

Part IIB Paper Outlines

Part IIB Paper 5 Political Economics

Paper Co-ordinator: Dr TS Aidt tsa23@cam.ac.uk

Paper content

Political economics examines how societies, composed of individuals with conflicting interests, desires and objectives, make policy choices and how these choices are shaped by economic and institutional constraints. It also studies how institutions emerge to structure decision making and to suppress violent conflict. In contrast to standard welfare economics which deals with the normative question of how a society should make optimal policy choices, political economics deals with the positive questions of how such decisions are actually made and why.

Political economics draws on insights from economics, political sciences, economic history and other social sciences to answer these questions and applies models of rational decision making to politics. Economic policy and outcomes vary enormously across time and space and the overarching question that political economics answers is *why*. In the process, we will consider issues like the capacity of elections to ensure that the will of the people is taken into account; whether lobbying by big firms and corporations is necessarily bad; whether democracy inevitable leads to large government and lots of redistribution; and why governments invest in state capacity.

The paper is divided in four sub-courses (as detailed below). Each sub-course will cover four or five topics and be built around a “**theory and evidence**” template. That is, for each topic one lecture roughly discusses the underlying theory with emphasis on intuition and ideas and one will be devoted to empirical applications and testing.

Aims

The aim of the paper is to teach students how to apply theoretical and empirical economic analysis to politics and public choice and in that way to give them the tools and insights they need to understand the relationship between political decision making processes and outcomes and the role and origins of institutions.

Objectives

Students should acquire knowledge of the workhorse models of political economics and be able to apply them to think about and critically analyse real world policy questions. They should be familiar with the empirical and practical relevance of the approaches.

Lecture Courses

Voting and elections (Dr TS Aidt, 10 lectures, weeks 1-4, Michaelmas Term; 3 lectures in weeks 1 and 2)

Elections play important roles in democratic societies. They aggregate conflicting preferences, information, and resolve conflicts of interests between elected representatives and their voters. This course discusses these roles and develops theoretical frameworks that enhance understanding of decision making in a (representative) democracy. The focus is on general-interest politics related to

the overall size of government, public goods, redistribution, and the composition of spending on public services and on the choice of tax bases.

Topic 1 (3 lectures): Preference aggregation and voting. This covers the choice of majority rule and the median voter model and its limitations. Empirical applications to franchise extension and to eliciting median voter preferences from survey data.

Topic 2 (2 lectures): Voting and complex policy issues. This covers the probabilistic voting model. The empirical application focuses on comparative politics models related to the effect of election systems on the public finances.

Topic 3 (3 lectures): Elections, accountability and selection. This covers political agency models. The emphasis is on the accountability and selection roles of elections. Empirical applications to term limits and direct democracy and to tests for political budget cycles.

Topic 4 (2 lectures): Foreign influence on elections. This covers models of foreign influence on elections in other countries and on evidence for foreign influence in the 2016 US presidential election and the 2016 EU referendum in the UK.

Political frictions (Dr V Kotsidis, 8 lectures, weeks 5-8, Michaelmas Term)

This course focusses on various political frictions that influence policy choices in democracies.

Topic 1 (2 lectures): Different election rules. This includes discussion of rules other than the majority rule commonly used to make collective decisions, including scoring rules.

Topic 2 (2 lectures): Common pool resources. This examines the common pool problem and the Law of 1/N.

Topic 3 (2 lectures): Bargaining and coalitions. This examines legislative bargaining, agenda setting power and coalition for formation processes.

Topic 4 (2 lectures): Experts and politicians. How can politicians trust experts? Should scientific evidence be the basis for policy?

Special-interest politics (Dr TS Aidt, 8 lectures, weeks 1-4, Lent Term)

This course examines the influence of special-interest groups on public policy. Special-interest or lobby groups are considered to mostly influence secondary policy issues, such as trade and environmental policy. Special interest groups can do so through a variety of channels, such as providing useful information to policy makers, providing campaign finance to political parties, or offering outright bribes to politicians or bureaucrats. The fundamental question addressed in this lecture course is how lobby groups influence public choices and what the positive and normative consequences of this may be.

Topic 1 (4 lectures): Lobbying for special favours. This introduces Olson's theory of collective action, revolving doors politics, informational lobbying and the common agency model of

special-interest politics. The applications will be to trade or environmental policy, including empirical testing of the “protection for sale” model.

Topic 2 (2 lectures): Rent seeking. This examines the social cost of rent seeking, contest theory, and rent dissipation. The empirical application draws on cases studies and evaluates attempts to quantify the rent seeking cost.

Topic 3 (2 lectures): Corruption. This introduces competing theories of corruption. Empirical applications draw on field experiments and cross country regression-based evidence on the consequences of corruption.

Institutions (Dr TS Aidt, 8 lectures, weeks 5-8, Lent Term)

This lecture course engages with the origins of the institutions that govern public decision making. In the two other lecture courses these were taken as given. The institutions in focus are those which protect property rights or allocate political rights to participate in public policy making and the question is: where do they come from?

Topic 1 (4 lectures): Economic theories of democratization. This engages with the transition from non-democracy to democracy. We cover the threat of revolution theory as well as alternative theories based on voluntary exchange of political power. The empirical application studies the causal drivers of suffrage reform in a historical perspective.

Topic 2 (2 lectures): Development, inequality and democracy. This engages with the long-standing debate amongst political scientists and economists about the link between democracy, inequality and economic development. Part of the debate is about the causal link between income growth (development) and democracy, part of it is about critical junctures in history, and part of the debate is about the role of inequality in the nexus. Empirical evidence will come from panel studies of contemporaneous and historical data aimed at establishing what is causing what.

Topic 3 (2 lectures): State capacity. This engages with the evolution of fiscal state capacity, i.e., the capacity to raise taxes and to provide public goods. Empirical evidence will come from historical analysis of the public finances of European states from 1600 to the present.

Preliminary reading

The paper will not be based on one textbook. It will draw on different books, journal articles and lecture notes. The main books are:

- Persson, Torsten and Guido Tabellini, 2000. *Political Economics: Explaining Economic Policy*. MIT Press.
- Besley, Tim 2006. *Principled Agents? The Political Economy of Good Government*. Oxford University Press.
- Mueller, Dennis, 2003. *Public Choice III*. Cambridge University Press.

- Besley, Tim and Torsten Persson, 2011. *Pillars of Prosperity*. Princeton University Press.
- Acemoglu, Daron and James Robinson, 2006. *Economic origins of dictatorship and democracy*. Cambridge University Press.
- Acemoglu, Daron, and James Robinson, 2012. *Why nations fail: The origins of power, prosperity, and poverty*. Profile Books.

Each lecturer will provide a detailed reading list for the relevant courses.

Supervision

Supervisions are arranged by Director of Studies in cooperation with the paper coordinator. A teaching assistant will be appointed to offer four of the eight supervisions. The eight supervision assignments will be available from the paper Moodle site.

The supervision assignments will be based around open-ended and structured essays.

Examination

The examination paper consists of 8 questions. The students are asked to answer 4 of these. The questions will be open-ended and structured essays similar in style to those in Public Economics (Paper 7) and Development Economics (Paper 8).