

POLI 200C: States and Markets
Spring 2010, SSB 104

Course Website: <https://webctweb.ucsd.edu/webct/logon/3355399248001>

Professor Lawrence Broz

jlbroz@ucsd.edu

SSB 389

Office Hours: Wed 12.30-2.30

Professor Megumi Naoi

mnaoi@ucsd.edu

SSB 373

Office Hours: Friday 3:00-4:00

A. Introduction

This module in the “Principles of Political Science” sequence provides an overview of the normative and positive issues associated with decentralized (market) and centralized (state) mechanisms of allocation. It is motivated by two questions at the heart of the discipline: (1) What is the appropriate role of government in the economy? (2) How do we explain the actual role of government in the economy?

Substantial portions of the readings are from economics, including some canonical papers from industrial organization and welfare economics. Topics covered include efficiency, social welfare, market failures, public goods, asymmetric information, moral hazard, adverse selection, government failures, regulation and rent-seeking, property rights, inefficient redistribution, time inconsistency, and political business cycles.

Required Books:

- Joe B. Stevens, *The Economics of Collective Choice*. Westview, 1993 (paperback ISBN: 0813315670 \$44)
- Robert H. Bates, *Markets and States in Tropical Africa: The Political Basis of Agricultural Policies*. University of California Press, 1981.
- Mancur Olson, *The Logic of Collective Action*. Revised 2nd printing, Harvard UP, 1990 (paperback ISBN: 0674537513, \$20).
- Arthur M. Okun, *Efficiency vs. Equality*. Washington DC: The Brookings Institution, 1975.

Recommended Books:

Students may also want to purchase a good microeconomics textbook, targeted for either advanced undergraduates or first-year graduate students in economics. An example of the former is Hal A. Varian,

Intermediate Microeconomics: A Modern Approach, 8th ed (W.W. Norton, 2009). An example of the latter is David M. Kreps, *A Course in Microeconomic Theory* (Princeton UP, 1990).

B. Requirements

1. Weekly Memo—Reflection & critiques of readings

You will be submitting a weekly memo on the discussion board at the course WebCt at <https://webctweb.ucsd.edu/webct/logon/3355399248001> by **Sunday 4:00 pm (Note: You can submit a memo as early as Tuesday of the previous week)**. The memo should be one paragraph to a page and contain either (i) a critique of some of the readings, (ii) possible discussion questions for the class meeting *and* your (tentative) answers, or, (iii) interesting ways to compare and contrast readings. The memo should not be a summary of readings. During the weeks you make a presentation, you do not need to turn in the memo.

2. Presentations on Discussion Questions

Each week, there will be presentations by students on questions that are posed on the syllabus. These presentations should be no more than 12 minutes each, and should be presented using PowerPoint slides or handouts. In general, weak presentations will simply summarize the readings (“A says x, B says y”). Good presentations will:

- Describe any key conceptual issues that must be addressed by work on the question;
- Describe the central arguments/debates in the literature on the question;
- Describe any methodological issues that bear on the question;
- Offer criticisms and/or suggest pathways for future research.

3. Mid-term and Final papers.

There will be one midterm and one final exam. The midterm will be distributed on April 19 and is due on April 26 at the beginning of class. The final will be given out on May 24 and is due on June 7th (Monday) by 5:00pm. Each exam is a take-home essay. Each paper should not be more than seven pages, 1.5 space, and 12 fonts. Late papers will be penalized one half grade per day.

C. Grades: Final grades will be awarded on the following basis:

1. Participation in course activities (40% of grade). These include:
 - a. Discussion of each week's assigned readings
 - b. Weekly Memo
 - c. Presentations
2. Take two exams, mid term and final (60% of grade).

D. Reading assignments

All readings will be posted to the course webpage. All dates and assignments are subject to change.

Week 1: Markets and States as Mechanisms of Allocation

How do we evaluate and compare alternative allocation mechanisms (i.e. systems for producing and exchanging resources)?

While markets are generally effective in the efficiency with which they allocate resources to their most valued uses, markets do not always work well. Moreover, they can produce equity outcomes that will not necessarily be supported by all members of a community. This segment of the course introduces the normative and positive aspects of markets and states as allocation mechanisms.

Readings:

- Stevens, chapters 1-2
- Okun, Arthur M. 1975. *Efficiency vs. Equality*, Washington DC: The Brookings Institution.
- Lerner, Abba P. "[The Economics and Politics of Consumer Sovereignty.](#)" *American Economic Review* (May 1972): 258-66.
- Hardin, Russell. 1993. "[Efficiency.](#)" in Robert E. Goodin and Philip Pettit, eds., *Companion to Contemporary Political Philosophy*, Oxford: Basil Blackwell, pp. 462-470.

Week 2: Market Failures and the Political Foundations of Economic Systems

What are the political foundations of a market economy? How do these preconditions differ with other forms of economic organization (e.g., traditional/ cultural allocation, socialism, and communism)?

Certain preconditions are associated with competitive markets, including the provision of property rights. In addition, markets work or fail for a variety of reasons, having to do with information, culture, and institutions.

Discussion Questions:

- What good is efficiency?
- What purposes should a "social contract" serve?
- When does market failure justify government intervention?
- Can fairness be a benchmark for public policy?

Readings:

- Stevens, chapters 3-4
- Hardin, Russell. 1997. "[Economic Theories of the State.](#)" in Dennis C. Mueller, ed., *Perspectives on Public Choice: A Handbook*, New York: Cambridge University Press, pp. 21-34.
- Coase, Ronald, "[The Nature of the Firm.](#)" *Journal of Law and Economics* 17, 2 (October 1974): 357-76.
- Greif, Avner. "[Cultural Beliefs and the Organization of Society.](#)" *Journal of Political Economy* 102, 5 (1994): 912-950.

Week 3: Incentives in Market Exchange, Part I

How do markets respond to ill-defined property rights and public goods problems? This segment surveys the voluntary market responses to these problems.

Discussion Questions:

- What are property rights and when do they emerge?
- What are the conditions under which property rights can be established and enforced by private actors?
- What are common pool resource problems and how can they be solved without government intervention?

Readings:

- Demsetz, Harold. 1967. "[Toward a Theory of Property Rights.](#)" *American Economic Review* 57, 2 (May): 347-59.
- Hardin, Garrett. 1968. "[The Tragedy of the Commons.](#)" *Science* 162: 124-48.
- Ostrom, Elinor. 1990. [Governing the Commons](#). Cambridge University Press, pp. 58-102 (chapters 3 and 4).
- Libecap, Gary D. 1996. "[Economic Variables and the Development of the Law: The Case of Western Mining Rights.](#)" in Alston, Eggertsson and North (eds) *Empirical Studies of Institutional Change*, Cambridge: Cambridge University Press: pp. 34-58.
- Sokoloff, Kenneth L. and Stanley L. Engerman. 2000. "[History Lessons: Institutions, Factors Endowments, and Paths of Development in the New World.](#)" *Journal of Economic Perspectives* 14, 3 (Summer):217-232
- Glaeser, Edward L., Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer. 2004. "[Do Institutions Cause Growth?](#)" *Journal of Economic Growth* 9, 3 (September): 271-303.

Week 4: Incentives in Market Exchange, Part II

How do markets respond to transaction costs and externality problems? This segment surveys the voluntary market responses to these problems.

Discussion Questions:

- Why do firms exist?
- When can markets give rise to opportunism, and how can opportunistic behavior be contained?
- What are the costs and benefits of vertical integration?

Readings:

- Stevens, chapter 5
- Coase, Ronald H. [“The Nature of the Firm,”](#) *Economica* 4, 16. (Nov., 1937): pp. 386-405.
- Coase, Ronald H. [“The Problem of Social Cost,”](#) *The Journal of Law and Economics*, 3 (Oct. 1960): 1-44.
- Klein, Benjamin. [“Fisher-General Motors and the Nature of the Firm.”](#) *Journal of Law and Economics* 43, 1 (April 2000): 105-42.
- Alchian, Armen A. and Harold Demsetz, [“Production, Information Costs, and Economic Organization,”](#) *American Economic Review* 62, 5. (Dec., 1972):777-795.
- Williamson, Oliver E. [“Credible Commitments: Using Hostages to Support Exchange.”](#) *American Economic Review* 73, 4 (September 1983): 519-40.

Week 5 Incentives in Market Exchange, Part III

How do markets respond to informational problems and other sorts of uncertainty in economic exchange? This segment surveys these problems and the associated market responses.

Discussion Questions:

- What are the sources of uncertainty that arise in economic exchange?
- How do markets respond to informational problems in economic exchange?
- Who bears and who should bear the information costs in market exchange?

Readings:

- Varian, Hal A. [“Asymmetric Information,”](#) in Hal A. Varian, *Intermediate Microeconomics: A Modern Approach*, 5th ed (W.W. Norton, 2002): 642-662.

- Spence, Michael. 1973. "[Job Market Signaling.](#)" *The Quarterly Journal of Economics* Vol. 87 #3 (August): 355-374
- Milgrom, Paul R. and John Roberts "[Bargaining Costs, Influence Activities, and the Organization of Economic Activity.](#)" in James E. Alt and Kenneth A. Shepsle (eds.), *Perspectives on Positive Political Economy* (Cambridge: Cambridge University Press, 1990): 57-89.
- Milgrom, Paul, Douglass C. North and Barry R. Weingast, "[The Role of Institutions in the Revival of Trade: The Medieval Law Merchant, Private Judges, and the Champagne Fairs.](#)" *Economics and Politics* 1 (1990): 1-23.
- Shleifer, Andrei and Robert W. Vishny. 1997. "[A Survey of Corporate Governance.](#)" *Journal of Finance* 52, 2. (June):737-783.

Week 6: Incentives in Politics

What are the similarities and differences between economic and political markets? This segment surveys a range of economic arguments that have been applied to political topics, highlighting the usefulness and the limitations of the approach. We cover some of the most prominent approaches (bulleted below) as well as the distinctive features of politics that complicate, or defy, economic analogy.

Discussion Questions:

- What are the incentives of politicians and why do they matter?
- Why do we need to control bureaucrats and how do we do it?
- How does the structure of political institutions affect public policy?

Readings:

- Stevens, Chapters 7 and 9
- Jon Elster, "[The Market and the Forum: Three Varieties of Political Theory.](#)" in Jon Elster and Aanund Hylland (eds.) *Foundations of Social Choice Theory*, pp.102-132, Cambridge UP, 1986.
- Weingast, Barry R and William J. Marshall, "[The Industrial Organization of Congress; or, Why Legislatures, Like Firms, Are Not Organized as Markets](#)", *Journal of Political Economy* 96, 1 (Feb. 1988): 132-63.
- Moe, Terry. "[The Politics of Structural Choice: Toward a Theory of Public Bureaucracy.](#)" In *Organizational Theory from Chester Bernard to the Present*, ed. Oliver Williamson, 116-153. Oxford: Oxford University Press, 1990.
- McCubbins, Matthew D., Roger G. Noll, and Barry R. Weingast. "[Administrative Procedures as Instruments of Political Control.](#)" *Journal of Law, Economics and Organization* 3 (1987): 243-277.

- Niskanen, William. [“Bureaucrats and Politicians.”](#) *Journal of Law and Economics*, December (1975) 18: 617-43.

Week 7: Political Failure I—Credibility and Economic Policy

Why is it that even a benevolent social planner would produce sub-optimal economic policies? This segment introduces the concept of credibility and incentives to adopt automatic rules and delegation schemes to conduct policy. It also relaxes the benevolent dictator assumption and considers the credibility problem in the context of real-world politicians with electoral and/or partisan ambitions.

Discussion Questions:

- What are possible solutions to the time inconsistency problem in economic policy?
- Under what conditions can reputation promote optimal economic outcomes?
- What are political business cycles and why do they emerge?

Readings:

- Drazen, Allan. 2000. [“The Time-Consistency Problem,”](#) and [“Laws, Institutions, and Delegated Authority,”](#) (chapters 4-5) in Alan Drazen, *Political Economy in Macroeconomics* (Princeton, NJ: Princeton University Press):101-165.
- Barro, Robert and David Gordon. 1983. [“Rules, Discretion and Reputation in a Model of Monetary Policy.”](#) *Journal of Monetary Economics* 12 : 101-121.
- Greif, Avner, Paul Milgrom and Barry Weingast. 1994. [“Coordination, Commitment and Enforcement: The Case of the Merchant Guild.”](#) *Journal of Political Economy* 102 (4): 745-776.
- Nordhaus, William. 1975. [“The Political Business Cycle.”](#) *Review of Economic Studies* 42 (1):169-90.
- Drazen, Allan. 2001. [“The Political Business Cycle after 25 Years.”](#) In *NBER Macroeconomics Annual 2000*, Ben S. Bernanke and Kenneth Rogoff, editors (15):75-138.

Week 8: Structure of Interests in Society

How efficient are political markets when societies are composed of actors with heterogeneous interests and asymmetric incentives to act politically? This segment covers the relationship between individual, group, and societal incentives and the consequences for political competition.

Discussion Questions:

- Is social class the basis of democratic policy-making?
- What types of interest groups are politically influential and why?

- What determines the size of government?

Readings:

- Olson, chapters 1 and 3.
- Przeworski, Adam and Michael Wallerstein, [“The Structure of Class Conflict in Democratic Society.”](#) *American Political Science Review* 76 (1982): 215-236.
- Meltzer, Allan H. and Scott Richards, [“A Rational Theory of the Size of Government”](#) *Journal of Political Economy* 89, 5 (1981): 914-927.
- Ronald Rogowski, ["Political Cleavages and Changing Exposure to Trade."](#) *American Political Science Review* 81, 4 (December 1987):1121-1137.
- Hibbs, Douglas. [“Political Parties and Macroeconomic Policy.”](#) *American Political Science Review* 71 (1977):1467-87.
- Iversen, Torben, chapters 1 and 3 from [Capitalism, Democracy and Welfare](#). Cambridge University Press. 2005.

Week 9: Political Failure II– Special Interest Politics

Does the structure of interests in society help or hinder the government to maintain an appropriate role in the economy?

Governments may overstep their legitimate role in the economy due to an exchange between (re)election-seeking politicians and special interests, involving campaign contributions.

Discussion Questions:

- What conditions foster rent-seeking?
- Does competition between interest groups ensure efficient public goods provision?
- Why do governments sometimes fail to choose the least costly method of redistribution?

Readings:

- Stevens, Chapters 8
- Viscusi, Kip et al., [“Introduction to Economic Regulation,”](#) in W. Kip Viscusi, John M. Vernon, and Joseph E. Harrington, Jr. *Economics of Regulation and Antitrust*, 3rd ed. (Cambridge, MA: MIT Press, 2000), pp. 297-336.
- Noll, Roger G. [“Economics Perspectives on the Politics of Regulation,”](#) In R.D. Willig and R. Schmalensee, eds. *Handbook of Industrial Organization*, Vol. 2, North-Holland (1989): 1254-1287.
- Krueger, Anne O. [“The Political Economy of Rent-Seeking.”](#) *American Economic Review* 3 (1974): 291-303.
- Tullock, Gordon, [“The Costs of Special Privilege,”](#) in James E. Alt and Kenneth A. Shepsle, *Perspectives on Positive Political Economy* (Cambridge University Press, 1990), pp. 195-211.

- Stigler, George J. [“The Theory of Economic Regulation,”](#) *The Bell Journal of Economics and Management Science* 2, 1 (Spring, 1971): 3-21.
- Peltzman, Sam. [“Toward a More General Theory of Regulation.”](#) *Journal of Law and Economics* 19 (1976): 211-240.
- Becker, Gary, [“A Theory of Competition among Pressure Groups for Political Influence,”](#) *Quarterly Journal of Economics* 98 (1983): 371-400.

Week 10: Political Failure, Part III – Predatory Government

What prevents government from overstepping its proper role and extracting resources for itself? Why is control over politicians problematic? With so much power over allocation, politicians face incentives to exploit their positions for personal enrichment, to the detriment of society. This segment covers the topic of political rent-seeking and the associated policies that hinder economic performance.

Discussion Questions:

- Can political corruption be prevented?
- What kinds of societies are most prone to predation?
- To what extent does democracy check predation?

Readings:

- Olson, M. 2000. [Power and Prosperity.](#) New York: Basic Books. Chapters 1 and 2.
- Bates, Robert H. 1981. *Markets and States in Tropical Africa: The Political Basis of Agricultural Policies.* Berkeley, CA: University of California Press.
- Shleifer, Andrei and Robert W. Vishny. 1993. [“Corruption,”](#) *Quarterly Journal of Economics*, v108 (3): 599-617.

McChesney, Fred S. Chapter 2 in *Money for Nothing : Politicians, Rent Extraction, and Political Extortion.* Cambridge, MA. Harvard University Press.