

## Econ 544: Political Economy, Institutions, and Business

Professor Francesco Trebbi

Winter 2019 (Jan 06 2020 to Apr 08, 2020)

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Office Hours: By Appointment (available to answer questions via email).

Course Materials:

- (1) Most of the readings are online, available through JSTOR.
- (2) Text: David P. Baron, Business and Its Environment, Pearson, 5<sup>th</sup> edition, 2007. (Suggested)
- (3) Text: Gene Grossman and Elhanan Helpman, Special Interest Politics, MIT Press, 2001. (Suggested)
- (4) Text: Jean-Jacques Laffont and Jean Tirole, A Theory of Incentives in Procurement and Regulation, MIT Press, 1993. (Suggested)
- (5) Text: Torsten Persson and Guido Tabellini Political Economics: Explaining Economic Policy, MIT Press, 2000. (Suggested)
- (6) Text: Allan Drazen, Political Economy in Macroeconomics, Princeton University Press, 2000. (Suggested)
- (7) Text: Alberto Alesina, Nouriel Roubini, Gerald Cohen, Political Cycles and the Macroeconomy, MIT Press, 1999. (Suggested)
- (8) Text: Nolan McCarthy, Keith Poole, Howard Rosenthal, Political Bubbles, Princeton University Press, 2013. (Suggested)

Course Objective:

This course addresses the interactions between profit-maximizing firms and a vast class of non-market agents, such as governments, political, legal and regulatory institutions, and the public. The focus of the class is on both international and US environments. The class emphasizes the operative implications of non-market institutions in affecting and constraining firm strategy. Topics and cases cover the analysis of economic and political institutions, economic policy, lobbying and special interest activity, regulation and antitrust, activism and media. We corroborate the analytical framework with real-world applications, ranging from the United States' historical experience to cross-country comparisons, to develop insight in interpreting fundamental politico-economic constraints.

A Note on Course Materials

The bulk of course materials will come from one source: the lectures notes. I will sometime refer directly to the suggested books and the course readings however. I will also make available some supplemental lecture notes. The supplemental notes (posted on my web page) are integration to the books. The lectures of the course will describe important empirical regularities in order to help

identify key questions, to guide model-building efforts, to evaluate the usefulness of the economic models, and/or to provide perspective on major politico-economic developments.

### How to Succeed in the Course

To succeed is simple: Come to class, follow the lectures, and do all the readings.

### Course Meeting time

Lectures, starting from the second meeting, will begin on time and end 10 minutes earlier, as per university costume.

There will be no practice exercitations before exams.

### Course Grade (and grading policies):

For MA students:

100% *Two Midterms and Final* (Midterms counts “one unit” each, final counts “three units” - take the highest three of those five units’ grades and count 33% each to produce your mark – i.e. the lowest two of those five grades are dropped).

The two midterms will occur on **February 13<sup>th</sup>** and **March 12<sup>th</sup> 2020** and will last about 1:20 hours.

The midterms will take place at the beginning of class. NOTE: If you cannot make these exam times and you want to take the midterm, you should not take my class. No alternate arrangements will be made.

For PhD students and research-oriented MAs (upon special permission by me):

100% *Replication++*: You will be assigned/chose an academic paper that you not only will need to completely replicate, but you will need to augment in at least two worthy directions (these may include finding lack of robustness along relevant dimensions or show novel results you obtained). A 30 minute in-class presentation of your paper and findings is also required. You will present a written submission of your Replication++ on the day of the final exam.

### Course Grading (continued)

Given my grading system above, you need not take the midterms (i.e. the midterms are optional). If you do not take the midterms, 100% of your course grade will be applied to the final exam’s mark. But, I strongly suggest you take the midterms and take these tests seriously. The midterm is easier than the final. That is my goal. I do not normalize the means of the midterm and final when computing the course average. I want to reward those who take the midterms and take the midterms seriously. If, for some reason (extreme medical emergency, death in the family) you cannot make the final exam, contact me in advance of the exam. For those who have an emergency and contact me in advance, you will be given a grade of an incomplete. For those who do not contact me in advance, you will fail the course. Those who receive an incomplete can sit the final exam the next time I teach this class (likely, although not guaranteed, winter or spring of next year). I will then assign a course grade based on your midterm and final exam scores. I do not give any make up finals! Again, you must notify me in advance (or as soon as possible) if you are going to miss the final.

Any Exam for which there is a re-grade request must be done within 7 days after I return the exam to you. The request for re-grade MUST be done in writing and attached to the exam when submitting the exam for a re-grade. The request must include a description of what the problem is and why you think the exam should be graded differently. In such cases, I will re-grade the whole exam – not just the question you identified.

### Final

Exam times for the final are set by the University and not me. I **NEVER** offer alternate final times. You must be able to make the final time for one of the three sections if you enroll in my course.

### Provisional Grades

Provisional grades will be assigned on the basis of the midterm's grades. Students interested in obtaining provisional grades will be required to take the midterm exam. This is the only way I can give a serious assessment of their performance.

### Communication

On occasion, I will post email questions from students and my answers to these questions. I will discuss the questions that I think lots of students have. Hopefully, this will be an efficient way to disseminate information and review core material from the course. All student identifiers will be removed when I post the questions.

Note: If you do not want your question posted, you can explicitly state that in any emails you send.

Additionally, I will tend to only answer email questions 2 days a week. We will set these days as the class progresses. Tentatively, I will plan on allocating Monday afternoons and Friday afternoons for responding to emails.

### Honor Code

Even if not explicitly stated on each test, the honor code is always in effect. By taking this course, you explicitly pledge your honor that you will not cheat (or help others to cheat) in any way on the quizzes/exams. Any violations will be punished to the greatest extent allowed.

## Course Outline/Reading List

The lectures of the course will describe important empirical regularities in order to help identify key questions, to guide model-building efforts, to evaluate the usefulness of the economic models, and/or to provide perspective on major politico-economic developments.

Topics covered in the course (and some of, but not all, the ancillary readings) are:

### ***Topic 1: Political Agency and Political Institutions***

Ch. 5 Political Theory and Government Institutions

Baron, David P., *Business and Its Environment*, Pearson, 5<sup>th</sup> edition, 2007.

Ch. 9 Institutions and Accountability

Persson, Torsten and Guido Tabellini *Political Economics: Explaining Economic Policy*, MIT Press, 2000.

Sartori, Giovanni. 1995. "How Far Can Free Government Travel?" *Journal of Democracy* 6, 3: 101-111.

Ch. 8 Electoral Rules and Electoral Competition

Persson, Torsten and Guido Tabellini *Political Economics: Explaining Economic Policy*, MIT Press, 2000.

Ch. 10 Political Regimes

Persson, Torsten and Guido Tabellini *Political Economics: Explaining Economic Policy*, MIT Press, 2000.

Acemoglu, Daron (2005). "Constitutions, Politics, and Economics: A Review Essay on Persson and Tabellini's The Economic Effects of Constitutions", *Journal of Economic Literature*, 43, 1025-1048.

Milesi-Ferretti, Gian Maria, Roberto Perotti and Massimo V. Rostagno, "Electoral Systems and Public Spending", *Quarterly Journal of Economics*, 117(2), 609-657, 2002.

Persson, Torsten, Guido Tabellini and Francesco Trebbi. Electoral Rules and Corruption (with), *Journal of the European Economic Association*, June 2003, 1(4): pp.958-989.

Besley, Timothy and Anne Case (1995). "Does Political Accountability Affect Economic Policy Choices? Evidence From Gubernatorial Term Limits," *Quarterly Journal of Economics*, 110(3), 769-98.

Dal Bó, Ernesto and Martín Rossi (2011). "Term Length and the Effort of Politicians," *Review of Economic Studies*, 78(4), 1237-1263

Diermeier, Daniel, Michael Keane, and Antonio Merlo. 2005. "A Political Economy Model of Congressional Careers." *American Economic Review*, 95:347-373

## ***Topic 2: Voting and Political Behavior***

Kawai, Kei, and Yasutora Watanabe. 2013. "Inferring Strategic Voting." *American Economic Review*, 103(2): 624-62.

Thomas Fujiwara (2011), "A Regression Discontinuity Test of Strategic Voting and Duverger's Law", *Quarterly Journal of Political Science*: Vol. 6: No. 3-4, pp 197-233.

Kendall, Chad, Tommaso Nannicini Francesco Trebbi. 2015. How Do Voters Respond to Information? Evidence from a Randomized Campaign, *American Economic Review*, 105(1): pp.322-53.

Cruz, Cesi, Phil Keefer, Julien Labonne, and Francesco Trebbi. 2018. Making Policies Matter: Voter Responses to Campaign Promises. NBER WP 24785.

## ***Topic 3: Legislators***

Lee, David, and Enrico Moretti, and Matthew J. Butler (2004). "Do Voters Affect or Elect Policies? Evidence from the U.S. House," *Quarterly Journal of Economics*, 119(3), 807-859.

McCarty NM, Poole KT, Rosenthal H. 2006. *Polarized America: the Dance of Ideology and Unequal Riches*. Cambridge, MA: MIT Press

Ch. 2 Poole Keith 2005. *Spatial Models of Parliamentary Voting*. Cambridge University Press

Canen, Nathan, Kendall, Chad, and Francesco Trebbi. 2018. "Unbundling Polarization", NBER WP 25110.

Krehbiel, K. (1993). Where's the party? *British Journal of Political Science*, 23(2):235-266.

Krehbiel, K. (2000). Party discipline and measures of partisanship. *American Journal of Political Science*, pages 212-227.

Levitt, S. D. (1996). How do senators vote? disentangling the role of voter preferences, party affiliation, and senator ideology. *American Economic Review*, 86(3):425-441.

Moskowitz, D. J., Rogowski, J., and James M. Snyder, J. (2017). Parsing party polarization. *mimeo*.

Heckman, J. J. and Snyder, J. M. (1997). Linear probability models of the demand for attributes with an empirical application to estimating the preferences of legislators. *The RAND Journal of Economics*.

Jenkins, J. A. (2000). Examining the robustness of ideological voting: evidence from the confederate house of representatives. *American Journal of Political Science*, pages 811-822.

Snyder, James M., and Timothy Groseclose. 2000. "Party Influence and Congressional Roll-Call Voting." *American Journal of Political Science* 44: 193-211.

#### ***Topic 4: Within Democracies: Politics and the Media***

Besley, Timothy, and Andrea Prat. 2006. "Handcuffs for the Grabbing Hand? Media Capture and Government Accountability." *American Economic Review* 96(3): 720–36

DellaVigna S, Kaplan E. 2007. The Fox News effect: media bias and voting. *Quarterly Journal of Economics* 122:1187–234

DellaVigna, Stefano and Gentzkow, Matthew, (2010), Persuasion: Empirical Evidence, *Annual Review of Economics*, 2, issue 1, p. 643-669

Gentzkow M, Shapiro JM. 2006. Media bias and reputation. *Journal of Political Economy* 114:280–316

Gentzkow M, Shapiro JM. 2010. What drives media slant? Evidence from US daily newspapers. *Econometrica* 78:35–71

Gentzkow M, Shapiro JM. 2011. Ideological segregation online and offline. *Quarterly Journal of Economics* 126:1799–839

Gerber AS, Karlan D, Bergan D. 2009. Does the media matter? A field experiment measuring the effect of newspapers on voting behavior and political opinions. *AEJ: Appl. Econ.* 1:35–52

Groseclose T, Milyo J. 2005. A measure of media bias. *Quarterly Journal of Economics* 120:1191–237

Prat, Andrea 2018. "Media Power," *Journal of Political Economy*, University of Chicago Press, vol. 126(4), pages 1747-1783.

Puglisi, Riccardo and James Snyder, 2015. "The Balanced Us Press," *Journal of the European Economic Association*, vol. 13(2), pages 240-264

Shleifer, Andrei, 2015 "Matthew Gentzkow, Winner of the 2014 Clark Medal" *Journal of Economic Perspectives*, 29(1), pp. 181–192

Snyder, James and David Strömberg, 2010. "Press Coverage and Political Accountability", *Journal of Political Economy*, 118(2), 355-408.

### ***Topic 5: Within Democracies: Money in Politics***

Ansola-behere, Steven, John de Figueiredo, James Snyder (2003). "Why is There so Little Money in U.S. Politics?" *Journal of Economic Perspectives*, 17(1) ,105-130.

Bertrand, Marianne, Matilde Bombardini and Francesco Trebbi. (2014). "Is It Whom You Know or What You Know? An Empirical Assessment of the Lobbying Process", *American Economic Review*, 104(12): pp.3885-3920.

Blanes i Vidal, Jordi, Draca, Mirko and Fons-Rosen, Christian. (2012) "Revolving door lobbyists", *American Economic Review*, Vol.102 (7). pp. 3731-3748.

Kang, Karam (2016). "Policy Influence and Private Returns from Lobbying in the Energy Sector", *Review of Economic Studies*, Vol.83(1), pp. 269-305.

Grossman, Gene and Elhanan Helpman, "Protection for Sale", *American Economic Review*, 84: 833-850, 1994.

Goldberg, Pnelopi, Koujianou, and Giovanni Maggi. 1999. "Protection for Sale: An Empirical Investigation." *American Economic Review*, 89(5): 1135-1155.

Stratmann, Thomas, "Some Talk: Money in Politics. A (Partial) Review of the Literature," *Public Choice*, 124(1-2): 135-156, 2005

Austen-Smith, D., "Interest groups, campaign contributions, and probabilistic voting", *Public Choice*, 54 (2), 123–139, 1987.

Austen-Smith, D., "Strategic transmission of costly information", *Econometrica*, 62, 955– 963, 1994.

Austen-Smith, D., "Campaign contributions and access", *American Political Science Review*, 89 (3), 566–581, 1995.

Austen-Smith, D., Banks, J.S., "Costly signaling and cheap talk in models of political influence", *European Journal of Political Economy*, 18, 263– 280, 2002.

Diermeier, Daniel, Michael Keane, and Antonio Merlo. 2005. "A Political Economy Model of Congressional Careers." *American Economic Review*, 95:347–373

Feldmann, Sven and Morten Bennesen. "Informational Lobbying and Political Contributions", *Journal of Public Economics*, 90.4-5, 631-656, 2006.

Bombardini, Matilde and Francesco Trebbi, "Votes or Money? Theory and Evidence from the US Congress," *Journal of Public Economics*, August 2011, 95(7-8): pp. 587-611.

Bombardini, Matilde and Francesco Trebbi, "Competition and Political Organization: Together or Alone in Lobbying for Trade Policy?" *Journal of International Economics*, May 2012, 87(1): pp. 18-26.

Bombardini, Matilde and Francesco Trebbi, "Empirical Models of Lobbying," *Annual Review of Economics*, Forthcoming.

Olson, Mancur, "The Logic of Collective Action: Public Goods and the Theory of Groups", Harvard University Press, Cambridge, 1965.

Potters, Jan, and Frans Van Winden. "Lobbying and Asymmetric Information." *Public Choice* 74, no. 3 (1992): 269-92.

Bertrand, Marianne, Matilde Bombardini, Ray Fisman, and Francesco Trebbi. 2018. "Tax-Exempt Lobbying: Corporate Philanthropy as a Tool for Political Influence". *American Economic Review*, Forthcoming.

Perez-Truglia, R. and Cruces, G. (2017). Partisan Interactions: Evidence from a Field Experiment in the United States. *Journal of Political Economy*, Vol. 125 (4), pp. 1208–1243.

### ***Topic 6: Within Democracies: Antitrust, Government Regulation, and Markets***

Ch. 9 Antitrust: Economics, Law, and Politics

Baron, David P., *Business and Its Environment*, Pearson, 5<sup>th</sup> edition, 2007.

Ch. 10 Regulation: Law, Economics and Politics

Baron, David P., *Business and Its Environment*, Pearson, 5<sup>th</sup> edition, 2007.

Ch. 1-2 Laffont, Jean-Jacques and Jean Tirole. *A Theory of Incentives in Procurement and Regulation*, MIT Press, 1993.

Laffont, Jean-Jacques and Jean Tirole, "The politics of government decision making: regulatory institutions", *Journal of Law, Economics and Organization*, 6 (1), 1 –31, 1990.

Lucca, David, Amit Seru, Francesco Trebbi, 2014 "The Revolving Door and Worker Flows in Banking Regulation" (with David O. Lucca and Amit Seru). *Journal of Monetary Economics*, July, 65: pp.17-32.

Agarwal, Sumit David Lucca, Amit Seru, Francesco Trebbi, 2014 "Inconsistent Regulators: Evidence from Banking" *Quarterly Journal of Economics*, May, 129(2): pp.889-938.

Trebbi, Francesco, Kairong Xiao. 2015 Regulation and Market Liquidity *Management Science*, May 2019, 65(5): pp.1949-1968.



### ***Topic 7: Conflicting Interests, Reforms, Crises, Populism***

Ch. 7 Elections and Changes of Policymakers. Drazen, Allan, *Political Economy in Macroeconomics*, Princeton University Press, 2000.

Ch. 8 Redistribution. Drazen, Allan, *Political Economy in Macroeconomics*, Princeton University Press, 2000.

Ch. 10 Inaction, Delay, and Crisis, Drazen, Allan. *Political Economy in Macroeconomics*, Princeton University Press, 2000.

Alesina, Alberto and Allan Drazen, "Why Are Stabilizations Delayed?", *American Economic Review*, American Economic Association, vol. 81(5), pages 1170-88, December, 1991.

Allan Drazen and Vittorio Grilli "The Benefits of Crises for Economic Reforms" *American Economic Review*, American Economic Association, vol. 83(3), 1993.

Atif, Mian, Amir Sufi, and Francesco Trebbi, 2012 "Resolving Debt Overhang: Political Constraints in the Aftermath of Financial Crises", *American Economic Journal: Macroeconomics*, April 2014, 6(2): pp. 1-28.

Atif, Mian, Amir Sufi, and Francesco Trebbi, 2010 "The Political Economy of the US Mortgage Default Crisis" *American Economic Review*, December, 100(5): pp. 1967-98.

Funke, M, M Schularick and C Trebesch (2016) "Going to extremes: Politics after financial crises, 1870-2014", *European Economic Review* 88, 227-260

DalBo', Ernesto, Fred Finan, Olle Folke, Torsten Persson and Johanna Rickne. 2018 "Economic Losers and Political Winners: Sweden's Radical Right" mimeo UC Berkeley

Fetzer, Thiemo. 2018. "Did austerity cause Brexit?" *American Economic Review*, Forthcoming.

Guiso, Luigi and Herrera, Helios and Morelli, Massimo, Demand and Supply of Populism (February 2017). CEPR Discussion Paper No. DP11871. Available at SSRN: <https://ssrn.com/abstract=2924731>

Allan Drazen and Vittorio Grilli "The Benefits of Crises for Economic Reforms" *American Economic Review*, vol. 83(3), 1993.

Michael D. Bordo, Christopher M. Meissner 2012 "Does Inequality Lead to a Financial Crisis?" NBER Working Paper No. 17896

Michael D. Bordo, Christopher M. Meissner 2011 "Do financial crises always raise inequality? Some Evidence from History" *mimeo* UCSD.

## ***Topic 8: Political Cycles and Fiscal Policy***

Ch. 2. Alesina, Alberto, Nouriel Roubini, and Gerald Cohen, *Political Cycles and the Macroeconomy*, MIT Press, 1999.

Ch. 3. Alesina, Alberto, Nouriel Roubini, and Gerald Cohen, *Political Cycles and the Macroeconomy*, MIT Press, 1999.

Alesina, Alberto, "Macroeconomic Policy in a Two-Party System as a Repeated Game", *Quarterly Journal of Economics*, MIT Press, vol. 102(3), 651-78, August, 1987.

Alesina, Alberto and Lawrence H. Summers, "Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence", *Journal of Money, Credit and Banking*, Blackwell Publishing, vol. 25(2), 151-62, May, 2008.

Alesina, Alberto and Gerald D. Cohen and Nouriel Roubini, "Electoral business cycle in industrial democracies", *European Journal of Political Economy*, Elsevier, vol. 9(1), 1-23, March, 1993.

Alesina Alberto, Guido Tabellini, Francesco Trebbi. 2017. "Is Europe an Optimal Political Area? Two Puzzles". *Brookings Papers on Economic Activity*, March.

Brender, Adi, and Allan Drazen. 2008. "How Do Budget Deficits and Economic Growth Affect Reelection Prospects? Evidence from a Large Panel of Countries." *American Economic Review*, 98(5): 2203-20.

Drazen, Allan, "The Political Business Cycle After 25 Years" NBER Macroeconomics Annual 2000, Cambridge, MA: MIT Press, 2000.

List, John and Daniel Sturm, "How Elections Matter: Theory and Evidence from Environmental Policy", *Quarterly Journal of Economics*, 121(4), 1249 – 1281, 2006.

Müller, A, K Storesletten and F Zilibotti (2016), "The Political Color of Fiscal Responsibility", *Journal of the European Economic Association* 14(1): 252-302.

Persson, T and L E O Svensson (1989), "Why a Stubborn Conservative Would Run a Deficit: Policy with Time-Inconsistent Preferences", *Quarterly Journal of Economics* 104(2): 325-345.

Petterson-Lidbom, P (2001), "An Empirical Investigation of the Strategic Use of Debt", *Journal of Political Economy* 109(3): 570-583.

Rogoff, K., "Equilibrium Political Budget Cycles", *American Economic Review*, 80, 21-36, 1990.

Rogoff, Kenneth and Anne Sibert, "Elections and Macroeconomic Policy Cycles", *Review of Economic Studies*, Blackwell Publishing, vol. 55(1), 1-16, January, 1988.