Abstract

We study the provision of dynamic incentives to self-interested politicians in an environment in which politicians cannot commit to policies and have private information about the size of government resources. In this environment, citizens discipline politicians by threatening to remove them from power. We consider a setting in which the best policies for citizens can be sustained in the absence of private information by the off-equilibrium threat of replacement. We present three results which emerge once private information is introduced. First, politicians are replaced along the equilibrium path as a means of inducing good performance. Second, if rents to politicians are paid along the equilibrium path, then intratemporal distortions to production emerge as a means of minimizing these rents and backloading incentives to politicians. Third, all politicians are eventually replaced and distortions never disappear in the long run.

Keywords: Optimal Taxation, Political Economy, Asymmetric and Private Information

JEL Classification: H21, P16, D82