

# Political Economy

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École polytechnique - CREST

Fall 2022

Schedule: Every Tuesday 13:00 to 15:00

# 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 with applications to redistributive politics and public good provision problems

Lecture 6: Comparative Politics

**Part II:** Legislative bargaining, populism, nationalism, dynamic models (fiscal policy, debt, state-building)

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?  
And new book: The Narrow Corridor: States, Societies, and the Fate of Liberty.

# 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.**

And research papers.

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

# 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 macroeconomic policies (e.g. debt).
- 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.

# Methods

- 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

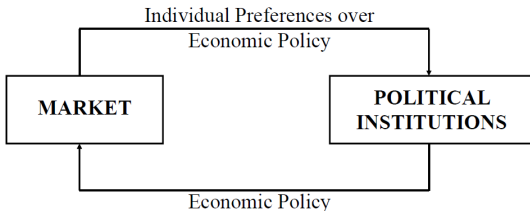
- Budget constraints
  - Informational constraints
- ⇒ Information about tastes, income, skills, health status,...
- Political feasibility
- ⇒ A carbon tax/ diesel tax may be efficient but how to get it thorough the political process. Or why it will never make it.
- ⇒ See the French Convention Citoyenne pour le climat (2019-2020) and the Conseil des prélèvements obligatoires (annual report, 2019).

# 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 30 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*).



# Independent authorities and Constitutional Courts

Rosanvallon (2020, *Le Siècle du populisme*): “Les cours constitutionnelles et les institutions indépendantes de régulation ont souvent été décrites comme “libérales” au sens où elles protégeraient les individus des risques de la tyrannie de la majorité. Il est vrai qu’elles ont de ce point de vue un “effet libéral”. Mais il faut en même temps bien les considérer comme des institutions pleinement démocratiques, c’est-à-dire participant à la mise en oeuvre d’une souveraineté collective.”

“Leur propre est d’avoir un caractère *indirect* puisque c’est fonctionnellement qu’elles sont au service de la construction de l’intérêt général. Il faut distinguer les institutions qui ont un *statut* démocratique (celles dont l’autorité procède de l’onction électorale) et celles qui ont une *qualité* démocratique, de par leurs objectifs et leur mode de fonctionnement.”

Democratic status derived from nomination process (evaluation of competence, hearings, independence) and functioning (deliberation, transparency, publication of decision and justifications, etc).

# Democracy: simpler definitions

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

Winston S. Churchill (House of Commons, 11 November 1947):  
“Democracy is the worst form of government, except for all the others.”

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.



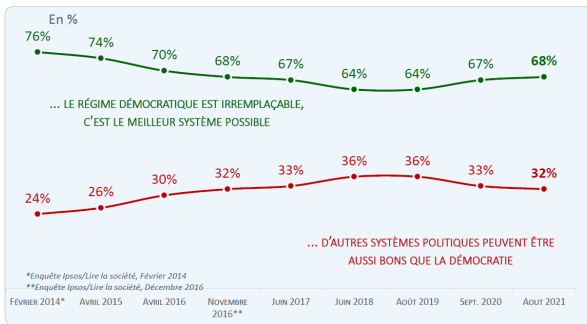
# Emerging discontents with democracies

Modern democracies face loss of confidence by the citizens.

- Survey shows that democracies not perceived to be the best systems by a fraction of citizens (Enquête annuelle “Fractures françaises” September 2021).
- General trend across the World.
- Change due to Covid-19?

## La confiance des Français dans le système démocratique progresse légèrement

De manière générale, diriez-vous que... ?










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## Pour un sympathisant RN sur deux, la démocratie n'est pas le système optimal

De manière générale, diriez-vous que... ?

	%	« Le régime démocratique est irremplaçable, c'est le meilleur système possible »									« D'autres systèmes politiques peuvent être aussi bons que la démocratie »								
		2021	2020	2019	2018	2017	Nov. 2016	Avril 2016	2015	Fév. 2014	2021	2020	2019	2018	2017	Nov. 2016	Avril 2016	2015	Fév. 2014
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EMPLOYÉ.E		<b>61</b>	54	59	59	70	60	59	74	73	<b>39</b>	46	40	41	30	40	41	26	27
OUVRIER.E		<b>58</b>	59	43	51	56	62	62	65	65	<b>42</b>	41	57	49	44	38	38	35	35
RETRAITÉ.E		<b>75</b>	81	78	72	76	73	79	79	81	<b>25</b>	19	22	28	24	27	21	21	19
MOINS DE 35 ANS		<b>58</b>	63	58	54	62	64	63	69	71	<b>42</b>	37	42	46	38	36	37	31	29
35-59 ANS		<b>68</b>	61	58	64	65	68	68	75	76	<b>32</b>	39	41	36	35	32	32	25	24
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Modern democracies face raising threats? New quoted term: Illiberal democracies (Zakaria, 1997; Foreign Affairs). Populism is not easy to define, as it comes in vintages and constantly evolves.

### Populism (Encyclopedia Britannica)

Populists claim to promote the interest of common citizens against the elites; they pander to people's fears and enthusiasms; and they promote policies without regard to the long-term or indirect consequences.

### Populism (Mudde, 2004)

Populism is a "thin-centered" ideology that considers society to be ultimately separated into two homogenous and antagonistic groups: "the pure people" and "the corrupt elite".

# Democracy or representative democracy?

- Loss of confidence in pillars of democracy (institutions, press).
  - Strong demand for direct democracy: référendum d'initiative citoyenne (RIC) by the Gilets jaunes.
- ⇒ Loss in confidence in representative democracy (Hamilton, 1777; Condorcet, 1790).

# First attempts: The origins of current discontents

Drivers of recent waves against democracies still poorly understood (see the survey of Guriev and Papaioannou, 2020).

1. “It is the economy stupid.”
  - Guiso et al. (2018): Economic insecurity causes faith in traditional parties to diminish, inducing disillusioned voters to abstain; in turn, economic insecurity and disillusion attract populist platforms offering short term protection in Europe.

- Becker et al. (2017) on Brexit: Exposure to the EU in terms of immigration and trade provides relatively little explanatory power for the referendum vote. Instead, fundamental characteristics of the voting population were key drivers of the Vote Leave share, in particular their education profiles, their historical dependence on manufacturing employment as well as low income and high unemployment.
- Fetzner (2019): austerity-induced welfare reforms (starting in 2010) important correlate of subsequent rise in support for the UK Independence Party and Leave support in the 2016 Brexit referendum.

2. Cultural backlash (e.g. Inglehart and Norris, 2016).
3. Globalisation, trade and immigration. Autor et al. (2016): robust positive effect of rising import competition from China on Republican vote share gains in 2016 Presidential Election.  
Dustmann et al. (2017): Non-economic cultural factor is far more important than economic considerations for the attitudes of individuals towards immigration.
4. Social capital, identity politics (Tocqueville, 1835; Bourdieu, 1972; Putnam, 1993, 2000; Shayo, 2009; Bonomi, Gennaioli and Tabellini, forth).



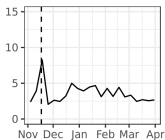
# Case study: Gilets jaunes

- Gilets jaunes (Algan et al., 2019; Boyer et al., 2020): Trust and mobility.

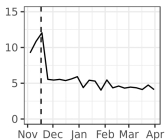
“Les déterminants de la mobilisation des gilets jaunes” (Boyer, Delemotte, Gauthier, Rollet and Schmutz), *Revue économique*, 2020.

“The Gilets Jaunes: Offline and Online” (Boyer, Delemotte, Gauthier, Rollet and Schmutz), CEPR working paper, 2020.

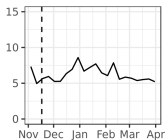
### Numbers



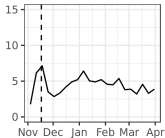
### Dates/Places



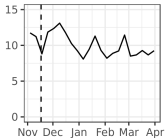
### Diffusion



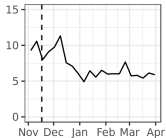
### Support



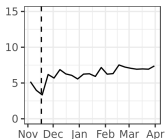
### Politics



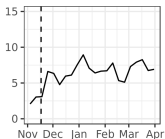
### Concerns



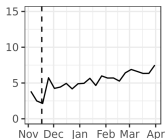
### Critiques

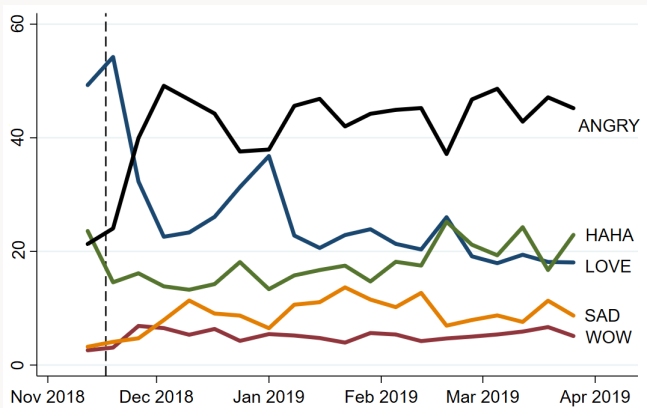


### Violence



### Insults





## Conference CEPR Research and Policy Network on Populism (2019):

- Populism is a normal democratic phenomenon that serves as a corrective to selective disengagement of traditional parties (Rovny and Woll, 2019).
  - Wealthy vote for right-wing parties “Merchant right”, educated vote in recent years for the left “Brahmin left” (Gethin, Piketty, Martinez-Toledano, forth).
- ⇒ Disenfranchised voters turn to radical parties.
- The risk of populism is not its rise in politics, but the trajectory of populist leaders once in office, which can turn into autocratic leadership.

# Media and new forms of mobilization

Technological changes interact with democracy.

- Printed press, radio, TV:
- In the U.S., Stromberg (2004) documents that radio increased political participation, whereas Gentzkow (2006) shows that the introduction of television decreased it.
- Durante et al. (2019): individuals with early access to Mediaset all-entertainment content more likely to vote for Berlusconi in 1994. Mechanisms: individuals exposed to entertainment TV as children were less cognitively sophisticated and civic-minded as adults, and ultimately more vulnerable to Berlusconi's populist rhetoric.

- Internet and political participation: Falck et al. (2014), Durante et al. (2018)

Gavazza et al. (2019): Internet has displaced other media with greater news content (i.e., radio and newspapers), thereby decreasing voter turnout, most notably among less-educated and younger individuals.

- Social media: Acemoglu et al. (2017), Qin et al. (2017), Enikolopov et al. (2017), Zhuravskaya et al. (forthcoming).

# Outline of the class

Introduction

**Lecture 2-5: Tools of political economics with applications**

Lecture 6: Comparative Politics

**Part II: Dynamic Political Economy**