizon over which interaction takes place. We would expect these electoral incentives to be mitigated by term limits but enhanced if the benefit of holding office per se is larger or the weight placed by politicians on short-term gains is smaller. These issues are properly addressed in a dynamic framework that explicitly accounts for informational asymmetries, but doing so requires precise attention to the ensuing technical complexities.

This paper considers elections in a dynamic political agency model similar to that analyzed by Banks and Sundaram (1998). In this framework, an office holder's policy choice (i.e., effort) is unobserved by voters and stochastically determines an outcome that is observable; moreover, politicians' preferences are indexed by their types, which are also unobserved by voters. Once an outcome is generated by the choice of a first-term office holder, voters must decide whether to replace the incumbent with a challenger, whereas politicians are automatically removed from office after their second term; and this process is repeated ad infinitum. The paper provides a partial characterization of stationary electoral equilibria for arbitrary parameterizations, along with sharper results for the case of highly office-motivated politicians. Of interest is the possibility that in response to electoral incentives, elected politicians decline the opportunity to shirk, foregoing policies close to their own ideal points and instead choosing policies that are good for voters; this phenomenon is referred to as *policy responsiveness.* Generally, an office holder chooses policies strictly higher than her ideal point in the first term of office, and as politicians become highly office motivated, the highest politician type mixes with positive probability between shirking (choosing policies close to its ideal point) and choosing arbitrarily high policies. Thus, a minimal level of policy responsiveness is achieved in equilibrium. However, the main substantive conclusion of the paper, collected in Theorems 4–6, is that the voters' equilibrium payoff is bounded above by the expected utility from the ideal point of the highest politician type. The upper bound holds generally across all parameter values. Moreover, it is robust to the introduction of new types with small prior probability, and for a given level of office benefit, the bound holds strictly regardless of the level of citizens' patience.

This bound on policy responsiveness described above is due to the *commitment problem of voters.* It is assumed that the electorate cannot write a binding contract to re-elect an incumbent following policy outcomes above a predetermined level. Rather, electoral outcomes are determined endogenously in equilibrium, where voters compare the expected stream of payoffs from re-electing the incumbent vs. the continuation value of a challenger; and as the voter's continuation value of a challenger increases, her incentive to re-elect the incumbent decreases, and elections lose their disciplining effect. More precisely, because second-term office holders simply choose their ideal points, the best case for voters is that a re-elected politician chooses the ideal point of the highest politician type. If the voters' continuation value of a challenger exceeded this payoff, then voters would always have an incentive to remove an incumbent after her first term to insert a more productive challenger. But then, of course, first-term office holders would have no incentive to depart from their ideal points in the first place. Therefore, the incentives of voters imply a general bound on the possibility of policy responsiveness: the continuation value of a challenger can never exceed the expected payoff from the ideal point of the highest politician type. Furthermore, if politicians are highly office motivated and voters can commit to a re-election standard at the beginning of the game, then the optimal cutoff for voters is below the equilibrium cutoff, and voter welfare would strictly increase if a lower cutoff were used. Thus, voters are too demanding in equilibrium relative to the optimum with commitment.