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Program Report

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Political Economy

Alberto F. Alesina*

The Political Economy Program is new at the NBER, and thus needs an introduction. What is political economics? And, why has the NBER chosen to have a program in it?

The best way to answer is to set back the clock to the mid-1980s. This was a time of great turmoil and transformation in the American economy. President Reagan was in the middle of his “revolution”: there were large deficits, taxes were being cut, and the economy was being deregulated. Continental Europe, in contrast, was entering a long period of sclerosis: some countries in Europe (but not all) had accumulated debt that was rising towards wartime levels. The need for structural reforms and liberalization in Europe was evident, but they were delayed. A dozen European countries were heading towards uncharted territories of monetary, and some sort of political, union. Latin America was in the midst of a huge debt crisis and a “lost decade”, with very high or even hyperinflations, foreign debt defaults, and large budget deficits. Unavoidable policy reforms were delayed, increasing the economic costs and leading to crisis. The

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Feldstein to Step Down as NBER President in June 2008

Martin Feldstein told the NBER Board of Directors that he will make this his last year as president of the NBER, a position he began in 1977. He will continue as an active NBER Research Associate as well as a professor of economics at Harvard. The NBER Board has established a search committee under the Chairmanship of NBER Director Michael Moskow, a former NBER Board Chairman and retired president of the Federal Reserve Bank of Chicago. The Board plans to elect Professor Feldstein's successor at its meeting in April 2008.

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Soviet Bloc was about to collapse; when it did, it opened a Pandora's box of politico-economic questions.

It was increasingly difficult to fit all of these complexities and varieties of experiences into traditional models of economic policy in which benevolent social planners maximize the utility of a representative individual. Some economists started exploring how political forces affected the choice of policies, paying special attention to distributive conflicts and political institutions, which are absent in representative agent models.

Let's be clear: they had predecessors; they were not building from scratch. The "Public Choice School" of Buchanan, Tullock, and associates had made contributions that cannot be overemphasized, especially in constitutional theory (together with Hayek), and in modeling politicians as self-interested agents. But, it remained on the sideline of mainstream economics, and the responsibilities lie on both sides. The Public Choice School refused to embrace the methodology of the field, which was in great transformation in the mid-1970s with the rational expectations revolution, game theory, and advances in econometrics. Traditional economists did not look outside the box, and ignored, with a hint of intellectual arrogance, the important contribution of Public Choice. There were exceptions: some economists made important contributions that were in a sense ahead of their time, from Becker's model of lobbies, to Nordhaus's political business cycle model, just to name two.

But from the mid-1980s onward, the new (or "renewed") field of political economics became more and more mainstream and established: in fact, it has been one the most rapidly growing and exciting field in economics. Even a cursory look at the NBER Working Paper series from the late-1980s onward reveals that, in a variety of different programs, political economics was more and more present: in macroeconomics, closed and open, from trade to public finance to labor, even in finance. Therefore, it makes sense to have a program that provides a home for those working in the field. However, perhaps to a larger extent than in other areas of research, any work that is broadly defined as political economics will continue to be represented in other programs as well.

The first phase of research in this area is well summarized, systemized, and extended in

three important books by Allan Drazen, Torsten Persson, and co-authors Guido Tabellini, Gene Grossman, and Elhanan Helpman, all conceived and written around the mid- to late-1990s. The research summarized here involves reasonably “traditional” topics: the influence of elections on the choice of economic policy; determinates of electoral outcomes; strategic manipulation of policies (especially fiscal policy); central bank independence; redistributive conflicts in fiscal policy; the political economy of delayed reforms in developing countries and of excessive deficits, lobbying models, fiscal federalism, and political business cycles.

Since the late-1990s, the field has taken on even more challenging topics. For instance: where do institutions come from? What is the origin of certain political institutions? How quickly do institutions change? What is the role of culture in explaining economic outcomes and developments? How does culture evolve? What is the role of ethnic identity in explaining economic conflict, success and failures? What explains why countries stay together or break apart and the size of nations? What is the role of the press in influencing individual political opinions?

The richness and variety of these questions is one of the reasons why the NBER Working Paper list in Political Economics and the Program Meetings in this area covers extremely diverse issues; it is impossible to mention them all, or even to group them in a few sub-sections. What follows is a sample of a few recent papers published by NBER in the Political Economics Program and/or presented in one of the Political Economics Program Meetings.

Democracy and Development

This is, of course, a hugely important topic. Does development deliver democracy or does a transition to democracy foster development? This question, studied for years by both economists and political scientists, is still hotly debated. In fact, several recent papers have addressed

various aspect of it. Recent results by Persson and Tabellini suggest that previous papers underestimated the positive effects of democracy on growth.¹ Aghion, Alesina, and Trebbi argue that democracy becomes especially useful to growth in more advanced sectors of the economy that need more freedom of innovation and flexibility, so the benefits of democracy are increasing with income per capita.² An efficient democracy also needs education and human capital—otherwise, it may not survive, as discussed by Glaeser, Ponzetto, and Shleifer.³ But others (Acemoglu, Johnson, Robinson, and Yared) question the effects of education and per capita income as determinants of democratic institutions.⁴ The difficulty of establishing efficient democracies is emphasized in papers by Acemoglu, Ticchi, and Vindigni; Acemoglu and Robinson; and Besley and Persson.⁵ Further, Persson and Tabellini,⁶ using a concept of “democratic capital” that captures the solidity of democratic rule, have examined transitions in and out of democracy, and the stability of the latter. Indeed, some regimes are more stable than others and often the fate of dictators and democracies may be influenced by events as unpredictable as successful versus unsuccessful assassination of leaders, a point made by Jones and Olken.⁷

Culture, Ethnicity, and the Formation of Beliefs

Perhaps at some deep level, cultural traits matter for economic choices and behavior, and they are profoundly different across nationalities. Political economists have just begun to investigate measurements of different cultures and their effects on politico-economic choices. Giuliano and I emphasize how different family structure affects many economic decisions, especially by measuring family ties, namely how tightly integrated families are.⁸ Cultural traits may negatively affect incentives to grow, as argued by Tabellini.⁹ But where does culture come from? It may come from past experience; for instance Fuchs Schuendeln and I study the effects of Communism on

preferences for state intervention in post-Communist societies.¹⁰ Culture evolves over time through transmission in families, a point made by Tabellini in a paper that examines the evolution of beliefs and trust.¹¹ Washington studies how children may affect the political beliefs of their parents.¹² Glaeser and Sacerdote study reversal of preferences in response to economic shocks.¹³

Cultural traits often are associated with ethnicity, language, and religion, and they evolve with history. Guiso, Sapienza, and Zingales study how cultural barriers may impede trade; Spolaore and Wacziarg explore how the diffusion of technology is facilitated by closeness, in terms of ethnicity, language, and culture; they find that it is.¹⁴ However, Giuliano, Spilimbergo, and Tonon argue that geographical features may be what really explain ethnic distance.¹⁵ Ethnic conflict may cause policy failures, even state failure and wars, especially if political borders do not well serve ethnic groups and interests, a point investigated by Easterly, Matuszeski, and me.¹⁶ Even within the United States, it is well known that racial and ethnic animosity affect policy choices and social capital. In an experiment based on the relief efforts for Hurricane Katrina, Fong and Luttmer find somewhat unexpected results.¹⁷

The press and the media are certainly major contributors to the formation of beliefs. In fact, several papers recently have studied what determines media ideological inclinations and their effects. Gentkow and Shapiro study newspapers’ slant; Della Vigna and Kaplan and Oberholzer-Gee and Waldfogel study the effects of television on electoral outcomes in the United States.¹⁸ Olken studies the effect of television on social capital in Indonesia.¹⁹

U.S. Elections

Several papers, with new tools and new points of view, have examined an “old” topic in political economics: how to predict U.S. elections and how to evaluate their impact on the economy. Leigh and Wolfers compare different approaches

for predicting elections, and Wolfers and Zitzewitz focus in particular on close elections and their ex-ante unpredictability, a topic investigated in a different context by Chang.²⁰

Snowberg studies the effect of elections on policies, using unpredictable elections to isolate “shocks.”²¹ Vigdor and Mullainathan and Washington investigate voters’ motivation and rationality.²² Belonging to a prominent family of politicians implies an electoral advantage, as shown by Dal Bo, Dal Bo, and Snyder who consider the entire history of the U.S. Congress.²³ Snowberg, Wolfers, and Zitzewitz study the effect of elections on policies, disentangling issues of reverse causality.²⁴

Institutions and Policy Outcomes

One of the central themes in political economics has been and continues to be the effect of different political institutions on economic outcomes. Using a theoretical model, Caselli and Gennaioli study how different voting rules and institutional structures make policy reforms more difficult; Ardagna, Trebbi, and I empirically consider a vast sample of countries asking what forces make policy reforms more likely to occur and to be successful.²⁵ Brander and Drazen ask what determines the occurrence of political business cycles in various institutional settings.²⁶ Political distortions and deficits are the subjects of Robinson and Torvik, Battaglini and Coate, and a paper by Tabellini and me; Grossman and Helpman study pork barrel policies, the budget process, and trade policy; Rajan and Zingales look at unemployment, and Shoven and Slavos focus on social security.²⁷ The role of competition in political markets is the subject of Mulligan and Tsui.²⁸ Trebbi, Aghion, and I also study the effects of electoral rules with an application to U.S. cities.²⁹

Corruption: Measures and Effects

In the last several years the topic of government corruption, especially in

developing and middle-income countries, has been the center of attention for not only academics but also policymakers. Should foreign aid and credit flow to countries run by corrupt governments or should support be stopped? The question is very important and therefore understanding corruption is essential. Often the perception of corruption may be different from reality, a topic tackled by Olken in reference to Indonesia.³⁰ He shows that perception and reality often differ predictably. Corruption in Indonesia, especially in local government, is also the topic of Henderson and Kuncoro.³¹ Olken and Barron study whether corruption in trucking levies in Turkey is consistent with an efficient model of rent extraction: they conclude that it is.³² Padro I Miquel focuses on rent extraction by rulers in Africa.³³ Ferraz and Finnan focus on local governments in Brazil.³⁴

Corruption may have long lasting major consequences. It may interfere with the development of liberal democracies, as pointed out by Di Tella and McCulloch.³⁵ It may also make it difficult to enforce an embargo against countries, as shown by Della Vigna and La Ferrara.³⁶

Conclusion

This brief and incomplete survey of papers recently issued and discussed in the Political Economic group highlights the wide variety of exciting topics covered in the field. It is impossible to review every paper of the group, especially since this is the first report and there is a “stock” of papers to be highlighted. I should conclude with the observation that the Political Economy group has provided a useful public good for the profession: a paper by Kim, Morse, and Zingales has examined the pattern of citation of economic articles in economics.³⁷ This is a paper that has made many economists happy and proud, and many disappointed!

¹ T. Persson and G. Tabellini, “The Growth Effect of Democracy: Is It Heterogeneous and How Can It Be Estimated?” NBER Working Paper No.

13150, June 2007; and T. Persson and G. Tabellini, “Democracy and Development: The Devil in the Details,” NBER Working Paper No. 11993, February 2006.

² P. Aghion, A. F. Alesina, and F. Trebbi, “Democracy, Technology, and Growth,” NBER Working Paper No. 13180, June 2007.

³ E.L. Glaeser, G. Ponzetto, and A. Shleifer, “Why Does Democracy Need Education?” NBER Working Paper No. 12128, April 2006.

⁴ D. Acemoglu, S. Johnson, J. A. Robinson, and P. Yared, “From Education to Democracy?” NBER Working Paper No. 11204, March 2005.

⁵ D. Acemoglu, D. Ticchi and A. Vindigni, “Emergence and Persistence of Inefficient States,” NBER Working Paper No. 12748, December 2006; D. Acemoglu and J. Robinson, “Persistence of Power, Elites, and Institutions,” paper presented in a POL Program Meeting, 2005; T. Besley and T. Persson, “The Origins of State Capacity: Property Rights, Taxation, and Politics,” NBER Working Paper No. 13028, April 2007. See also D. Acemoglu, “Modeling Inefficient Institutions,” NBER Working Paper No. 11940, January 2006, and, “Politics and Economics in Weak and Strong States,” NBER Working Paper No. 11275, April 2005.

⁶ T. Persson and G. Tabellini, “Democratic Capital: The Nexus of Economic and Political Change,” paper presented in a POL Program Meeting, 2006.

⁷ B. F. Jones and B. A. Olken, “Hit or Miss? The Effect of Assassinations on Institutions and War,” NBER Working Paper No. 13102, May 2007.

⁸ A. F. Alesina and P. Giuliano, “The Power of the Family,” NBER Working Paper No. 13051, April 2007.

⁹ G. Tabellini, “Culture and Institutions: Economic Development in the Regions of Europe,” paper presented in a POL Program meeting, 2005.

¹⁰ A. F. Alesina and N. Fuchs Schuendeln, “Goodbye Lenin (or not?): The Effect of Communism on People’s Preferences,” NBER Working Paper No. 11700, October 2005.

¹¹ G. Tabellini, “Incentives and Social

Norms," paper presented at a POL Program Meeting, 2007.

¹² E. Washington, "Female Socialization: How Daughters Affect Their Legislator Fathers' Voting on Women's Issues," NBER Working Paper No. 11924, January 2006.

¹³ E. L. Glaser and B. Sacerdote, "Aggregation Reversals and the Social Formation of Beliefs," NBER Working Paper No. 13031, April 2007.

¹⁴ L. Guiso, P. Sapienza, and L. Zingales, "Cultural Biases in Economic Exchange," NBER Working Paper No. 11005, December 2004; E. Spolaore and R. Wacziarg, "The Diffusion of Development," paper presented in a POL program meeting, 2006.

¹⁵ P. Giuliano, E. Spilimbergo, and G. Tonon, "Genetic, Cultural and Geographical Distance," paper presented in a POL Program meeting, 2006.

¹⁶ A. F. Alesina, W. Easterly, and J. Matuszes, "Artificial States," NBER Working Paper No. 12328, June 2006.

¹⁷ C. M. Fong and E.F.P. Luttmer, "What Determines Giving to Hurricane Katrina Victims? Experimental Evidence on Income, Race, and Fairness," NBER Working Paper No. 13219, July 2007.

¹⁸ M. Gentzkow and J. M. Shapiro, "What Drives Media Slant? Evidence from U.S. Daily Newspapers," NBER Working Paper No. 12707, November 2006; S. DellaVigna and E. Kaplan, "The Fox News Effect: Media Bias and Voting," NBER Working Paper No. 12169, April 2006; F. Oberholzer-Gee and J. Waldfogel, "Media Markets and Localism: Does Local News en Español Boost Hispanic Voter Turnout?" NBER Working Paper No. 12317, June 2006.

¹⁹ B. A. Olken, "Do Television and Radio Destroy Social Capital? Evidence from Indonesian Villages," NBER Working Paper No. 12561, October 2006.

²⁰ A. Leigh and J. Wolfers, "Competing Approaches of Forecasting Elections: Economic Models, Opinion Polling, and Prediction Markets," NBER Working Paper No. 12053, February 2006. R. Chang, "Electoral Uncertainty and the Volatility of International Capital Flows," NBER Working Paper No. 12448, August 2006.

²¹ E. Snowberg, J. Wolfers, and E. Zitzewitz, "Partisan Impacts on the Economy: Evidence from Prediction Markets and Close Elections," NBER Working Paper No. 12073, March 2006.

²² S. Mullainathan and E. Washington, "Sticking with Your Vote: Cognitive Dissonance and Voting," NBER Working Paper No. 11910, January 2006.

²³ E. Dal Bó, P. Dal Bó, and J. Snyder, "Political Dynasties," NBER Working Paper No. 13122, May 2007.

²⁴ E. Snowberg, J. Wolfers, and E. Zitzewitz, "Party Influence in Congress and the Economy," NBER Working Paper No. 12751, December 2006.

²⁵ F. Caselli and N. Gennaioli, "Economics and Politics of Alternative Institutional Reforms," NBER Working Paper No. 12833, January 2007. A.F. Alesina, S. Ardagna, and F. Trebbi, "Who Adjusts and When? On the Political Economy of Reforms," NBER Working Paper No. 12049, February 2006.

²⁶ A. Brender and A. Drazen, "Why is Economic Policy so Different in Old and New Democracies?" paper presented in a POL program meeting, 2006; "How do Budget Cycles and Economic Growth Affect Reelection Prospects?" NBER Working Paper No. 11862, December 2005. See also A. Drazen and M. Eslava, "Pork Barrel Cycles" NBER Working Paper No. 12190, May 2006, and "Electoral Manipulation via Expenditure Composition: Theory and Evidence," NBER Working Paper No. 11085, January 2005.

²⁷ J. A. Robinson, and R. Torvik, "A Political Economy Theory on the Soft Budget Constraint," NBER Working Paper No. 12133, April 2006; M. Battaglini and S. Coate, "A Dynamic Theory of Public Spending, Taxation and Debt," NBER Working Paper No. 12100, March 2006; A.F. Alesina and G. Tabellini, "Why is Fiscal Policy often Procyclical?" NBER Working Paper No. 11600, September 2005; G. M. Grossman and E. Helpman, "Party Discipline and Pork Barrel Politics," NBER Working Paper No. 11396, June 2005; R. Rajan and L. Zingales, "The Persistence on Underemployment: Institutions, Human

Capital, or Constituencies," paper presented at a POL Program Meeting, 2005; J. B. Shoven and S. N. Slavov, "Political Risk Versus Market Risk in Social Security," NBER Working Paper No. 12135, April 2006; G. M. Grossman and E. Helpman, "Separation of Powers and the Budget Process," NBER Working Paper No. 12332, June 2006, and "A Protectionist Bias in Majoritarian Politics," NBER Working Paper No. 11014

²⁸ C. B. Mulligan and K. K. Tsui, "Political Competitiveness," NBER Working Paper No. 12653, October 2006.

²⁹ P. Aghion, A.F. Alesina, and F. Trebbi, "Choosing Electoral Rules: Theory and Evidence from U.S. Cities," NBER Working Paper No. 11236, April 2005.

³⁰ B. A. Olken, "Do Television and Radio Destroy Capital? Evidence from Indonesian Villages," NBER Working Paper No. 12561, October 2006.

³¹ J. V. Henderson and A. Kuncoro, "Sick of Local Government Corruption? Vote Islamic," NBER Working Paper No. 12110, March 2006.

³² B. A. Olken and P. Barron, "The Simple Economics of Extortion: Evidence from Trucking in Aceh," NBER Working Paper No. 13145, June 2007.

³³ G. Padro i Miquel, "The Control of Politicians in Divided Societies: The Politics of Fear," NBER Working Paper No. 12573, October 2006.

³⁴ C. Ferraz and F. Fynn, "Electoral Accountability and Corruption in Local Governments: Evidence from Audit Reports," paper presented at a POL Program Meeting, 2006.

³⁵ R. Di Tella and R. McCulloch, "Why Doesn't Capitalism Flow to Poor Countries?" NBER Working Paper No. 13164, June 2007.

³⁶ S. Della Vigna and E. La Ferrara, "Detecting Illegal Arms Trade," presented at a POL Program Meeting, 2007.

³⁷ E. H. Kim, A. Morse, and L. Zingales, "What Has Mattered to Economics Since 1970?" NBER Working Paper No. 12526, September 2006.