Statesmen, Populists and the Paradox of Competence

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Abstract

We examine a two-period election model in which voters are uncertain about the candidates' competence and do not know whether these politicians are more concerned about the long–term consequences of their decisions (statesmen) or about the public's opinion as to their competence and preferences (populists). Our main finding suggests that the public may benefit by disregarding the candidates' competence and by reelecting candidates based on its beliefs whether a politician is a statesman. This paradox of competence may explain why politicians are so concerned about being perceived as statesmen. Our model illustrates that politicians who delay irreversible project decisions signal low competence.

Keywords: populists, statesmen, paradox of competence, double-sided asymmetric information, polls

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1 Introduction

In this paper we examine how voters can and should deal with populists. We consider a model in which the public is uncertain about a politician's competence and does not know whether this politician is concerned about the long-term consequences of his decisions (statesman) or about the public's opinion concerning his competence and his preferences (populist). A competent agent can evaluate the consequences of a public investment project, and should invest either immediately or never. An incompetent agent should wait for more information. A statesman is solely interested in good policy and will therefore mimic the socially efficient solution exactly. Depending on his competence and the information he receives, he will either invest immediately, never, or wait for more information in order to make an informed decision, while a populist takes investment decisions that maximize his reelection chances.

The main finding suggests that the public benefits by disregarding the candidates' competence and by reelecting candidates based on its beliefs whether a politician is a statesman. We call this the paradox of competence. At a more detailed level, we obtain the following insights:

We first show that populists distort their decisions in order to avoid being seen as incompetent or as populists. If the public values competency, competent *and* incompetent populists will immediately invest in mimicking a competent statesman in order to gain public favor and enhance their reelection prospects. The policy decisions of both competent and incompetent populists will be distorted. Since even competent populists are affected by these distortions, the public faces a paradox called the paradox of competence. Thus, if the public bases its choice of a politician on its belief about this politician's competence, social welfare will be low.

If the public's reelection decision is based solely on its belief whether a politician is a statesman or not, there will still be welfare losses, as populists will randomize between investment in a project and waiting, to maximize their chances of being recognized as statesmen. The socially optimal solution would, however, require that a competent populist should only invest if he has received favorable information, and that an incompetent populist should never invest. Nevertheless, welfare losses are smaller when the public solely values statesmanship than when it values competency. As a result, voters should reelect politicians mainly based on their belief whether a politician is a statesman or not.

Our analysis may help to shed light on the role of trust in politics. In a comprehensive study, Lupia and McCubbins (1998) show that voters use signals that convey information about the consequences of policy alternatives and signals that convey trust. As the interests of statesmen and voters coincide, the level of trust in our model could be described as the probability of a politician being a statesman.

Our model might explain why voters are so concerned about political trust and, in turn, why some politicians are so concerned about the public's perception of their being a statesman or not. It is thus consistent with an important body of empirical literature that emphasizes the role of trust in politics. The growing significance of political trust in the U.S. has been established by Nye et al. (1997), Warren (1999), and Putnam (2000). Hetherington (2005) indicates that trust in a government has become an important and autonomous predictor of the support to be expected for government policies. It is more important than partisanship or ideology. A number of examples supports this view. Dover (1998), for instance, indicates that many public appearances of President Clinton were solely designed to foster his being perceived as a statesman.

The paper is organized as follows: In the next section we relate our approach and the findings of the paper to the existing literature. In section 3 we outline the model. The socially optimal solution is characterized in section 4. In section 5 we identify the equilibria under linear reelection schemes. In section 6 we discuss the optimal reelection strategy for the public. In section 7 we examine equilibria for general reelection schemes, an discuss various extensions in section 8. Section 9 concludes.

2 Relation to the Literature

Our model combines the option value of waiting for more information with career concerns. This paper's major innovation is its discussion of the interplay between the public's uncertainty about the politician's preferences and the uncertainty about the agent's competence. We show that the two-dimensional informational asymmetry about the preferences and competence of politicians leads to the paradox of competence. Our work borrows from, and contributes to, various branches of the literature.

First, our model is related to the work on career concerns that goes back to the seminal contribution by Holmström (1982). Given their career concerns, managers or politicians may mimic others in order to signal their own ability (see Scharfstein and Stein (1990), Rogoff and Sibert (1988) and Rogoff (1990)). Rogoff (1990) has shown that a political budget cycle arises due to temporary information asymmetries about the incumbent leader's competence in administering the public goods production process.[1] In our model, we focus on the communication problem that arises when the public is unsure about the competence and preferences of politicians. Such two-dimensional information asymmetry leads to a paradox of competence.

Second, there is a large amount of literature on the option value that provides an explanation as to why a decision-maker should delay decisions, even if the current net present value of the project is positive (see Pindyck (1991) and Dixit (1992)). Consider a project that costs a fixed and sunk amount in the present period and generates uncertain benefit in the future. If a firm makes such an irreversible decision right away, it loses the value of any new information that might have affected the investment decision. This lost option value is an opportunity cost that must be regarded as part of the cost of investment. Hence, traditional net present value rules must be modified to include the option value, i.e., the value of waiting and hence the value of keeping the investment option alive.

In our model, a competent agent should either invest immediately or never, while an incompetent agent should wait for more information. Reputational concerns, however, will lead a populist to take immediate action, even if social welfare requires that he should wait for further information.

Third, our paper belongs to a body of literature on how reputational concerns affect

[1] Rogoff and Sibert (1988) propose a neat generalization of a continuum type framework and allow for budget deficits.

policy decisions. Coate and Morris (1995) show how a combination of asymmetric information about policies and politicians can explain the choice of inefficient redistribution methods. Hess and Orphanides (1995) show that a president with a bad reputation may even risk war to give himself an opportunity to improve his reputation.

In Morris (2001), reputational concerns give rise to political correctness: an adviser who does not wish to be thought of as biased (e.g., racist) may not truthfully reveal his information. Beniers and Dur (2004) also examine the interplay between two types of information asymmetry. They show that politicians may have stronger incentives to behave opportunistically if other politicians are more likely to do the same. As a consequence, a political culture of behaving in a public-spirited way may be self-reinforcing. In our paper, we introduce a new type of two-dimensional uncertainty: the competence of a politician and the question whether a politician is concerned about the long–term consequences of his decisions (statesman) or about public opinion (populist). We show that such two-dimensional asymmetric information yields inefficient delay or overhasty action in political decision-making.

3 Model and Assumptions

We analyze a game of signaling and information gathering. There are two periods. For simplicity, we assume that the agent whose decisions we are analyzing, is risk-neutral. The costs and benefits of a policy are measured in dollars. The game takes the following course

3.1 Game Structure

Period 0: Nature determines two characteristics of politicians who have been elected for a first term. First, a politician can either be competent or incompetent. Competence is denoted by η. η is either G (competent) or B (incompetent). The *a priori* probability that $\eta = G$ is g_0 and that $\eta = B$ is $1 - g_0$. Each agent knows his own type. Second, a politician can either be a statesman or a populist, as denoted by β. β is either S (statesman) or P (populist). The *a priori* probability that $\beta = S$ is h_0 and that $\beta = P$ is $1 - h_0$. η and β are assumed to be stochastically independent. Hence, the public faces four possible types of politicians denoted by SG, SB, PG, and PB, depending on the combination of statesman/populist and competence/incompetence.

Period 1: At the beginning of the politician's term, the public decides on the reelection scheme, which is denoted by R. The politician must decide whether to invest in a given project with an expected return denoted by EV. The investment yields a net return beginning in the next period. Its present value is V_i, with i being either High (H) or Low (L). The *a priori* probability for value V_i is π_i. The agent, not the public, observes a noisy signal S_j about the return from the project. The signal is either high (S_H) or low (S_L). The probability that an agent of type η will receive a correct signal is the same in both states and is denoted by t_η. Hence, $t_\eta = \text{pr}\{S = S_H | V = V_H, \eta\} = \text{pr}\{S = S_L | V = V_L, \eta\}$.

The politician decides whether to invest immediately or to postpone the decision, options denoted by I and NI respectively. The public observes the agent's decision and forms a posterior estimate of the probability (a) that the agent is competent and (b) that he is a statesman. The public's belief that the agent is competent is denoted by g_1; with probability $1-g_1$ he is not competent. Similarly, h_1 denotes the public's belief that the agent is a statesman, where with probability $1 - h_1$ the public thinks that he is a populist.

The public makes the reelection decision. Reelection probability is denoted by q,$(0 \leq q \leq 1)$.

Period 2: All remaining uncertainty about the project is resolved. If the politician is reelected and has postponed the project, he can embark on the project in period 2. Net benefits from the project undertaken in period 2 are discounted by the factor $\delta < 1$. The reelected politician's private benefits from holding office are denoted by Q $(Q > 0)$, independently of whether he still has a chance to invest. If the politician has been rejected, his utility is normalized to zero. A new politician is reelected, and he can adopt the project if it has not been undertaken in period 1.

The information an agent receives depends on his competence in judging situations and his ability to generate information about the consequences of the project. Hence, the probability of an agent receiving a correct signal (that is, observing S_j when the project has return j) depends on his type η. We interpret the term investment in a broad sense. It might extend to infrastructure projects, policy reforms (welfare, labor market etc.), or foreign involvement. To simplify notation, and for reasons of tractability, we make an additional assumption:

$$1 = t_G > t_B \geq \frac{1}{2}. \tag{1}$$

This means that we assume that a competent agent will receive a correct signal with certainty. He is perfectly informed about the consequences of the project. In the following, we describe the project returns, preferences, and reelection schemes in more detail.

3.2 Project returns

We assume that the investment should not be made if no further information is received. The expected investment return in this case is denoted by EV_0. Hence, we assume

$$EV_0 = \pi_H V_H + (1 - \pi_H) V_L < 0. \tag{2}$$

Obviously, an economic problem will only ensue if the project should be adopted in the favorable state and rejected in the less favorable state. Hence, we assume

$$V_H > 0, V_L < 0. \tag{3}$$

Finally, we denote an agent's expected investment return from the project in period 1 by $EV^{\eta}_{S_j}$, depending on the type η and the signal S_j the agent has observed. The formula for $EV^{\eta}_{S_j}$ will be given in section 4.

3.3 Preferences

Next we specify the preferences. At the beginning of period 1, when the politician decides whether to invest or not, the politician has an expected utility denoted by U_A. Similarly, when the public decides about the reelection scheme in period 1, it has expected benefits U_p. We assume that the public is solely concerned about the expected returns on the investment, i.e. $U_p = EV$. The public chooses a reelection scheme that will maximize expected returns.

The politician's utility can depend on social welfare and the private benefits from holding office, which are denoted by Q. The second element of a politician's utility reflects the desire of the agent to be reelected. If the public believes that the politician is highly competent or a statesman, he may have a higher likelihood of being reelected, so he may hold the office again.

We concentrate on the agent's expected utility as he faces the decision whether or not to invest. We assume that utility is additively separable, i.e.

$$U_A = m\,EV^{\eta}_{S_j} + (1-m)q\,Q \tag{4}$$

Parameter m, with $0 \leq m \leq 1$, is the weight the agent assigns to investment returns and hence to social welfare, compared to the weight $(1-m)$ he assigns to the expected value of holding office in period 2.

Utility increases with expected welfare and with the expected value of holding office, which, in turn, depends on q. How q is determined will be discussed in the next section. We will focus on two opposing constellations, depending on whether a politician is type S or type P.

Statesman: A statesman's utility is given by $U_S = EV^{\eta}_{S_j}$

Populist: A populist's utility is given by $U_P = q\,Q$

A statesman has a weight of m equal to 1, meaning that he is solely motivated by the policies he implements.[2] He has the same utility function as the public. A populist is

[2] In principle, someone who cares only about social welfare could nevertheless have reelection con-

characterized by $m = 0$, so he is only concerned about the public's beliefs and thus about his chances of winning the election. As the value of office enters linearly in U_P, we can normalize the value of office, i.e. we set $Q = 1$.

We note that our model exhibits a potential conflict for populists between the short-term assessment of their competence by voters (at the end of period 1) and the long-term assessment of competence after uncertainty about projects has been resolved (in the second period). As their concern is with reelection, populists only care about the short-term evaluation of competence. The neglect of the long-term assessment of competence in the populists' utility function can be justified by a term limit for two periods, so that reelection concerns at the end of period 2 are absent.

3.4 Reelection schemes

Finally, we assume that the public chooses a reelection scheme in period 1 that will determine reelection probability q, depending on the *a posteriori* assessment of the politician. The reelection scheme is given as

$$R := q(g_1, h_1) \tag{5}$$

To provide an intuitive analytical solution, we focus on linear reelection schemes, i.e. $q(g_1, h_1) = \alpha\, g_1 + (1 - \alpha)h_1$. Note that $0 \leq q \leq 1$. The weight α $(0 \leq \alpha \leq 1)$ reflects the weight that the public attaches to the belief that the agent is competent. $1 - \alpha$ represents the weight of the public's belief that the agent is a statesman. Later, we will show that the solution under linear reelection schemes cannot be improved upon by any other type of reelection scheme. Accordingly, focusing on linear schemes represents no loss of generality.

4 Socially Optimal Solution

We first characterize the socially optimal solution, assuming that the public has perfect information about the agent's competence and the signals and enforces socially efficient

cerns: if he delays a decision, he must consider what would happen in the future. As uncertainty about projects is fully resolved, such concerns are irrelevant in our model.

decisions via sufficient punishment of a politician who has made a wrong decision. Thus it is irrelevant whether a politician is a statesman or a populist. Since type η is given, the agent's decision is reduced to maximizing expected net benefits from the project, given his information set. An agent who receives a signal in period 1 uses Bayes' theorem to evaluate the probability of the project having a high return. Suppose the agent has observed signal S_H. Then the posterior probabilities of the project having a high return or a low return are

$$pr_\eta(V_H|S_H) = \frac{t_\eta \pi_H}{t_\eta \pi_H + (1-t_\eta)(1-\pi_H)} \tag{6}$$

$$pr_\eta(V_L|S_H) = \frac{(1-t_\eta)(1-\pi_H)}{t_\eta \pi_H + (1-t_\eta)(1-\pi_H)} \tag{7}$$

Note that $pr_\eta(V_H|S_H)$ is strictly monotonically increasing in t_η with

$$pr_G(V_H|S_H) = 1 \tag{8}$$

$$pr_B(V_H|S_H) = \pi_H \quad \text{for} \quad t_B = \frac{1}{2} \tag{9}$$

Similarly, the posterior probability $pr_\eta(V_H|S_L)$ is given by

$$pr_\eta(V_H|S_L) = \frac{(1-t_\eta)\pi_H}{(1-t_\eta)\pi_H + (1-\pi_H)t_\eta} \tag{10}$$

Suppose that S_H has occurred. If the agent invests, then the expected value of social welfare is

$$EV^\eta_{S_H} = V_H \frac{t_\eta \pi_H}{t_\eta \pi_H + (1-t_\eta)(1-\pi_H)} + V_L \left(1 - \frac{t_\eta \pi_H}{t_\eta \pi_H + (1-t_\eta)(1-\pi_H)}\right) \tag{11}$$

Suppose, on the hand, that the agent delays the decision for one period. Since all uncertainty is resolved in period 2, the assumptions imply that if the project's returns turn out to be high, the agent who did not invest in period 1 will invest in period 2. In the Appendix, we prove the following proposition:

Proposition 1

If the agent observes S_L in period 1, neither a competent nor an incompetent agent should invest in period 1. If the agent observes S_H, a unique critical value t_B* exists, with

$$1/2 < t_B* < 1, \tag{12}$$

such that an incompetent agent should delay the project decision till period 2 if, and only if, $t_B \leq t_B*$. A competent agent should invest immediately.

5 Equilibria under Linear Reelection Schemes

In this section we examine the equilibria of the game, parameterized by the linear reelection schemes that the public commits to in period 0. For simplicity of presentation, we have assumed that the signals S_H and S_L are completely uninformative for the incompetent agent: $1/2 = t_B < t_B^*$.[3] Thus, from a social welfare perspective, an incompetent agent should delay the project decision until period 2. A competent agent should invest immediately if, and only if, he observes S_H.

We next solve the corresponding signaling game and determine the perfect Bayesian equilibria for the game.

We first consider the behavior of the statesman. Since the statesman's utility only depends on the expected returns, the solution to his problem is independent of the behavior of the populist and the public's belief. We obtain

Proposition 2
In any equilibrium, the statesman plays his dominant strategy:

$$SG\text{: } I\ (S_H),\ NI(S_L)$$

$$SB\text{: } NI(S_H), NI(S_L)$$

$I(S_H)$, $I(S_L)$, $NI(S_H)$, and $NI(S_L)$ denote the strategy choices depending on the signal obtained. To determine the behavior of the populist, we observe that the decisions of the statesman put positive probability on both I and NI. Therefore, all beliefs can be determined by Bayes' theorem. Next we observe that a competent and an incompetent populist will choose I and NI with the same probabilities. An incompetent populist can always mimic the decisions of a competent populist in terms of probabilities for I and NI, because the public cannot observe competence. Hence, if strategy choices for a competent populist are optimal, the same is true for a less competent populist. In the following, we construct Bayesian equilibria in which the probability that I or NI,

[3] Our analysis is valid for all values $t_B < t_B^*$. If $t_B > t_B^*$, an incompetent statesman has sufficiently high ability in decision-making and acts like a competent statesman. The same is true for the populist, and no inefficiencies will occur.

respectively, are chosen is the same for both types of populists.[4]

We use p^0 to denote the probability with which PG and PB select investment I. $1-p^0$ is the probability with which NI will be chosen by both types of populist. Given the probability p^0 that the populist will select I, straightforward calculations show that the posterior probabilities of the public are as follows:

$$g_1(I,p^0) = \frac{h_0 g_0 \pi_H + (1-h_0) g_0 p^0}{h_0 g_0 \pi_H + (1-h_0) p^0} \tag{13}$$

$$g_1(NI,p^0) = \frac{h_0 g_0 (1-\pi_H) + (1-h_0) g_0 (1-p^0)}{h_0 (1-\pi_H g_0) + (1-h_0)(1-p^0)} \tag{14}$$

$$h_1(I,p^0) = \frac{h_0 g_0 \pi_H}{h_0 g_0 \pi_H + (1-h_0) p^0} \tag{15}$$

$$h_1(NI,p^0) = \frac{h_0 (1-g_0 \pi_H)}{h_0 (1-\pi_H g_0) + (1-h_0)(1-p^0)} \tag{16}$$

Given that the public assumes that the populist will play I with some probability of p^0, the problem for both types of populists is given by

$$\max_p \left\{ p\left(\alpha g_1(I,p^0) + (1-\alpha) h_1(I,p^0)\right) + (1-p)\left(\alpha g_1(NI,p^0) + (1-\alpha) h_1(NI,p^0)\right)\right\}$$

A Bayesian equilibrium exists if an optimizer of the above problem equals p^0, i.e. the strategy choice of a populist is optimal, given the beliefs of the public, and if these beliefs are determined by Bayes' law. It is not guaranteed a priori that a solution actually exists. In the Appendix we show

Proposition 3

Suppose that competent and less competent populists choose I with the same probability.

[4] We will comment later on whether equilibria exist in which PG and PB select different probabilities when they choose I.

(i) Suppose that $\alpha \geq \alpha^*$ *with*

$$\alpha^* := \frac{(1-h_0)(1-g_0\pi_H)}{(1-h_0)+g_0\pi_H(h_0-g_0)} \tag{17}$$

Then in any Bayesian equilibrium, populists will choose

PG,PB: I *with probability* 1

(ii) Suppose that $0 \leq \alpha < \alpha^*$. *Then in any Bayesian equilibrium, populists will choose*

PG,PB: I *with probability* p^*

NI *with probability* $1-p^*$

Probability p^* *is given by*

$$p^* = \frac{g_0\pi_H\left[\alpha(h_0-g_0)+(1-h_0)\right]}{(1-\alpha)(1-h_0)} \tag{18}$$

This proposition has intuitive implications. Suppose, for example, that $\alpha = 1$, i.e., the public only considers the competence of a politician when it is deciding whether or not to reelect him. Only a competent statesman will choose investment I upon observing S_H, so, both types of populist will choose I with probability 1 in order to maximize the public's beliefs about their competence. For $p = 1$, the *a posteriori* beliefs of the public are

$$g_1(I) = \frac{h_0g_0\pi_H+(1-h_0)g_0}{h_0g_0\pi_H+(1-h_0)} > g_0 \tag{19}$$

$$g_1(NI) = \frac{g_0(1-\pi_H)}{(1-\pi_Hg_0)} < g_0 \tag{20}$$

We thus obtain $g_1(I) > g_1(NI)$, as only an incompetent statesman or a competent statesman observing S_L will choose NI.

To interpret the case of $\alpha = 0$, we obtain from proposition 3

Corollary 1

Suppose $\alpha = 0$. Then in any equilibrium, populists will play

$$\text{PG,PB: } I \text{ with probability } p^* = \pi_H g_0$$
$$NI \text{ with probability } 1 - p^* = 1 - \pi_H g_0$$

For $\alpha = 0$, populists will precisely mimic the behavior of statesmen by choosing I with probability $p^* = \pi_H g_0$, as this guarantees that the *a posteriori* beliefs h_1 are the same for both I and NI. Note that in the case of $\alpha = 0$ no configuration other than $p^* = \pi_H g_0$ can be an equilibrium. Suppose, for example, that the populist always chooses NI. Probability $h_1(NI)$ would be low, whereas $h_1(I) = 1$. In this case, however, NI is the worst choice, given the beliefs of the public.

Proposition 3 indicates two sources of inefficiency from the presence of populists. First, an incompetent populist should always choose NI. No matter what value of α is considered by the public, this will never occur in equilibrium. Second, a competent populist should choose I after observing S_H. If, however, p^* differs from π_H, this will be impossible. In the next section we examine these inefficiencies in more detail.

We note that further equilibria might occur with $\alpha = 0$, since PG and PB may use different mixing strategies so that their joint behavior is in line with $p^* = \pi_H\, g_0$. Such equilibria increase the inefficiencies originating from the presence of populists.

6 Optimal Linear Reelection Strategy Under Commitment

6.1 The main result

In this section we complete our discussion by considering the appropriate choice of α for the public in order to minimize welfare distortions. To derive the equilibria, we assume the tie-breaking convention that if politicians are indifferent, then they will adopt the strategy profile that maximizes the voter's well-being, subject to the constraint of maintaining the equilibrium.

In the last section we derived the equilibrium probability of investment in the first period. The results in section 5, however, only indicate that the aggregate probability of investing and not investing needs to be p^* for both preference types. As incompetent populists do not receive information, they mix I and NI with probabilities p^* and $1-p^*$. Using the tie-breaking rule, we next specify the signal-dependent choice for a competent populist. Accordingly, if he plays I with probability p^*, we assume that

$$\begin{aligned}
\text{if } p^* \geq \pi_H: \quad & \text{PG plays } I \text{ upon } S_H \\
& \text{PG plays } I \text{ upon } S_L\text{, with prob. } \tfrac{p^*-\pi_H}{1-\pi_H} \\
& \text{PG plays } NI \text{ upon } S_L\text{, with prob. } \tfrac{1-p^*}{1-\pi_H} \\
\text{if } p^* < \pi_H: \quad & PG \text{ plays } I \text{ upon } S_H\text{, with prob. } \tfrac{p^*}{\pi_H} \\
& PG \text{ plays } NI \text{ upon } S_H\text{, with prob. } \tfrac{\pi_H-p^*}{\pi_H} \\
& PG \text{ plays } NI \text{ upon } S_L
\end{aligned}$$

Given that both incompetent and competent populists both mimic the behavior of statesmen, the tie-breaking rule minimizes distortion for the public. With this tie-breaking rule, we can now state the optimal voting strategy for the public, as denoted by α^0. In the Appendix we prove

Proposition 4

The optimal reelection strategy for the public is as follows:

(i) If $K < 0$, the public will choose $\alpha^0 = 0$

(ii) If $K \geq 0$, the public will choose

$$\alpha^0 = \frac{(1-h_0)(1-g_0)}{(1-h_0) + g_0\,(h_0 - g_0)}\ , \tag{21}$$

where K is a constant given by

$$K = V_H\,[g_0\,(1-\delta) + \pi_H(1-g_0)(1-\delta)] + V_L\,[(1-\pi_H)(1-g_0)].$$

6.2 Discussion

The case $\alpha^0 = 0$ is called the *paradox of competence.* In this case, voters only use their posterior belief about statesmenship. Whether or not this case actually occurs will depend on the constant K. K represents a "reduced" expected value of the investment. K can only be positive if V_H is sufficiently large. Moreover, a reelection strategy $\alpha^0 > 0$ can only occur if the future is much less important than the present (δ low). In all other cases, the distortions introduced by populists in their attempt to indicate competence are larger than those made by attempts to mimic statesmen.

In order to gain further intuition for this result, let us first consider the case $\alpha = 1$, i.e., competence is the only important thing for reelection. Let us recall that, in the first period, a statesman will only invest if he is competent and observes S_H. Moreover, the probability of a populist investing in the first period, p^*, is independent of his competence. Consequently, voters know that competent incumbents are more likely to invest in the first period, so they would only reelect an incumbent who invested in the first period. Therefore, a populist incumbent would always invest in the first period because investing is a signal of competence.

A tradeoff in a populist's investment decision appears if $\alpha < 1$. Note that, in the example discussed above, investing in the first period also signals that the incumbent is a populist, as populists are more likely to invest than statesmen. This would decrease the incumbent's reelection chances if $\alpha < 1$. The lower α is, the less important it is for a populist incumbent to invest in the first period and to signal competence.

Given that p^* is increasing with respect to α, finding the voters' optimal reelection rule is equivalent to finding the p^* that maximizes the voters' expected utility. This expected utility is denoted by W.

Note first that, if $p^* \geq \pi_H$, W is decreasing in p^*. This is the case because a higher p^* makes it more likely that a competent populist will invest after observing S_L and also makes it more likely that an incompetent populist will invest.

In the case $p^* < \pi_H$, a higher p^* makes it more likely that a competent populist will invest after observing S_H, which would make W increasing with respect to p^*. On the other hand, a higher p^* also makes it more likely that an incompetent populist will invest (which would make W decreasing with respect to p^*). Any of these two effects may be dominant. Consequently, if the first effect is dominant, the optimal reelection rule will be to set α such that $p^* = \pi_H$. If the second effect is dominant, the optimal reelection rule is to set $\alpha = 0$ so that p^* takes the minimum possible value. The latter case represents the *paradox of competence.*

The following corollary is an immediate consequence of Proposition 4:

Corollary 2

Suppose that $\delta = 1$. *Then* $\alpha^0 = 0$.

We conclude from this corollary that when discounting is irrelevant, the public should use only its assessments of the preferences of the candidates for its reelection decision. Moreover, since the constant K is linear in the discount factor, $\alpha^0 = 0$ is optimal if the discount factor is sufficiently high. The evaluation of competence should be neglected in order to minimize the distortions caused by the policy decisions.

6.3 Implications

In this section we draw some further implications from the model. We focus on the case $\alpha^0 = 0$. Suppose that the probability that a politician is competent is given, but that the likelihood of politicians being populists varies.

Populists introduce three kinds of distortions. Competent populists who have observed S_H (S_L) may choose NI (I). Incompetent populists will choose I with positive probability.

As populists mimic the behavior of the statesmen completely, so that the a-posteriori beliefs h_1 are the same for both I and NI, all those running – competent statesmen, incompetent statesmen, competent populists, incompetent populists – will have the same probability of being reelected. Interestingly, incompetent statesmen have higher reelection chances when populists are present. If only statesmen were present, incompetent statesmen would partially reveal themselves as such and be rejected. As statesmen do not care about reelection chances, the higher likelihood of incompetent statesmen getting reelected hurts only the public.

It is straightforward to show that the expected welfare of the public is monotonically increasing in h_0. That is, the higher the probability that a politician is a populist, the larger the expected policy distortions and the lower the welfare.

Finally, in the equilibrium with $\alpha^0 = 0$ we have $p^* = g_0\pi_H$. As $p^* < \pi_H$ in the equilibrium in Proposition 4, society is better off with a competent populist than with an incompetent statesman, as the former will play I upon S_H with some probability and NI otherwise. The incompetent statesman will always choose NI.

7 Robustness

Our results have been derived for linear reelection schemes allowing for analytical solutions. However, as we will now show, there are no other reelection schemes that would perform better than linear schemes. So, our restriction to linear schemes turns out to be no loss of generality.

To develop this robustness argument, we assume that the public uses a general scheme $q = f(g_1, h_1)$. Mapping from beliefs to voting behavior could be non-linear or even discontinuous. In the Appendix we show

Proposition 5

There are no other reelection schemes that would lead to higher welfare than the linear scheme with α^0, as determined in Proposition 4.

The intuition for this robustness result is a consequence of the proof of Proposition 4. The expected welfare of the public in general is a function of the equilibrium probability p^* that populists will choose I. Recall from Corollary 1 that the optimal welfare probabilities are either $p^* = \pi_H$ or $p^* = g_0\pi_H$. In the first case, the distortions caused by the competent populists are minimized. In the second case, welfare is maximized by choosing the minimum probability of selecting I that populists can have in equilibrium. Which case actually is welfare-optimal depends on the parameters captured by the constant K. Since in both cases the welfare-optimal probabilities can be implemented under the linear scheme, no other scheme can perform better, so our results are robust.[5]

Finally, we note that the public has no incentive to revise its optimal reelection scheme at the end of period 1, immediately before the reelection takes place. As all uncertainty is resolved in the second period, all politicians will choose the same course of action if the project decision is still open.

8 Conclusion

In this paper we have discussed the policy distortions present when a pool of political candidates consists of populists whose primary concern is with public opinion. Policy distortions are large if the public bases its reelection decision on its evaluation of competence. The paradox of competence implies that the public should reelect politicians based on its own assessment of their preferences.

The model can be extended in several directions that represent fruitful avenues for future research. For instance, we have focused here on polar cases, i.e. politicians are either populists or statesmen. If politicians have mixed motives, less than complete mimicking of statesmen might occur. Embedding the political agency problem addressed in this paper into a framework with repeated decisions is another avenue for future research, as the analysis might lead to new insights since voters care about the type of politicians who might replace the incumbent.

[5]In principle, the public might also try not to reelect the agent at all, in order to limit distortions. This could be achieved e.g. by term limits. Then the behavior of populists is indeterminate. However, if the evaluation of competence in activities other than current office (e.g. in future careers) is of an arbitrarily small value for populists, they would choose I with probability one, thus inducing more distortions than in the optimal case.

9 Appendix

Proof of Proposition 1

Note that if S_L were observed, then

$$EV^G_{S_L} = V_L < 0$$

$$EV^B_{S_L} \leq \pi_H V_H + (1-\pi_H)V_L < 0$$

and neither type of agent would invest immediately.

If S_H were observed, we obtain

$$EV^G_{S_H} = V_H > \delta V_H > 0 \tag{22}$$

Hence, a competent agent should invest immediately.

For an incompetent agent, we obtain

$$EV^B_{S_H} = V_H \frac{t_B \pi_H}{t_B\pi_H + (1-t_B)(1-\pi_H)} + V_L \left(\frac{(1-t_B)(1-\pi_H)}{t_B\pi_H + (1-t_B)(1-\pi_H)} \right) \tag{23}$$

If an incompetent agent waits, his expected benefits are

$$\frac{t_B \pi_H}{t_B\pi_H + (1-t_B)(1-\pi_H)} \delta V_H > 0 \tag{24}$$

For $t_B = 1$, $EV^B_{S_H}$ equals V_H; waiting yields only δV_H. For $t_B = 1/2$, $EV^B_{S_H}$ equals $EV_0 < 0$, and waiting is preferred. As the difference between $EV^B_{S_H}$ and the expected profits from waiting increases strictly monotonically in t_B, the existence of t^*_B is established via the mean value theorem. t^*_B is given by

$$t^*_B = \frac{1}{1-(1-\delta)\frac{\pi_H V_H}{(1-\pi_H)V_L}}$$

■

Proof of Proposition 3

There are three possibilities. The populist prefers I over NI, NI over I, or is indifferent between I and NI. We begin with the last case. The populist is indifferent if, and only if

$$\alpha g_1(I, p^0) + (1-\alpha)h_1(I, p^0) = \alpha g_1(NI, p^0) + (1-\alpha)h_1(NI, p^0) \tag{25}$$

Inserting the expressions from Equations 13, 14, 15 and 16, and using the simplification

$$q := h_0 g_0 \pi_H + (1-h_0)p^0$$
$$1 - q = h_0(1 - \pi_H g_0) + (1-h_0)(1-p^0)$$

yields

$$\begin{aligned} &\alpha\, g_0(1-h_0)p^0 + h_0 g_0 \pi_H - q\left(\alpha\, g_0(1-h_0)p^0 + h_0 g_0 \pi_H\right) \\ &= q\big[\alpha\left(h_0 g_0 + g_0(1-h_0) - g_0(1-h_0)p^0\right) + h_0 - h_0 g_0 \pi_H - \alpha h_0\big] \end{aligned} \tag{26}$$

Rearranging terms and simplifying yields

$$p^0 = \frac{g_0 \pi_H \left[\alpha(h_0 - g_0) + (1-h_0)\right]}{(1-h_0)(1-\alpha)} \tag{27}$$

In equilibrium, we must have $p^* = p^0$, where p^* is the probability that the populist will choose I. Let us consider the boundary conditions for p^*.

Since $\alpha \leq 1$, we have $\alpha(h_0 - g_0) + (1-h_0) > 0$ and therefore $p^* \geq 0$ for any value of α. The other boundary condition $p^* \leq 1$ requires

$$\alpha\big[g_0 \pi_H (h_0 - g_0) + (1-h_0)\big] \leq g_0 \pi_H (h_0 - 1) + 1 - h_0,$$

which implies

$$\alpha \leq \frac{(1-h_0)(1-g_0\,\pi_H)}{(1-h_0) + g_0 \pi_H (h_0 - g_0)} =: \alpha^*$$

Hence, for $\alpha \leq \alpha^*$ and $p^0 = p^*$ as derived in Equation (27), the populist is indifferent between I and NI. Therefore, given p^* and associated *a posteriori* beliefs of the public and $\alpha \leq \alpha^*$, a mixed strategy is optimal for the populist. The rationality of the public's beliefs requires that the populist play I with probability p^*.

In the next step, we consider the case $\alpha > \alpha^*$. According to Equation (27), p^* would become larger than 1. Straightforward calculations show that the populists are better off by selecting I over NI. Therefore, a populist will choose I when $\alpha > \alpha^*$ with certainty.

In the last step, we observe that a pure strategy equilibrium does not exist when the populist selects NI. For the case of $\alpha > \alpha^*$, this follows from the considerations in the last paragraph. When $\alpha \leq \alpha^*$, choosing NI with probability 1 would imply the following beliefs:

$$\begin{aligned}
g_1(I, 0) &= 1 \\
g_1(NI, 0) &= \frac{h_0 g_0 (1 - \pi_H) + (1 - h_0) g_0}{h_0 (1 - \pi_H g_0) + (1 - h_0)} \\
h_1(I, 0) &= 1 \\
h_1(NI, 0) &= \frac{h_0 (1 - g_0 \pi_H)}{h_0 (1 - \pi_H g_0) + (1 - h_0)}
\end{aligned}$$

Hence,

$$\begin{aligned}
&\alpha g_1(I, 0) + (1 - \alpha) h_1(I, 0) = 1 \\
&> \alpha g_1(NI, 0) + (1 - \alpha) h_1(NI, 0),
\end{aligned}$$

which implies that NI is not the populist's optimal choice. Given the beliefs associated with $p^0 = 0$, it is in fact the worst choice.

■

Proof of Proposition 4

We first derive the expected welfare of the public for different choices of α.

If $\alpha \geq \alpha^*$, populists will play I with probability $p^* = 1$ according to Proposition 3, and social welfare, denoted by W_{p*}, is given by

$$W_{p^*=1} = h_0 \Big(\pi_H V_H \big(g_0 + \delta (1 - g_0) \big) \Big) + (1 - h_0) \left(\pi_H V_H + (1 - \pi_H) V_L \right)$$

Next, suppose populists play I with probability p^*, but $p^* \geq \pi_H$. Welfare in this case is given by

$$\begin{aligned}
W_{p^* \geq \pi_H} = h_0 \Big(\pi_H V_H \big(g_0 + \delta (1 - g_0) \big) \Big) &+ (1 - h_0) \Big[g_0 \big(\pi_H V_H + (1 - \pi_H) \frac{p^* - \pi_H}{1 - \pi_H} V_L \big) \\
&+ (1 - g_0) \big(p^* (\pi_H V_H + (1 - \pi_H) V_L) + (1 - p^*) \delta \pi_H V_H \big) \Big]
\end{aligned}$$

For $p^* \leq \pi_H$, we obtain

$$W_{p^*\leq\pi_H} = h_0\Big(\pi_H\, V_H\big(g_0 + \delta\,(1-g_0)\big)\Big) + (1-h_0)\Big[g_0\,\pi_H\,V_H\,\Big(\frac{p^*}{\pi_H} + \frac{\pi_H - p^*}{\pi_H}\,\delta\Big) + (1-g_0)$$
$$\Big(p^*\big(\pi_H\,V_H + (1-\pi_H)\,V_L\big) + (1-p^*)\,\delta\,\pi_H\,V_H\Big)\Big]$$

Since $W_{p^*\geq\pi_H}$ is monotonically decreasing in p^*, $W_{p^*>\pi_H} < W_{p^*=\pi_H}$, $W_{p^*\geq\pi_H} = W_{p^*\leq\pi_H}$ for $p^* = \pi_H$. Since $W_{p^*\leq\pi_H}$ is linear in p^*, the welfare-optimal mixing probabilities are either $p^* = \pi_H$ or $p^* = g_0\,\pi_H$. $p^* = g_0\pi_H$ is the smallest possible value for p^* that occurs for $\alpha = 0$.

$W_{p^*=\pi_H} < W_{p^*=g_0\,\pi_H}$ if, and only if

$$g_0\,\pi_H\,V_H\big[1 - g_0 - (1-g_0)\,\delta\big] + (1-g_0)^2\,\pi_H\,\Big(\pi_H\,V_H\,(1-\delta) + (1-\pi_H)\,V_L\Big) < 0$$

or equivalently $K := V_H\,\big[g_0\,(1-\delta) + (1-g_0)\,\pi_H(1-\delta)\big] + (1-\pi_H)\,V_L\,(1-g_0) < 0$.

Hence, for $K \leq 0$, the optimal choice of the public is $\alpha^0 = 0$ in order to induce $p^* = g_0\,\pi_H$. For $K > 0$, the optimal choice for the public is

$$\alpha^0 = \frac{(1-h_0)(1-g_0)}{(1-h_0) + g_0(h_0 - g_0)}$$

which, using Equation 18, implies that $p^* = \pi_H$.

This completes the proof.

■

Proof of Proposition 5

Any equilibrium with a reelection scheme $f(g_1, h_1)$ produces a probability of p^* that a populist will play I. The equilibrium probability is determined by

$$\underset{p}{\text{argmax}}\Big\{p\Big(f\big(g_1(I,p^*), h_1(I_p^*)\big)\Big) + (1-p)\Big(f\big(g_1(NI,p^*), h_1(NI,p^*)\big)\Big)\Big\} = p^*$$

We next observe from the proof of Proposition 4 that welfare is a linear function of p^*, which is the only effect of the reelection scheme on welfare. As shown in Proposition 4, the welfare-optimal mixing probabilities are either $p^* = \pi_H$ or $p^* = \pi_H g_0$. As the linear scheme can implement the welfare-optimal p^* in both possible cases, no other scheme can perform better.

■

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