

The Behavior of Leaders

A Political Economy Perspective

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- **How Do Leaders Behave (Or Perhaps Misbehave)?**

- ▶ How can we explain their behavior?
- ▶ How can we control the misbehavior?

- **Standard Approach in Economics**

- ▶ No “leaders” *per se* – only policies

- **Political Economy Approach to Leaders**

- ▶ Leaders have their own objectives which may or may not correspond to social welfare maximization

Standard Approach in Economics

- **What is the effect of different policies? (positive question)**
- **Based on this, what is optimal policy? (normative question)**
 - ▶ “Leaders” carry out optimal policy once it is known
 - ▶ There is no problem in the behavior of leaders
 - ★ only the technical problem” of specifying or calculating the best policy
 - ▶ Or, a mechanism design problem – getting citizens to comply with (socially optimal) government policy
 - ★ inducing optimal *citizen* behavior (“If citizens would pay their taxes, the government would use the money optimally”)

Political Economy Approach

- **Leaders are also self-interested**

- ▶ They maximize their own welfare
- ▶ Getting leaders to do what is in the citizen's best interests
 - ★ discipline
 - ★ selection
 - ★ altruistic behavior by politicians

- **Leaders are not unitary actors**

- ▶ Their actions may reflect constraints rather than simply objectives
- ▶ Understanding interactions among policymakers

Accountability

- Getting leaders to do what is in the citizen's best interests (and disciplining them if they don't)
- Accountability issues arise whenever the interests of the policymaker are not a priori aligned (or known by citizens with certainty to be aligned) with those of the citizen
- Main tool that voters have is not to re-elect the policymaker

Principal-Agent Approach

- Problem of accountability is well represented as one of “agency”
 - ▶ “principal” engages an “agent” to take certain actions on his behalf
 - ▶ Relationship between citizen and policymaker can be modeled as a principal-agent problem
- Political agency model is widely used in political economy
 - ▶ Voting – many principals and a single agent
 - ▶ Lobbying legislators – multiple principals and multiple agents
- Key role of informational asymmetries between principal and agent

Moral Hazard and Adverse Selection

- Moral Hazard as the basic asymmetric information problem in political accountability
 - ▶ policymaker takes actions that negatively impact the principal, but that are not fully observable by the principal
 - ▶ hence, issues of accountability
- Adverse Selection
 - ▶ agents may also differ in an unobserved characteristic which affects the utility of the principal
 - ▶ hence, desire to elect the “best” policymaker

Accountability via Trigger Strategies

- Controlling bad performance by voting rules that require a given level of performance to gain re-election
 - ▶ Ferejohn (1986) – voter commits not to re-elect incumbent if performance is too low *independent* of expectations of future performance
 - ▶ can induce better performance when moral hazard is only issue
- Fearon (1999) – candidate heterogeneity makes it impossible for voters to use the sort of retrospective voting rules on which sanctioning poor performance depends
 - ▶ voters pick the best candidate looking forward
 - ▶ but then the incumbent has no incentive to perform well to be re-elected
 - ▶ Hence, once candidates differ, rational voters are forward-looking and trigger punishment strategies don't work
- In fact, even with candidate heterogeneity, there *can be* discipline and accountability

A Simple Political Agency Model

- Aruoba, Drazen, and Vlaicu (2014)
- Policymaker may serve a maximum of two terms
 - ▶ What is the effect on performance of possibility (versus no possibility) of re-election?
- Both moral hazard ...
 - ▶ “bad” policymakers don’t want to supply effort
 - ▶ threat of not being re-elected may discipline them
- ... and selection
 - ▶ voters prefer “good” leaders
- Type of politician is unobserved
 - ▶ voters face an inference problem of inferring politician motivation from observed performance

Political Agency Model – Set-up

- A governor is one of two unobserved types – “good” ($\theta = G$) or “bad” ($\theta = B$)
 - ▶ “good” governors have 0 cost of exerting high effort” ($e = H$), while “bad” governors have a positive cost $c \times r$, where r is rent from holding office
 - ★ assume “bad” governors have zero cost of exerting low effort ($e = L$)
 - ▶ prior probability that a governor is good is $\pi = \mathbb{P} \{ \theta = G \}$
- Let $c(e; \theta) \equiv$ the cost of effort e for a governor of type θ

$$c(H; G) = c(L; B) = 0 \text{ and } c(H; B) = c > 0$$

- ▶ c, θ observed by the governor but unobserved by the electorate
 - ▶ different levels of effort lead to different distributions of observed possible outcomes
- Probability of re-election is ρ_H if high effort and ρ_L if low effort
 - ▶ equilibrium probabilities depend on both performance of the governor given his effort and probability of re-election given his performance

Governor's Decision

- Good governor ($\theta = G$) exerts high effort in both terms of office
 - ▶ ($e_1 = e_2 = H$)
- Bad governor ($\theta = B$) exerts low effort in second term ($e_2 = L$)
 - ▶ exerts high effort in first term ($e_1 = H$) only if cost c is low enough relative to expected increase in re-election probability $\rho_H - \rho_L$
- Electorate doesn't observe c , but understands maximization problem that governors face
 - ▶ therefore they can calculate the probability that a bad governor exerts effort

Voters

- Voters observe performance y_1
 - ▶ y_i is stochastic, where higher effort means higher distribution of outcomes
 - ▶ observing y_1 , voter calculates $\hat{\pi}(y_1)$ posterior that governor is good
- election shock ε occurring right before the election unrelated to the performance of the incumbent governor
 - ▶ last-minute news about either the incumbent or the challenger
 - ▶ exogenous preference for one of the candidates
 - ▶ $\varepsilon > 0$ favors challenger
- Voter decides whether or not to re-elect incumbent to maximize expected lifetime utility $W(y_1, \varepsilon)$
 - ▶ re-elect incumbent ($R = 1$) iff $\varepsilon < \hat{\varepsilon}(y_1)$
 - ★ equivalent to high enough posterior $\hat{\pi}(y_1)$
- Derive re-election probabilities ρ_L and ρ_H from voter's re-election rule based on realizations of y_1 (hence inference on θ) and ε

Structural Estimation of the Political Agency Model

- Look at behavior of two-term limited governors in first and second term to see effect of re-election incentive on performance
- Many papers have used a reduced-form approach
 - ▶ problem of disentangling the importance of various factors
 - ▶ problem of assessing the welfare impact of term limits
- ADV (2014) present a structural approach
 - ▶ maximum likelihood estimation of structural parameters of the model
 - ▶ quantify discipline and selection effects
 - ★ is it discipline or selection that explain better outcomes when re-election is allowed?
 - ▶ welfare effects of changing term limits
- More broadly, empirical relevance of political agency model

Data

- Stints of U.S. governors limited to two terms over 1982-2012
- Performance variable y
 - ▶ we use average job approval ratings (JARs)
 - ★ surveys of voters at various points of the governor's term where respondents asked to rate the governor as "excellent", "good", "fair" or "poor"
 - ★ fraction of respondents who classify the governor as "excellent" or "good" out of those who express an opinion
 - ★ up to and including June of an election year at the end of the first term of the incumbent
 - ★ growth in real income per capita, unemployment, fiscal variables did significantly less well in explaining election outcomes
- Whether re-elected or not
 - ▶ not running if eligible classified as losing

Governor Types, Performance, and Accountability

One-Term (Counterfactual) Benchmark

Good governors (% of governors)	48.2%
High effort (% of governors)	48.2%
Average Performance	54.1

Two-Term Limit

Good governors in Term 1	48.2%
Good governors in Term 2	55.8%
High effort in Term 1 (% of governors)	61.7%
High effort in Term 2 (% of governors)	55.8%
Average Performance in Term 1	56.8
Average Performance in Term 2	55.6

Measures of Interest

Discipline 1 : Fraction Disciplined	26.0%
Discipline 2 : Performance Term 1 - Performance 1-Term	2.7
Selection: Good Governors in Term 2 - Good Governors in Term 1	7.7%
Selection 2 : Performance Term 2 - Performance 1-Term	1.5

Discipline – Corrupt Politicians

“An honest politician is one who, when he is bought, will stay bought.”

Simon Cameron, U.S. Senator from Pennsylvania before and after the U.S. Civil War

His corruption was so notorious that a Pennsylvania congressman, Thaddeus Stevens, when discussing Cameron's honesty with Lincoln, told Lincoln that “I don't think that he would steal a red hot stove.”

When Cameron demanded Stevens retract this statement, Stevens told Lincoln “I believe I told you he would not steal a red-hot stove. I will now take that back.”

- Large empirical literature on corruption and controlling it
- Theoretical literature on trading policy for favors from special interests

Selection

- Fearon (1999) on elections
 - ▶ voters “think about elections more as opportunities to select good types than as mechanisms establishing accountability”
 - ▶ “good type who would act in their behalf independent of re-election incentives”
 - ▶ Elections produce policy that voters want by sorting among types
 - ★ socially-minded versus rent-seeking
 - ★ competent versus less-competent
 - ★ ideologically preferred

Selection under Imperfect Information

- Key problem of inferring a leader's underlying preferences
- “Citizen-candidate” approach
 - ▶ once elected, candidates do what they find optimal
 - ▶ voters know a candidates preferences before electing him or her
 - ▶ applied mainly to ideology rather than willingness to supply effort, etc.
- Do voters really know how much politicians share their preferences and concerns?
 - ▶ and hence what the leader will do when in office?
- How can politicians credibly supply this information?
 - ▶ campaign promises (??)
 - ★ punish an incumbent who didn't fulfill his promises (George Bush père: “Read my lips. No new taxes.”)
 - ▶ using an incumbent's observed policy to infer his/her preferences
 - ★ Drazen and Eslava (2010, 2013) on “Programmatic Targeting”
 - ★ targeted spending meant to credibly signal a politician's policy priorities

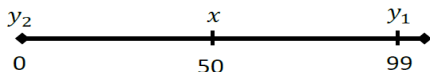
Is Selection Necessary?

- “Fiduciary” behavior
 - ▶ the **fact of holding an office** induces other-regarding behavior
- Experiment – the “Dictator Game”
 - ▶ “Proposer” is given a sum which he/she may keep or give part to “responder”
 - ▶ Subgame perfect outcome is to keep it all
 - ▶ robust finding – about 30-40% of proposers give to responders
- Is this the effect of being chosen to lead?
 - ▶ or, simply differences in underlying altruism?

Being “Chosen To Lead”

Drazen and Ozbay (2014) experimental results

- Two candidates, one voter with positions on a line with known “types” (no other information on candidates)



- One candidate is chosen as a leader
 - ▶ election – voter chooses one of the candidates
 - ▶ appointment – one of the candidates is chosen at random
- No re-election
 - ▶ or any other mechanism to align preferences of leader with citizens
- Chosen leader chooses a policy between 1 and 100
 - ▶ not necessarily equal to his type
- Payoffs depends (negatively) on distance between type and policy

Non-Selfish Leader Behavior

Do Leaders Behave Non-Selfishly?

(Fraction of observations where Policy is not Leader's Type)

	Election	Appointment	Difference	Mann-Whitney test
Policy is not Leader's Type	.4	.2625	.1375	z=4.13
Number of cases	(0.025) 160	(0.022) 105	(0.033)	p=0.00

Standard errors in parentheses. Number of observations: Election=400; Appointment=400

- Candidates do not simply carry their (selfish) preferences into office
- Significantly greater under elected than appointed leaders

To Whom Are Leaders Altruistic?

Toward Whom Do Leaders Move When They Move?

	Voter	Losing Candidate	Proportion test
Election (N=160)	.763 (.034)	.563 (.039)	z=3.78 p=.00
Appointment (N=105)	.8 (.039)	.705 (.045)	z=1.60 p=.11
Election Leader is in center (N=70)	.771 (.050)	.229 (.050)	z=6.43 p=.00
Appointment Leader is in center (N=30)	.6 (.089)	.4 (.089)	z=1.55 p=.12

Standard errors in parentheses. Since we allow for integer amounts, being in Center is defined as: $votertype-1 > winnertype > losertype+1$ or $votertype+1 < winnertype < losertype-1$ so that there is always room for the leader to compromise if she wants.

- Elected leaders favor the voter (who elected them) over the other “citizen”
- Appointed leaders favor the two citizens equally

To Whom Are Leaders Altruistic? (cont.)

How Much Do Leaders Move Toward Voters?

Average Movement Relative to Initial Distance (μ)

	Election (N=114)	Appointment (N=77)	Mann- Whitney test
μ	.381 (.034)	.266 (.030)	$z=2.153$ $p=.021$

Standard errors are in parentheses. These values are conditional on moving toward the voter ($0 < \mu \leq 1$).

- Elected leaders are not only more likely to move toward the voter, but move more when they move

Elected vs. Appointed Leaders and Non-Voters

How Much Do Leaders Move towards Losing Candidate?

Average Movement Relative to Initial Distance (μ')

	Election (N=87)	Appointment (N=68)	Mann-Whitney test
μ'	.221 (.025)	.245 (.024)	$z=1.783$ $p=0.07$

Standard errors are in parentheses. These values are conditional on moving toward the losing candidate ($0 < \mu' \leq 1$).

- Combined with results in previous slides on elected leaders moving towards voters, their behavior suggests not simply reciprocity rather than simple altruism

Reciprocity

- Rabin – “people do not seek uniformly to help other people; rather, they do so according to how generous these other people are being”
 - ▶ reciprocal behavioral is a robust finding of the experimental literature
 - ★ material sacrifice is present to show kindness in those experiments
- Elections (as opposed to appointment) are a setting where reciprocity would be exhibited
 - ▶ elected leaders reciprocate by acting in the interests primarily of voters who elected them

Reciprocity (cont.)

- Does reciprocity to kindness require material sacrifice by the giver?
 - ▶ elected leaders appear to reciprocate to voters ...
 - ▶ ... but voters make no material sacrifice in electing the leader if voting is costless
 - ▶ voting for closer candidate may be simply self-interest
- We investigate a formal “citizen-candidate” model with reciprocal preferences
 - ▶ we show theoretically that material sacrifice is **not** necessary to generate reciprocity
 - ▶ the crucial aspect to being considered as kind is simply to improve the other’s payoff

Reciprocity to Voters

Reciprocity to Voters

Percentage Choosing a Policy toward a Voter between the Two Candidates

	Election	Appointment	Mann-Whitney test
Leader is the <i>further</i> candidate (NOBS of ordinary citizen in middle and the further candidate is the leader)	.579 (.113) N=19	.228 (.047) N=79	z= 3.00 p= 0.03
Leader is the <i>closer</i> candidate (NOBS of ordinary citizen in middle and the closer candidate is the leader)	.345 (.045) N=111	.176 (.053) N=51	z= 2.19 p= 0.03
Mann-Whitney test	z= 1.93 p=0.05	z= 0.70 p= 0.48	

Standard errors are in parentheses. Since we allow for integer amounts, being in the Center is defined as: $winnertype-1 > votertype > losertype+1$ or $winnertype+1 < votertype < losertype-1$ so that there is always room for the leader to compromise if he wants. Also, $winnertype=0$ and $winnertype=100$ are excluded to avoid any movement to favor moving toward the voter.

- Especially strong when a voter votes for the further candidate

Non-Unitary Policymakers

- Interactions among “co-policymakers”
 - ▶ executive and legislature
 - ▶ agenda setters within legislatures
 - ▶ executive and bureaucracy
- Large theoretical (and empirical) literature
 - ▶ how can a leader induce other “co-policymakers” to adopt her preferred policy?
 - ★ regular pork versus Kosher (Halal) pork
 - ▶ what policy emerges when there are “co-policymakers”?
 - ★ a lot of work on legislatures
 - ▶ how much freedom of action does the executive have?
 - ★ for example, relative to the bureaucracy

The Effect of Leaders – Theory

- Policy preferences of a policymaker would be reflected in changes in the actual composition of expenditures.
- Several reasons why one might not observe such a tight relation:
 - ▶ expenditure is mandated by law (entitlements) or past government decisions
 - ▶ new officeholders may face a learning curve
 - ▶ choice of policies favored by “median voter”
 - ★ perhaps it takes time to learn voter preferences
 - ▶ elected leaders are not unitary policymakers – legislators, special interest groups, and the existing bureaucracy may block them

The Effect of Leaders – Some Empirics

- Brender and Drazen (2013) look at changes in the composition of government spending as a measure of policy change
 - ▶ many other aspects of policy, but spending composition is often indicator of broader policy directions
- Replacement of a leader has no **significant** effect on expenditure composition in first two years, relative to no change in leader
 - ▶ not due to entitlement spending – removing Health and Social Protection spending does not change basic result
- Leadership changes **do** result in greater composition change over four-year horizon, predominantly in developed countries
- It takes time for a leader to make policy changes
 - ▶ FDR's "100 days" was an anomaly

Teşekkür ederim!
Thank you for listening!