

Part IIB Paper Outlines

Part IIB Paper 5 Political Economics

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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.

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 will discuss the underlying theory with emphasis on intuition and ideas rather than of formalism 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, the role and origins of institutions, and the relationship between resource endowments, governance and conflict.

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; 4 lectures in week 1)

Elections play important roles in democratic societies. They aggregate conflicting preferences, information, and resolving 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 (2 lectures): The political economy of redistribution. This covers the politics of redistribution including Becker's theory of politically efficient redistribution. The theory will be applied to test predictions related to tax efficiency and the size of government.

Topic 4 (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.

Special-interest politics (Dr TS Aidt, 8 lectures, weeks 5-8, Michaelmas 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 (2 lectures): Common pool resources. This examines a particular aspect of special-interest group politics related to the common pool problem and legislative bargaining. The application will be to tests of the law of $1/N$ and to tests of agenda setter power.

Topic 2 (2 lectures): Lobbying for special favours. This introduces Olson's theory of collective action, revolving doors politics, 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 3 (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 4 (2 lectures): Corruption. This introduces the grabbing and helping hand 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 1-4, 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 (2 lectures): The natural state. How did human societies managed to transit from the “natural state” with high levels of violence to systems that instilled a measure of social order? We focus on the basic institutions related to property and collective decision making and draw on constitutional political economy and game theory to provide answers.

Topic 2 (2 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 3 (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 4 (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.

The political economy of resources and conflict (Dr P Krishnan, 8 lectures, weeks 5-8, Lent Term)

This course examines the relationship between resources, governance and conflict. There is now an emerging literature in Development Economics and Political Economy that focuses on the role of resources in affecting governance and conflict. Each set of two lectures will offer a theoretical conceptualisation of the issue, followed by the relevant empirical evidence.

Topic 1 (2 lectures) A Measure of Conflict Potential: The concept of Polarisation. There are good reasons for caring about the distribution of income or about ethnic diversity. Inequality in these dimensions alters relative preferences over income redistribution and/or public goods, potentially causing conflict. Different measures will be contrasted (inequality, fractionalisation and polarisation), to understand what might be appropriate in various circumstances, with empirical evidence.

Topic 2 (2 lectures) Conflict, economic shocks and economic performance. Does poor economic performance cause violent civil conflict? Empirical work suggests this is the case. We examine the relationship between political institutions, resource rents, aid and other economic shocks and conflict.

Topic 3 (2 lectures) Conflict, resources and institutions. While there is a purely economic explanation for the resource curse, Dutch disease, it has become evident that the key issues are political. The interplay is potentially in both directions: politics can affect the exploitation

of natural assets, and natural assets can affect politics and institutions. We examine models of both the unconditional and conditional resource curse (conditional on institutions) and the empirical evidence for the conditional resource curse.

Topic 4 (2 lectures) Institutional reforms and the persistence of conflict. While there is mounting evidence for a conditional resource curse, there is much less known about which institutions matter. This is vital for understanding the persistence of conflict and improving post-conflict outcomes. We examine the evidence on both legal and political reforms in affecting the path of recovery post conflict.

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.
- North, Wallis and Weingast, 2009. *Violence and Social Order*. 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.
- Collier, Paul, 2009. *Wars, Guns and Votes: Democracy in Dangerous Places*. Random House.

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 lecturers guarantee the remaining four supervisions for up till 20 students. The eight supervision assignments will be available from the paper web-page.

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. A sample exam paper will be made available. The questions will be open-ended and structured essays similar in style to those in Public Economics (Paper 7) and Development Economics (Paper 8).