

EC260: The Political Economy of Public Policy

Session: Two

Prerequisites: Introductory Microeconomics, basic knowledge of calculus and statistics

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Does democracy promote economic growth and welfare? What determines the size and evolution of the welfare state? Is regulation done in the interest of consumers? Is there a feasible third way between markets and governments in the delivering of public services? To answer these and many related questions it is necessary to understand the complex relationships between politics and economics. Governments and political processes define the boundaries of economic relationships and the rules of market interactions. Moreover, governments themselves allocate resources and these allocations reflect complex political bargaining. Understanding the interaction between politics and economics can help us to gain insight into the key questions of public policy making.

This course will examine public-policy making, its characteristics, determinants and consequences in liberal democracies. The course will first provide theoretical foundations from both economics and political science and then examine a number of topics from both theoretical and applied areas of political economy: collective action, electoral competition, fiscal policy and redistribution, bureaucracy, rent-seeking, regulation, information and accountability, constitutional reforms.

The course is organized around 12 lectures (3 hours each). Each lecture will cover a topic and classes (1 hour each) will then be devoted to solve problems and discuss specific questions related to that topic. Problems and questions on each topic will be distributed during the first lecture.

Assessment. This course is assessed by one written examination at the end of the course. This will account for 50% of the mark. Additionally, students are required to write a 3,000 words essay that will account for the remaining 50% of the final mark. A list of essay titles will be distributed during the first lecture.

Texts

Main Textbooks

Kenneth A Shepsle *Analyzing Politics* London: W.W. Norton (1997)
& Mark S Bonchek

This is the main reference for this course. It will cover most (but not all!) of the material. It can be usefully complemented by other readings that will be indicated in the syllabus.

For some topics we will use selected parts of

D.C. Mueller Public Choice III, Cambridge: Cambridge University Press (2003)
(Library reference: JF.1001.M94).

Useful books for beginners

P. Dunleavy *Democracy, Bureaucracy and Public Choice* (Hemel Hempstead: Harvester-Wheatsheaf, 1991).

(Useful for some topics on elections, parties, interest groups and bureaucracies).

P. A. McNutt *The Economics of Public Choice*, Second Edition, Aldershot, Edward Elgar, 2002.

(Okay for selected topics, but not comprehensive for this course)

A stimulating read, definitely recommended:

A.K. Dixit: *The Making of Economic Policy*, The MIT Press, 1996.

Advanced Textbooks

These two books are harder but some might enjoy:

Allan Drazen *Political Economy in Macroeconomics* (Princeton, 2000)

Torsten Persson *Political Economics: Explaining Economic Policy*,
& Guido Tabellini MIT Press (2000).

Classic Books

A. Downs *An Economic Theory of Democracy* (New York: Harper and Row, 1957).

M. Olson *The Logic of Collective Action* (Cambridge, Mass: Harvard Univ Press, 1965).

W. Niskanen *Bureaucracy and Representative Government* (Chicago: Aldine-Atherton, 1971), now republished as *Bureaucracy and Public Economics* (Edward Elgar, 1995)

Journals which are especially useful for this course are *American Political Science Review*, *American Journal of Political Science*, *Journal of Political Economy*, *American Economic Review*, *Quarterly Journal of Economics*, *Journal of Politics*, *Journal of Theoretical Politics*, *Public Choice*, *Journal of Public Economics*.

In the following, readings marked * are recommended.

Syllabus and Reading List

1. Introduction to Political Economy. Rationality and methodological individualism. Preference Aggregation and Manipulation

This lecture will introduce the basic method of political economy. We will explore the possibility of aggregating individual preferences into collective decisions and the challenges that this process poses.

*Drazen, A.	Ch. 1.
*Persson, T. & Tabellini, G.	Ch. 1.
*Mueller	Chs. 23, 24, 28.
Shepsle & Bonchek	Chs 1-4

2. Public goods and the collective action problem.

The particular characteristics of public goods pose a number of problems for what concerns their supply. Free-riding and collective action problems will be analysed with the aid of simple game-theoretic concepts.

*Mueller	Ch.2
*Shepsle & Bonchek	Chs. 8-10
M. Olson,	<i>The Logic of Collective Action</i> , pp. 1-16.
K. Dowding,	<i>Power</i> (Buckingham, Open University Press, 1996) ch. 2.

3. Elections and public policy. Majority rule

The majority rule has a special place in collective decision-making. We will see why and will analyse electoral competition in majority systems. We will derive several results on public policy formation under majority voting

*Mueller	Ch. 5, 11
Shepsle & Bonchek	Ch. 5
Persson & Tabellini	Ch. 3

4. The public choice of redistribution. Welfare spending and the size of the public sector

Why countries with apparently very similar economic characteristics differ in the amount of resources that are redistributed to the poor? We will use the models developed in lecture 3 to analyse welfare spending and the size of the public sector

- *Mueller Ch 19.
- *Drazen. Ch. 8.
- *V.Larcinese Voting over redistribution and the size of the welfare state: the role of turnout. *Political Studies*, 55, 568-585.
- J. Cullis
& P. Jones *Public Finance and Public Choice*, McGraw-Hill, Ch. 14
- Persson & Tabellini Ch. 6.
- A. Meltzer
& S. Richards A rational theory of the size of government, *Journal of Political Economy*, 89, 914-927, 1981
- Husted, T.A &
L.W. Kenny: The Effect of the Expansion of the Voting Franchise and the Size of Government, *Journal of Political Economy*, 105, 54-82, 1997.
- P. Lindert What limits social spending?, *Explorations in Economic History*, 33, 1-34, 1996
- R. Perotti Income distribution and investment, *European Economic Review*, 38, 827-835, 1994.

5. Information, mass media and public policy

The mass media appear to be increasingly important in elections. Ultimately they might have a powerful influence on public policy. Is this true? And if yes, to which extend? We will analyse several theories of mass media influence in politics and have a look at what the data say.

- *V. Larcinese *Information, Elections and Public Policy*. It will be downloadable from the author's web page.
- *V.Larcinese Does Political Knowledge Increase Turnout? Evidence from the 1997 British General Election, *Public Choice*, 131, 387-411.

- Grofman, E. (ed.) *Information, Participation, and Choice* (The University of Michigan Press, 1993). Introduction (Grofman), ch. 1 (Popkin), ch 3 (Grofman – Withers), 4 (Uhlener), 6 (Grofman)
- A. Lupia & M.D. McCubbins *The democratic dilemma: can citizens learn what they need to know*. New York: Cambridge University Press
- M.X. Delli Carpini & S. Keeter *What Americans know about Politics and why it matters*, New Haven: Yale University Press, 1996.
- J.G. Matsusaka Explaining voter turnout patterns: an information theory, *Public Choice*, 84, 91-117, 1995.
- J. Zaller *The nature and origins of mass opinion*, New York, Cambridge University Press, 1991
- J. Zaller The myth of mass media effectiveness revived, in “*Political Persuasion and attitude change*” (D. Mutz ed.), Ann Arbor, University of Michigan Press, 1996.

6. Electoral rules and policy outcomes

Institutions might influence the way voters and their elected representatives act. Thus, constitutional rules might have important consequences for public policy. We will focus on electoral rules and their impact on the provision of public goods and overall public spending.

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| *Mueller | Ch. 13 |
| Persson & Tabellini, | Ch. 10 |
| Shepsle & Bonchek | Chs. 11, 12 |
| A. Lijphart | <i>Patterns of Democracy</i> , Yale University Press, 1999, Chs. 1, 8 |

7. Political Agency (1): Institutions and Political Accountability

Government performance depends on the quality of elected officials and the actions they take. We look at institutional mechanisms for holding politicians to account.

Besley, T (2004) 'Paying Politicians: Theory and Evidence', *Journal of European Economic Association*, 2, 2-3, 193--215

Besley, T. and Case, E (1995) 'Incumbent behaviour: vote-seeking, tax-setting, and yardstick competition', *American Economic Review*, 85

Caselli F and Morelli. M (2004) 'Bad Politicians', *Journal of Public Economics*, 88, 3-4

Dal Bo. E, Dal Bo. P, and Di Tella, R (2007), 'Plato O Plomo, Bribe and Punishment in a Theory of Political Influence', *American Political Science Review*, 100, 1, 41-55

Dal Bo, E and Di Tella, R (2003) 'Capture by Threat', *Journal of Political Economy*, 111(5): 1123-1154.

Dewan, T and Dowding, K (2005) 'The Corrective Effect of Ministerial Resignations', *American Journal of Political Science*, 49, no 1.

Dewan, T and Myatt, D (2007) 'Scandal, Protection and Recovery in Political Cabinets', *American Political Science Review*,

T. Dewan and Myatt D (2008) 'The Declining Talent Pool of Government', available from <http://www.lse.ac.uk/collections/government/PSPE/WorkingPapers.htm>

Ferejohn, J (1999) *Accountability and Authority, Toward a Theory of Political Accountability*, in Przeworski, Manin and Stokes ed.

8. Organisation of Legislatures and Legislative Procedures

The organisational rules of a legislature can have a big impact on how resources are allocated. We look at a number of features of the legislative process: log-rolling, coalitions, bargaining, confidence rules, and rule by committee.

Mueller p104-123 p278-295

Shepsle and Bonchek Ch 12, 14

Diermeier, D (2006): 'Coalition Governments', in the *Oxford Handbook of Political Economy*.

Baron, D and Ferejohn, J (1987) 'Bargaining in Legislatures', American Political Science Review, vol 83.

Diermeier, D. and Feddersen, T (1998): 'Cohesion in Legislatures and the Vote of Confidence Procedure', *American Political Science Review*, 92, 856--869

Diermeier, D. and Merlo, A. (2004): 'An Empirical Investigation of Bargaining Procedures,' *Journal of Public Economics*, 88 (3)

Weingast, B and Marshall, W 'The Industrial Organization of Congress. Or why legislatures like firms are not organized as markets', Journal of Political Economy, 96 (2) 1988 pp. 132-63

Krehbiel, K Information and Legislative Organization Michigan 1991

9. Interest Groups

Interest groups have an impact on the policy making process, but what is the extent of their influence, what tactics do they use and how might political mechanisms affect their impact.

*Mueller

Ch. 15

Dal Bo, E. (2007) 'Bribing Voters', *American Journal of Political Science*, 51, 4

Groseclose, T and Snyder, J (1996) 'Buying Supermajorities', *American Political Science Review*, 90, 303-15

Landes and Posner (1975) The Independent Judiciary in Interest Group Perspective *Journal of Law and Economics*, 18, 875-77

10. Political Leadership

Leadership and Information. Leadership and Coordination. What makes a good Leader? What makes a successful leader? Empirical analysis of leadership effects.

Shepsle and Bonchek, chapter 14

Jones, B and Olken, B (2005) 'Do Leaders matter? National Leadership and Growth since World War 2', *Quarterly Journal of Economics*, 120, 3, 835--864

Dewan, T and Myatt, David (2008) 'The Qualities of Leadership: Direction, Communication, and Obfuscation', *American Political Science Review*, forthcoming, available from

Canes-Wrone B, Herron, M and Shotts, K (2001) 'Leadership and Pandering: A Theory of Executive Policy-making', *American Journal of Political Science*, 45, 3, 532--550

Humphreys, M., Masters, M and Sandbu, M (2006): 'The Role of Leadership in Democratic Deliberations: Results from a Field Experiment in São Tomé and Príncipe,' *World Politics*, forthcoming

Myerson, R (2004): 'Justice, Institutions, and Multiple Equilibria,' *Chicago Journal of International Law*, 5(1), 91–107.

Wantchekon, L. (2003): 'Clientelism and Voting Behavior: Evidence from a Field Experiment in Benin,' *World Politics*, 55

11.The Origins and Effects of Political Institutions

What are the political implications of different constitutional forms? Does Democracy always lead to better policy outcomes? Is rule by the people for the people an illusionary goal? What are the redistributive implications of Democracy and Oligarchy?

Mueller, chapter

Acemoglu, D and Robinson, J (2006) 'The Economic Origins of Dictatorship and Democracy', *Cambridge University Press*

Acemoglu, D and Robinson, J (2001) 'Why did the West Extend the Franchise: Distribution and growth in Comparative Perspective', *Quarterly Journal of Economics*, 115 (4), 1167-1199

Acemoglu, D and Robinson, J (2000) 'A Theory of Political Transitions', *American Economic Review*, 91, pp 938-963

Dal Bo E, Dal Bo, P. and Snyder, J (2006) 'Political Dynasties', forthcoming *Review of Economic Studies*, available at SSRN: <http://ssrn.com/abstract=909251>

Dewan, T and Myatt, D (2007) 'Leading the Party: Coordination, Direction and Communication', *American Political Science Review*, 101, 4

Maskin, E and Tirole, J (2004) 'The Politician and the Judge: Accountability in Government', *American Economic Review*, 94,4, 1034-105

12 Political Agency (2)

What motivates political agents? What type of incentives are effective at securing quality service provision? How does the relationship between the legislature and the bureaucratic

administration affect policy outcomes? In this session we take a further look at how look at how principal –agent analysis can illuminate aspects of bureaucracy

Mueller

Ch 17

Shepsle and Bonchek

Ch 13

Berlinski S, Dewan T and Dowding K(2008) The Impact of Individual and Collective Performance on Tenure, available from
<http://www.lse.ac.uk/collections/government/PSPE/WorkingPapers.htm>

Besley T. and Ghatak M. Competition and Incentives with Motivated Agents. (2005) *American Economic Review* 95,3,616–36.

D. Epstein and S O'Halloran. (1994) 'Administrative Procedures, Information, and Agency Discretion: Slack vs. Flexibility'. *American Journal of Political Science*, 38, 697–722

S. Gailmard and Patty J (2007) 'Zealots and Slackers: Civil Service, Policy Discretion, and Policy Expertise', *American Journal of Political Science*, 51,4,873--889

B. Weingast and Moran M (1983) 'Bureaucratic Discretion or Congressional Control? Regulatory Policymaking by the Federal Trade Commission', *Journal of Political Economy* 91, 1983, pp. 775-800.