1. Internalizing Political Externality: Evidence from Japanese Corporations

Do corporations owned largely by other firms participate in politics more aggressively? Assuming that political action generates externality to others, this chapter theoretically and empirically investigates how a firm’s political behavior is affected by its financial structure. I first derive the optimal political expenditure under two behavioral assumptions: shareholder-value and firm-value maximization. Next, I compare the theoretical predictions to the empirical pattern found in a dataset of Japanese corporations publicly traded from 1991-2003. The data show that the number of retired bureaucrats in a private firm’s boardroom, the measure of political activity of the firm, is negatively correlated with the share of equities held by non-financial firms, and positively with that held by financial institutions. The findings are largely consistent with the theoretical prediction under the assumption that i) there exists positive political externality between financially interlinked firms, and ii) firms maximize their own profit and the value of assets they hold.

2. Persistent Credit Ratings

How do credit rating agencies (CRAs) adjust their ratings over time? And, how are the incentives for CRAs to inflate their ratings affected by their rating updating rules? In principle, CRAs can update ratings continuously over business cycles reflecting the transitory default probability at any point in time. Or, they can hold ratings fixed through the business cycle, and inform the market of estimated default probabilities under the supposedly worst situation. The former methodology, called point-in-time (PIT) rating, can be more informative, while ratings stability, another desirable feature of credit ratings, is better attainable with the latter methodology, through-the-cycle (TTC) rating. In practice, the CRAs have commonly adopted TTC method for the sake of ratings stability. The financial crisis compellingly showed how ill-oriented
incentive systems can lead to a disastrous event. In this chapter, I construct a simple model to examine how a rating method, PIT or TTC, shapes the incentive for CRA to inflate their ratings. The analysis shows that CRAs indeed prefer TTC, so TTC rating tends to prevail in the market. At the same time, however, the incentive to inflate ratings is higher with TTC method than with PIT.

3. Information Filtering and Political Polarization

Recent empirical studies show that polarization among the politicians is quite substantial in the United States, while its counterpart among the voters is ambiguous. This chapter provides a theoretical model in which policy positions chosen by political elites can vary even when nothing changes in the voters’ side. Incorporating anticipatory utility to a simple probabilistic voting model, I show that the model generates two types of equilibria: rational-voting and blind-voting equilibria. In the latter, individual voters might optimally filter unpleasant information out in order to maximize anticipatory utility, i.e., voters rather choose to enjoy a self-delusive hope. It turns out that there are multiple equilibria in intermediate range of parameters, which means that political elites do have power to initiate polarization by coordinating to blind-voting equilibrium. Not surprisingly, information filtering leads to a welfare loss due to poor collective decision makings. This result suggests a new constraint for efficient operation of democratic political system.