

**POLI 200C: States and Markets**  
**Spring 2014, W 12:00-2:50pm, SSB 104**  
**Course Website: <http://ted.ucsd.edu>**

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SSB 388

Office Hours: TU 1:15-3:00 pm or appt

**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. 1993. *The Economics of Collective Choice*. Westview Press.
- Robert H. Bates. 1981. *Markets and States in Tropical Africa: The Political Basis of Agricultural Policies*. University of California Press.
- Mancur Olson. 1990. *The Logic of Collective Action*. Revised 2<sup>nd</sup> printing, Harvard University Press.

*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*, 8<sup>th</sup> 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 short weekly memo to all course participants at the TED website:

<http://ted.ucsd.edu> by **Tuesday at 5:00 pm**. The memo should be one paragraph to one page in length 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 at the end of class on fourth week and is due at the beginning of class on fifth week. The final will be given out at the end of class on tenth week and is due Friday at 5:00pm on finals week. 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.

Discussion Questions:

- What is an “allocation mechanism”?
- How should we evaluate alternative allocation mechanisms?
- How relevant are normative concerns?

Readings:

- Stevens, chapters 1-2
- Okun, Arthur M. 1975. [\*Efficiency vs. Equality: The Big Tradeoff\*](#). Washington DC: Brookings (abridged, pp. 1-16).
- Lerner, Abba P. ["The Economics and Politics of Consumer Sovereignty."](#) *American Economic Review* (May 1972): 258-66.
- Sandal, Michael J. ["What Money Can't Buy: The Moral Limits of Markets."](#) The Tanner Lectures on Human Values. Delivered at Brasenose College, Oxford, May 11 and 12, 1998.
- Besley, Timothy. 2013. ["What's the Good of the Market? An Essay on Michael Sandel's, "What Money Can't Buy?"](#) February 21, 2013.
- Saez, Emmanuel. ["Income Inequality: Evidence and Policy Implications."](#) Slides from Saez's 2013 Arrow Lecture, Stanford University.

### 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?

*Readings:*

- Stevens, chapters 3-4 (skim)
- 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 Lighthouse in Economics."](#) *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.
- Edwards, Jeremy and Sheilagh Ogilvie. 2012. ["Contract Enforcement, Institutions, and Social Capital: The Maghribi Traders Reappraised."](#) *The Economic History Review* 65 (May):421–444.
- Spolaore, Enrico. 2012. ["The Economics of Political Borders."](#) *CEPR Working Paper Series No. 3854*

**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, Chapter 3, pp. 58-102.
- 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.

- Skarbek, David. 2011. [“Governance and Prison Gangs.”](#) *American Political Science Review* 105, 4 (November): 702-716.

#### **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.
- Lake, David A. [“Anarchy, Hierarchy, and the Variety of International Relations.”](#) *International Organization* 50, 1 (Winter, 1996):1-33.

#### **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.

- Akerlof, George A. 1970. [“The Market for “Lemons”: Quality Uncertainty and the Market Mechanism.”](#) *Quarterly Journal of Economics* 84, 3 (August): 488-500.
- Spence, Michael. 1973. [“Job Market Signaling.”](#) *The Quarterly Journal of Economics* Vol. 87 #3 (August): 355-374.
- Fearon, James D. 1999. [“Electoral Accountability and the Control of Politicians: Selecting Good Types versus Sanctioning Poor Performance.”](#) In Adam Przeworski, Susan C. Stokes and Bernard Manin (eds.), *Democracy, Accountability, and Representation*. pp. 55-97. Cambridge: Cambridge University Press.
- Lohmann, Susanne. 1994. [“The Dynamics of Informational Cascades: The Monday Demonstrations in Leipzig, East Germany, 1989-91.”](#) *World Politics* 47, 1 (October): 42-101.

### **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
- 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.
- Erol Akçay, Joan Roughgarden, James Fearon, John Ferejohn, and Barry R. Weingast. [“Biological Institutions: The Political Science of Animal Cooperation.”](#) Working paper, July 2013.

## Week 7: Political Failure I—Credibility and 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?
- Can political institutions resolve commitment problems?

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.
- North, Douglass C. 1993. [“Institutions and Credible Commitment.”](#) *Journal of Institutional and Theoretical Economics*. 149, 1 (March): 11-23.
- Posen, Adam S. [“Declarations Are Not Enough: Financial Sector Sources of Central Bank Independence.”](#) *NBER Macroeconomics Annual 1995*, edited by Ben S. Bernanke and Julio J. Rotemberg, MIT Press.
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## 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, class, and societal incentives and the consequences for political competition.

Discussion Questions:

- Is social class the basis of democratic policy-making?
- What determines the size of government?
- What determines the level of redistributive fairness in public policy?

Readings:

- 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.
- Boix, Carles and Susan C. Stokes. 2003. [Endogenous Democratization](#). *World Politics* 55 (July): 517-49.
- Hibbs, Douglas. [“Political Parties and Macroeconomic Policy.”](#) *American Political Science Review* 71 (1977):1467-87.
- Bartels, Larry. 2005. [“Homer Gets a Tax Cut: Inequality and Public Policy in the American Mind.”](#) *Perspectives on Politics* 3, 1 (March): 15-31.

### **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 types of societal groups are politically influential and why?
- What conditions foster rent-seeking regulation?
- Does competition between interest groups ensure efficient provision of regulation?
- Why do governments sometimes fail to choose the least costly method of redistribution?

Readings:

- Olson, Chapters 1 and 3.
- Stevens, Chapters 8
- 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.
- Rogowski, Ronald and Mark Andreas Kayser. 2002. [“Majoritarian Electoral Systems and Consumer Power: Price-Level Evidence from the OECD Countries.”](#) *American Journal of Political Science* 46, 3 (July): 526-539.

### **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:

- Bates, Robert H. 1981. *Markets and States in Tropical Africa: The Political Basis of Agricultural Policies*. Berkeley, CA: University of California Press.
- Olson, Mancur. 1993. [“Dictatorship, Democracy, and Development.”](#) *American Political Science Review* 87, 3 (September):567-576.
- Acemoglu, Daron, Thierry Verdier, and James A. Robinson. 2004. [“Kleptocracy and Divide-and-Rule: a Model of Personal Rule.”](#) *Journal of the European Economic Association* 2 (2-3): 162-192.
- 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):217-233.