

W4370
POLITICAL ECONOMY
MW 9.10-10.25

Professor Alessandra Casella

TA's: Justin Svec (jcs2104)
David Lopez-Rodriguez (dl2260)

Office: 1030 IAB
Office hours: Wed 4-6
Email: ac186.

Prerequisites: Calculus III, Intermediate Micro, Intermediate Macro.

Requirements: One midterm (March 2nd), one final exam, and approximately seven problem sets. The midterm will count for 40 percent of the grade, and the final for 60 percent. The problems sets will be graded as check, check plus, check minus. They are meant to help you and to provide tangible proof of serious effort. Problem sets results will be used to decide marginal exam grades. The exams will be based on the lectures.

There is no textbook, but the following books will be useful and are on reserve in the Business Library:

Hindriks, J. and G. Myles, 2006, *Intermediate Public Economics*, MIT Press: Cambridge.

Mueller, D.C., 2003, *Public Choice III*, Cambridge University Press: Cambridge, UK.

Shepsle, K.A. and M. S. Bonchek, 1997, *Analyzing Politics*, Norton: New York.

Introduction

Sonnenschein, Hugo, 1983, *The Economics of Incentives: An Introductory Account*, Nancy Schwartz Memorial Lecture, J. L. Kellogg School of Management, Northwestern University, 1983 (available on Ted Bergstrom's web page at: <http://www.econ.ucsb.edu/~tedb/econ230b.html>)

1. Limits and potential of markets.

- Externalities and public goods
- The Coase theorem.
- Example: existing markets for pollution permits.
- Theory: A decentralized mechanism when agents are few.

Coase, R., 1960, "The Problem of Social Cost", *The Journal of Law and Economics*, 3, 1-44.

Farrell, Joseph, 1987, "Information and the Coase Theorem", *Journal of Economic Perspectives*, 2, 113-129.

Dales, J., 1968, *Pollution, Property and Prices*, Toronto University Press: Toronto.

Tietenberg, T., 2006, *Emissions Trading*, Resources for the Future: Washington, DC (2nd edition).

Joskow, P.L., R. Schmalensee and E. M. Bailey, 1998, "The Market for SO₂ Emissions", *American Economic Review*, 88, 669-685.

Casella, A. 1999, "Tradable Deficit Permits", *Economic Policy*, 29, October.

Fisher, Frank and Annette Huber-Lee, 2005, *Liquid Assets. An Economic Approach for Water Management and Conflict Resolution in the Middle East and Beyond*, Washington, DC: Resources for the Future.

Varian, H., 1994, "A Solution to the Problem of Externalities when Agents are Well-Informed", *American Economic Review*, 84, 1278-1293.

2. Public goods provision.

- Optimal provision (the Samuelson Lindhal condition).
- Decentralized provision of public goods and free-riding.
- Experimental results.
- The Vickrey-Clarke-Groves mechanism.
- Voting as mechanism: Ledyard and Palfrey.

Hindriks, J. and G. Myles, Ch. 5.

Andreoni, J., 1988, "Why Free Ride? Strategies and Learning in Public Goods Experiments", *Journal of Public Economics*, 37, 291-304.

Isaac, R.M., K.F. McCue and C.R. Plott, 1985, "Public Goods in an Experimental Environment", *Journal of Public Economics*, 26, 51-74.

Falkinger, J., E. Fehr, S. Gaechter and R. Winter-Ebmer, 2000, "A Simple Mechanism for the Efficient Provision of Public Goods: Experimental Evidence", *American Economic Review*, 90, 247-264.

Chen Y. and R. Gazzale, 2004, "When Does Learning in Games Generate Convergence to Nash Equilibria", *American Economic Review*, 94, 1505-1535.

Clarke, E.H., 1971, "Multipart Pricing of Public Goods", *Public Choice*, 17-33.

Groves, T., 1973, "Incentives in Teams", *Econometrica*, 41, 617-631.

Ledyard, J. and T. Palfrey, 2002, "The Approximation of Efficient Public Good Mechanisms by Simple Voting Schemes", *Journal of Public Economics*, 83, 153-171.

3. Voting:

- Arrow's Impossibility theorem
- Gibbard-Satterthwaite non-manipulability theorem
- Majority rule.
- Alternatives to majority rule
- Majority rule and common values

Shepsle and Bonchek, Chs 4-8.

Mueller, Chs 4-8.

Arrow, K., 1951, *Social Choice and Individual Values*, Wiley (Yale University Press, 1990).

Gibbard, Allan F., 1973, "Manipulation of Voting Schemes: A General Result" *Econometrica* 41: 587-601;

Satterthwaite, Mark A., 1975, "Strategy-Proofness and Arrow's Conditions: Existence and Correspondence Theorems for Voting Procedures and Social Welfare Functions," *Journal of Economic Theory* 10: 187-217;

Black, D. 1958, *The Theory of Committees and Elections*, Cambridge University Press.

Dasgupta P. and E. Maskin, 2004, "The Fairest Vote of All", *Scientific American*, March, 92-97.

Jean-François Laslier and Karine Straeten, 2008, "A live experiment on approval voting," *Experimental Economics*, 11, 97-105.

Casella, A., A. Gelman and T. Palfrey, 2006, An Experimental Study of Storable Votes, *Games and Economic Behavior*.

Piketty, T., 1999, "The Information Aggregation Approach to Voting", *European Economic Review*, 43, 791-800.

Austen-Smith, David and Jeffrey Banks, 1996, "Information Aggregation, Rationality and the Condorcet Jury Theorem", *American Political Science Review*, 90, 34-45.

4. Redistribution.

- Rent-seeking and lobbying
- Fairness and redistribution

Hindriks, J. and G. Myles, Ch. 11.

Mueller, Ch. 3; Ch. 20.

Myerson, R., 1993, "Incentives to Cultivate Favorite Minorities under Alternative Voting Systems", *American Political Science Review*, 87, 856-869.

Lizzeri, A. and N. Persico, 2001, The Provision of Public Goods under Alternative Electoral Incentives", *American Economic Review*, 91, 225-239

Lizzeri and Persico, 2004, "Why Did the Elites Extend the Suffrage? Democracy and the Scope of Government", *Quarterly Journal of Economics*, 119, 705-763.

Acemoglu, D. and J. Robinson, 2000, "Why Did the Elites Extend the Franchise?" *Quarterly Journal of Economics*, 115, 1167-99.

Meltzer and Richards, 1981, "A Rational Theory of the Size of Government", *Journal of Political Economy*, 914-27.

Piketty, Thomas, 1995, "Social Mobility and Redistributive Politics", *Quarterly Journal of Economics*, 110, 551-584.

Alesina, A. and M. Angeletos, 2005, "Fairness and Distribution: U.S. versus Europe," *American Economic Review*, September, 913-35;

Alesina, A., E. Glaeser and B. Sacerdote, 2001, "Why Doesn't the US Have a European-Style Welfare State?", *Brookings Papers on Economic Activity*, and Harvard Institute of Economic Research, D.P. No. 1933.