

8493 Advanced Political Economics

Fall 2009

Vincenzo Galasso

Goals:

The goal of this course is to discuss current topics in political economics. This means to study the formation of economic policy from a positive, rather than a normative, perspective. Thus, the course will address questions such as: what are the political and institutional determinants of fiscal policy and macroeconomic policy in modern democracies? Which features of political institutions are more likely to foster economic development? Why are seemingly inefficient public policies preserved over time, and what can be done to overcome opposition to reform? We will also discuss issues related to the development of institutions and how cultural factors affect policy making and institutions.

The course will thus train students to understand how policy decisions are made, and how they can be improved. This will prove helpful in the analysis and forecast of policy decisions, by market analysts or by professionals working in government or international organizations.

Course outline:

The course will start with a discussion of how political decisions are taken and how institutions shape these decisions. Some basic “tools” of political economics are introduced. We then focus on political determinants of policy choices in modern democracies. Thus, we ask how electoral competition shapes redistributive programs, such as the European welfare states and structural reforms. We discuss the conflict of interest between opportunistic politicians and the general public, and among successive politicians. We ask how these conflicts shapes dynamic public policies. The next part of the course will address the relevance of institutions, democratization and culture for economic growth and development. Finally, we turn to the analysis of the individuals behind these institutions, the politicians, to discuss their career concerns and the political selection process.

Exam (only written exams):

- midterm exam: 15 points out of 30
- final exam: 15 points out of 30

Problem sets: 2 points (i.e., extra), but only if the exam is held by the end of March 2010

Office Hours

- Vincenzo Galasso on Wednesday 8.30-10 am at via Roentgen 5th floor, room C1 – 12
- Annaig Morin by appointment. Please, write to annaig.morin@phd.unibocconi.it

Readings and Course Outline

Textbook:

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

Useful problem sets for the course are solved and discussed in the *Workbook to Accompany Political Economics – Explaining Economic Policy*, by Brocas, Castanheira, Razin and Stromberg, MIT Press 2000

Other recent general surveys of the literature are:

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

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

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

*Required readings are denoted with a **

1. Introduction

* General Introduction : PT, Ch. 1

J. Buchanan and R. Musgrave (1999), *Public Finance and Public Choice - Two Controversial Visions of the State*, MIT Press

2. Political Decisions: Elections, Bargaining and Lobbying

* PT, Ch. 2 & 3

Ordeshook, “Game Theory and Political Theory”, Cambridge University Press 1986. ch.2, 4, 6

Lindbeck, A., and J. W. Weibull (1987) “Balanced-Budget Redistribution as the Outcome of Political Competition”, *Public Choice*.

* Stromberg, D. (2009) “How the Electoral College Influences Campaigns and Policy: The Probability of Being Florida” *American Economic Review*.

Shepsle, K. (1979) “Institutional Arrangements and Equilibrium in Multidimensional Voting Models”, *American Journal of Political Science*.

* Baron, D., and J. Ferejohn (1989) “Bargaining in Legislature”, *American Political Science Review*.

* Austen-Smith, David and Michael Wallerstein. (2006). Redistribution and affirmative action. *Journal of Public Economics*. 90(10-11): 1789-1823

Becker, G. (1983) “A Theory of Competition among Pressure Groups for Political Influence”, *The Quarterly Journal of Economics*.

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

Olson, M. (1965) “The logic of collective action” Cambridge: Harvard University Press.

3. Redistributive Policies: Cleavage on Income and Age, and Dynamics Aspects

* PT, Ch. 6

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

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

Krusell, P., and J.V. Rios Rull (1999), "On the Size of the US Government: Political Economy in the Neoclassical Growth Model", *American Economic Review*, 89, 1156-1181.

Lindert, P. (1996), "What Limits Social Spending?" *Explorations in Economic History*, 33, 1-34.

* Galasso, V. and P. Profeta (2002), "The political economy of social security: A survey", *European Journal of Political Economy*, 18, 1-29.

Boldrin, M. and A. Rustichini (2000) "Equilibrium with Social Security", *Review of Economic Dynamics*, 3, 41-78.

* Boeri, Boersch-Supan, and Tabellini (2001), "Would you like to shrink the welfare state? A survey of European Citizens", *Economic Policy* 16: 7-50.

Cooley T.F., and J. Soares, (1999) "A positive theory of social security based on reputation" *Journal of Political Economy*, 107, 373-388.

Casey B. Mulligan & Ricard Gil & Xavier Sala-i-Martin, 2002. "Social Security and Democracy," NBER Working Papers 8958, National Bureau of Economic Research, Inc.

Galasso, V. (2006) "The Political Future of Social Security in Aging Societies", *The MIT Press*.

Benabou, Roland and Efe Ok, 2001, "Social Mobility and the Demand for Redistribution," *Quarterly Journal of Economics*. 116, 447-487.

Alesina, Alberto and George-Marios Angeletos, 2005, "Fairness and Redistribution: US versus Europe," *American Economic Review*, 95(4), 960-980.

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

* J.I. Conde Ruiz and V. Galasso (2003) "Early Retirement", *Review of Economic Dynamics*, 6, 12-36.

J.I. Conde Ruiz and V. Galasso (2003) "Macroeconomics of Early Retirement", *Journal of Public Economics*, 88, 1849-1869.

Hassler, J., Rodriguez Mora, J.V., Storesletten, K., and Zilibotti, F. (2003), "The Survival of the Welfare State", *American Economic Review*, 93, 87-112.

4. The Political Economy of Structural Reforms

* T. Boeri., J.I. Conde Ruiz and V. Galasso (2008) “The Political Economy of Flexicurity”,

Blanchard, O. and Tirole (2004) “The design of unemployment insurance and employment protection” MIT Department of Economics Working Paper No. 04-15. available at <http://ssrn.com/abstract=527882>

Saint Paul, G. (1996) “Exploring the Political Economy of Labor Market Institutions”, *Economic Policy*, 23, 265-315.

Saint Paul, G. (2000) “The Political Economy of Labor Market Institutions” Oxford University Press.

J. Hoj, TT Dang, V. Galasso, and G. Nicoletti (2006) “The Political Economy Of Structural Reform: Empirical Evidence From Oecd Countries”, OECD Eco Working Paper.

* O. Blanchard, and F. Giavazzi. (2003) "The Macroeconomic Effects of Labor and Product Market Deregulation. *Quarterly Journal of Economics*, 118-3 (August), 879-909.

F. Caselli and N. Gennaioli (2009) “Economics and Politics of Alternative Institutional Reforms” *Quarterly Journal of Economics*

S. Carrillo, M. Castanheira, V. Galasso, G. Nicoletti, E. Perotti and L. Tsyganok (2006) “How to gain Political Support for Reforms in "Structural Reforms without Prejudices" edited by T. Boeri, M. Castanheira, R. Faini and V. Galasso, Oxford University Press

Fernandez and Rodrik, Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty, *American Economic Review*, 1991

Alesina, A., S. Ardagna and V. Galasso (2009) “The Euro and Structural Reforms,” in A. Alesina and F Giavazzi (eds.) *Europe and the Euro*, University of Chicago Press and NBER

5. Dynamic Policies: Credibility, Delegation, Reputation and Public Debt

* PT Ch. 12 (up to section 12.2.3 included) , 13

Lucas, R. E., (1986), “Principle of Monetary and Fiscal Policy”, *Journal of Monetary Economics*, vol. 17.

* Chari, V.V., and P. Kehoe (1990) “Sustainable Plans”, *Journal of Political Economy*

Fischer, S. (1980) “Dynamic Inconsistency, Cooperation, and the Benevolent Dissembling Government”, *Journal of Economic Dynamics and Control*.

Kotlikoff, L.J., Persson, T., and Svensson, L.E.O. (1988) “Social Contract as Assets: A Possible Solution to the Time-Consistency Problem.” *American Economic Review*.

* Alesina, A., and G. Tabellini (1996) “A Positive Theory of Budget Deficits and Public Debt”, *Review of Economic Studies*.

Calvo, G. (1988) "Servicing the Public Debt: the Role of Expectations" *American Economic Review*.

Grilli, V., D. Masciandaro, and G. Tabellini (1991) "Political and Monetary Institutions and Public Financial Policies in the Industrial Countries" *Economic Policy*.

6. Growth, Economic Policies and Institutions

PT (2000), Ch 14.

Alesina, A., and D. Rodrik (1994) "Distributive Politics and Economic Growth", *Quarterly Journal of Economics*

Perotti, R. (1996) "Growth, Income Distribution and Democracy: What the Data Say", *Journal of Economic Growth*.

Krusell, P., V. Quadrini, and J.V Rios-Rull (1997), "Politico-Economic Equilibrium and Economic Growth", *Journal of Economic Dynamics and Control*.

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

* Banhabib, J., and A. Rustichini (1996) "Social Conflict and Growth", *Journal of Economic Growth*.

Benabou, R., (2005) "Inequality, Technology, and the Social Contract", *Handbook of Economic Growth*, P. Aghion and S. Durlauf, eds., North-Holland.

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

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

* Acemoglu, D. and J. Robinson (2006) "Economic Backwardness in Political Perspective" *American Political Science Review*

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

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

* Acemoglu, D. and J. Robinson (2001) "A Theory of Political Transition" *American Economic Review*, 91: 938-963.

Acemoglu, D. and J. Robinson (2000) "Why did the west extend the franchise? Growth, Inequality and Democracy in Historical Perspective" *Quarterly Journal of Economics*, 115: 1167-1199.

Lizzeri, A. and N. Persico (2004) “Why did the elites extend the suffrage? Democracy and the scope of the government” *Quarterly Journal of Economics*, 119: 707-765.

Glaeser, Edward L., Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 2004, “Do Institutions Cause Growth?” *Journal of Economic Growth*, 9(3), 271-303.

Glaeser, Edward L., Giacomo Ponzetto and Andrei Shleifer, 2007, “Why Does Democracy Need Education?” *Journal of Economic Growth*, 12, 77-99.

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

* G. Tabellini, (2005) The role of the state in economic development, *Kyklos*

7. The role of politicians: Agency, Career Concerns and Selection

* PT, Chp 4 (sections 4.1-4.2, section 4.4.1, section 4.5-4.6) ; Chp 9

Persson, Tabellini and Trebbi (2003), “Electoral rules and Corruption”, *Journal of the European Economic Association*, vol.1(4):958-989

Besley, T. (2006), *Principled Agents? The Political Economy of Good Government*, Oxford UP

* Besley, T. (2005), “Political Selection,” *Journal of Economic Perspectives*, 19(3), 43-60.

Merlo A. (2007) “Whither Political Economy? Theories, Facts and Issues”, in R. Blundell, W. Newey and T. Persson (eds.), *Advances in Economics and Econometrics, Theory and Applications: Ninth World Congress of the Econometric Society*, Cambridge: Cambridge University Press.

Diermeier, D., Keane, M., Merlo, A., 2005. A Political Economy Model of Congressional Careers. *American Economic Review* 95, 347–373.

Galasso, V., Nannicini, T., 2009. Competing on Good Politicians, CEPR WP 7363.

Jones, B., Olken, B., 2005. Do Leaders Matter? National Leadership and Growth Since World War II. *Quarterly Journal of Economics* 120(3), 835–864.

Merlo, A., V. Galasso., M. Landi and A. Mattozzi, 2009, The Labor Market of Italian Politicians, Second Version, PIER Working Paper No. 09-024