

THE POLITICAL ECONOMY OF PUBLIC POLICY (EC260)

Course duration: 54 hours lecture and class time (Over three weeks)

LSE Teaching Department: Department of Economics

Lead Faculty: Prof Torun Dewan and Dr Valentino Larcinese

Pre-requisites: Introductory Microeconomics, basic knowledge of calculus and statistics

Course Description:

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

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

The course is organized around 12 lectures (3 hours each). Each lecture will cover a topic and classes (90 minutes each) will then be devoted to solve problems and discuss specific questions related to that topic. Problems and questions on each topic will be distributed during the first lecture.

Assessment:

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

Reading

Main Textbooks:

- Kenneth A Shepsle *Analyzing Politics* London: W.W. Norton (2010)

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

For some topics we will use selected parts of

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

Useful books for beginners:

- P. Dunleavy *Democracy, Bureaucracy and Public Choice* (Hemel Hempstead: Harvester-Wheatsheaf, 1991).
(Useful for some topics on elections, parties, interest groups and bureaucracies).
- P. A. McNutt *The Economics of Public Choice*, Second Edition, Aldershot, Edward , Elgar, 2002.
(Okay for selected topics, but not comprehensive for this course)

2

A stimulating read, definitely recommended:

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

Advanced textbooks:

These two books are harder but some might enjoy:

- Allan Drazen *Political Economy in Macroeconomics* (Princeton, 2000)
- Torsten Persson *Political Economics: Explaining Economic Policy*, & Guido Tabellini, MIT Press (2000).

Classic Books:

- Downs, *An Economic Theory of Democracy* (New York: Harper and Row, 1957).
- M. Olson, *The Logic of Collective Action* (Cambridge, Mass: Harvard Univ Press, 1965).
- W. Niskanen, *Bureaucracy and Representative Government* (Chicago: Aldine-Atherton, 1971), now republished as *Bureaucracy and Public Economics* (Edward Elgar, 1995)

Journals:

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

In the following, readings marked * are compulsory, other readings are just suggestions.

Syllabus and Reading List

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

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

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

2. Public goods and the collective action problem

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

- Mueller- Ch. 2
- *Shepsle & Bonchek- Chs. 8, pp 237-250 and pp 260-277
- *M. Olson - *The Logic of Collective Action*, pp. 1-16.
- K. Dowding - *Power* (Buckingham, Open University Press, 1996) ch. 2.

3. Elections and public policy. Majority rule

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

- *Mueller - Ch. 11.1 and 11.3
- * Shepsle & Bonchek - Ch. 5 (pp 85-115 only)
- Persson & Tabellini - Ch. 3

4. The political economy of inequality and redistribution. Welfare spending and the size of the public sector

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

- *V.Larcinese - Voting over redistribution and the size of the welfare state: the role of turnout. *Political Studies*, 55, 568-585. 2007
- V.Larcinese - Electoral Competition and Redistribution with Rationally Informed Voters, *Contributions to Economic Analysis and Policy*, vol. 4 issue 1. 2005
- OECD (2011).- *Divided We Stand. Why Inequality Keeps Rising*. Paris: OECD, pp.21-43
- Persson & Tabellini - Ch. 6.
- A. Meltzer - A rational theory of the size of government, *Journal of* & S. Richards *Political Economy*, 89, 914-927, 1981
- Husted, T.A &, The Effect of the Expansion of the Voting Franchise and
- L.W. Kenny: the Size of Government, *Journal of Political Economy*, 105, 54-82, 1997.
- P. Lindert- What limits social spending?, *Explorations in Economic History*, 33, 1-34, 1996
- R. Perotti- Income distribution and investment, *European Economic Review*, 38, 827-835, 1994.

5. Political Agency (1): The Economic Theory of Electoral Accountability Institutions and Political Accountability

4

Government performance depends on the quality of elected officials and the actions they take. We look at the role of elections with regard to performance and accountability.

- Baro, R (1973) 'The Control of Politicians: An Economic Model' , *Public Choice* 14, 19-42
- Besley, T (2007) Principled Agents; The Political Economy of Good Governance, Chapter1
- Besley, T (2004) 'Paying Politicians: Theory and Evidence', *Journal of European Economic Association*, 2, 2-3,193--215
- Besley, T. and Case, E (1995) 'Incumbent behaviour: vote-seeking, tax-setting, and yardstick competition', *American Economic Review*, 85
- Ferejohn, J (1986) 'Incumbent Performance and Electoral Control', *Public Choice*, 50, 5-25
- Ferraz, C and F. Finan (2009) "Electoral Accountability and Corruption: Evidence from the Audits of Local Governments", NBER working paper 14937
- Galasso, V and Nannicini T (2011) "Competing on Good Politicians", *American Political Science Review*, 105,1
- Maskin and Tirole 'The Politician and the Judge', *American Economic Review*, 94,4

6. Organisation of Legislatures and Legislative Procedures

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

- Mueller- p104-123 p278-295
- Shepsle and Bonchek - Ch 12,14
- Diermeier, D (2006): 'Coalition Governments', in the *Oxford Handbook of Political Economy*.
- Baron, D and Ferejohn, J (1987) 'Bargaining in Legislatures', *American Political Science Review*, vol 83.
- Diermeier, D. and Feddersen, T (1998): 'Cohesion in Legislatures and the Vote of Confidence Procedure', *American Political Science Review*, 92, 856--869
- Diermeier, D. and Merlo, A. (2004): "An Empirical Investigation of Bargaining Procedures," *Journal of Public Economics*, 88 (3)
- Crombez, C., T. Groseclose and K. Krehbiel (2006): *Journal of Politics*, 68(2)
- Romer, T., and H. Rosenthal (1978): "Political Resource Allocation, Controlled Agendas, and the Status Quo," *Public Choice*, 33(4), 27--43
- Weingast, B and Marshall, W 'The Industrial Organization of Congress. Or why legislatures like firms are are not organized as markets', *Journal of Political Economy*, 96 (2) 1988 pp. 132-63
- Krehbiel, K *Information and Legislative Organization* Michigan 1991
- Shepsle, K (2003) Losers in Politics (and how they sometimes become winners): William Riker's Heresthetic, *Perspectives on Politics*, Vol 1, No 2, 307-315

5

7. Interest Groups

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

- *Mueller- Ch. 15
- Caselli F and Morelli. M (2004) 'Bad Politicians', *Journal of Public Economics*, 88, 3-4
- Dal Bo, E. (2007) 'Bribing Voters', *American Journal of Political Science*, 51, 4
- Dal Bo.E , Dal Bo.P, and Di Tella, R (2007), 'Plato O Plomo, Bribe and Punishment in a Theory of Political Influence', *American Political Science Review*, 100,1, 41-55
- Dal Bo, E and Di Tella, R (2003) 'Capture by Threat', *Journal of Political Economy*, 111(5): 1123-1154.
- Dewan, T and Myatt, D (2007) 'Scandal, Protection and Recovery in Political Cabinets', *American Political Science Review*,
- Groseclose, T and Snyder, J (1996) 'Buying Supermajorities', *American Political Science Review*, 90, 303-15

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

8. Political Leadership

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

- Alquist, J and Levi, M (2011) 'Leadership: What it means, what it does, and what we know about it', *Annual Review of Political Science*.
- Shepsle and Bonchek, chapter 14
- Jones, B and Olken, B (2005) 'Do Leaders matter? National Leadership and Growth since World War 2', *Quarterly Journal of Economics*, 120, 3, 835--864
- Dewan, T and Myatt, David (2008) 'The Qualities of Leadership: Direction, Communication, and Obfuscation', *American Political Science Review*, forthcoming, available from
- Canes-Wrone B, Herron, M and Shotts, K (2001) 'Leadership and Pandering: A Theory of Executive Policy-making', *American Journal of Political Science*, 45, 3, 532--550
- Humphreys, M., Masters, M and Sandhu, M (2006): 'The Role of Leadership in Democratic Deliberations: Results from a Field Experiment in São Tomé and Príncipe', *World Politics*, forthcoming
- Myerson, R (2004): 'Justice, Institutions, and Multiple Equilibria', *Chicago Journal of International Law*, 5(1), 91--107.
- Wantchekon, L. (2003): 'Clientelism and Voting Behavior: Evidence from a Field Experiment in Benin', *World Politics*, 55

6

9. The Origins and Effects of Political Institutions

What are the political implications of different constitutional forms? Does Democracy always lead to better policy outcomes? Is equality of representation an illusory goal? What are the redistributive implications of Democracy and Oligarchy?

- Acemoglu, D and Robinson, J (2006) 'The Economic Origins of Dictatorship and Democracy', *Cambridge University Press*
- Acemoglu, D and Robinson, J (2001) 'Why did the West Extend the Franchise: Distribution and growth in Comparative Perspective', *Quarterly Journal of Economics*, 115 (4), 1167-1199
- Acemoglu, D and Robinson, J (2000) 'A Theory of Political Transitions', *American Economic Review*, 91, pp 938-963
- Berlinski, S and T. Dewan (2010): Did the Extension of the Franchise Increase the Liberal Vote in Victorian Britain? Evidence from the Second Reform Act, available from my homepage

- Dal Bo E, Dal Bo, P. and Snyder, J (2006) 'Political Dynasties', *Review of Economic Studies*, 76,1
- Dewan, T and Myatt, D (2007) 'Leading the Party: Coordination, Direction and Communication', *American Political Science Review*, 101, 4
- Baland, Jean-Marie, and James A. Robinson. 2008: Land and Power: Theory and Evidence from Chile. *American Economic Review* , 98(5), 1737–65
- Gagliarduci, S and D. Passerman (2010): Gender Interactions within Hierarchies: Evidence from the Political Arenas, NBER working paper
- Husted, T., and L. Kenny (1997): The Effect of the Expansion of the Voting Franchise on the Size of Government, *Journal of Political Economy*, 105, 54{83.
- Lizzeri, L. and N. Persico (2004): Why did the West Extend the Franchise? Democracy and the Scope of Government with an Application to Britain's Age of Reform, *Quarterly Journal of Economics*, 119,2,705-63
- Maskin, E and Tirole, J (2004) 'The Politician and the Judge: Accountability in Government' , *American Economic Review*, 94,4, 1034-105

10. Political Agency (2)

What motivates political agents? What type of incentives are effective at securing quality service provision? How does the relationship between the legislature and the bureaucratic administration affect policy outcomes? In this session we take a further look at principal –agent analysis of policy making

7

- Mueller - Ch 17
- Shepsle and Bonchek - Ch 13
- Berlinski S, Dewan T and Dowding K(2008) The Impact of Individual and Collective Performance on Tenure, *Journal of Politics*, 72,2
- Besley T. and Ghatak M. Competition and Incentives with Motivated Agents. (2005) *American Economic Review* 95,3,616–36.
- T. Dewan and Myatt D (2010) 'The Declining Talent Pool of Government', *American Journal of Political Science*, 54,2
- D. Epstein and S O'Halloran. (1994) 'Administrative Procedures, Information, and Agency Discretion: Slack vs. Flexibility'. *American Journal of Political Science*, 38, 697–722
- S. Gailmard and Patty J (2007) 'Zealots and Slackers: Civil Service, Policy Discretion, and Policy E

11. Information, mass media and public policy

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

- *Stefano DellaVigna & Persuasion: Empirical Evidence, NBER working paper 15298

Matthew Gentzkow

- Larcinese: The Channeled Italian Voters, in F. Padovano & R. Ricciuti (eds) "Italian Institutional Reforms", Springer 2008
- Della Vigna, S. and E. Kaplan (2007): The Fox News Effect: Media Bias and Voting, *Quarterly Journal of Economics*, 122: 1187-1234.
- Stromberg, D. (2004): Radio's Impact on New Deal Spending, *Quarterly Journal of Economics* 119: 189-221.
- *Larcinese, V., R. Puglisi, J. Snyder (2007): Partisan Bias in Economic News: Evidence on the Agenda Setting Behavior of US Newspapers, *Journal of Public Economics* 2011
- Groseclose T. and J. Milyo (2005): A Measure of Media Bias, *Quarterly Journal of Economics*, 120, 1191-1237
- Gentzkow, M. (2006): Television and Voter Turnout, *Quarterly Journal of Economics*, 121.
- V. Larcinese [Does Political Knowledge Increase Turnout? Evidence from the 1997 British General Election](#), *Public Choice*, 131, 387-411.

12 Electoral rules and policy outcomes

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

- *Persson & Tabellini: *The Economic Effects of Constitutions* (selected parts), MIT Press, 2003
- Mueller - Ch. 13
- Persson & Tabellini, - Ch. 10
- Lijphart - *Patterns of Democracy*, Yale University Press, 1999, Chs. 1, 8

Credit Transfer: If you are hoping to earn credit by taking this course, please ensure that you confirm it is eligible for credit transfer well in advance of the start date. Please discuss this directly with your home institution or Study Abroad Advisor.

As a guide, our LSE Summer School courses are typically eligible for three credits within the US system and 7.5 ECTS in Europe. Different institutions and countries can, and will, vary. You will receive a digital transcript and a printed certificate following your successful completion of the course in order to make arrangements for transfer of credit.

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