

POLECON 686 – POLITICAL MACROECONOMICS

This Ph.D. level course covers research in positive political economy with special emphasis on macroeconomic aspects. First, the course will survey topics in business cycles theory such as political business cycles, monetary policy delegation and central bank independence, and optimal fiscal policy (political determinants of short-run macroeconomic management). Second, the course will cover topics in the political economy of economic growth, such as the interplay of political instability, income inequality, human capital accumulation and growth (political determinants of long-run economic performance). Third, the course will cover new issues in international political macroeconomics, with specific focus on the political economy of trade protection, the economics of country formation and international policy coordination.

Textbooks: The course will rely on two required textbooks in addition to the assigned articles and books:

- Persson, Torsten and Guido Tabellini, Political Economics, Explaining Economic Policy, Cambridge: MIT Press, 2000. (PT1)
- Drazen, Allan, Political Economy in Macroeconomics, Princeton: Princeton University Press, 2000. (AD)

In addition, you may find the following collection of seminal papers useful, since it will contain a lot of the required articles, which will save you the bother of having to locate them separately:

- Persson and Tabellini, Monetary and Fiscal Policy (2 volumes), Cambridge: MIT Press, 1994 (contains a collection of articles, some assigned below). (PT2, vol. 1 and vol. 2)

Other useful books that you should own if you are serious about doing research in political macroeconomics are:

- Alesina, Roubini and Cohen, Political Cycles and the Macroeconomy, MIT Press, 1997.
- Alesina and Spolaore, The Size of Nations, MIT Press, Cambridge, MA forthcoming 2003.

Prerequisites: First-year graduate micro, first-year graduate econometrics. First-year macro and a Ph.D. course in formal political economy (especially voting theory) will prove very useful but are not prerequisites.

Requirements: The requirements of the course are 4 problem sets (for a total of 50% of the grade) and a final paper (50%).

Problem sets: The problem sets will be due roughly every two weeks in class. They will be returned promptly with solutions sets. You are urged to work on the problem sets alone. The goal of the problem sets is to make sure you learn the mechanics of the main workhorse models in political macro.

Final paper: The paper will be due on the last day of class. The final paper can take one of two forms: 1) a critical survey of part of a literature we saw in class, including directions for future research. Such a survey would be useful to those who anticipate writing on political macroeconomics, but are not yet familiar with the field. The scope of the survey should not exceed the scope of one or two lectures in the course. 2) A piece of original research. This option is preferable for those who already know part of the literature, and are confident of the topic they wish to write a thesis about (or have already started). The goal of the final paper is to get you committed to a topic so that you can start working on a more substantial project as soon as the class ends. There are no space constraints, either as a lower or as an upper bound.

Administrative details: My office is in the Lou Henry Hoover Building room 222. You can drop by anytime but it is a good idea to email me first (wacziarg@gsb.stanford.edu) or call (650 723 1086) to make sure I am in. On Wednesdays I spend time at the Institute for International Studies in Encina Hall, at the Center for Democracy, Development and the Rule of Law, and you can find me at my office there (CDDRL is on the first floor of the Central West wing of Encina Hall).

COURSE SCHEDULE¹

Part I. The Political Economy of Macroeconomic Policy (7 sessions)

A. Monetary Policy, Delegation and Central Bank Independence

Session 1: Tuesday, January 7 - Background: Time Consistency in Monetary Policy.

Required readings

- PT1, Chapter 15, pp. 393-405
- Barro and Gordon (1983), Rules, Discretion and Reputation in a Model of Monetary Policy, Journal of Monetary Economics, vol. 12 (in PT2).

Additional Readings (in order of importance):

- AD Chapter 4.
- Kydland and Prescott (1977), Rules Rather than Discretion: The Inconsistency of Optimal Plans, Journal of Political Economy (in PT2).

Session 2: Thursday, January 9 - Reputation and Delegation.

Required Readings

- PT1, Chapter 15, pp. 405-414 and Chapter 17.2.
- Rogoff (1985), The Optimal Degree of Commitment to an Intermediate Monetary Target, Quarterly Journal of Economics vol. 100 (in PT2).

Additional Readings

- AD Chapters 5 and 6.
- Alesina and Summers (1993), Central Bank Independence and Macroeconomic Performance, Journal of Money, Credit and Banking.
- Lohman, S (1992), Optimal Commitment in Monetary Policy: Credibility versus Flexibility, American Economic Review.
- Grilli, Masciandaro and Tabellini (1991), Political and Monetary Institutions and Public Finance Policies in the Industrial Countries, Economic Policy vol. 13 (in PT2).
- Alesina and Gatti (1995), Independent Central Banks: Low Inflation at No Cost ?, American Economic Review Papers and Proceeding, May.
- Barro (1986), Reputation in a Model of Monetary Policy with Imperfect Information, Journal of Monetary Economics, vol. 17.
- Cukierman and Meltzer (1986), A Theory of Ambiguity, Credibility and Inflation under Discretion and Asymmetric Information, Econometrica vol. 53.

¹ Subject to change as we go along – you will be notified in class or by email when this is the case.

B. Political Business Cycles

Session 3: Tuesday, January 14 – Background and Opportunistic Cycles

Required Readings

- PT1, Chapter 16, pp. 419-426.
- Alesina, Roubini and Cohen, Chapters 1 and 2.
- Nordhaus, W. (1975), The Political Business Cycle, Review of Economic Studies, vol. 42.

Additional Readings

- AD, Chapter 7, section 7.3.
- Alesina and Cukierman (1990), The Politics of Ambiguity, Quarterly Journal of Economics, vol. 105.
- Rogoff, K and A. Sibert (1988), Elections and Macroeconomic Policy Cycles, Review of Economic Studies vol. 55.

Session 4: Thursday, January 16 - Partisan Cycles and Empirical Evidence

Required Readings

- PT1, Chapter 16, pp. 426-431.
- Alesina, Roubini and Cohen, Chapters 3, 4.
- Alesina, A (1987), Macroeconomic Policy in a Two-Party System as a Repeated Game, Quarterly Journal of Economics Vol. 102, No. 3. (Aug.), pp. 651-678.

Additional Readings

- AD, Chapter 7, section 7.4
- Alesina, Roubini and Cohen, Chapter 5, 6.
- Alesina, A (1988), Macroeconomics and Politics, NBER Macro Annual, 1988.
- Alesina, A (1988), Credibility and Policy Convergence in a Two Party System with Rational Voters, American Economic Review, Vol. 78, No. 4. (Sep.), pp. 796-805.
- Alesina, A and Roubini (1992), Political Cycles: Evidence from OECD Economies, Review of Economic Studies, Vol. 59, No. 4. (Oct.), pp. 663-688

Assignment 1: Problem Set 1 due: PT1, problems 15.7.2, 17.5.2, additional problem on Barro-Gordon to be handed out in class..

C. Government Size and Fiscal Policy

Session 5: Tuesday, January 21 – The Determinants of Government Size

Required Readings

- PT1 Chapter 10.
- AD, Chapter 14, pp. 675-707.

- Persson, Roland and Tabellini (2000), Comparative politics and public finance, *Journal of Political Economy* 108, pp. 1121-1161.

Additional Readings

- Rodrik (1998), Why do More Open Countries Have Larger Governments? *Journal of Political Economy*, vol. 106 no. 5
- Alesina and Wacziarg (1998) Openness, Country Size and the Government, *Journal of Public Economics*, September, 69, 305-322
- Gian Maria Milesi-Ferretti, Roberto Perotti and Massimo Rostagno (2002) Electoral Systems and Public Spending, *Quarterly Journal of Economics*, May.

Session 6: Thursday, January 23 – Public Debt and Fiscal Deficits, part 1

Required Readings

- PT1, Chapter 13, sections 13.1, 13.2, 13.3
- Barro (1979), On the Determination of Public Debt, *Journal of Political Economy*, Vol. 87, No. 5, Part 1. (October), pp. 940-971

Additional Readings

- Lucas and Stokey, Optimal Monetary and Fiscal Policy in an Economy without Capital, *Journal of Monetary Economics*, vol. 12 (in PT2)
- Persson and Svensson (1989), Why a Stubborn Conservative would Run a Deficit: Policy with Time- Inconsistent Preferences *The Quarterly Journal of Economics*, Vol. 104, No. 2. (May), pp. 325-345.
- Aghion and Bolton (1991), Government Domestic Debt and the Risk of Default: A Politico-Economic Model of the Strategic Role of Debt, in Dornbusch and Draghi, *Public Debt Management: Theory and History*, Cambridge: CUP.

Session 7: Tuesday, January 28 – Public Debt and Fiscal Deficits, part 2

Required Readings

- PT1, Chapter 13, sections 13.4
- Alesina and Tabellini (1990) “A Positive Theory of Fiscal Deficits and Government Debt”. *Review of Economic Studies*, vol. 57, pp. 403-414.
- Alesina and Drazen (1991), “Why are Stabilizations Delayed?” December 1991, *American Economic Review* vol. 81, no. 5, pp. 1170-1188 (in PT2).

Additional Readings

- AD Chapter 10, section 10.6 (find it...)
- Alesina, Perotti and Tavares (1998) *The Political Economy of Fiscal Adjustments*, *Brookings Papers on Economic Activity*, Spring 1998, pp. 197-266
- Tabellini and Alesina (1990), Voting on the Budget Deficit, *American Economic Review* vol. 80, no. 1 (March), pp. 37-49 (in PT2).
- Cukierman and Meltzer (1989), A Political Theory of the Government Debt and Deficits in a Neo-Ricardian Framework, *American Economic Review* vol. 79

- Alesina (1988), The End of Large Public Debts in Giavazzi and Spaventa, High Public Debts: The Italian Experience, Cambridge: CUP.
- Tabellini (1991), The Politics of Intergenerational Redistributions, Journal of Political Economy vol. 99.
- Roubini and Sachs (1989), Political and Economic Determinants of Budget Deficits in the Industrial Democracies, European Economic Review, vol. 33.

II. The Political Economy of Growth and Distribution

Session 8: Thursday, January 30 - Growth, Inequality and Redistribution, Part 1: Models of Redistribution

Required Readings

- PT1, Chapter 6, section 6.1
- AD, Chapter 8, sections 8.1-8.4
- Meltzer and Richard (1981), A Rational Theory of the Size of Government, Journal of Political Economy vol. 89 (in PT2).

Additional Readings

- Rodriguez, F. (1999), Does Inequality Lead to Redistribution? Evidence from the United States, Economics & Politics 11(2), July.

Session 9: Tuesday, Feb 4 - Growth, Inequality and Redistribution, Part 2: Inequality, Public Goods and Growth

Required Readings

- PT1, Chapter 14, section 14.1
- AD, Chapter 11, sections 11.1, 11.2, 11.3.
- Barro, R. (1990), Government Spending in a Simple Model of Economic Growth, Journal of Political Economy vol. 38.
- Alesina and Rodrik (1994), Distributive Politics and Economic Growth, Quarterly Journal of Economics.

Additional Readings

- Barro and Sala-i-Martin (1992), Public Finance in Models of Economic Growth, Review of Economic Studies, vol. 59, no. 4.
- Perotti (1993), Political Equilibrium, Income Distribution and Growth, Review of Economic Studies.

Assignment 2: PT1, problems 6.7, 13.8.1, 14.7.2, additional problem on tax smoothing to be distributed in class.

Session 10: Thursday, February 6 – Growth, Inequality and Redistribution, Part 3: Empirical Evidence

Required Readings

- Barro (1991), Economic Growth in a Cross-Section of Countries, Quarterly Journal of Economics vol. 106
- Persson and Tabellini (1994), Is Inequality Harmful for Growth, American Economic Review.
- Perotti (1996), Growth, Income Distribution and Democracy: What the Data Say, Journal of Economic Growth, vol. 1.

Additional Readings

- Perotti (1993), Political Equilibrium, Income Distribution and Growth, Review of Economic Studies.
- Forbes, Kirstin (2000), A Reassessment of the Relationship Between Inequality and Growth, American Economic Review 90 (4, September): 869-887

Session 11: Tuesday, February 11 - Political Instability and Economic Growth

Required Readings

- PT1, Chapter 14, Section 14.2
- AD Chapter 11, section 11.5
- Alesina, Ozler, Roubini and Swagel (1996) “Political Instability and Economic Growth,” Journal of Economic Growth, June, 2:189-213.

Additional Readings

- Alesina and Perotti (1996), Income Distribution, Political Instability and Investment, European Economic Review, vol. 40

Session 12: Thursday, February 13: Political Institutions and Economic Growth, Part I: Specific Institutions

Required Readings

- AD, Chapter 11, Section 11.4, 11.6
- Barro (1996), Democracy and Growth, Journal of Economic Growth, vol. 1

Additional Readings

- Tavares and Wacziarg (2001), How Democracy Affects Growth, European Economic Review.
- Mauro P. (1995), "Corruption and Growth", Quarterly Journal of Economics, 109, p. 681-712
- Alesina (1997), “The Political Economy of High and Low Growth,” in B. Pleskovic and J. Stiglitz (eds.) Proceedings of the 1997 ABCDE Conference, World Bank, Washington D.C., 217-48.

- Knack, Stephen and Keefer, Philip, 1995: “Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures,” *Economics and Politics* 7, 207-227.
- La Porta, Rafael, Lopez-de-Silanes, Florencio, Shleifer, Andrei, and Vishny, Robert, 1999: “The Quality of Government,” *Journal of Law, Economics, and Organization* 15, 222-279.

**Session 13: Tuesday, February 18 - Political Institutions and Economic Growth,
Part 2: Recent Debates**

Required Readings

- Acemoglu, Johnson and Robinson (2001), *The Colonial Origins of Comparative Development: An Empirical Investigation*, AER.
- Engerman and Sokoloff (2002) *Factor Endowments, Inequality, and Paths of Development Among New World Economies*, NBER Working Paper w9259
- Rodrik, Dani, Arvind Subramanian and Francesco Trebbi, (2002) *Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development*, NBER Working Paper w9305

Additional Readings

- Acemoglu, Daron, and Robinson, James, 2000: “Why Did the West Extend the Franchise? Democracy, Inequality, and Growth in Historical Perspective,” *Quarterly Journal of Economics* 115, pp.1167-1199.

III. Topics in International Political Economy [to be amended]

Session 14: Thursday, February 20 - The Political Economy of Reform

Required Readings

- Rodrik and Fernandez (1991), *Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty*, *American Economic Review* 81(5), December.

Additional Readings

- Sargent (1982), *The End of Four Big Inflations*, in Hall et al., eds, *Inflation: Causes and Effects*, University of Chicago Press.
- Rodrik (1989), *Promises, Promises: Credible Policy Reform via Signaling*, *The Economic Journal* 99, September.
- Reread Alesina and Drazen AER 1991

Assignment 3: PT1, problem 14.7.1, 14.7.4, 14.7.5

Session 15: Tuesday, February 25 - Macroeconomic Policy Coordination

Required Readings

- Persson and Tabellini, Chapter 18
- AD Chapter 12, sections 12.5 and 12.6

Additional Readings

- Frankel and Rockett (1988), International Macroeconomic Policy Coordination When Policy-Makers Do Not Agree On the Model, American Economic Review 78, no. 3, June

Session 16: Thursday, February 27 – The Political Economy of International Trade Policy, Part 1: First Generation Models

Required Readings

- Bhagwati (1983), Directly Unproductive Profit Seeking Activities, in Lectures on International Trade, MIT Press, chapter 30.
- Mayer (1984) “Endogenous Tariff Formation”, American Economic Review, Vol. 74, No. 5. (Dec.), pp. 970-985.

Additional Readings

- Rodrik (1995), The Political Economy of Trade Policy, chapter 28 in Grossman and Rogoff: Handbook of International Economics, Volume 3.
- Vousden, (1990), The Economics of Trade Protection, Cambridge: CUP, Chapter 8.

Session 17: Tuesday, March 4 - The Political Economy of International Trade Policy, Part 2: Interest Group Models

Required Readings

- Pinelopi Koujianou Goldberg and Giovanni Maggi (1999) "Protection for Sale: An Empirical Investigation", American Economic Review, December, vol. 89, no. 5, pp 1135-1155.
- Kishore Gawande and Usree Bandyopadhyay (2000), "Is Protection for Sale? Evidence on the Grossman-Helpman Theory of Endogenous Protection", Review of Economics and Statistics, February, vol. 82, no 1, pp 139-152

Additional Readings

- Helpman and Grossman (1994), Protection for Sale, American Economic Review v. 84, n. 4 September: 833-50 (please review it if you have already read it, and read it otherwise)

**Session 18: Thursday, March 6 – Fiscal Federalism and Country Formation, Part 1:
Country Formation**

Required Reading

- AD, Chapter 16, Section 14.6
- Alesina and Spolaore (1997), On the Number and Size of Nations, Quarterly Journal of Economics November 1997, 112, 1027-56
- Alesina, Spolaore and Wacziarg (2000) “Economic Integration and Political Disintegration,” American Economic Review, December, vol. 90, 1276-96

Additional Reading

- Alesina, Alberto and Romain Wacziarg (2000), “Is Europe Going Too Far?”, Carnegie-Rochester Conference Series on Public Policy, vol. 51, no. 1, December 1999, pp.1-42.
- Bolton, Patrick and Gerard Roland (1997), “The Breakups of Nations: A Political Economy Analysis”, Quarterly Journal of Economics, November, pp. 1057-89

Assignment 4: PT1 Problem 18.6.1, additional problems on Fernandez-Rodrik and on country formation to be distributed.

**Session 19: Tuesday, March 11 – Fiscal Federalism and Country Formation, Part 2:
Fiscal Federalism**

Required Reading

- To be announced/distributed

Additional Reading

- Wallace E. Oates (1999), An Essay on Fiscal Federalism, Journal of Economic Literature, Vol. 37, No. 3. (Sep.), pp. 1120-1149