

Bavarian Graduate Program in Economics

PUBLIC AND POLITICAL ECONOMICS

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30 hours, two morning sessions (1.5 hours each), two afternoon sessions (1.5 hours each).

Goals

This course provides an introduction to the main tools, and some of the most interesting results for public economics, emerging from the modern literature on political economics (or political economy, as is also known). In political economics the emphasis shifts from normative to positive analysis. Rather than asking how economic policy should be organized to meet some given efficiency or equity objectives, this literature asks how the different political institutions (the voting mechanism, the form of the state, the functioning of the legislature, the degree of electoral competition etc.) determine which policies will in fact be adopted. The normative perspective re-emerges, in case, in the choice of optimal political institutions. But a part of this literature, adopting an historical perspective, also asks why some countries adopted some institutions rather than others or why in some cases seemingly beneficial reforms are not adopted while inefficient institutions persist.

The literature is enormous, as political economics has been one of the faster growing fields in economics in the last 20 years. Given time constraints, the course will focus more on tools than results, presenting only a very selective list of applications, the ones that are perhaps more relevant for public economics (and shaped of course by my own research interests). The references offer suggestions for further reading.

Course outline:

The course will begin by discussing in detail what has been, and still is, the main workhorse for many political economy models, the median voter's theorem and its consequences for many public finance features (e.g. the convergence hypothesis in a Downsian framework). Next, we will discuss extensions and limitations of the theorem (partisan policy, multi-issues, uncertainty, lobbying, limited turnout, single issue parties etc). These extensions cast serious doubts on the central tenet of the theorem, that is, that in a democracy policy typically responds to the preferences of citizens' majority. The median voter also implicitly assumes plurality voting. With different electoral mechanisms, post-electoral policy is likely to be more important. Consequently, we will discuss party formation as related to the electoral system, and policy formation as the result of legislative bargaining. This will also allow us to discuss some issues in comparative politics (proportional versus plurality rules, presidential versus parliamentary regimes, single versus dual ballot mechanisms) and their effects on governments' redistribution policy. The median voter also assumes that electoral promises are always kept, but the relationship between voters and citizens can be more often characterized as an agency relationship in an incomplete contract setting. Consequently, we will study models of retrospective voting and some of the most interesting consequences arising from these models (endogenous candidacy, the selection of politicians, yardstick competition). Many political economy models, including the median voter, are static, but some issues in policy are truly dynamic, as decisions taken today constrains choices available

tomorrow. We will then briefly discuss some examples of dynamic policy, that are perhaps more relevant for long term phenomena such as growth or the emergence of federations. Finally, all the above assumes the existence of a democratic system. However many countries are not democracies and even in no democratic systems, issues of policy formation and of selection and accountability of politicians emerge. We will then briefly look at some recent work focusing on autocracies.

The main textbook for this part of the course is:

Persson-Tabellini, *Political Economics: Explaining Economic Policy*, MIT Press, 2000 (PT)

Problems sets for the textbook are discussed and solved in *The Workbook to Accompany "Political Economics: Explaining Economic Policy"* by Brocas, Castanheira, Razin and Stromberg, MIT press 2000.

Further useful general surveys of the literature are offered by:

Grossman and Helpman: *Special Interest Politics*, MIT Press, 2001 (GS)

Drazen, *Political Economy in Macroeconomics*, Princeton University Press, 2000

Roland, *Transition and Economics – Politics, Markets and Firms*, MIT Press, 2000

Besley, *Principled Agents*, Oxford UP, 2006.

Mueller, *Public Choice II*, Cambridge UP, 1989 (MU)

*Required readings are denoted with a **

Lecture 1

Arrow's theorem. Median voter theorem, Condorcet winner in direct democracy. Sincere and strategic voting.

*PT , chapter 1 and 2;

Mas-Colell, A., Whinston, M., Green, J., (MWG) 1995, *Microeconomic Theory*, Oxford, Oxford University Press, chapter 21;

GS, chapter 2;

MU, part 2;

Lecture 2

Representative democracy and the Downsian framework: the convergence hypothesis. Robustness and applications. Meltzer and Richard's model, pensions, secessions. Ends against the middle. The role of beliefs.

*PT, chapter 3. 3.1-3.3; chapter 5.1, 5.2 ; chapter 6, 6.1-6.3

*Meltzer, A., and S. Richard, (1981) "A Rational Theory of the Size of Government," *Journal of Political Economy*, 89, 914-927.

Boadway, R., and Keen, M., "Redistribution", *Handbook of Income Distribution*, Volume I, 667-779.

Roberts, K., 1977, "Voting over income tax schedule", *Journal of Public Economics*, 8: 329-40.

*Epple, D., and Romano, R., 1996, "Ends against the middle", *Journal of Public Economics*, 297-325.

Bolton P and Roland G, 1997, "The breakup of countries: a political economic analysis" *Quarterly Journal of Economics*, 1057-1090.

Bordignon M and Brusco S., 2001, "On Optimal Secession Rules", *European Economic Review*, 1811-1834.

Galasso, V., and Profeta, P., 2002, "The political economy of social security", *European Journal of Political Economy*, 18.1-29.

*Alesina, A., and Angelotos, G. M., 2005, "Fairness and Redistribution". *American Economic Review*, 913-35.

Benabou, R. and Tirole J., 2006, "Belief in a Just World and Redistributive Politics," *Quarterly Journal of Economics*, 121, 699-746.

Piketty, T., 1995, "Social Mobility and Redistributive Politics" *Quarterly Journal of Economics*, 110, 551-584.

Austen-Smith, D., 2000, "Redistributing Income under Proportional Representation", *Journal of Political Economy*, 108, 1235-1269

Lecture 3

Extensions: multiple issues: uncertainty, single issue groups. Lobbying and special interest groups. The role of media. Turn-out and the paradox of voting;

*PT, chapter 3.4; chapter 3.5;

*Hettich, W., Winer, S., 1988, "Economic and Political Foundations of Tax Structure" *AER*, 78: 701-12;

Hettich, W., Winer, S., 1999, *Democratic choice and taxation: a theoretical and empirical analysis*, New York, Cambridge UP.

*Feddersen, T. and Pesendorff W., 1996, "The Swing voter's curse" *American Economic Review*, 86: 408-24.

Feddersen, T., 2004, "Rational choice theory and the paradox of not voting" *Journal of Economic Perspectives*, 18, 99-112.

Palfrey T. and Rosenthal H., 1985, "Voter participation and strategic uncertainty", *American Political Science Review*, 79: 62-78.

*Merlo, A, 2006, "Whither Political Economy? Theories, Facts and Issues" *Mimeo*, University of Pennsylvania.

*Grossman, G., and E. Helpman (1994) "Protection for Sale" *American Economic Review*;

GT, chapter 3.1, 4 and 7;

Besley, T., and Coate, S., 2001 "Lobbying and Welfare in a Representative Democracy", *Review of Economic Studies*, 68, 67-82

Prat, A. and Stromberg D, 2010, "The political Economy of mass media", *mimeo*, LSE.

DellaVigna, S. and Kaplan E., 2007, "The Fox news effects: media bias and voting" *Quarterly Journal of Economics*, 122, 1187-1234.

Bordignon, M., Colombo, L. and Galmarini, U, 2008. "Fiscal federalism and lobbying" *Journal of Public Economics*, vol 92, 2288-230.

Lecture 4

Different systems of voting. Proportional versus Plurality rules. Duverger's Law and Duverger's hypothesis. Bargaining in a legislature. Presidential versus Parliamentary system. Dual ballot and single ballot.

PT, 5.4, 8; 10;

*Feddersen T., 1992, "A voting model implying Duverger's law and positive turnout" *American Journal of Political Science*, 36: 938-962;

Feddersen, T. and Pesendorfer, W., 1997, "Voting behaviour and information aggregation in elections with private and common values ", *Econometrica*, 65 (5)

*Morelli, M., 2004. "Party Formation and Policy Outcomes under Different Electoral Systems" *Review of Economic Studies*, 71:829-53

Persson, T., Roland, G., Tabellini, G., 2003. "How do electoral rules shape party structures, government coalitions, and economic policies?," NBER Working Paper 10176.

Persson, T., Roland, G., Tabellini, G., 1997, "Separation of powers and political accountability", *Quarterly Journal of Economics*, 112: 1163-1202.

Degan, A., Merlo, A., 2006. "Do voters vote sincerely?," *mimeo*, Pennsylvania University.

Alesina A. and Rosenthal H., 1996, "A theory of divided government", *Econometrica*, 63: 1311-1341.

Baron D. and Diermeier, 2001, "Elections, Governments and Parliaments in proportional representation systems" *Quarterly Journal of Economics*, 116:933-967.

*Baron, D., and J. Ferejohn , 1989 "Bargaining in Legislature", *American Political Science Review*.

Austen-Smith, D. and Banks, J, 1988, 'Elections, Coalitions, and Legislative Outcomes', *American Political Science Review*, 82: 405--422.

Banks, J and Duggan J, 2006, 'A General Bargaining Model of Legislative of Policy-making', *Quarterly Journal of Political Science*, 1: 49--85.

Lizzeri, A., and Persico, N., 2001, "The Provision of Public Goods under alternative electoral systems" AER, march.

Bordignon, M., Nannicini T. and Tabellini G., 2010, "Moderating political extremism; single versus dual ballot rule", *mimeo*, Catholic University (WP Cesifo, 2009).

Lecture 5

Endogenous candidacy. Agency model of politics. Retrospective voting. Discipline and selection effect of elections. The selection of politicians. Accountability and Yardstick competition.

PT, 4, 5.5., 9,

Besley T. and Coate S., 1997, "An economic model of representative democracy", *Quarterly Journal of Economics*, 112: 85-114;

*Osborne, M.J., Slivinsky, A., 1996. "A model of Political Competition with Citizen-Candidates," *Quarterly Journal of Economics*, 111, 65--96.

Levy, G., 2004, "A Model of Political Parties", *Journal of Economic Theory*, 115, 250-277.

Bordignon, M. and Minelli, E., 2001, "Rules transparency and political accountability" *Journal of Public Economy*, 80:73-98.

Coate S. and S. Morris, 1995, "On the form of transfer to special interests" *Journal of Political Economy* 103, 1210-1235

*Besley T. and M. Smart, 2007, "Fiscal restraints and voter welfare" *Journal of Public Economics*, 91, 755-773.

Besley T. and A. Case, 1995, "Incumbent behaviour: vote seeking, tax setting and yardstick competition" *American Economic Review* 85, 35-45.

Bordignon, M., 2010, "Exit and voice: yardstick versus fiscal competition", *mimeo*, Catholic University (also Cesifo WP).

*Besley T., 2005,. "Political Selection." *Journal of Economic Perspectives*, Volume 19, Number 3, Summer 2005, Pages 43–60.

Besley T., 2004. "Paying politicians: theory and evidence." *Journal of the European Economic Association* 2, 193-215.

Nannicini T., and Galasso V., 2010,. "Competing on good politicians." WP version, *American Political Science Review*, forthcoming (2011).

Caselli F. and Morelli M, 2004,. "Bad politicians", *Journal of Public Economics* 88, 759-782.

Merlo A. and Mattozzi M. 2007,. “The Transparency of Politics and the Quality of Politicians.” *American Economic Review*, vol. 97(2), pages 311-315.

Lecture 6

Dynamic voting. Debt, growth and the formation of institutions. Federations. Autocracies.

PT, 11, 12, 13, 14;

* Tabellini G., and A. Alesina (1990) “Voting on the Budget Deficit” *American Economic Review*.

* Persson, T., and G. Tabellini (1994) “Is Inequality Harmful for Growth?”, *American Economic Review*.

Acemoglu, D., S. Johnson and J. Robinson (2001) “The Colonial origins of Comparative Development: An Empirical Investigation” *American Economic Review*, 91: 1369-1401.

* Acemoglu, D. and J. Robinson (2000) “Political Losers as a Barrier to Economic Development” *American Economic Review Papers and Proceedings*, 90: 126-130.

Shleifer A., and R. Vishny (1992) “Corruption” *Quarterly Journal of Economics*, 108: 599-618.

*Fernandez, R. and Rodrik, D., 1991, “Resistance to reform: Status Quo Biases in the presence of Individual-Specific Uncertainty” *American Economic Review*, 81,1146-55.

Paulo Mauro (1995) “Corruption and Growth” *Quarterly Journal of Economics*, 110: 681-713.

Guiso, Luigi, Paola Sapienza, and Luigi Zingales, 2006, “Does Culture Affect Economic Outcomes?” *Journal of Economics Perspectives*, 20(2), 23-48.

Besley T. and Reynal-Querol M., 2009,. “Do Democracies Select More Educated Leaders?” *mimeo*, LSE

Acemoglu D., Egorov G., and Sonin K. 2009,. “Political selection and the persistence of bad governments.” *The Quarterly Journal of Economics*, 125: 1511-1575.

*Alesina A, Angeloni, I. and Etro F., 2005, “International Unions” *American Economic Review*, 95:602-615.

Bordignon M. and Brusco S., 2007. “On Enhanced Cooperation”, *Journal of Public Economics*, 90:2063-90