

# Course on **Politics and Economics: Theory and Applications**

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## Course description

The aim of this course is to provide an introduction to the field of political economics and to discuss some current topics in the field. The relationship between economics and politics is complex and we are interested in how political institutions affect economic outcomes (e.g. GDP, public spending) and how economic forces (e.g. income distribution, globalization) influence political institutions. In the first part of the course (classes 1 and 2), we will cover the main tools used by economists and political scientists to analyze the politics of economic policymaking (e.g. median voter, lobbying models). In the second part of the course (classes 3-5), we will look at three applications: the political economy of fiscal federalism, the political economy of trade policy and the political economy of growth.

The course is open to graduate students in the Economics and Political Science Departments. The approach of the course is to cover few topics but in depth. We will generally focus on one or two papers or book chapters in each class and discuss the model and the derivation of key results.

## References

The main textbook for the first part of the course is

- Persson and Tabellini (2000) *Political Economics: Explaining Economic Policy*, MIT Press, Cambridge. (PT)

Other useful general references:

- Drazen (2000) *Political Economy in Macroeconomics*, Princeton University Press.
- Grossman and Helpman (2001) *Special Interest Politics*, MIT Press, Cambridge.

- Besley (2005) *Principled Agents? The Political Economy of Good Government*, Oxford University Press.

## Prerequisites and requirements

A basic understanding of key solution concepts in game theory (e.g. Nash equilibrium, subgame perfect equilibrium) and a working knowledge of optimization theory are necessary. Any advanced microeconomics textbook provides an overview of game theory (e.g. Varian, *Microeconomic Analysis*, third edition, Norton & Company, New York, Chapter 15). A good background of optimization theory is Chang, *Fundamental Methods of Mathematical Economics* (third edition), McGraw-Hill, London. For a more advanced treatment, see Sunduram, *A First Course in Optimization Theory*, Cambridge University Press.

The course requirement consists in a final take-home exam. An informal requirement is class participation: sharing your questions and comments with the rest of the class. If there is enough interest, an additional requirement will be students' presentation of a paper from the reading list of part 2. We will discuss this possibility in the first class.

## Class schedule

There will be five classes. We shall meet each Tuesday from 11 to 13 in Villa San Paolo, Room 1, starting from 9 October 2007.

## Part 1: General tools

*weeks 1 and 2*

*Week 1*

Preferences and institutions, Median voter equilibria, Probabilistic voting, Agency models.

*Required readings:*

- PT, chapters 2, 3 and 4.

*Week 2*

Partisan politicians, Endogenous candidates, Legislative bargaining, Lobbying.

*Required readings:*

- PT, chapters 5, 6 and 7.

*Additional readings:*

- Grossman and Helpman (2001). Chapter 7, 8.

## Part 2: Applications

*weeks 3, 4 and 5*

*Week 3*

**The political economy of trade policy:**

*Required readings:*

- Grossman and Helpman, 1994, Protection for Sale, American Economic Review, 84:4, 833-850.
- Ornelas, 2005, Rent Destruction and the Political Viability of Free Trade Agreements, Quarterly Journal of Economics, 120:4, 1475-1506.

*Additional readings:*

- Grossman and Helpman, 1995, Trade Wars and Trade Talks, Journal of Political Economy, 103, 675-708.

- Grossman and Helpman, 1995, The Politics of Free-Trade Agreements, *American Economic Review*, 85:4, 667-690.
- Krishna, 1998, Regionalism and Multilateralism: A Political Economy Approach, *Quarterly Journal of Economics* 113, 1.
- Limao, 2005, Trade Policy, Cross-border Externalities and Lobbies: Do Linked Agreements Enforce More Cooperative Outcomes?, *Journal of International Economics*, 67, 1.
- Maggi and Rodriguez-Clare, 2007, A Political Economy Theory of Trade Agreements, *American Economic Review*, Forthcoming.
- Mitra, D., 1999, Endogenous Lobby Formation and Endogenous Protection: A Long-Run Model of Policy Determination, *American Economic Review*, 89, 1116-1134.

*Week 4*

**The political economy of fiscal federalism:**

*Required readings:*

- Besley and Coate, 2003, Centralized versus Decentralized Provision of Local Public Goods: A Political Economy Analysis, *Journal of Public Economics*, 87:12, 2611-2637.
- Brou and Ruta, Special Interests and the Gains from Political Integration, *Economics and Politics*, 18:2, 191-218.

*Additional readings:*

- Alesina and Spolaore, 2003, *The Size of Nations*, MIT Press, Cambridge.
- Alesina, Angeloni and Etro, 2005, International Unions, *American Economic Review*, 95, 602-15.
- Bolton and Roland, 1997, The Breakup of Nations: A Political Economy Analysis, *Quarterly Journal of Economics*, 112 (4), 1057-90.
- Casella and Feinstein, 2002, Public Goods in Trade: On the Formation of Markets and Jurisdictions, *International Economic Review*, 43, 437-462.
- Dur and Roelfsema, 2005, Why Does Centralization Fails to Internalize Policy Externalities?, *Public Choice*, 122, 395-416.

- Lockwood, 2002, Distributive Politics and the Benefits of Decentralization, *Review of Economic Studies*, 69, 2, 313-37.
- Tommasi and Weinschelbaum, 2007, Centralization versus Decentralization: A Principal-Agent Analysis, *Journal of Public Economic Theory*, Forthcoming.

*Week 5*

**Endogenous institutions and the political economy of growth:**

*Required readings:*

- Acemoglu, 2006, *Introduction to Modern Economic Growth*, Part 8: Political Economy of Growth (chapters 22, 23 and 24), mimeo, MIT.

*Additional readings:*

- Acemoglu and Robinson, 2005, *Economic Origins of Democracy and Dictatorship*, MIT Press, Cambridge.
- Aghion, Alesina and Trebbi, 2007, Democracy, Technology and Growth, mimeo, Harvard.
- Alesina and Rodrik, 1994, Distributive Politics and Economic Growth, *Quarterly Journal of Economics*, 109, 465-90.
- Bellettini and Ottaviano, 2005, Special Interests and Technological Change, *Review of Economic Studies*, 72, 43-56.
- Drazen (2000). Chapters 10, 11 and 13.
- PT, chapter 14.
- Spolaore and Wacziarg, 2005, Borders and Growth, *Journal of Economic Growth*, 10:4, 331-386.
- Tabellini, 2007, Culture and Institutions: Economic Development in the Regions of Europe, mimeo, Bocconi University.
- Ticchi and Vindigni, 2005, Endogenous Constitutions, mimeo, Princeton University and Università di Urbino.