Creating Fact

Hideaki Murase

Abstract

We often observe that democratically-elected politicians adopt unpopular policies. The observations appear puzzling because politicians must seek popularity of the electorate in democracies. This paper argues that the adoption of unpopular policy can be interpreted as the politicians' attempt to *create fact*. In the existence of electoral uncertainty and the cost of policy change, an incumbent politician wants to restrict a challenger's discretion in policymaking and makes a future policy favorable to the incumbent by adopting a radical policy that is hard to change. We also offer some comparative statics results and discuss the determinants of the extent of policy radicalness.

1．Introduction

We often observe that politicians adopt unpopular policies in democracies. Some of recent examples are the privatization of public enterprises by Margaret Thatcher in the United Kingdom, the tax reform toward high-income class by Ronald Reagan in the United States, the introduction of consumption tax by Noboru Takeshita (and the subsequent rise in the tax rate by Ryutaro Hashimoto) in Japan, and the rapid transition from socialism to market economy by Boris Yeltsin in Russia. These policies are "radical" in the sense that politicians position themselves far from a centrist political opinion at the time of policy adoption.

The observations appear to be puzzling because, in democracies, there is a possibility of alternation in office and hence politicians must seek popularity of the electorate in order to win election.

Why do politicians risk on radical policies? In this paper, we argue that the adoption

of radical policy can be interpreted as the politicians' attempt to *create fact*. Specifically, this paper focuses on two key elements behind the adoption of radical policy : the uncertainty in electoral outcome and the cost of policy change.

The mechanism can be explained as follows. Due to the electoral uncertainty, with positive probability an incumbent will lose power in the future and a challenger will get position to choose a future policy. Anticipating this possibility, the incumbent attempts to reduce a challenger's discretionary power in policymaking and to take control over future policy while he stays in office. If the incumbent adopts a moderate policy, the cost of policy change by the challenger will not so high. Hence, the challenger will more easily overthrow the incumbent's policy choice and make a costly policy change in the future if taking over office. Meanwhile, if the incumbent adopts a radical policy, the challenger will prefer avoiding a high cost of policy change and be likely to continue adopting the incumbent's policy. Therefore, the adoption of radical policy today is rationalized from the incumbent's standpoint, since it can make a policy in the future favorable to the incumbent even if the incumbent will lose office. As is clear from this discussion, contrary to the standard intuition, the adoption of radical policy considered in this paper can arise from the possibility of alternation in office in democracies, but not despite it.

In previous researches, several articles studied the effects of electoral uncertainty on the nature of policy adopted by the incumbent. Persson and Svensson (1989) showed that a conservative incumbent may run a fiscal deficit in order to limit the fiscal expansion by the liberal challenger. Similarly, Tabellini and Alesina (1990) argued that when there is a difference in preference over public goods among political parties, the balanced-budget fiscal policies do not constitute a political equilibrium. Cukierman, Edwards, and Tabellini (1992) identified the adoption of inefficient tax schemes as politicians' rational response to political instability. Glazer (1989) argued that public investment is biased toward durable projects because durability implies a lasting influence of the incumbent on the future. (See, for an extensive survey, Persson and Tabellini, 2000.) However, those articles consider special situations around the determination of fiscal policies and do not relate the results to the radical-moderate dimension of policy choice. The present paper hence shows that their results have more general insight and application beyond the situations specific to fiscal politics.[1]

The rest of paper is organized as follows. The next section explains the setup of the

model. Section 3 solves the equilibrium of the model and shows that electoral uncertainty leads an incumbent politician to adopt a radical policy. Section 4 implements some comparative statics in order to discuss the determinants of the extent of radicalness of policy. Section 5 offers some concluding remarks.

2. Model

Consider a two-period game with two political parties, L and R. In period 1, party L is the incumbent and makes a one-dimentional policy choice, x_1^L. An election is held at the end of period 1. With probability p, party L wins the election, whereas with probability $1-p$, party R wins the election. This electoral uncertainty is assumed to reflect random shifts in electorate's preference. In period 2, the winner chooses a policy x_2^I ($I=L, R$). It is assumed that continuing a policy ($x_2^I=x_1^L$) imposes no costs on the party in office ; however, changing a policy ($x_2^I\neq x_1^L$) requires the effort exerted by the party in office. The effort cost takes a form of $c(x_1^L-x_2^I)^2$, where c is a positive constant. Here, it is naturally assumed that when the party in office changes a policy, with more distance between the period 1's policy and period 2's policy, the effort cost is larger.

Party L's payoff depends on the policies adopted in period 1 and period 2 and on the cost of a policy change. The payoff function is expressed as :
$$U^L= -(x_1^L-y^L)^2-p\{(x_2^L-y^L)^2+c(x_1^L-x_2^L)^2\}-(1-p)(x_2^R-y^L)^2, \qquad (1)$$
where y^L is party L's bliss point.

Similarly, party R's payoff function is expressed as :
$$U^R= -(x_1^L-y^R)^2-p(x_2^L-y^R)^2-(1-p)\{(x_2^R-y^R)^2+c(x_1^L-x_2^R)^2\}, \qquad (2)$$
where y^R is party R's bliss point.

Without loss of generality, it is assumed that $-\infty<y^L<y^R<\infty$. That is, party L has the bliss point to the left of that of party R. Then we say that the policy is *radical* if $x_1^L<y^L<y^R$.

---

1) Another strand of literature that considered the relation of electoral uncertainty to the incumbent's policy manipulations takes the opposite view that politicians are office-motivated. Aghion and Bolton (1990) showed that a conservative incumbent may run a fiscal deficit in order to limit the probability of winning election of the liberal challenger who prefer further expansion of fiscal policy (see also Milesi-Ferretti and Spolaore, 1994 ; Milesi-Ferretti, 1995). Specifically, Glazer, Gradstein and Konrad (1998) obtained an interesting prediction that if politicians are sufficiently office-motivated, the policy adopted by the incumbent will be radical.

3. Equilibrium

The equilibrium of the model can be solved by backward induction. Consider first the sub-games in period 2. Suppose that party L wins the election at the end of period 1. Party L, given period 1's policy choice x_1^L, chooses x_2^L to maximize :

$$-(x_2^L - y^L)^2 - c(x_1^L - x_2^L)^2. \tag{3}$$

The optimal policy choice is given by :

$$x_2^L(x_1^L) = \frac{y^L + cx_1^L}{1+c}. \tag{4}$$

Next suppose that party R is in office in period 2. Similarly, given period 1's policy choice x_1^L, party R chooses x_2^R to maximize :

$$-(x_2^R - y^R)^2 - c(x_1^L - x_2^R)^2, \tag{5}$$

which yields the optimal choice of party R :

$$x_2^R(x_1^L) = \frac{y^R + cx_1^L}{1+c}. \tag{6}$$

Now consider the game in period 1. In period 1, party L chooses x_1^L to maximize U^L, subject to (4) and (6), i.e. taking into account the reaction of period 2's party in office to period 1's policy choice. Thus, the following maximization problem gives the equilibrium choice of policy in period 1 :

$$\max_{x_1^L} U^L = -(x_1^L - y^L)^2 - p[\{x_2^L(x_1^L) - y^L\}^2 + c\{x_1^L - x_2^L(x_1^L)\}^2] - (1-p)\{x_2^R(x_1^L) - y^L\}^2. \tag{7}$$

The solution of the problem is obtained as :

$$x_1^L = y^L - \Phi, \tag{8}$$

where $\Phi = \dfrac{(y^R - y^L)(1-p)c}{(1+c)^2 + pc + c^2}$.

Proposition 1.   The policy adopted by the incumbent is radical, $x_1^L < y^L < y^R$, if the uncertainty in electoral outcome and the cost of policy change exist.

Proof.   Since we have assumed that $y^L < y^R$, $\Phi > 0$ if $p < 1$ and $c > 0$. Therefore, $x_1^L < y^L < y^R$

Corollary. $x_1^L < x_2^L < y^L$ and $y^L < x_2^R < \dfrac{y^R + cy^L}{1+c} < y^R$ if $p < 1$ and $c > 0$.

Facing the electoral uncertainty, the incumbent wants to retain control over the future policy even when losing office. To this end, he/she adopts a radical policy that is harder

to change. In words, Proposition 1 states that the incumbent finds it optimal to *create fact* by adopting a radical policy.

4． Determinants of policy radicalness

Under what circumstances, is the adopted policy likely to be more radical？ Proposition 1 shows that Φ parameterizes the extent of policy radicalness. Hence this section offers some comparative statics results about Φ, and discusses the determination of the policy radicalness.

To make intuition underlying the results clear, let us first summarize the loss and gain of policy radicalness for the incumbent (see again Eq. (7)). The loss is : the cost of policy deviation from the incumbent's bliss point in the present ; the cost of policy deviation and that of policy change when the incumbent will win office in the future (with probability p). The gain is : the benefit of less policy deviation from the incumbent's bliss point when the challenger will take over office in the future (with probability $1-p$). If the loss is small relative to the gain, the incumbent naturally adopts a more radical policy.

・The ideological polarization

First, let us consider how the magnitude of the ideological difference between the incumbent and the challenger affects the extent of policy radicalness of the incumbent.

$$\frac{\partial \Phi}{\partial (y^R - y^L)} = \frac{(1-p)c}{(1+c)^2 + pc + c^2} > 0. \tag{9}$$

Proposition 2a. The policy adopted by the incumbent is more radical, as the ideological positions of the incumbent and the challenger is more polarized.

The intuition for this result is the following. When the ideological positions are more polarized, the challenger has a strong incentive to implement a larger policy change if taking over office. Anticipating this, the incumbent adopts a more radical policy while being in office, in order to minimize the adverse effect of such a future policy change. In words, the ideological polarization increases the gain of radical policy, but keeps the loss unchanged. As a result, the radicalness of adopted policy turns out to be large.

・The electoral uncertainty

Next, let us take up the effect of the magnitude of electoral uncertainty on the extent of radicalness of the adopted policy.

$$\frac{\partial \Phi}{\partial p} = -\frac{(y^R - y^L)c(1+c)(1+2c)}{\{(1+c)^2 + pc + c^2\}^2} < 0. \tag{10}$$

<u>Proposition 2b.</u> The policy adopted by the incumbent is more radical, as the electoral uncertainty increases.

In this case, the balance of loss and gain from policy radicalness changes as follows. A rise in the probability of the challenger in office decreases the relative weight attached to the cost of the incumbent in office in the future but increases that attached to the benefit of restricting the challenger's future policy deviation. Hence, the electoral uncertainty increases the gain of radical policy, but decreases the loss. As a result, the incumbent adopts a more radical policy even at the sacrifice of present policy preference.

・The cost of policy change

Finally, let us discuss how an increased cost of policy change affects the extent of radicalness of the adopted policy.

$$\frac{\partial \Phi}{\partial c} = \frac{(y^R - y^L)(1-p)(1-2c^2)}{\{(1+c)^2 + pc + c^2\}^2} > (<)0 \qquad if \qquad c < (>)\frac{1}{\sqrt{2}}. \tag{11}$$

<u>Proposition 2c.</u> The policy adopted by the incumbent is more radical as the cost of policy change increases if the cost is small, but it is less radical if the cost is large.

The mechanism behind this experiment is somewhat complex. A rise in the cost of policy change increases not only the cost of future policy change by the incumbent, but also the benefit of less future policy deviation when the challenger will be in office. Notice, however, that the restriction of policy change also increases the cost of policy deviation in the future when the incumbent will be in office. Hence, when the cost of policy change is small, the gain dominates the loss, and then the incumbent finds it optimal to adopt a more radical policy even at the expense of present and future policy preference ; meanwhile, when the cost of policy change is large, the opposite is true, and therefore the incumbent adopts less radical policy.

5．Conclusion : A Republican Clinton

This paper has demonstrated that the observed adoption of radical (and hence unpopular) policies in democracies can be caused by the incumbent politicians' attempts to *create fact*.

Finally, let us briefly discuss the effects of such an attempt in the real world. *The Economist* (November 2, 1996) argued, "Clinton governs like a Republican." This story can be interpreted as that given *the fact created* by the Reagan-Bush Republican administration in 1980s, the Clinton administration implemented policies that lean toward the Republican and depart from the traditional Democrat in 1990s.

Examples may also include the "Third Way" by Tony Brair in the United Kingdom, the (failed) National Welfare Tax Plan by Morihiro Hosokawa in Japan, and the "Realism" of Vladimir Putin in Russia. Although I do not intend to offer a specific explanation for the real politics, the prediction of the model in this paper seems quite consistent with these observations.

References

［1］ Aghion, P. and Bolton, P. 1990. "Government Domestic Debt and the Risk of Default in a Political Economic Model of the Strategic Role of Debt," In : R. Dornbusch and M. Draghi, eds., *Public Debt Management : Theory and History*, Cambridge : Cambridge University Press.

［2］ Cukierman, A., Edwards, S., and Tabellini, G. 1992. "Segniorage and Political Instability," *American Economic Review*, 82, pp. 537-55.

［3］ Glazer, A. 1989. "Politics and the Choice of Durability," *American Economic Review*, 79, pp. 1207-13.

［4］ Glazer, A., Gradstein, M. and Konrad, K. A. 1998. "The Electoral Politics of Extreme Policies," *Economic Journal*, 108, pp. 1677-1685.

［5］ Milesi-Ferretti, G. M. 1995. "The Disadvantage of Tying Their Hands : On the Political Economy of Policy Commitments," *Economic Journal*, 105, pp. 1381-1402.

［6］ Milesi-Ferretti, G. M. and Spolaore, E. 1994. "How Cynical can an Incumbent Be ? Strategic Policy in a Model of Government Spending," *Journal of Public Economics*, 55, pp. 121-140.

［7］ Persson, T. and Svensson, L. E. O. 1989. "Why a Stubborn Conservative would Run a Deficit : Policy with Time-inconsistent Preferences," *Quarterly Journal of Economics*, 104, pp. 323-44.

［8］ Persson, T. and Tabellini, G. 2000. *Political Economy : Explaining Economic Policy*. Cambridge MA : MIT Press.

［9］ Tabellini, G. and Alesina, A. 1990. "Voting on the Budget Deficit," *American Economic Review*, 80, pp. 37-49.