Recent Economic Perspectives on Political Economy, Part II[*]

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Abstract

In recent years some of the best theoretical work on the political economy of political institutions and processes has begun surfacing outside the political science mainstream in high quality economics journals. This two-part paper surveys these contributions from a recent five-year period. In Part I, the focus is on elections, voting and information aggregation, followed by treatments of parties, candidates, and coalitions. In Part II, papers on economic performance and redistribution, constitutional design, and incentives, institutions, and the quality of political elites are discussed. Part II concludes with a discussion of the methodological bases common to economics and political science, the way economists have used political science research, and some new themes and arbitrage opportunities.

This is the second part of a two-part survey of articles germane to political science found in the leading economics journals in recent years. We undertook this task because it had become apparent in recent years that a considerable body of formal political economy began appearing in the top economics journals. In the five-year period from the point we commenced this project (2000-2004), we found more than one hundred articles in the five leading journals.[1] From this universe we survey approximately sixty, with references to many others as well. In Part I, the focus was on elections, voting and information aggregation, followed by a treatment of parties, candidates, and coalitions. In this part we examine papers on redistribution, constitutional design, and the incentives and quality of political elites. We conclude with a discussion of the methodological and theoretical foundations of political economy shared by economist and political scientist alike, the resources each political economy type draws from the other's literature, and some available intellectual arbitrage opportunities.

1. Economic Performance and Redistribution

Economists dating back at least to Adam Smith have been interested in matters of economic performance, with issues of competition (and industrial organization more generally), welfare, economic growth, and the distribution of wealth and income especially salient. For most of the twentieth century, the analysis of these topics has been conducted within a neoclassical framework, with some studies providing micro-economic details while others are mainly macroeconomic. Little attention was paid to political arrangements and their potential impact on economic performance. Indeed, Paul Samuelson dismissed Kenneth Arrow's famous social choice theorems as merely "Arrow's Mathematical Politics," suggesting they had little to do with economics proper.[2] The field of regulation constituted a partial exception to this general pattern, emphasizing the impact on public policies of regulatory institutions.

In recent years we have witnessed something of a sea change, as economists have come to the realization that an understanding of the role of political institutions is central to their enterprise. The *locus classicus* of this growing literature is Persson and Tabellini's treatise, *Political Economics*.[3] Several papers related to themes developed there have emerged in our sample of papers. Persson, Roland, and Tabellini (PRT) exemplify one of the distinguishing marks of modern analytical approaches to economic performance, *viz.*, taking features of the political landscape as explanatory variables.[4]

They provide micro-foundations for variations and regularities in the practice of public finance – taxing, spending, and borrowing – in modern political regimes. They set the context with three fairly standard assumptions – no benevolent actors, no direct democracy, no outside enforcement. The first is a standard self-interest motivation for all actors. The second focuses attention on representative democracy and various political institutions thereof. The third means that promises, threats, and other intentions must be self-enforcing or self-enacting, i.e., they must be in the interest of the actors making them to carry them out if required. Politics, in this view, is strategic interaction amongst self-interested agents in institutional contexts with no external enforcement mechanism (like sheriffs and courts in an economic contracting setting). With these assumptions in hand, PRT examine public spending in alternative political regimes. They identify three conflicts of interest:

- between politicians and voters over the level of politician rents,

- amongst politicians over the division of rents, and

- amongst voters over spending priorities.

These conflicts play out differently in different institutional settings. That is, a political equilibrium in which these various conflicts of interest are in balance displays different properties in different political settings. PRT contrast spending in separation-of-powers presidential regimes and legislatively cohesive parliamentary regimes.

The paper contains a series of formal models – variations on the Baron and Ferejohn divide-the-dollar model – distinguishing these regimes in terms of the distribution of agenda power.[5] Presidential regimes are characterised by dispersed agenda power – different legislators (typically members of jurisdiction-specific committees) possess proposal power in different policy areas; the full legislature may approve, modify, or defeat proposals; and a president has a final veto. PRT operationalise this by exploring a highly stylised setting in which the legislator possessing agenda power over the determination of taxes (and hence the size of government) differs from the one charged with making proposals for the distribution of spending, either on a (national) public good or targeted expenditures in different constituencies (on pork or local public goods). At the end of a legislative session, legislators and the president face different electorates and are (re)elected independently according to a retrospective assessment by their respective voters.

Parliamentary regimes, in contrast, have more concentrated agenda power, with the "government" making proposals in the shadow of a potential no-confidence vote and parliamentary dissolution (which endogenously affects the cohesiveness of the parties of government). PRT operationalise this arrangement by assuming that "nature" randomly selects a proposer and a majority coalition of parties in parliament (from amongst all such possible majority coalitions) with the power to choose tax and expenditure policy simultaneously. A coalition partner has a veto over policy proposals which, if exercised, generates a governmental crisis with the potential for the government to fall and its agenda power lost. Parliamentary politicians, too, face constituents who retrospectively assess their performance.[6]

PRT write down specific and distinctive game forms for each of the two regimes, specify agent preferences, and then deduce equilibrium behavior and outcomes. The contrasts between regimes are fascinating. In comparison to parliamentarism, presidential government is associated with a smaller public sector (lower tax rate), fewer rents enjoyed by politicians, less redistribution (taxing some constituencies in order to target spending on others), and inefficiently low spending on the national public good. In contrast, parliamentary government has a larger public sector (more taxation), more rents enjoyed by politicians, and more spending on both the public good and redistribution. PRT point out that each regime's institutional design entails a trade off.

Presidential regimes cope better with agency problems, holding politicians more accountable (thus driving their rents to low levels), whereas parliamentary regimes solve conflicts amongst voters better (thus enabling coordination on public-good provision).

PRT are concerned with the way in which institutional arrangements affect the "public economy" of taxing and spending. In particular, they normalise the "size" of the economy to unity and explore the different *tax-rate* decisions different regimes will make; they do not trace the impact of taxing and of spending, either pork targeted to particular districts or expenditures devoted to public goods, on subsequent economic performance. What they have produced, however, is an elegant apparatus that may serve as a building block in a more expansive inquiry. The contribution here is in tackling a conventional subject of public finance with an explicit treatment of political mechanisms instead of a black box. The next steps will entail fleshing out the political mechanisms, which are now rather starkly and sketchily detailed, and connecting the endogenous "public economics" decisions to subsequent adaptations in the broader economy.[7] A bigger question involves the selection of institutional arrangements and, in particular, on whether the differences in the public economy documented above associated with various institutional arrangements are *causally connected* (i.e., a consequence of the institutions) or, instead, are *equilibrium associations* (i.e., policy and institutions "hang together" and may both be the effect of not-yet-identified features of the underlying society).

Lizzeri and Persico (LP) explore a very similar question, but vary the electoral system (winner-take-all electoral arrangements versus proportional representation) rather than the political regime (presidential versus parliamentary) as in PRT.[8] They also focus exclusively on national-level politicians (better thought of as parties or pre-electoral coalitions) – that is, a national government elected either according to PR or winner take all. Office benefits for politicians are thus allocated either in proportion to the vote or entirely to the politician/party receiving the most votes. In their model, each of two candidates promises the voters, in the spirit of Downs, either a pure public good, national in scope, in which case each voter gets a constant payoff, or a pure-transfer option that must satisfy a balanced-budget constraint. The latter consists of targeted spending and taxes that vary across voters. (Restrictively, a party must offer either the public good or a distribution of targeted benefits, not some mix of each.) Voters are treated individually, so they need not be grouped into, say, geographic districts with net payments constant for all residing in the same location. Each voter sizes up the alternatives on offer from the two candidates and votes for the best one.[9]

LP are most interested in the nature of candidate strategies in equilibrium under different voting arrangements. They produce some interesting findings. If the public good is valued by voters above some upper threshold, then in equilibrium both candidates promise the public good in both the PR and winner-take-all systems. If, on the other hand, the public good is valued below a lower threshold, then each candidate in equilibrium offers the same transfer option (of zero net transfer in expectation to every voter), again independent of voting arrangements. If, however, the public good is of intermediate value, lying above the lower threshold but below the upper one, then there are only mixed strategies in equilibrium (where a mixed strategy promises the public good with probability α and a fixed distribution of transfers – for details consult the paper – with probability 1-α). Here, too, there is convergence of the two candidate strategies under either voting arrangement, but the mixed strategy to which they converge differs according to the electoral system. Both of the candidates in the winner-take-all arrangement always offer the public good with probability exactly equal to ½. In the PR arrangement, in contrast, the probability rises monotonically from 0 to 1 as the value of the public good rises from the lower to the upper threshold of the intermediate range. Against a standard of efficiency, LP conclude that PR and winner-take-all systems are identical for higher- and lower-valued public goods, but differ for intermediate-valued ones: PR is superior to winner-take-all arrangements when the public good is at the higher end of the intermediate-value category, while winner takes all dominates PR when public good are at the lower end of the intermediate range.

As in PRT, LP present a very stylised version of political competition. PRT compare separation-of-powers to fusion-of-powers regimes in a district-based electoral context, while LP compare winner-take-all to PR in a single national constituency context. Both map electoral/voting arrangements into policy (public goods, redistribution) in terms that would be familiar to the comparativist in political science. Both provide the theoretical scaffolding on which to hang additional levels of micro-detail, thus providing a foundation for a major comparative research program.[10]

David Austen-Smith studies the income distribution under multiparty PR, comparing it to that under a two-party, winner-take-all arrangement.[11] He focuses on the political choice of a tax system, and wishes to provide an account of the oft-cited empirical regularity that countries with PR "typically exhibit higher average tax rates and flatter distributions of post-tax income than those using (essentially) two-party majority rule."[12] His is an advance over some of the previous papers discussed inasmuch as there actually *is* an economy in his model, consisting of a distribution of ability types allocated (endogenously as choices in response to taxes) across three

occupational categories – employers, employees, and voluntarily unemployed. The income distribution is determined by a tax rate on incomes with tax revenues redistributed. He identifies a sufficient condition – namely that the cost of entering the workforce is sufficiently low – that leads to the result quoted above. Furthermore, he finds that national income is lower and voluntary unemployment is higher in PR systems than under two-party majority rule. He provides intuition for these results by showing that the pivotal voter differs in the two systems. Under PR she is "the voter with average employee income amongst only those types who choose to be employees ex post." Under two-party majority rule, the pivot is "the voter with median income in the electorate at large, irrespective of that voter's (equilibrium) choice of occupation."[13] Austen-Smith provides a formal argument as to why the fact of these different pivotal voters implies different tax rates, and thus different income distributions, under the two electoral arrangements.

Austen-Smith's political arrangements are simple: PR entails equilibrium positioning of parties on the tax-rate dimension, followed by multiparty legislative bargaining over a tax rate; two-party majority rule is of the Downsian variety with one winner taking all and implementing its promised tax rate. Austen-Smith's economic arrangements are equally simple: an economy is a distribution of talents across employment categories (with the residual voluntarily unemployed) and a production function for a single commodity with managerial talent and labour as inputs. What is especially novel is the identification of a *political-economic equilibrium*. He not only identifies such an equilibrium under two stripped-down electoral arrangements, but also conducts comparative statics on various features of the economy (for example, the elasticity of demand for labour and the technological cost of acquiring skills to enter the workforce).

It will be important to explore how robust Austen-Smith's conclusions are to making both the political system and the economy more complex.[14] An important next consideration is the *choice* of electoral system, a consideration that applies to PRT and LP as well. In the present model, why a society with a given distribution of talents and occupational opportunities would opt for one or the other electoral arrangement is not examined. Yet this *is* clearly a choice that is taken, explicitly or implicitly. There is thus a need to complement models with exogenous political arrangements with an *explanation* of institutional sorting amongst political economies as actually occurs. We will take up some of the recent work focusing on explanations of institutions in the next section.[15]

A second subset of papers under review provides some leverage on providing endogenous accounts of institutional choice – that is, treating political practices and institutions as matters to

be explained. The *locus classicus* is Acemoglu and Robinson (AR) on franchise extension.[16] AR are interested in accounting for the expansion of the electorate in the 19th and early 20th centuries in most advanced industrial societies, an old chestnut preoccupying political sociologists of an earlier era.[17] These societies subsequently experienced unprecedented redistribution and welfare programs, attributable in part at least to franchise extension, and financed chiefly by taxation on assets and income of precisely the political elites who extended the franchise in the first place. AR provide a strategic account of the reasons these elites willingly diluted their influence and thereby exposed their wealth and income to redistributive impulses.

Imagine a political elite confronting the prospect of social unrest. Somehow, politically disadvantaged groups have managed to overcome collective action obstacles to pose a threat. In principle, the elite could promise policy reform of some sort, for example an improvement in working conditions or housing or the distribution of land. They might well deliver on the promise initially, for to fail to do so would provoke the social unrest they currently fear. But once the conditions of unrest have dissolved, or the obstacles to collective action have re-emerged, it is possible for this elite to renege on its promises. That is to say, if the favourable conditions under which politically disadvantaged groups can mobilise are transitory, then promises from the elite that extend beyond the period in which those conditions are expected to hold are not credible. In order to be credible, the promise has to take a more durable form, one difficult for the elite to reverse. AR suggest that franchise extension possesses this greater durability – it is more difficult to reverse than, say, a land reform that can be undone. Indeed, the political empowerment of previously disenfranchised groups makes them a more permanent and potent force leaning against reversal.

Thus, institutions are explained in terms of their greater credibility in comparison to less durable policy commitments. AR suggest, furthermore, that if the conditions under which disadvantaged groups may pose a threat to a political elite are not so transitory – for example, if a durable union movement amongst workers exists – then, *counter-intuitively*, political elites need not extend the franchise because their policy promises now have greater permanence and credibility. The reason: Since disadvantaged groups' capacity to cause mischief is not so transitory, they are able to keep the elite's feet to the fire with greater constancy, thereby deterring reneging. AR note that a country like Germany may well have had franchise extension *delayed* precisely because it possessed a strong labour movement.[18]

Lizzeri and Persico (LP) argue, in contrast, that threats to the social order were not the only reason elites extended the franchise.[19] With 19th century Britain firmly in mind, they suggest an

alternative explanation, namely that an extended franchise gives politicians better incentives. With a restricted electorate there is a tendency toward too much clientelism and patronage. With a mass electorate, on the other hand, reelection-seeking politicians are encouraged to promise *legislation*, not bribes, favours, and privileges. LP call into question AR's explanation, noting that in 19th century Britain the extension of the franchise is *not* associated with fiscal growth generally, and certainly not associated with a growth in payments to the poor. Rather, it is associated with a growth in public goods related to urban infrastructure and public health. Rapid urbanization, they claim, is the shock that produced divisions within the elite. The desire of some for improved urban conditions provided them with incentives to join forces with previously disenfranchised groups, supporting franchise extension in the expectation that the urban working class would also favour improved urban infrastructure, public health, and the provision of other public goods. They provide a formal model giving conditions under which a majority of the elite will favour such franchise expansion.[20]

Both Acemoglu-Robinson and Lizzeri-Persico provide formal models to explain franchise extension, the former emphasizing credible elite responses to threats to the social order while the latter emphasise a more peaceful transition in which members of the elite are divided according to their preference for greater public goods production. Bits of evidence have been adduced for each position. Some facts and methodological issues remain in dispute (e.g., whether franchise extension in fact preceded an expansion of welfare and other redistributive policies, and whether a causal connection is persuasive). Resolution and synthesis await further work.

Before leaving the topic of franchise extension, we mention a paper that may not, on its face, appear related – Bolton and Rosenthal (BR) on the political economy of personal debt.[21] They explore the circumstances leading to ex post political intervention in debt contracts in a democracy. BR note that if such interventions are anticipated ex ante, they may affect interest rates, lending volume, and other aspects of the debt market; it is not clear whether such ex post interventions are welfare improving. On the other hand, if political interventions are unanticipated, there are two inefficiencies that are potentially mitigated: (i) debtors who would have been foreclosed may well be more productive if their debt is relieved or rescheduled; (ii) even debtors not foreclosed may beneficially have access to credit. In addition, there is an externality that may induce pivotal voting blocs to support ex post intervention. By not forcing otherwise foreclosed debtors into the labour market, the supply of labour is restricted keeping labour wages higher than they otherwise would be.

BR offer a simple model of an agricultural economy consisting of rich farmers, and three skill-classes of poor farmer – bad, average, and good. There are two economic states – high and low. If a farmer is foreclosed, he loses his land and enters the labour pool. BR show that rich farmers (who constitute the supply side of the debt market and the demand side of the labour market) always oppose debt moratoria. As holders of debt, they are harmed by moratoria (the debt they hold is discounted); and as demanders of labour, they are harmed by moratoria (which prevent otherwise foreclosed borrowers from being thrown into the labour market that would increase labour supply and thus reduce wages). Amongst poor farmers, BR show that bad and average skill types always support moratoria (see the paper for a parallel logic). For at least some distributions of the voters across farmer types, the good-type of poor farmer becomes pivotal, supporting moratoria (with other poor farmers) when the state of the economy is low (and other conditions are satisfied) and opposing moratoria otherwise (with rich farmers). What connects this argument to those we have just reviewed is the matter of the franchise requirement, which determines the distribution of voters across farmer types. A high wealth restriction, for example, would protect rich farmers from democratic interventions (by disproportionately excluding from the voting rolls those that would systematically support debt moratoria). If, however, there were a credible threat of social unrest (as in AR), or there were divisions amongst rich farmers, some of whom sought solidarity with poorer farmers for, e.g., local public good provision (as in LP), then there may well be a move for franchise extension with an impact on credit markets (and its ambiguous welfare effects).

We conclude this section with a second bite at the apple from Acemoglu and Robinson.[22] They revisit their earlier treatment of the extension of the franchise in the West, raising another issue that had preoccupied earlier generations of political sociologists: Why has mass democracy been durable in Northern Europe and so hard to consolidate in Latin America? Their earlier argument claimed that franchise extension constituted a credible means by which a political elite could promise redistribution and thus avert social unrest. But exactly how credible is this commitment? The history of Latin American democracy suggests that it is not always, with *coups* against elected regimes constituting reversals of this commitment. In unequal societies the poor, when political power is extended to it by a political elite, may not be able to resist pursuing substantial redistribution, especially when economic conditions are bad, which stimulates a counter-response from the original elite.[23] The threat of a coup thus has a similar effect to that of a revolution: a coup is a non-constitutional means by which a social group, namely the rich, can attain political influence.

Redistribution may then be limited in a democracy under threat of a coup. AR refer to such democracies as semi-consolidated, since, although the poor may wield political power, the decisions made by the poor with regard to redistribution reflect the power wielded by the rich through their credible threat to resort to non-constitutional tactics. Since the rich have more to lose through redistribution in highly unequal societies, the threat of a coup is higher also in such societies. In an extension to their earlier arguments, AR show that in highly unequal societies the commitment to limit redistribution is not credible. Such democracies remain unconsolidated, cycling between democratic phases, with unfettered redistribution to the poor, and oligarchy, during which the gains to the poor are retrenched. The political development of post-war Argentina provides an interesting example, with the populist and redistributive democracies under both Juan and Isabel Peron overthrown by military coup. Thus the paper by AR is important in illustrating the critical relationship between inequality and fiscal volatility as polities cycle in and out of democracy: "Inequality emerges as a crucial determinant of political instability because it encourages the rich to contest power in democracies and also often encourages social unrest in nondemocratic societies."[24]

Most of the papers reviewed in this section have set political features either as right-hand-side explanatory factors or as something to be explained. With political factors as right-hand side explanatory variables, economic performance is only implicitly examined.[25], Political features are used to provide an account of public decisions with economic content – tax rates, expenditure patterns, public good provision – but ultimate implications for economic activity and performance (growth, employment, inflation, etc.) are left for another day. In the case of political arrangements as left-hand side variables, something we take up more fully in the next section, explanations of political arrangements are offered, but, in the papers just examined, hardly in a very comprehensive way and often on the basis of a highly stylised characterization of economic conditions. Tightening some of the linkages, only loosely coupled at present, constitutes an agenda of future work that will provide a theoretical basis for cross-country empirical work (something of a light industry in applied economics) connecting features of political systems to economic performance.

2. Constitutional Design

From the papers reviewed in the previous section, we know that institutions have policy and redistributive effects. But we have not yet examined why institutions are chosen in the first instance. In this section we explore the contributions of papers on constitutional design. How might institutional rules be constitutionally altered and, if altered, how stable are new

arrangements? That is, how do underlying conditions sustain a set of institutional arrangements, and are these arrangements robust to changes in underlying conditions? These questions inform a fascinating series of papers which have as their theme the idea of *endogenous institutions.*

A starting point to this literature is a fascinating paper by Barbera and Jackson who analyse voting rules which can themselves be altered under voting procedures.[26] Many constitutions specify a voting rule for ordinary legislative practices and a distinctive voting rule for constitutional matters. For example, some legislatures use majority rule on standard legislative business but require a two-thirds majority to change its own rules. The paper addresses which sets of rules constitute equilibrium outcomes: A constitution is *self-stable* if, under its rules, the procedures will remain unchanged and hence will survive over time.

The authors analyse a stylised setting in which voters face a choice over a pair of alternatives A and B, where A represents the status quo and B represents a specific policy change. A voting rule is characterised by a threshold number of votes required for B to pass into law. The threshold, itself, is also subject to a voting rule requirement. Thus a constitution consists of two elements: the number of votes required for B to pass, and an additional voting rule which sets out the number of votes required to change the voting rule which is in place. The constitution is chosen at the first stage of the game and the choice over alternatives takes place in the second stage. In period one voters are uncertain of their preferences for either A or B.

One might think it obvious that, given this setting, the proponents of policy change would seek a low threshold and opponents a high one. Indeed, this expectation holds. A voter who is more likely to find herself in favour of B will always have a preferred threshold level which is no higher than a strict majority of voters; by contrast a voter who is more likely to be an opponent of B will always have a preferred threshold which is at least as large as a strict majority. However, Barbera and Jackson's examination of which rules will prove stable offers additional and subtle insights. A key result is that if the society is homogeneous, in the sense that all members of society have the same ex-ante probability of being in favour of B, then the only constitution which is self-stable is one that consists of majority rule over both elements. That is, decisions are made by majority rule and decisions over how to change the voting rule also require majority support. This result holds even when all members of society are very likely to find themselves in favour of B, or alternatively are very likely to be against. The reason is that, in a homogeneous society, for any realization of preferences each voter is more likely to find herself in the majority (whether as an A-supporter or a B-supporter), and hence has a preference for a majoritarian constitution. If, however, society is heterogeneous then there may be no self-stable constitutional

rule or there may be multiple self-stable constitutional arrangements. The existence of equilibria is, however, assured if sub-majority rules, that is rules in which an alternative is chosen with the support of less than half of the population, are excluded from consideration. Another interesting result is that amongst the multiplicity of equilibria, one constitutional arrangement is always present. This is the constitution in which decisions are made by majority rule but where decisions over how policy decisions are made require unanimity.

Messner and Polborn analyse a similar setting and provide a new rationale for qualified majority rules, focusing more explicitly on the redistributive effects of constitutional arrangements. In their model, voters vote over projects that yield a future flow of benefits to citizens.[27] Younger voters will benefit more from a project of any given scale, since the benefits will flow to them over a longer time horizon. Thus voter preferences over project scale are monotonically decreasing in his or her age. Suppose then that a society were to choose today how decisions over projects should be made and suppose that the constitutional decision were binding on future votes over projects (i.e., the constitutional issue will not be revisited). The voter who would be decisive under simple majority rule − if that is the rule for choosing projects − is the voter of median age. Today's median will be aware, however, that though she benefits from today's project, her gain relative to costs from future projects will decline the older she gets. Thus, whereas majority rule may seem a good idea with regard to today's project, it would not appear so for future projects. Based on this logic and using an overlapping generations model, Messner and Polborn provide a fascinating insight: "If people's preferences depend on their age in a systematic way, a supermajority rule is a way for the median voter to transfer power to his average future self."[28] By voting in favour of a supermajority rule which governs decisions over proposals, the median elector knows that fewer reform projects will pass in the future, thus maximizing his welfare over the remainder of his life-span.[29]

The determinants of constitutional choice also lie at the heart of a paper by Aghion, Alesina and Trebbi (AAT). In their analysis, the key variable to be explained is the level of insulation that is chosen by society for its political leadership.[30] For example, the Westminster Model of democracy provides leaders with a high degree of insulation as they are able to implement reforms with fewer checks and balances. By contrast, and to adopt Lijphart's well-known categorization, a consensual democracy has a low level of insulation as leaders are constrained in their policy actions.[31] AAT analyse a model in which a leader is chosen to implement a policy reform which provides differential benefits for the citizenry. As in the model of Barbera and Jackson, the game begins with a constitutional stage in which society chooses the

level of support which the reform must enjoy before it becomes policy. There are two sources of uncertainty: as in Messner and Polborn, citizens are not fully informed as to the flow of benefits which they will accrue pending reform; secondly, they do not observe the politician's type. A good type always implements the reform and a bad type always expropriates from the citizenry. Thus a low level of insulation, corresponding to, for example, a large fraction of votes required to implement reform, acts as protection against expropriation and allows the blocking of reform by a minority once the distribution of ex-post preferences are realised. On the other hand a high level of insulation insures that the policy is implemented whenever the politician is of the good type.

The authors show that the optimal level of insulation is increasing in the constitutional level of protection of individual property rights and wealth, and is decreasing in the level of uncertainty over the value of the reform. The key comparative static in their analysis concerns the degree of social polarisation. AAT show that a more polarised society is less likely to insulate its leadership. When ex-post preferences are unknown ex-ante, then, as polarisation increases, an individual anticipates she is more likely to find herself in a situation where she loses out through the reform process, and hence she would like political leaders to be constrained in their actions; this need no longer be the case, however, if ex-post preferences are revealed ex-ante. These results should be of interest to political scientists familiar with the work of Lijphart, who observes that "plural" societies in which groups are divided along ethnic, linguistic and/or religious lines are more likely to adopt "consensual" political arrangements, which in AAT's parlance are systems with low levels of insulation. In formalizing the choice over institutional arrangements AAT are able to show the conditions under which Lijphart's claims are likely to hold. Whether those conditions are satisfied depends on the level of uncertainty over the value of future reforms.

As stated above, constitutional requirements in place at a given moment reflect current circumstances. Constitutional forms may however adapt as circumstances change. Lagunoff asks an important question: what are the determinants of the extent to which a constitution will protect the rights of minorities?[32] He then explores how the protection of minorities through constitutional measures may develop over time, when the constitution is amendable under majority rule. The issue under discussion in this paper is the level of constitutional protection for individuals who partake in activities which are perceived as deviant by the majority. The right to partake in such activities is subject to constitutionally defined legal standards which are themselves subject to majority rule. Thus, unlike in the papers by Barbera and Jackson and by Messner and Polborn, the constitutional rule is fixed, but the specific legal standards are not. The key idea in this paper is that, when monitoring a minority is imperfect, a member of the majority

may be incorrectly identified as a minority deviant and "hence, preferences for some diversity arise endogenously from a voter's fear that his own behaviour may be wrongly punished by an excessively intolerant standard". In the dynamic game, Lagunoff explores the effect of learning about citizen's behaviour through technological improvements and shows that the level of tolerance is increasing in the rate of turnover in the majority's composition – thus a permanent majority will impose stricter legal standards.

The endogenous institutions literature thus far addressed focuses on the initial choice of constitutional requirements for law-making. A related question is the degree to which decision-making power should be delegated to non-majoritarian institutions such as the judiciary, and what effects such delegation might have. Maskin and Tirole ask when such delegation leads to more *informed* policy outcomes.[33] They analyse three institutional arrangements: a system of direct democracy, one of representative democracy, and one of rule by judiciary. In their setting citizens are faced with a choice between A and B. They would all have the same preference if perfectly informed. The scenario is, however, one of imperfect information and A is the popular choice - that is, it is the alternative which is believed to be best with better than fair odds – and would be chosen under a direct democracy. In contrast to the citizens, both the politician (who makes the decision under representative democracy) and a judge (who makes the decision under rule by judiciary) know not only their own preference but also the correct ranking for society. The institutional choice is thus related to the incentive to delegate due to the greater expertise of the politician and the judge; delegation may increase the likelihood that society gets the outcome it would prefer if fully informed. In such a situation, one might think that society would always delegate to a politician since, unlike a judge, a politician can be held accountable. However there are two conflicting motives to take account of. A politician's personal preferences may not be congruent with the choice society would make if perfectly informed. Such a politician may be made accountable through his career concern: by offering the public what they would want if informed, he increases his chances of re-election and this effect may override his concern for implementing his preferred policy. (Maskin and Tirole refer to this as a concern for the politician's legacy). However, it is also possible that the politician will merely pander to popular beliefs in the hope of being re-elected. Thus whilst a career concern may induce accountability, it may also induce the politician to take decisions which are not in society's best interest, hence diminishing the advantage of delegating to a politician. A judge, by contrast, does not face an electoral incentive. Whilst he has no incentive to pander, neither need he be responsive. If the judge has non-congruent preferences, he can not be held accountable. Thus there are conflicting

elements at play with regard to whether society should delegate, and if they delegate whether it should be to the politician or the judge.[34]

Some clear results emerge even in a very simple two-period model. If the reelection concern of the politician overrides his immediate policy goals then the choice of a representative democracy is always dominated.[35] In the case where the concern for reelection is not so large that a politician will always pander to populist demand, representative democracy may be preferred to either direct democracy or judicial power (or a hybrid of the two). This is the case where the public information is low and where the probability that the politician's preferences are congruent is sufficiently high. The key innovation in Maskin and Tirole's paper is in showing that, once one takes into account the different incentives of a politician and a judge, and in particular the inclination of the former to pander to public opinion, representative democracy does not always yield more informed policy choices and, indeed, society may prefer to delegate to a judge, or not to delegate at all.

The role of the judiciary in the policy process is also explored in a paper by Hanson which revisits the central theme, introduced into the political economy literature by Landes and Posner, of the effect of an independent judiciary on policy durability.[36] In their seminal but controversial article, Landes and Posner suggested that an independent judiciary will be more likely to interpret future legislation in light of the wishes of the enacting coalition.[37] By contrast, a dependent judiciary will be more amenable to the desires of a current legislative majority. They thus suggested that an interest group would be willing to pay a higher price for legislation in the presence of an independent judiciary because it is expected to be more durable.[38]

This analysis does not take into account the idea that judges in an independent judiciary may have political preferences of their own. In the words of Maskin and Tirole, the judiciary's preferences need not be "congruent" with those of the enacting coalition. As Hanson points out, the degree of judicial dependence is itself a constitutional choice which is made under a given set of political circumstances. Thus we can theoretically explore the conditions under which it may be optimal to offer a degree of judicial independence. Hanson does so with the help of a simple spatial model in which a politician can choose either an independent or a dependent judiciary and where the preferences of the judiciary are unknown. He explores the effects of two exogenous parameters: the probability of re-election of the politician and the ability of the politician to screen the judges. His model provides two simple and intuitive findings: the higher is the probability of re-election, the lower is the optimal level of judicial independence; the higher is the degree of screening, the higher is the optimal level of judicial independence. Hanson takes these

insights to a rich data set which records the level of judicial independence in the US states and finds some support for his propositions. In particular, a merit plan under which incumbent judges face re-election on an up-or-down ticket based on their record is widely perceived as being most consistent with the ideal of an independent judiciary; switching to adoption of such a merit plan at the state level appears to be related to the key parameters of Hanson's model.

We finish our discussion on constitutional design by turning to an old chestnut in the political economy canon, namely the allocation of decision making power between federal and local units of government. Centralisation of power at the federal level is often taken as illustrative of the desire by politicians at the centre to grab more power for themselves. Cremer and Palfrey, by contrast, argue that such a process reflects the ways in which local political fights become nationalised.[39] Their results are based on variations on a basic game in which minimum federal standards are decided at the first stage according to the preferences of the median voter in the federal constituency. Each local district then chooses a level of provision, with the amount satisfying the federal mandate acting as a lower bound on what the district may implement. They show that, in equilibrium, in any constituency where the median voter has a preference at least as high as that mandated by the federal government, delegation to the federal level has no effect on citizens' welfare. In these districts a majority of voters are at least as well off with a federal mandate as they would be if the decision were made at the local level without a mandate. However since the median in at least one district has a preference for a lower standard than that mandated, some voters are always made worse off. Surprisingly, Cremer and Palfrey show that such welfare losses are larger when there are efficiency gains to be had from federal provision of a public good.

Finally, we turn our attention to a paper which offers new insights on the classic trade-off between greater efficiency of public goods provision and the costs of policy uniformity when policy is imposed from above, as highlighted in the classic argument of Oates.[40] The insight of policy uniformity is not derived from any formal model of political decision-making – the Oates de-centralisation theorem relies on a black-box depiction of government policy-making. Lockwood's contribution is in analysing the assumption of policy uniformity, when decisions are made by a legislative body under majority rule. He analyses a setting similar to that in earlier work by Weingast, Shepsle and Johnsen:[41] Citizens enjoy benefits from region-specific projects, though regions vary with respect to the costs and benefits of these local public goods and with regard to the extent of the externalities which they impose on other regions (through the development of their projects). Lockwood compares two regimes. In a decentralised regime,

each region pays for its own project. Under a centralised regime, delegates from the regions vote on which projects are to be funded nationally, with decisions made by majority rule.[42] Using an agenda-setting model with a privileged status quo, Lockwood analyses the set of projects which are approved in equilibrium under centralization. A key result of his analysis is that the set of proposals which are funded is invariant to the level of between-region benefits, a conclusion related to the idea that central government is less responsive to the tastes of local citizens.[43]

The analysis of constitutional design, which has its roots in an older Public Choice literature, is an expanding field of enquiry. Developments in this topic are in part driven by substantive concerns. As economists and political scientists become more aware of the public finance effects of different institutional arrangements, there is renewed interest in analysing the initial choice of such institutional arrangements. The analysis of constitutional design offers rich pickings for formal modelers. As the literature we have surveyed highlights, political economists should think not only about how different game forms can be used to represent different institutional arrangements, but explore also how such arrangements are themselves part of an equilibrium of a larger game involving constitutional design.

3. Incentives, Institutions and the Quality of the Political Elite

Thus far we have looked at papers that analyse how different institutional arrangements come about and their effects on economic performance. Of course institutions are also important at the micro-level as a selection mechanism for agents and as a source of performance incentives for those selected. That is, they affect which individuals are attracted to a political career and how they perform once chosen. Alongside the literature on endogenous institutions, a vibrant field of research has emerged looking at the effect of different institutional arrangements on the *quality* of political elites. This literature draws upon two separate strands from the political economy canon. The first looks at the effect of electoral institutions upon the behaviour of politicians of different types. That literature typically distinguishes ``bad'' politicians from ``good'' ones in that the former would, in the absence of any institutional device to correct their behaviour, expropriate the citizenry.[44] The second is the theme of state capture of the legislative process by interest groups, and the institutional determinants of that process, introduced and developed by the Chicago School of political economy and reflected to some extent in the papers by Prat and Besley and Coate discussed in Part I of this essay, and Hanson earlier in the present paper.

Caselli and Morelli envisage a scenario where the political process is captured by a group of bad politicians. Here, and in contrast to the conventional use of the term, they have in mind

politicians who lack talent. They analyse the conditions under which politicians with different attributes run for office and in so doing are able to address an interesting but controversial question: how can we explain cross-national variation in the quality of political elites?[45]

They start from an analysis of the conditions under which talented members of society, by which they mean those who can attract large salaries in the private sector, nevertheless run for office. A necessary condition is that the rents from office are greater than the cost of running for office. The rent from office is simply the difference in the value of a political career over and above the benefits of a career in the private sector. This rent may be affected by such things as salary, perks and other monetary benefits including the value of bribes which may be offered. Additional benefits that flow from the prestige of holding office are also considered. A key feature of their simple set up is that low quality types have a comparative advantage because the value of their outside career option is lower. Moreover, since the current political elite controls the reward structure of the future political elite, through for example the setting of the salary scale for incoming politicians, they can also directly affect the incentives for "good" politicians to run for office.

There is also another effect of the current political elite on overall quality. The current rent from office is increasing in the quality of the existing pool of politicians. For a talented individual considering her career options, a career in politics becomes more valuable when other talented politicians are in post, and less attractive when the talent pool is not deep. For all of these reasons, a pool of bad politicians may become a self-selecting elite. Put another way, a state in which only bad politicians run for, and are elected to, office may be a self-enforcing equilibrium. An interesting feature of this result is that is does not depend upon any institutional structures as such. Even a relatively open, democratic and accountable system can give rise to an equilibrium in which only bad politicians emerge. It is one of several possible equilibria.

An interesting feature of the Caselli and Morelli paper is that bribes may actually *increase* the likelihood that talented politicians run for office. By increasing the rents available from office, bribes may attract more talented members of society to seek a political career. Dal Bo and Di Tella explore a scenario where interest groups can use threats of physical harm or legal harassment, rather than bribes.[46] By thus expanding the methods of persuasion available to interest groups, they provide a more realistic assessment of how the state might be captured by such groups. A key feature of their analysis is that threats, unlike bribes, always have a negative effect on politicians' welfare. Whereas a politician can always turn down a bribe and receive only his official wage, a punishment imposed from an interest group will always lead to a reduction in

a politician's welfare. In the Dal Bo and Di Tella model, a president determines policy under threat of an interest group which may punish him for pursuing good policies (in the sense of being welfare-enhancing for the citizenry at large) which, though preferred by voters (pursuing good policies increases the probability of re-election), are detrimental to the interest group concerned. Such punishments may offset the value which a politician derives from re-election. To counter this effect a political party may offer some protection to the president from the interest group. Nevertheless punishments will be observed in equilibrium since it never pays a party to offer full protection. Moreover, Dal Bo and Di Tella show that, once one takes into account the broader range of tactics that interest groups deploy, even honest politicians who have a concern for re-election can implement bad policies or, at least, delay the implementation of good ones.[47]

When taken together these papers offer an important corrective to the conventional and sanguine view of the role of open and democratic procedures in enhancing the quality of our political elites. Democratic competition allows citizens to weed out politicians of inferior caliber only when good types are available to replace them. Caselli and Morelli show that we can not take this for granted. Moreover, as Dal Bo and Di Tella show, even politicians of high moral standing may not always act in the public interest. These papers take a promising direction, raise important questions and offer interesting new insights. What is missing is a fuller account of how different institutions affect the incentives of politicians to run for office and influence the decisions they make once they are there.

Indeed, the key contribution of political economy to the broader concerns of political science has been in its development of an understanding of how institutions both reflect and shape the incentives and motivations of political actors, most notably through the literature on transactions costs and the analysis of institutions as solutions to common agency and commitment problems.[48] We finish our survey with two papers in this vein, both of which take bureaucracy as their subject matter. Both focus on how the size and scope of bureaucracy reflects the incentives of bureaucratic agents; in so-doing, they offer new insights into old problems.[49]

Acemoglu and Verdier (AV) take the standard public choice view that bureaucracy exists as a response to market failure, but then directly model the source of the potential failure deriving implications for the size and type of the bureaucratic response.[50] In their analysis a firm may choose a technology which exhibits either a positive or a negative externality, where the choice of technology is unobserved. If either of these externalities is of sufficient magnitude, then this justifies a role for a public bureaucracy whose investigative agents distribute carrots and sticks to induce desired behaviour. The government controls the size of the bureaucracy, the wages of

bureaucrats and also determines the resources which are allocated to provide the incentives to entrepreneurs to choose the good technology. In short, the government faces an optimization problem: It intervenes at a cost not only in terms of direct resources but also in terms of the withdrawal of agents from productive activities; and it provides salaries to agents which are sufficiently large for them to engage in monitoring. However, bureaucrats are corruptible and may colour their reports to create a favourable impression of a firm's activities.[51]

AV show that if the cost of market failures is large and if the costs of bureaucracy are not too prohibitive, then the optimal allocation of agents between public and private sectors is one in which some degree of bureaucracy exists. The size of the bureaucracy and the salaries paid to bureaucrats reflect the extent of the underlying problem to be corrected, and also the necessary and sufficient behavioural incentives of bureaucrats given these problems. In the most interesting case explored by AV, the existence of the opportunity for corruption increases the salaries earned by bureaucrats. An increase in salary has the effect of increasing the value of a career as a civil servant. Any gain through bureaucratic corruption is offset by the increase in the loss of earnings should such behaviour be uncovered.[52] Moreover, in cases where bureaucratic intervention is justified despite the corruption incentive (and the corresponding higher salaries of bureaucrats), that is where the cost of externalities is sufficiently large, then the optimal size of bureaucracy is also larger (than in the case where there is no possibility for corruption). This is because a larger bureaucracy increases the probability that a firm which utilises the bad technology is monitored which, in turn, reduces the cost of the incentives to induce correct behaviour. Since bribes are proportional to the overall value of carrots and sticks, this reduces the incentives for corrupt actions and the higher salaries which are earned in lieu of these incentives. When taken together, an interesting result emerges. If the cost of externality is sufficiently large then both the size of bureaucracy and the salaries earned by bureaucrats are larger when bureaucrats are corruptible.

Prendergast tackles the issue of bureaucracy with similar concerns in mind.[53] In her principal-agent analysis, a bureaucrat is in charge of an allocation of some good to a consumer. As in AV, the actions of the bureaucrat are investigated ex-post. Such investigations are however more likely to be instigated at the behest of a consumer who perceives some injustice with regard to her allocation. This creates a misalignment of incentives; a bureaucrat is more likely to accede to consumer demands in the hope that this will ward off investigation. Oversupply of output need not then be related to the desires of bureaucrats for overproduction (contra Niskanen), but may simply reflect the desire of a bureaucrat for an easy life. Prendergast compares these inefficient

outcomes to those which would prevail in a world where consumers could be relied upon to inform bureaus truthfully, and as such would receive their just allocation.

Both of these papers offer new insights into old problems. Acemoglu and Verdier point out that, whereas a large bureaucracy with increased salaries may superficially appear to confirm public choice accounts of bureaucrats carving out larger rents for themselves, these features may also arise as part of an institutional response to the underlying problem, once one takes self-interested bureaucratic motives into account. Moreover, the key result in the paper by Prendergast is that bureaucratic inefficiency is due to imperfection in information which gives rise to bureaucracy in the first place. Both of these papers thus highlight how key features of bureaucracy are related to underlying problems which give rise to bureaucratic intervention; they help us to understand the role of bureaucracy, by helping us to envisage what the world would look like in the absence of bureaucracy.

4. Discussion and Conclusions

We will make no attempt to summarise our *tour d'horizon*. In concluding, however, we would like to make three general observations.

Common methodological bases. The political economy models we have surveyed in Part I and Part II of this essay generally draw on one or more of three garden-variety models of mixed-motive settings we think of as political-economic. The oldest of them all is the *spatial model* of committees and elections. In this approach, the interests of political-economic agents are represented by single-peaked utility functions on points in a single- or multi-dimensional geometric space. The agents can be voters, legislators, or bureaucrats; the alternatives can be ideologies, policy bundles, legislative motions, or budgets. The model is rich in this sense – it travels well from context to context. It also is modular, permitting the inclusion of ex ante stages like agenda setting; intermediate stages like intra-institutional bargaining; and ex post stages like vetoing, implementation and monitoring. The spatial model has also come to be seen as inclusive of modern social choice theory and the analysis of structure-induced equilibrium. Interestingly, the spatial model began in a purely economic context (the location of firms in a geographic space), was transported to political science (most notably by Downs and Black), and has since under girded developments in political economics as seen in many of the papers reviewed here.

A home-grown economic approach to political economy is the *citizen-candidate model*.[54] Associated chiefly with Osborne and Slivinsky and Besley and Coate, this approach reflects dissatisfaction with taking the alternatives on offer – parties or candidates in elections – as

exogenous. The "entry decision," as it is known in these models, is made an endogenous product of rational calculation. (The analogue in institutional models, as opposed to electoral settings, is agenda-setting.)

The political science product that serves as theoretical inspiration in many of the papers under review is the *Baron-Ferejohn bargaining model*. It, in turn, was inspired by Rubinstein's famous alternating-offers bargaining model, with Baron and Ferejohn generalizing it by embedding it in a context of democratic political institutions.[55]

Practically all of the papers we have covered in this essay draw on one or more of these three wellsprings. Nearly all are explicitly strategic, so it is fair to say that non-cooperative game theory is the unifying thread, the *sine qua non* of political economy. Interestingly, there are few that draw on prisoners' dilemma models or collective action approaches – perhaps a result of our selection bias (only looking at political economy contributions in a small number of economics journals), but then again perhaps a straw in the wind. As surprising, an intense interest in reputational factors found in research of the 1980s and 1990s is only a minor theme in the present collection of papers.[56]

Economists' Uses of Political Science. Modern political economy is not a one-way street from economics to political science. While political science has always been a discipline that has begged, borrowed, and stolen from cognate fields, many of the approaches common in the papers we have reviewed have a clear political science pedigree. Spatial models, born in economics and subsequently revitalised by an economist, nevertheless had a lengthy incubation inside political science proper in the 1960s and 1970s before economists rediscovered and redeployed them in their own research. Divide-the-dollar bargaining, invented by a game theorist, took on a new life when it was extended from the world of bilateral bargaining to multilateral settings in which it was no longer a requirement that everyone agree before a deal was struck. The latter settings are much more explicitly political, combining (super)majority decision rules and formal characterisations of agenda power. In political-economic research one finds references to the "Baron-Ferejohn model" more frequently than to the original "Rubinstein model." Of the three foundational approaches described above, only the citizen-candidate model has primarily an economic heritage. And even in this case, the problems which stimulated it were not economic problems (e.g., entry decisions of firms in markets), but explicitly political ones revolving around elections. Of newer vintage are the so-called "cheap talk" games whereby costless signals provide limited information to decision-makers. This class of models originated in economics through the

seminal contribution of Crawford and Sobel,[57] but received many of its best known applications in political science through the work of Gilligan and Krehbiel.[58]

A second source of intellectual stimulation from political science evident in the papers reviewed here is empirical. We have consciously excluded empirical political economy from our sample, but there are many references in the theoretical papers to empirical patterns uncovered by political scientists and political sociologists with which political-economic theories seek to come to terms: Seymour Martin Lipset and Barrington Moore, for example, have clearly influenced Acemoglu and Robinson and other contributors to the literature on redistribution; Duverger has clearly influenced the work of Morelli, Picketty and others working on party systems and party competition (discussed in Part I); and Lijphart has clearly inspired Aghion, Alesina and Trebbi's analysis of the relationship between social differentiation and constitutional forms.

New Themes and Arbitrage Opportunities. Subdividing the sample of papers into substantive categories as we have done camouflages linkages across categories. Initially our thought was to focus on analytical themes, but we have opted for a more substantive categorisation of papers. Nevertheless, some themes emerge which clearly cross the divides we have imposed here. The first is the role commitment plays in the papers we sample. This is an important focus in the papers on political parties, a concern arising from the growing use of the citizen-candidate framework in which policy commitments are not deemed credible. It is also central to the broad project of Acemoglu and Robinson. Another theme that emerges clearly is that of information aggregation. This literature, whilst central to the concerns of political science, has been more fully developed in the economics literature, most notably perhaps, through the collaboration between Feddersen and Pesendorfer, and it is not surprising that this has developed into a major area of research.[59]

Other interesting new themes and modeling trends emerging in the economics literature have so far, to our knowledge, received less attention in formal political science. The first is the theme of *endogenous* institutions. Whereas the papers which we have surveyed focus almost exclusively on voting rules, this appears to be a developing area and we are sure that insights with regard to other areas of constitutional design will soon follow. Another theme is that of the *quality* of politicians, picked up in the papers by Caselli and Morelli and by Dal Bo and Di Tella. The interesting feature in these papers is the emphasis on the composition of the political elite -- that is, the ratio of good to bad types, which contrasts with more standard accounts focusing on how incentives provided by institutions may lead various types to choose appropriate behaviour. These new papers emphasise issues of selection bias rather than moral hazard. Another

interesting development is the focus on communication. The papers by Picketty and Razin (discussed in Part I) are novel in that they focus on voting as a means of communicating information to parties and candidates, not just selecting winners.[60]

Finally, an interesting development concerns the modeling techniques themselves. Some of the papers we have surveyed develop models which go beyond the partial equilibrium properties of specific elements of the political landscape, for example the relationship between parties in coalitions or between parties and voters, in an attempt to model the ways in which these different elements hang together. This is notable in the work of Morelli, and is also present in the papers by Baron and Diermeier and Diermeier and Merlo. The work by Austen-Smith deserves special mention here for integrating key aspects of the economy with political processes, in turn identifying a political-economic equilibrium. Models which capture the ways in which different elements of the political landscape work together to produce both political and economic outcomes are likely to inform political science in the future.

[1] The journals from which we have drawn articles are the *American Economic Review, Econometrica, Journal of Economic Theory, Journal of Political Economy, Quarterly Journal of Economics,* and the *Review of Economic Studies*.

[2] Paul A. Samuelson, "Arrow's Mathematical Politics," in Sidney Hook, ed, *Human Values and Economic Policy* (New York: New York University Press, 1967).

[3] Torsten Persson and Guido Tabellini, *Political Economics: Explaining Economic Policy* (Cambridge: MIT Press, 2000).

[4] Torsten Persson, Gerard Roland, and Guido Tabellini, "Comparative Politics and Public Finance," *Journal of Political Economy* 108 (2000), 1121-61.

[5] David P. Baron and John A. Ferejohn, "Bargaining in Legislatures," *American Political Science Review* 83 (1989), 1181-1206.

[6] In both regimes district-based constituencies with first-past-the-post electoral arrangements are assumed. Some of the papers reviewed shortly examine alternative specifications.

[7] For example, preference aggregation problems within institutions (cycling), or the means by which they are resolved, are not elaborated upon.

[8] Alesandro Lizzeri and Nicola Persico, "The Provision of Public Goods under Alternative Electoral Incentives," *American Economic Review* 91 (2001), 225-239.

[9] Voters are treated as having identical tastes. LP note that introducing heterogeneity does not yield many new insights.

[10] A related paper we mention in passing is Jean-Francois Laslier and Nathalie Picard, "Distributive Politics and Electoral Competition," *Journal of Economic Theory* 103 (2002), 106-30. Given a normative ideal of equal division of a surplus, they ask what political institutions will produce this. Studying two-party Downsian competition in a multidimensional strategy space, they find that, in every equilibrium mixed strategy, any distribution of the surplus receiving positive probability weight has the property that no individual receives more than twice the average. I.e., Downsian competition in equilibrium limits the amount of social inequality.

[11] David Austen-Smith, "Redistributing Income under Proportional Representation," *Journal of Political Economy* 108 (2000), 1235-69.

[12] Austen-Smith, "Redistributing Income," 1236.

[13] Austen-Smith, "Redistributing Income," 1239.

[14] The parties in Austen-Smith's rendition of PR, for example, are associated with occupational categories – thus there is one for the employer class (a conservative party), one for the employee class (a center party), and one for the unemployed (a radical party). This is a pretty good modeling move for a simple political arrangement. As the economy becomes more complex, with more occupational categories, and the political dynamics get more complex, with social as well as economic bases for political conflict for example, more subtle modeling choices must be made.

[15] Related to the work of Austen-Smith is Costas Azariadis and Vincenzo Galasso, "Fiscal Constitutions," *Journal of Economic Theory* 103 (2002), 255-81. They are interested in intergenerational fiscal relationships – e.g., social security transfers from young to old, security of public debt repayments, maintaining the currency – and their durability over time under different

political arrangements. Constitutional regimes, restricting contemporaneous majority choice by (in effect) giving constraining power to previous generational choices, provide "an endogenous mechanism of partial policy commitment" (257). The authors in this way begin to provide an account of political arrangements by incorporating rational expectations about their impact on economic patterns.

[16] Daron Acemoglu and James A. Robinson, "Why did the West Extend the Franchise? Democracy, Inequality, and Growth in Historical Perspective," *Quarterly Journal of Economics*, 115 (2000), 1167-1200. This paper is part of a much larger project, Daron Acemoglu and James A. Robinson, *Economic Origins of Dictatorship and Democracy* (Cambridge: Cambridge University Press, 2005).

[17] It is no accident that AR's recent book has a title very similar to Barrington Moore, Jr., *Social Origins of Dictatorship and Democracy* (Boston: Beacon Press, 1966).

[18] A closely related paper, though more abstract and less historically grounded, is John P. Conley and Akram Temimi, "Endogenous Enfranchisement When Groups' Preferences Conflict," *Journal of Political Economy* 109 (2001), 79-102. They determine when an unenfranchised group should threaten in order to secure the franchise. These authors focus much more on what such a group must do, and whether it is in their interest to do it, to make their threats *credible*. The equilibrium conditions of their model revolve around privileged groups' losses from extending the franchise, non-privileged groups' threat technology, and the degree of policy conflict between groups.

[19] Alessandro Lizzeri and Nicola Persico, "Why Did the Elites Extend the Suffrage? Democracy and the Scope of Government, with an Application to Britain's 'Age of Reform'," *Quarterly Journal of Economics* 119 (2004), 707-65.

[20] They are only tangentially concerned with the downside of franchise extension from the elite's perspective, namely the redistributive impulse of newly enfranchised voters.

[21] Patrick Bolton and Howard Rosenthal, "Political Intervention in Debt Contracts," *Journal of Political Economy* 110 (2002), 1103-34.

[22] Daron Acemoglu and James A. Robinson, "A Theory of Political Transitions," *American Economic Review*, 91 (2001), 938-63.

[23] As AR note, this argument bears a familial relationship to one proposed by Ellman and Wantchekon (taken up in section 2 of Part I of our essay). AR observe that, backward inducting

from the prospect of a coup, the poor could set a tax rate just low enough to dissuade the elite from mounting a coup. "Although the society always remains democratic [in this case], it is in some sense 'under the shadow of a coup,' as the coup threat limits overall redistribution." Acemoglu and Robinson, "A Theory of Political Transitions," 948.

[24] Acemoglu and Robinson, "A Theory of Political Transitions," 957. An extremely rich alternative explanation for "consolidation" (though not pitched in this way) is developed in Roland Benabou and Efe A. Ok, "Social Mobility and the Demand for Redistribution: The POUM Hypothesis," *Quarterly Journal of Economics* 116 (2001), 447-87. They examine the extent to which beliefs in the "prospect of upward mobility" (POUM) discourage massive expropriation and redistribution even with an extended franchise. This requires that a sufficient number of voters with less-than-median income (a fortiori, less-than-mean income) entertains beliefs about the attractiveness of their own future prospects and those of their progeny. They show that there exists a range of incomes below the mean that will oppose lasting redistribution if and only if tomorrow's expected income is a rising and concave function of today's income. (As well, voters cannot be too risk averse, for if they were they would desire the insurance provided by redistributive policies.)

[25] There are a few exceptions, e.g., Austen-Smith's contribution.

[26] Salvador Barbera and Matthew O. Jackson, "Choosing How to Choose: Self-stable Electoral Rules", *Quarterly Journal of Economics* 119 (2004), 1011-1048.

[27] Matthias Messner and Mattias K. Polborn , "Voting on Majority Rules", *Review of Economics Studies* 71 (2004), 115-132.

[28] Messner and Polborn, "Voting on Majority Rules," 131.

[29] Whereas Messner and Polborn focus on changes in the decisive voter under different majority requirements with regard to the age of the population, a related concern is addressed by Jehiel and Scotchmer who focus on changes in the composition of the citizenry due to immigration. In their set up individuals with heterogeneous preferences for a public good which is locally provided, and has no positive spillovers, form jurisdictions and establish rules under which immigrants may be admitted. A partition of the citizenry into jurisdictions is stable when, under the existing rules, no migrant who would be attracted to a jurisdiction is allowed to move under existing rules of exclusion. Philipe Jehiel and Suzanne Scotchmer, "Constitutional Rules of Exclusion in Jurisdiction Formation", *Review of Economic Studies* 68 (2001), 393-413.

[30] Philippe Aghion, Alberto Alesina, and Francesco Trebbi , "Endogenous Political Institutions", *Quarterly Journal of Economics* 119 (2004), 565-612.

[31] Arendt Lijphart, *Democracies: Patterns of Majoritarian and Consensus Government in Twenty-One Countries* (New Haven: Yale University Press, 1984)

[32] Roger Lagunoff, "A Theory of Constitutional Standards and Civil Liberties", *Review of Economic Studies* 68 (2001), 109-132.

[33] Eric Maskin and Jean Tirole "The Politician and the Judge: Accountability in Government", *American Economic Review* 94 (2004), 1034-1054.

[34] A related question, addressed by Shleifer, Glaeser and Johnson is whether law enforcement is best carried out by regulators or judges, challenging the view that enforcement of contracts by judges is always superior. In some areas such as insider trading, judges may be unwilling to bear prohibitive search costs of investigation. Appointed regulators, on the other hand, may be overzealous in their pursuit of wrongdoing; their immediate career concerns may override a concern for justice. Andrei Shleifer, Edward Glaeser and Simon Johnson, "Coase versus the Coasians", *Quarterly Journal of Economics* 116 (2001), 853-899.

[35] A politician for whom the value of office is high will always pander to the electorate in the first period and implement his ideal policy in the second period. Moreover, since such a politician always yields to populist pressures, his first period actions do not reveal his preferences. The desire by a politician to give in to populist pressures also reduces his incentive to collect costly information. Thus if a politician is not perfectly informed, though better informed than the public, then representative democracy becomes a less attractive option. We note however that these results rely upon a problematic assumption. In their model, the ability of the public to monitor the politician or the judge is equivalent. This seems unrealistic. Both politicians and judges will reveal their preferences through the actions they take, the politician through his legislative behaviour and the judge through his pronouncements; but it seems likely that in most circumstances the public is better able to screen politicians.

[36] Andrew F. Hanssen, "The Optimal Level of Judicial Independence", *American Economic Review* 94 (2004), 712-729.

[37] William M. Landes and Richard A. Posner, "The Independent Judiciary in an Interest Group Perspective", *Journal of Law and Economics* 18 (1975), 875-901

[38] As pointed out by Horn, legislative and administrative procedures that increase the cost of revisions in legislation also increase the value of any law from which interest groups might benefit. See Murray J. Horn, *The Political Economy of Public Administration* (Cambridge: Cambridge University Press, 1995).

[39] Jacques Cremer and Thomas R. Palfrey, "Federal Mandates by Popular Demand," *Journal of Political Economy* 108 (2000), 905-927.

[40] Wallace Oates, *Fiscal Federalism,* (New York: Harcourt-Brace, 1972).

[41] Barry Weingast, Kenneth Shepsle and Christopher Johnsen, "The Political Economy of Benefits and Costs: A Neoclassical Approach to Distributive Politics", *Journal of Political Economy* 89 (1981), 642-64.

[42] Bennedsen and Feldman analyse a similar model where a multimember legislature allocates a public good with differential benefits across districts. They compare the incentives of lobbyists to gather and disseminate information to a decentralised legislature like the US Congress to a centralised parliament with strong party cohesion. Morton Bennedsen and Sven Feldmann, "Lobbying Legislatures", *Journal of Political Economy* 110 (2002), 919-946.

[43] Ben Lockwood, "Distributive Politics and the Costs of Centralisation", *Review of Economic Studies* 69 (2002), 313-337.

[44] See for example John Ferejohn, "Incumbent Performance and Electoral Control", *Public Choice* 30 (1986) and, more recently, Timothy Besley and Anne Case, "Incumbent Behaviour: Vote-seeking, Tax-setting and Yardstick Competition", *American Economic Review* 85 (1995), 25-45.

[45] Francesco Caselli and Massimo Morelli, "Bad Politicians", *Journal of Public Economics* 88 (2004), 759-782.

[46] Ernesto Dal Bo and Rafael Di Tella "Capture by Threat,"*Journal of Political Economy* 111 (2003), 1123-1153.

[47] In a companion paper, Dal Bo and Di Tella focus on the trade-off which interest groups face when both bribes and threats are available to them: "Plato O Plomo: Bribes and Punishments in a Theory of Political Influence", *American Political Science Review* 100 (2006), 41-55. The theme of protecting politicians from interest groups is taken up by Torun Dewan and D. P. Myatt,

"Scandal, Protection and Recovery in the Cabinet", *American Political Science Review,* 101 (2007), 63-79.

[48] See Avinish Dixit, *The Making of Economic Policy: A Transactions-Costs Politics Perspective* (Cambridge, Massachusetts: MIT Press, 2000).

[49] The classic in this genre is William Niskanen, *Bureaucracy and Representative Government* (Chicago, Aldine, 1971).

[50] Daron Acemoglu and Thierry Verdier, "The Choice Between Market Failures and Corruption", *American Economic Review* 90 (2000), 194-211.

[51] In Prendergast's paper taken up below, such misreporting is due to the bureaucrat's incentive to hold on to her job.

[52] This effect is similar to that identified in the efficiency-wages literature. See Carl Shapiro and Joseph E. Stiglitz, "Equilibrium Unemployment as a Worker Discipline Device," *American Economic Review* (1984)

[53] Canice Prendergast, "The Limits of Bureaucratic Efficiency", *Journal of Political Economy* 111(2003), 929-958.

[54] This is not entirely home grown in economics. An important precursor is Timothy J. Feddersen, "A Voting Model Implying Duverger's Law and Positive Turnout," *American Journal of Political Science*, 36 (1992), 938-962.

[55] Ariel Rubinstein, "Perfect Equilibrium in a Bargaining Model," *Econometrica* 50 (1982), 97-109.

[56] One exception is Silbert's study of the impact of a committee structure on the incentive for policy-makers to follow inflationary policy. See Anne Silbert, "Monetary Policy Committees: Individual and Collective Reputations," *Review of Economic Studies* 70 (2003), 649-666.

[57] Crawford and Sobel, "Strategic Information Transmission".

[58] Thomas Gilligan and Keith Krehbiel, "Collective Decision-making and Standing Committees: An Informational Rationale for Restrictive Amendment Procedures," *Journal of Law, Economics and Organization* 3 (1987), 145-193.

[59] See for example, Timothy Feddersen and Wolfgang Pesendorfer. "The Swing Voter's Curse," *American Economic Review* 86 (1996), 408-24

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[60] Earlier efforts to model communication by political scientists appear in the literature. For example, see Richard McKelvey and Peter Ordeshook, Elections with Limited Information: A Fulfilled Expectations Model Using Contemporaneous Poll and Endorsement Data as Information Sources, *Journal of Economic Theory* 36 (1985), 55-85.