ECON 5403 F – Topics in the Theory of Public Economics

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Course Objectives: This term ECON 5403 will deal with political economy and public finance. It provides an introduction to analytical methods, approaches and research questions that arise in the study of the political economy of public sector economics and of public policy generally. Microeconomics and analytical political theory are combined in the search for a more comprehensive vision of the economic and political forces underlying the structure and evolution of the public sector and the consequences of political institutions for the allocation and distribution of resources. Topics covered include selected aspects of public goods and externalities, the free-rider problem and collective action, the operation of collective choice mechanisms such as pure majority rule, the relationship between the institutions of representative democracy and economic welfare, the modelling of political competition, special interest politics, time consistency, electoral competitiveness, the efficiency of democracy, and other issues. Some attention is paid to the historical evolution of ideas about these issues.

Course Requirements: There will be one take-home exam (50%) and a project (50%). Due date will be one week after the last class. Sets of questions will be handed out periodically that review material considered in class. The test will to some extent be based on these questions. The purpose of the project is to help you make the transition from consumers of research to producers of it. This project may be completed by a team of 2 students (who will receive the same mark).

Reference Textbook:

Dennis Mueller. Public Choice III. Cambridge University Press. 2003. An excellent overview of the field that is partly a text and partly a reference book. We will not rely only on this book.

Additional References:


Useful supplementary books (*= a book on reserve. See ARES).


*Allan Drazen. Political Economy in Macroeconomics. Princeton University Press, 2000. (A recent textbook with many useful chapters surveying some of the topics we will cover. Emphasizes applications to macroeconomic policy issues).


Some administrative matters:
(i) Academic Accommodation
You may need special arrangements to meet your academic obligations during the term because of disability, pregnancy or religious obligations. Please review the course outline promptly and write to me with any requests for academic accommodation during the first two weeks of class, or as soon as possible after the need for accommodation is known to exist. Students with disabilities requiring academic accommodations in this course must register with the Paul Menton Centre for Students with Disabilities (PMC) for a formal evaluation of disability-related needs. Documented disabilities could include but are not limited to mobility/physical impairments, specific Learning Disabilities (LD), psychiatric/psychological disabilities, sensory disabilities, Attention Deficit Hyperactivity Disorder (ADHD), and chronic medical conditions. Registered PMC students are required to contact the PMC, 613-520-6608, every term to ensure that your Instructor receives your Letter of Accommodation, no later than two weeks before the first assignment is due or the first in-class test/midterm requiring accommodations. If you only require accommodations for your formally scheduled exam(s) in this course, please submit your request for accommodations to PMC by Nov 8, 2013 for the Fall term and Nov 8, 2013 for the Winter term. You can visit the Equity Services website to view the policies and to obtain more detailed information on academic accommodation at http://carleton.ca/equity/accommodation.

(ii) University policy on plagiarism: Please be aware that plagiarism is serious offence at Carleton and should be recognized and avoided. For further information on how to do so, please see “Pammett on Plagiarism and Paraphrasing” at www.carleton.ca/economics/courses/writing-preliminaries

Course Outline and Reading List: The timetable by week is tentative. Required reading will be on Reserve in the library (marked with a *) or available on ARES. Always check ARES first, then Library Reserves. Some material is found on my website: www.carleton.ca/~winers as indicated. Please let me know right away if anything is missing from the reserve shelves or web sites listed. Choice of readings may be altered as we go along.

Important notes on the outline: (i) While the whole outline is lengthy, I have kept the amount of required reading within reasonable bounds. (ii) Note also that we will study only a modest subset of the material listed here, especially in the applications sections, as indicated in class. (iii) It is wise to stay well informed as to what material is relevant for the coming week, so as to economize on reading.
Week 1

1. **An Introduction to The Political Economy of Public Finance**

   *How should we approach political economy and public finance? Basic issues concerning the direction of contemporary research.*


   **Supplementary**


Weeks 2, 3 and 4

2. **The Free Rider Problem and the Evolution of Cooperation**

   *Why people join, or do not join, with others in the pursuit of common goals. The essential free-rider problem in collective action. Introduction to basic non-cooperative game theory, and its use to study the evolution of cooperation.*


   * T. Sandler, *Collective Action*. Chapter 2 " (Basic themes..." . Overlaps with, but emphasizes different issues than Mueller.)

   **Applications (to be selected)**


Science Review, 91(2), 1997, 245-263. (On the evolution and stability of constraints on the power of
government in democratic systems as a problem of collective action. This paper reminds us not to take the
existence of the rule of law or democracy for granted).

Supplementary
Mancur Olson. The Logic of Collective Action, Harvard University Press, 1965
Elinor Ostrom, Governing the Commons: The Evolution of Institutions for Collective Action, Cambridge
intervention.)
to dynamic or repeat play contexts. See especially chapter 4 on local truces in trench warfare of WW I and
the last chapter on golden rules for cooperation).
latest treatise on collective action, dealing especially with the possibility that there are multiple equilibria
in collective action games.)

Weeks 5 and 6.
Determination of Policy Outcomes
The median voter theorem of Black. The instability of pure majority rule and the interaction of voting rules and
preferences. Structure-induced equilibrium and the evolution of legislative institutions. Veto Players. Agenda
total control and other heresthetic manoeuvres.

*K. Shepsle and M. Bonchek, Analyzing Politics. Chapter 5: Spatial Models of Majority Rule, and Chapter 6:
Strategic Behavior.
D. Mueller, Public Choice III. Chapter 5. (A more technical introduction. Don't focus on proofs unless instructed.
Overlaps somewhat with Shepsle and Bonchek, but worth reading for its technical details and its different
perspective).

Applications (to be selected)
Barry Weingast and W. Marshall (1988), "The Industrial Organization of Congress; or, Why Legislatures,
Like
Firms, Are Not Organized as Markets", Journal of Political Economy 96(1), 132-163. (An
application of
the structure induced equilibrium approach to the organization of Congress, with hints about
parliamentary government. Transactions costs are important too).
and Costs: A Neoclassical Approach to Distributive Politics." Journal of Political Economy 89: 642-
664.(On the common pool problem in politics.)
(Individual Veto Players).
and Nerve Gas", and Conclusion.)
Thomas Romer and Howard Rosenthal (1978). "Political Resource Allocation, Controlled Agendas and the
Status Quo," Public Choice 33(4) (Winter): 27-43. (On control by the bureau of the median voter by
agenda manipulation).
1181-1206. (Studies how legislative structure and legislator behaviour affects agenda power and legislative outcomes).

**Supplementary**


(On the common pool problem in all democratic systems.)

*M. Hinich and M. Munger. *Analytical Politics*. Chapter 2: The Spatial Model of Downs and Black; and Chapter 3: Two Dimensions - Elusive Equilibrium. (An alternative to Shepsle and Bonchek.)


**Weeks 7 and 8**

**5. Modelling Representative Democracy When the Allocation of Economic Resources Matters**

*Spatial voting models of political equilibrium. Anthony Downs formalized as spatial, probabilistic voting. The Representation Theorem and the 'invisible hand' in a democracy. First past the post and proportional electoral systems. Politicians with policy preferences and endogenous candidates. The time-consistency problem as conflict of interests.*


**Applications**


**Supplementary: Alternative models of electoral equilibrium**

*W. Hettich and S. Winer. *Democratic Choice and Taxation*. Chapter 2: Models of Political Economy and the Study of Taxation. (This chapter provides an overview and comparison of many of the relevant models addressed in this section of the course).


See also the previously referenced books by Adams, Merrill and Grofman (2005), and by Schofield and Sened (2006)

**Supplementary: The role of governance from various perspectives**
A. Breton. Competitive Governments, 1996. Chapter 4 (On how budgetary processes in congressional and parliamentary systems evolve to control spending.)
W. Pommerehne, "The Empirical Relevance of Comparative Institutional Analysis", European Economic Review 34, 1990, 458-469. (Summarizes empirical work from Switzerland and elsewhere on the importance of direct vs. representative democracy.)

**Supplementary: Redistribution and Special Interest Politics**
*A. Drazen. Political Economy in Macroeconomics, Princeton 2000. (Chapter 8 provides a nice survey.)

**Weeks 9, 10 and 11**

A closer look at several good papers that combine theory and empirics, and which also introduce my own current research program.


Week 12 (if we dont run out of time)

10. Is Democracy Efficient?
We turn briefly to the normative side of political economy, which we have already considered in the context of our study of electoral equilibrium. Interest groups: good or bad for economic efficiency? Is there an invisible hand in a competitive political system? Under what circumstances? What can go wrong? What is a failure in a policy process?. How do we think about these matters?.

(Regarding sources of inefficiency)

(Regarding sources of efficiency)
Don Wittman. “Why Democracies Produce Efficient Results", Journal of Political Economy 97(6), December 1989, 1395-1424. A rosy picture of democracy. (See also Becker below)

Supplementary:
W. Hettich and S. Winer, "Economic Efficiency, Political Institutions and Policy Analysis", Kyklos 46(1), 1993, 3-26. (An overview of alternative theoretical approaches we have considered and their implications for the art of policy advising).


The following topics are included for interest – we will not have time to cover them directly.

Commitment and Contracting over Time in the Presence of Collective Choice
Dynamic issues, mostly stemming from commitment problems that arise over time. The readings here just scratch the surface of these topics.


Dictatorship
Just a taste of recent work on this fascinating topic.


Collective Choice and the Theory of Policy
Alternative views about whether and how collective choice should be incorporated into the study of public policy, and in the formulation of policy advice.


Applications (the debate in the context of tax policy):

versus


versus

Econ 5403, Fall 2013.  
SHORT RESEARCH PROJECT
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**Due date: to be arranged**

The research paper is designed to help you to go beyond being merely a consumer of research done by others. It allows you to start from the work of others, but then to propose your own research project that goes beyond what you have read. Combining this paper with an assignment for another course is fine provided you discuss this with me first. The project paper consists of two related parts:

**Part I** (approximately 6-8 pages double-spaced): This part represents a review of one or two research articles. One or both of the articles may be empirical in nature (review statistical or case study evidence concerning a main hypothesis), or, if you wish, you may deal with theory only. Articles chosen must deal with the same general topic or issue.

You are responsible for choosing the article(s). One of them may be a research article from the readings assigned for the course. The main topic treated in the articles must relate to some aspect of the course material. You may wish to seek my advice in choosing a specific topic and in locating relevant articles. I will suggest topics as we proceed through the term.

Your discussion in Part I should touch on the following:
- main thesis or hypothesis in each article  
- analytic techniques used in each article  
- type of data used and sources of the data  
- main conclusions reached in each article  
- how the articles complement and/or contradict each other, and why they do so

It is suggested that you use these or similar headings to organize the first part of your paper.

Copies of articles that are not part of the readings for the course must be attached to the paper when handing it in.

**Part II** (approximately 6-8 pages, double-spaced): In this part, you develop a research proposal on one aspect of the topic discussed in the two papers reviewed in Part I. You may start from the research design in one of the papers and amend it to make it your own. (This can be done, for example, by changing or extending the theoretical model in some manner; by changing the list of explanatory variables in an empirical analysis, or by changing the time period for which the statistical analysis is carried out.) You must explain why you are proposing these changes in the research design. Alternatively, you may propose your own research design that takes a different approach from the designs used in the two articles. Again, you must justify your design. Your proposal should have the following elements:

1. An hypothesis or clearly formulated economic question that can be investigated with either a theoretical model or empirical data, or both.

2. If you plan to do **theory**, a discussion of the model that you will use to examine your hypothesis or research question. This discussion should not be a general introduction to methodology. What is required is a discussion of the properties of the model in relation to the research question of interest, including:
   - what general features is it necessary for the model to have in order to deal with this question;
- the critical aspects of the particular model you are proposing that will play key roles in determining the nature of conclusions. (You may wish to build on ideas from other papers here.);
- how the treatment of the points above differ from that in the papers reviewed earlier;
- justification as to why this alternative model structure is well suited to answer your research question, including a discussion of why there is likely to be some interesting 'distance' between your assumptions and your conclusions;
- a time estimate for completing the project (assuming that would devote 15 hours a week to it);
- a brief discussion of how your research project will add to economic knowledge

(2') If you plan to do empirical work, you should discuss:
- the essential or critical aspects of the statistical model that will play key roles in determining the nature of conclusions about the question of interest;
- how your treatment in the points above differs from that in the papers reviewed earlier;
- justification as to why this alternative model structure is well suited to answer your research question;
- the data that will have to be collected for the research project and of the likely sources where they can be found;
- an example of such data (such as a relevant statistical table) and a discussion of how the numbers in the data set relate to the examination of your hypothesis or research question;
- a time estimate for completing the project (assuming that would devote 15 hours a week to it);
- a brief discussion of how your research project will add to knowledge.

It is suggested that you use above headings (or similar ones) in organizing your proposal that correspond to these points.

In designing your research proposal, it is important to be realistic. This means that you must be very clear about the question that you are investigating, the nature of the model used for theoretical work, and the data required for empirical work. It is generally better to choose a narrow topic than a broad one.

**Bibliography:** The paper must have a separate page with proper bibliographic citations of the two articles reviewed and any other articles cited. The bibliography should also include proper entries for the source of the data example in Part II and for the data sources that you plan to use in the proposed research.

**Team Research:** You may combine with another member of the class and turn in a joint paper. If you choose to do this, both authors will receive the same grade. Groups of more than two authors are not allowed.