

Political Economy

Pierre Boyer and Alessandro Riboni

École Polytechnique - CREST

Master in Economics

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Schedule: Every Wednesday 08:30 to 11:45

Introduction of the class

Focus: Overview of the field of political economics

Political economy or Political economics

- Originally Economics \Rightarrow Political Economy
(see Heilbroner (1953) *Worldly Philosophers*)

Political economy originated in moral philosophy. Developed in the 18-19th century as the study of the economies of states, or polities, hence the term political economy (Adam Smith, John Stuart Mill, Thomas Robert Malthus, David Ricardo, Karl Marx).

Late 19th century, the term economics came to replace political economy (Alfred Marshall, William Stanley Jevons, Francis Ysidro Edgeworth, Léon Walras, Vilfredo Pareto)

- In the class Political economy = Political economics (a term coined by Roger Myerson)

Outline of the class

Part I: Introduction

Lecture 2-5: Tools of Political Economics (Electoral competition, Agency Models of Election, Partisan Politicians, Probabilistic Voting, Interest-groups)

with applications to redistributive politics and public good provision problems

Lecture 6: Comparative Politics (Electoral Rules and Electoral Competition)

Part II: Legislative Bargaining, populism, Dynamic Political Economy (Fiscal and Monetary Policy, Government Debt, Legal and Fiscal Capacity, Welfare State Dynamics)

Lecture notes/slides will be made available.

References

- Acemoglu D. and J. Robinson, 2006. Economic origins of dictatorship and democracy. Cambridge University Press.
- Austen-Smith David and Jeffrey Banks 2005 Positive Political Theory I and II University of Michigan Press
- Besley, T., 2006. Principled Agents Oxford University Press.
- Besley, T and T. Persson, 2011. Pillars of Prosperity. Princeton University Press.

Fun to read: Acemoglu D. and J. Robinson, 2012. Why Nations Fail?

References

- Grossman G. and E. Helpman, 2001. Special interest politics. MIT
- Drazen, A., 2000. Political Economy in Macroeconomics. Princeton University Press.
- **Persson, T. and G. Tabellini, 2000. Political Economics: Explaining Economic Policy. MIT Press.**
- Persson, T. and G. Tabellini, 2003. The economic effects of constitutions. MIT Press.

And research papers.

- ECTS credits: 4.0
- Written exams of 90min: questions on the classes and exercises

What about you?

- Background
- Interests: why are you here?
- Expectations
- ...

What we plan to achieve

- Introduce game theoretic models that will be used to understand how politicians' motivations affect public-policy decisions.
- Toolbox of political economics
- Applications to important topics in political economy: redistribution, comparative politics, and deb
- Interaction between political incentives and macroeconomic policies
- Frontier for research in political economy.

Political Economy and Public economics

- Public economics is the study of economic efficiency, distribution, and government economic policy
 - Public economics attempts to understand both how the gov't makes decisions and what decisions it should make
 - Public economics at the core of Economics
- ⇒ foundation for practical policy analysis.

- Modern Public economics: use of economic models
- Models as a tool to develop arguments coherently with a rigorous logical basis
- ⇒ Models provide a guide to the consequences of new policies (few experimentation and past experience cannot always be relied on)
- ⇒ Each model intended to be a simplified description of the part of the economy that is relevant for the analysis
- Incorporation of independent decision-making by firms, consumers, and **politicians**

Institutional setting

- Mixed economy where individual decisions are respected but the gov't attempts to affect these through the policies it implements
 - Many alternative objectives can be assigned to the gov't
- ⇒ Gov't can be assumed to care about the aggregate level of welfare in the economy
- ⇒ Gov't composed by a set of individuals that pursue their own selfish agenda

Political Economy is going to define the objective of head of government or more generally policy-makers.

Feasible policies

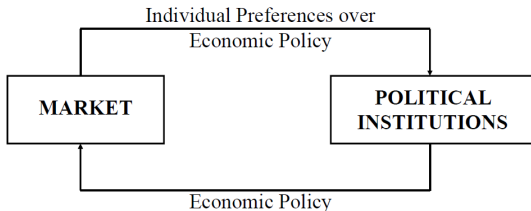
- Budget constraints
 - Informational constraints
- ⇒ Information about tastes, income, skills, health status,...
- Political constraints

Political Economics: What do we talk about

Definition: Political Economics define the application of Economic Analysis to political institutions. It is devoted to the study of political institutions by the methods for analysis of behavior developed in Economics.

- Political economics' research agenda over the last 20 years: how to explain observed variation in economic policy over time, place, and institutions
- Key actors in the political arena: voters; candidates; legislatures; political parties; interest groups

The Political Economics Approach



Public Economics: Economic policy chosen by a benevolent government or social planner.

Political Economics: Economic policy chosen by politicians subject to constraints and incentives

Novelty of this approach

Individuals as economic **and** political agents:

- Economic agents take labor, savings, consumption decisions
- Political agents (Voters) decide over the economic policy (Redistribution, public goods, etc)

Possible Conflicts

Policy instruments may be related to different types of conflicts:

- (i) Among individuals (e.g., redistributive policies),
- (ii) Between individuals and politicians (e.g., rents and corruption);
and
- (iii) Among politicians (e.g., rents and elections).

1. Policy instruments related to conflicts among individuals.

Key issues: redistribution (how targeted?), dynamic policies (public debt, growth), rents

- ▶ One-dimensional conflict

Typical of broad redistributive programs (e.g. welfare state programs, pure public good)

- ▶ N-dimensional conflict

Typical of narrowly target redistribution (e.g. local public goods, agricultural subsidies, trade protection, non-linear income taxation)

2. Which form of political participation?

- Voting
- Voting plus lobbying
- Post-electoral politics

3. Which electoral rule?

- We often neglect the effects of electoral rule on party system
(most of the time two parties)
- Yet, majoritarian vs proportional elections directly influence
some policies

Political Economics' Main Points

- Equilibrium reflects economic conflict among groups of voters:
⇒ What are their economic interests?

- Equilibrium policy reflects political influence of different economic groups:
⇒ What determines their influence?

Main Points

- Different assumptions on voter's behavior lead to different answers:
 1. Voters only care about policies. Then size of economic groups is all that matters when one-dimensional conflict.
 2. Voters also care about "parties". Then also responsiveness to policy favors matters.
- Influence also reflects ability of economic groups to be politically organized.
- Political influence also depends on the electoral rule.

INDIVIDUAL PREFERENCES



AGGREGATION MECHANISM:
POLITICAL INSTITUTIONS



COLLECTIVE PREFERENCES

Political regimes: criteria

- Who rules?
- How is compliance assured?
- Is government centralized or fragmented?
- How is power acquired?
- What is the balance between state and individual?
- How is economic life organized?
- Is the regime stable?

Different regimes: Western democracies, authoritarian regimes, post-communist regimes, ...

Democracy: a definition (Dahl, 1971)

- 1 Right to vote
- 2 Right to be elected
- 3 Right of political leaders to compete for support and votes
- 4 Free and fair elections
- 5 Freedom of expression
- 6 Freedom of association
- 7 Alternative sources of information (Media pluralism)
- 8 Institutions for making public policies depend on votes and other expressions of preferences (Accountability); see Pierre Rosanvallon (2008) *La Légitimité démocratique*

Democracy: a simpler definition

U.S. president Abraham Lincoln (1809-1865) defined democracy as:
“Government of the people, by the people, for the people”

Two essential features:

- High tolerance of opposition - seen as a means to check the power of government
- Ensures that participation in politics should be open and responsive to the public

Lijphart (1999) *Patterns of democracy* distinguished between two types of Western democracies:

- Majoritarian democracies (e.g. Westminster model, UK, NZ, Australia, Canada, Israel, and India)
- Consensus democracies (e.g. Netherlands, Belgium, Austria and Switzerland)

Western democracies: Majoritarian Systems

Majoritarian systems are often marked by:

- Single-party government
- A two-party system
- Simple plurality or first past the post voting system
- Unitary or centralised government
- An uncodified constitution

France is closer to majoritarian system, Germany to consensus system but mixed.

Western democracies: Consensual Systems

Consensual Systems are often marked by:

- Coalition governments
- A separation of powers between executive and assembly
- A multiparty system
- Proportional representation voting system
- Federalism / devolution
- Constitution and bill of rights

In the class: Electoral systems

- Not many details on actual institutions: We look more at the electoral incentives than real-institutional features of the systems
- ⇒ Focus on a common framework but frequent references to real-world
- Read political science literature where more details are given.

Outline of the class

Introduction

Lecture 2-5: Tools of political economics with applications

Lecture 6: Comparative Politics

Part II: Dynamic Political Economy