Political Economy

Academic Year: (2017 / 2018)	**Review date: 05-09-2017**

Department assigned to the subject: Economics Department

Coordinating teacher: LOEPER , ANTOINE

Type: Electives ECTS Credits : 6.0

Year :   Semester :

REQUIREMENTS (SUBJECTS THAT ARE ASSUMED TO BE KNOWN)

PREREQUISITE
Attendance to class is mandatory. The announced dates for midterms and homeworks are final, and they cannot be rescheduled with any justification.
Most of the material that is taught in this class is theoretical. The students who choose this class must be aware of the fact that the content of the material is quite mathematical, although only basic mathematical tools will be used. The students are expected to have some familiarity with microeconomics. THE TOOLS THAT THE STUDENTS NEED TO KNOW ARE THE FOLLOWING:
-         the concept of ordinal preferences (weak and strict preferences, transitive preferences, rational preferences)
-         calculus (differentiation of a simple function of two variables)
-         basic maximization theory (how to maximize a function of one variable or two variables)
-         welfare economics (social welfare functions, public goods, free-riding)
-         basic notions of game theory (Nash equilibrium, in pure and mixed strategy)

OBJECTIVES

Attendance to class is mandatory. The announced dates for midterms and homeworks are final, and they cannot be rescheduled with any justification.
Standard economic models have shown that in some cases, markets are not perfect and can fail to achieve a socially optimal outcome. The question is then: how can we remedy these inefficiencies? A naïve public economic approach would state that, with appropriate tools (taxes, subsidies, public provisions, antitrust policies, regulations...), a public intervention can fix the market failure and restore the social optimum.
However, this approach is not satisfactory because it compares a realistic market system with all its imperfections to an ideal, benevolent, and omniscient government which always implements the right policy. As everyone knows, governments do not always implement socially optimal policies. Political representatives may be biased because of reelection concerns, lobbying, or outright corruption; voters can vote against their interest because they are poorly informed about the candidates and the policies they propose; even when voters are perfectly informed, majority rule does not always lead to the socially optimal decision. A realistic model of government or collective decision should take into account these political failures.
Taking into account the possibility of market failures and government failures, to assess whether public intervention is beneficial, one has to compare the potential failures of free markets, and economic freedom in general, with the potential failures of public interventions and collective action. Market failures are relatively well understood by economists. Therefore, to complete the picture, one has to understand how government and collective institutions function. This is precisely what political economy is about.
Political economy uses the modern tools of economic analysis (basic decision theory, welfare economics, incentive theory, and game theory) to analyze the functioning and failures of political institutions.
The questions that we will focus on in this class are the following:
-         How to make collective decisions for a group of individuals with heterogeneous needs and preferences? What are the typical failures of different voting rule? Can we design a voting rule that makes rational decisions and that satisfies some minimal democratic requirement?
-         How do governments function? Can we use parsimonious economic models to predict the level of public good provision and the degree of redistribution in a democracy?
-         How does electoral competition work? Why are economic competition and electoral competition so different in nature?
-         What is the role and influence of interest groups in the political process?

THEME 1: A NORMATIVE THEORY OF VOTING
Preferences aggregation rules and voting rules: how to make collective decisions based on the preferences of the individual members of society?
Majority rule: we will see why majority rule can be viewed as the most democratic voting rule. We will compare it to alternative voting rule such as the unanimity rule, or the Borda rule.
Condorcet cycles and voting paradoxes: we will see why voting can lead to irrational decisions.
Arrow and Brown's impossibility theorems.
The tension between equity, rationality, and resoluteness.

THEME 2: A POSITIVE THEORY OF VOTING
The median voter theorem: how to make predictions on the outcome of a majoritarian decision process.
We will use this model to explain why a democratic decision processes can solve the free-riding problem in public good provision.
We will see that the degree of redistribution of the taxation system used to finance the public goods in democratic societies can distort the incentives of voters, and thus distort the outcome of the majoritarian decision process.
We will analyze the issue of redistribution, and capital versus labor taxation in democratic societies.
The chaos theorem: why voting over multiple issues at the same time can lead to unpredictable decisions and chaos.

THEME 3: VOTING IN LEGISLATURE
We will describe the voting procedure used in practice in most legislatures, and build a simple model to predict the outcome of these voting procedures.
We will see how the details of the voting procedure can affect the outcome of the vote.
We will see how the agenda setter (the person in charge of setting the agenda of the legislature) can manipulate the outcome of the vote.

THEME 4: ELECTORAL COMPETITION
We will build a simple model of electioral competition that will allow us to:
-        see how political competition can shape the incentives of politicians, and is the likely outcome of an electoral race,
-        predict the outcome of an electoral race,
-        investigate whether political competition forces candidates to propose what the citizens wants,
-        discuss the impact of politicians¿ ideologies, credibility, and political parties.

THEME 5: INFORMATION AGGREGATION AND VOTING
The Condorcet jury theorem: under which circumstances can majority rule aggregate efficiently the information held by each individual?
We will compare information aggregation in markets versus information aggregation in elections and referendums.

THEME 6: POLITICAL PARTICIPATION AND VOTER BEHAVIOR
We will study the incentives of voters in large elections. We will see in particular what incentives they have to participate in the election, and to invest time and energy to carefully weight the different options.

THEME 7: PUBLIC CHOICE
Political representation and agency costs: do elected official do what they are supposed to do, or what is in their interest?
One man one vote versus one dollar one vote: what is the role of special interests, lobbying, and money in politics?
Rent seeking: what is it? Is it really different from economic competition?

METHODOLOGY

During the first 10 weeks (approximately), the course will alternate between theory groups ("magistrales") and class groups ("reducidos"). The class groups will be devoted to the illustration and application of the theory through exercises, presentation of research papers, and class discussions. Students are expected to be active during class discussion, and to express their opinion on the most controversial points of the theory.

The last 4 weeks (approximately) of the course will be devoted to student presentations.

PREREQUISITE

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- calculus (differentiation of a simple function of two variables)
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- welfare economics (social welfare functions, public goods, free-riding)
- basic notion of game theory (Nash equilibrium, in pure and mixed strategies)

ASSESSMENT SYSTEM

The continuous evaluation will be based on two problem sets (homework), two midterm exams (in class), and student presentations (in group) (optional or not, depending on the number of students enrolled in the class).
The midterm exam and the final exam will consist of theoretical exercises and short qualitative questions.
The course grade will be the greater of the two following grades:
(i) Continuous Evaluation only: weighted average between (i) attendance and participation (4%), (ii) grades of two homeworks (3% each), (iii) first midterm (35%), and (iv) second midterm (55%). Additionally, the students can do an optional presentation that may increase their continuous evaluations´ grade by up to 15 points out of 100.
(ii) CONTINUOUS EVALUATION AND FINAL EXAM: A weighted average of the final exam grade (60%) and the continuous evaluation grade as described in (i) (40%).
In particular, if you pass the continuous evaluation (that is, if you get 50 points over 100 or more in (i)), you do not need to take the final exam to pass the course. If you fail at the continuous evaluation (that is, if you get less than 50 points over 100in (i)), you can still pass the course if you get a sufficiently good grade at the final exam.
In the "convocatoria extraordinaria", the course grade of the students will be based only on the grade of the extraordinary exam.

% end-of-term-examination: 60

% of continuous assessment (assigments, laboratory, practicals…):   40

BASIC BIBLIOGRAPHY

- Shepsle, K. A. and M. S. Bonchek Analyzing politics : rationality, behavior, and institutions., New York, W.W. Norton., 1997
- Timothy Besley Principled Agents? : The Political Economy Of Good Government, The Lindahl Lectures. Oxford University Press, 2007