I. Reminder of Course Introductory Overview:

A. Subject: A course in *political economy*, meaning political control of economic policy and political management of the domestic and international economy.

1. In particular, how this political control of economic policy and management of the domestic and international economy has evolved in response to “globalization”.

2. Emphasizes economic, political, & societal pressures on publics & policymakers that accompany globalization of *markets*, i.e., *increasing international economic interdependence*.

B. Approach: positive, interdisciplinary, and academic

1. *Positive*, as opposed to normative, means:
   a. Theory, and empirical evaluation of theory, about how these political economies actually function, and neither:
   b. How they would function under some idealized circumstances, nor
   c. How we judge they ought to work under some normative ideal.
2. **Interdisciplinary:**
   a. Primarily, as the course title would suggest, **political science** and **economics**. Positive study of political control/management of policy/economy ⇒ need to know:
      (1) incentives of policymakers (political science (& econ)),
      (2) what actions & instruments they have available for pursuing those incentives (econ (&pol sci)), and
      (3) how those tools & instruments affect the outcomes to which these incentives relate (econ &pol sci).
   b. In partic. re: CICS, course also aims provide some knowledge of some of core content & methodologies of these disciplines. Partly in service to the above, but also in own right.

3. **Academic:** i.e., interested in positive political-economic **theory**.
   a. Models & understandings of how things work, processes & relationships between variables;
   b. Descriptive exposition and pedagogy about practice & implementation less emphasized.

C. **Process:**
   1. Will proceed via thorough exposition of a series of political-economy texts, supplemented by a few additional articles and chapters.
   2. We will use these texts also to motivate pedagogical pauses, as necessary, to work through important methodologies (e.g., basic regression analysis) and theories (e.g., basics of fiscal & monetary macroecon. management, & of int’l trade & finance).
3. Schedule:

a. Overview of Positive Political Economy:

(1) Begin, accordingly, today w/ overview of what are political economy and positive social science.
(2) Giving some disciplinary background for positive political economy.
(3) Some models, methods, & tools first introduced; some (not all) will reappear through course: economic voting, game theory, median-voter theorem, regression analysis.

b. Classic Political Economy:

(1) Start substantive exploration with selections from Tufte’s classic, Political Control of the Economy:
(a) Bases to understand economic policymaking as policymakers responding to their incentives, given their tools, and how those tools work in that political-economic context.
(b) Tufte’s “electoral cycles” theory one of cores of political management of the economy that Clark is going to bring to reconsideration in the globalized economy (particularly, capital mobile).
(c) Will see more regression analysis (& other basic quantitative methods empirical evaluation).
(2) Continue with Hibbs’ classic *The American Political Economy*

(a) Elaborates the partisan incentives of elected policymakers in macroeconomic management.

(b) Hibbs’ “partisan cycles” theory, the other core to be explored by Clark, emphasizes differences in relative economic preferences left & right core constituencies of left & right parties, & how these different relative preferences shape the tradeoffs left *vs.* right policymakers will prefer to make in macro management.

(c) Introduce basic theories of fiscal & monetary policy management of macroeconomy; again see more regression analysis (as we will rather often throughout, so I’m going to stop mentioning it...).

![Graph of partisan cycles](image)

**c. Democratic Management of Globalized Economy:**

(1) Via Clark’s *Capitalism, Not Globalism:* electoral & partisan macro mngmnt under *globalization*, esp. highly mobile capital, w/ varying exchange-rate regimes & central-bank institutions.

(2) Important methodological and theoretical tools & models covered here will include: “Interaction Effects”: effect of X on Y depends on Z. Such context conditionality core to modern pol econ & among the major implications of *globalization*. The **Mundell-Fleming Model** of macroeconomic management in the open economy with high capital mobility and varying exchange-rate regimes.
(3) Franzese’s articles at end 1st half can serve as kind of summary synthesis of political management of open & institutionalized domestic economy.
(4) [Second Half] Hays’ *Globalization & the New Politics of Embedded Liberalism* explores nature & thorniness of Rodrik’s “globalization dilemma”, which is that:

(a) *Embedded Liberalism*: (Ruggie’s concept) international economic liberalization embedded in compensatory economic and social domestic and international policies.

(b) *Globalization Dilemma*: (Rodrik’s concept) increasing international economic integration both (a) exposes populations to greater economic risks (of external origin), thereby increasing public demands on governments to somehow to redress those risks, and (b) increases constraints on govts from raising revenues to fund policies and support institutions that could address those popular concerns.

(c) Hays shows the severity of the risks/concerns and the tightness of the funding constraints induced by increased globalization vary depending on domestic political-economic conditions (namely, labor-market (de)centralization and political-system (non)majoritarianism.

(d) Important theoretical & methodological building blocks here include:

i) Ricardian trade theory of *comparative advantage*,

ii) Stolper-Samuelson distributional implications of Heckscher-Ohlin factor-based comparative-advantage;

iii) basic political theories & models of broad differences b/w *majoritarian vs. proportional democracies*;

iv) &perhaps some sophisticated empirical methods (spatial econometrics) appropriate for modeling “interdependence”, which at core globalization & particularly the tax competition underlying govts’ funding-constraints ½ of dilemma.
d. Three modules surveying Critical Remaining Topics:

(1) Globalization and the political economy of international trade and finance;
(2) Globalization and inequality & development;
(3) Globalization and political-economic anxieties, tensions, & options.
(4) Follow selections recent academic articles or chapters these topics, again introducing & explicating basic theories & evidence regarding international finance & economic development as needed.
II. What is *Political Economy*:

A. At least four kinds/areas of study:

1. The Political Consequences of Economic Outcomes/Conditions
2. Microeconomic Choice-Theory (utility max & game theory) Applied to Politics
3. Normative Political Economy, two sorts: (pol-econ) philosophy, welfare economics
4. Positive Political Economy: What Policy *is* or *will* be enacted—how the political-economic system works. (Physics, not Metaphysics.)

B. The Political Consequences of Economic Outcomes/Conditions

1. E.g., Economic Voting: how econ performance affects election outcomes
   a. US: economic voting = core of most election-prediction models [See fig’s next pp]
   b. Comparative: (Lewis-Beck, Powell & Whitten, Duch & Stevenson) [See fig’s next pp]
      (1) In all democracies, tendency for incumbents presiding over stronger economic performance to garner more votes
      (2) Comparative insight is that domestic & international political structure, institutions, conditions (such as globalization, e.g.) modify/moderate this relationship
Figure 1. Bread and Peace Voting in US Presidential Elections

![Graph showing the relationship between incumbent party vote share and weighted-average per capita real income growth over the term.]

Model: \( \text{Vote}_t = \beta_0 + \beta_1 \left( \sum_{j=0}^{14} \lambda^j \Delta \ln R_{t-j} \left(1 / \sum_{j=0}^{14} \lambda^j \right) \right) + \beta_2 \text{CUM KIA}_t \)

<table>
<thead>
<tr>
<th></th>
<th>( \beta_0 )</th>
<th>( \beta_1 )</th>
<th>( \lambda )</th>
<th>( \beta_2 )</th>
<th>( \bar{R}^2 )</th>
<th>SEE</th>
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</thead>
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<tr>
<td>1. Benchmark model, Eq. 1 (1952–1996)</td>
<td>46.1</td>
<td>4.1</td>
<td>0.95</td>
<td>-0.37</td>
<td>.90</td>
<td>1.97</td>
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<tr>
<td></td>
<td>(42.2/.00)</td>
<td>(7.4/.00)</td>
<td>(26.9/.00)</td>
<td>(-5.5/.00)</td>
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\[ \text{logit}(\pi_{ik}) = \beta_0 + \beta_1 X_{ik} + \sum_{j=1}^{J_k} \Phi_{jk} Z_{ijk}. \] (1)

In this notation, \( v_{ik} \) indicates a vote for the chief executive party by voter \( i \) in each of \( k \) election surveys where \( i = 1, \ldots, n_k \). Likewise, \( X_{ik} \) are retrospective economic evaluations measured at the individual level and \( Z_{ijk} \) are other characteristics of individuals that shape

![Graph showing economic voting for various countries over different years.](image)

3.1 A map of economic voting for the party of the chief executive. The upper bound of on
Alternatively, same authors, different ways of presenting similar set of estimates:

![Graph 1: Confidence bands for economic vote, PM parties.](image)

Notice that magnitude of economic vote generally greater in countries with typically single-party, majority governments (e.g., *inter alia*).
\[ V = \ldots + 0.81 \times Econ + 2.58 \times Open - 0.71 \times Econ \times Open \ldots \]
\[ \Rightarrow \frac{\Delta V}{\Delta Ec} = +0.81 - 0.71 \times Open \]
2. Likewise Presidential Approval: econ conditions strongly affect incumbent evaluation

a. Central questions: Are voters’ evaluations...
   (1) Pro- vs. Retro-spective?
   (2) Personal vs. Sociotropic?
   (3) Partisan (Differentially) vs. Valence (Commonly) issue-oriented?
   (4) Symmetric vs. Asymmetric in reward and punishment?
   (5) Sensitive to appropriate credit/blame allocation?

b. Some important contributions to this literature:
   (1) Kinder & Kiewet (socio); Kinder & Markus (retro); Achen & Bartels (naive retro)...
   (2) MacKuen, Erikson, Stimson: “Peasants or Bankers” (APSR): forward, economy

3. International Economic Exposure: Trade & monetary open \( \Rightarrow \) interdependence \( \Rightarrow \) (?)

   a. Keohane-Nye & the IPE interdep lit: interdep states have shared not just conflict interests
   b. 1 strand liberal peace lit: interdep states no war

4. Growth/Development & Democratization

   a. Huntington’s *Pol. Order in Changing Soc.’s*: effect econ struct & change on soc-pol stbly
   b. Political Dev’p Lit (Deutsch, Przeworski et al.): relation ec devp to “pol devp” (see fig...)
The Relationship Between the
Degree of Democracy and of Economic Development

1980 Economic Development (Natural Log of Real GDP per Capita)

1980 Degree of Democracy (2=Highest, 14=Lowest)

Dem=26.1 -2.29(GDP)
s.e. (2.27) (.286)
N = 121, r = .59
C. Microecon Choice-Theory (utility max & game theory) applied to politics

1. International Relations Applications

a. Ken Waltz’ *Theory of International Politics*: market-structure theory of international system (billiard-ball states, maxing power, security, etc.) ⇒ Bipolar stable, balancing

b. Thomas Schelling’s *The Strategy of Conflict*: game-theory applications to international conflict – importance of focal points.

c. Coop in anarchy: Int’l Relations as iterated PD (Axelrod’s *Evolution of Cooperation*)

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**The Prisoners' Dilemma**

```
Confess
  / 
Confess /   \ Stay S ent
  \   /
    \  (10 years, 10 years)

     (free, 15 years)

Confess
  / 
Confess /   \ Stay S ent
  \   /
    \  (15 years, free)

     (5 years, 5 years)

Stay S ent
```

● Prisoner One
● Prisoner Two
2. US Politics Applications: Legislative (comm’s, vetoes, etc.) & Party Pol
   
a. Black’s Median-Voter Theory: 1-D preferences, 3+ voters ⇒ median rules

Note: Salaries in thousands of dollars.

Figure 6.1. Voter Preferences for Political Scientist Salaries
b. Down’s *Economic Theory of Democracy*: Hotelling-style locational theory of 2-party systems (convergence) — 2-prty compete on 1 dim., certainty, & all vote ⇒ full converge to median
c. Condorcet, Arrow, McKelvey-Schofield *Chaos Theorems:*

(1) 2+ Dimensions ⇒ majority-rule & simple MVT does not generally work / ⇒ chaos, etc.

(2) Bottom-left shows example of circular indifference curves for actors with solid-dot ideal points through hollow-dot *status quo* or proposal; and other, smaller indifference circles of higher utility.

(3) Example at bottom-right:

(a) *Status Quo* at X, voters’ ideals at p1, p2, p3;
(b) Any proposal in shaded areas beats it (called “winset of X”, btw);
(c) Such a winning proposal, call it Z, becomes the new *status quo*, so imagine three new circles, centered at p1, p2, and p3, going through Z. Creates three new lens-shaped winsets any proposal in which would beat Z and become the new status quo, and so on...
2D (or higher), no DDM member, Sincere Voting ⇒ (extreme) Agenda Power

![Graph showing Agenda Manipulation and Faculty Salaries](image)

**Figure 6.4. Agenda Manipulation and Faculty Salaries**

Yet 9 only opt 10 beats! 1 aspect McKelvey-Schofield Chaos. From anywhere to almost anywhere!

d. Figure shows example of extreme agenda-power & illustrates McKelvey-Schofield’s from almost anywhere to almost anywhere result. More generally, however:

1. We don’t have dem’s w/ this free-wheel anyone make any proposal anywhere at any time; rules proposal, amend, vote can induce (different) eqba (eg. Shepsle, Baron-Ferejohn, Romer-Rosenthal)

2. [Maybe can’t give the outcome the normative appeal of “public will”, but at least get an outcome, with at least some manner of public input.]
3. Comparative Politics Applications: Same as U.S., plus...
   a. Tsebelis: **Veto Actors** retard policy-adjustment. [Explain]
   b. BdM$^2$S$^2$: **Winset-Selectorate** model.
      (1) In systems w/ larger winsets, leaders prefer maintain coalition by public-good generation.
      (2) ...w/ large winsets relative to selectorates favors more equal distributions among win coalition.
      (3) ...w/ small winsets relative to selectorates favor leaders, w/ less to even the small winning coalition
   c. Studies of Coalition Formation: e.g., Laver & ... (Hunt, Schofield, Shepsle (x2)), Riker...
      (1) Minimum-Winning Coalitions (MWC) [explain logic];
      (2) Ideologically compact MWC’s
      (1) Majoritarian (low DM) / Proportional Representation (large DM)
         ⇒ High Disproportionality & High Thresholds Entry / High Proportionality & Low Thresholds
         ⇒ Few parties, tending toward 2 as DM toward 1 / More fractionalized party systems
         ⇒ Tendency toward single-party, majority gov’t / Coalition & minority government
D. Normative Political Economy, two sorts:

1. PE Philosophy:
   a. Rawls and others apply microeconomic methods to enquire re: “justice” & “fairness”: e.g., what would rep agent choose from behind *veil of ignorance*
   b. Sen *et al.* on economic “justice” & “fairness”; broader conceptualization, operationalization, and measurement of economic performance.

2. Welfare Macro/International Economics:
   a. What policy *should* (normatively) be enacted to achieve “ideal” (i.e., pareto optimal, i.e., efficient) outcomes. What’s done in most economics:
      
      (1) Model the economy, with policies to be exogenously set,
      
      (2) Ask what policies a “benevolent social planner” (usu. meaning policymaker utility=unweighted sum of citizens’ utilities) would enact, given that model of how exogenous policies would affect outcomes of interest to those citizens.
   b. What policy *would* (hypothetically) be enacted under some set of ideal conditions
      
      (1) Sometimes these normative welfare-economic analyses even taken as basis for predictions of what policies policymakers would in fact enact.
      
      (2) Or, policymakers might be given some other utility functions, intended to reflect their own political preferences, but economy and private citizens left without political preferences or options.
E. **Positive Political Economy (PPE):** What Policy is or will be enacted – i.e., Physics, not Metaphysics.


2. Limitations of Welfare Macro/International Economics
   a. *Not* benevolent social-planners but politically constituted governments $\Rightarrow$ No reason to expect ideal policies. Policymakers actors with interests like everyone else.
   b. Also, private actors’ preferences may extend beyond those arising in the formal, exchange, market economy.
   c. Plus, private actors’ options for action not constrained to the market; they may have political options as well.
   d. Still more, private actors’ and/or policymakers ‘rationality’ may be limited in some way(s).

3. Implications of these limitations
   a. Even the understanding of what economic outcomes certain policies may produce likely flawed when political & social considerations ignored. I.e., by ignoring 2a-d, economics alone can even get the (economic) theories of relations policies $\Rightarrow$ outcomes wrong.
   b. $\Rightarrow$ *A fortiori* that welfare economics is incompletely equipped to answer what actual policies and what actual outcomes we may expect. We need **positive political economy** theories.
III. Joint Determination of Social, Political, & Economic Outcomes: (could call this the first principle of political economy)
The Cycle of Political Economy

Examples of the Elements at Each Stage:

(A) Interests:
   - Sectoral Structure of Economy
   - Income Distribution
   - Age Distribution
   - Trade Openness

Elections:
   - Electoral Law
   - Voter Participation

Government Formation:
   - Fractionalization
   - Polarization

(B) Representation:
   - Partisanship

Policy:
   - Fiscal Policy
   - Monetary Policy
   - Institutional Adjustment

Government Termination:
   - Replacement Risk

(C) Outcomes:
   - Unemployment
   - Inflation
   - Growth
   - Sectoral Shift
   - Debt
   - Institutional Change

Result of Outcomes at T-1 → Action at Time T0 → Result of Outcomes at T0

On to T+1

Exogenous Factors

Government Termination

Partisan Representation in Government
IV. [Introduction to Positive Social-Science Theory mostly cut to additional lecture-notes 1b. Suffice this to serve as summary:]

A. Building blocks of positive social-scientific theory:

1. Identify the important actors in some context of interest.
   a. E.g., Tufte: econ policymaking in dem’s ⇒ incumbent (elected) policymakers & voters.

2. Determine those actors’ interests and options.
   a. E.g., Tufte: voters–support incumb or not; value recent econ perform. Incumbents–seek reelection, have various policy tools useful to shape voters’ recent econ experience/percepts.

3. Determine the relation between the actors’ actions, their chosen options, and outcomes. Have actors choose actions according to some logical decision rule.
   a. E.g., Tufte explains how various policies affect voters’ (perceptions) of recent economic performance and how those perceptions shape their votes.
   b. E.g., Tufte’s actors apply rational choice (i.e., cost-benefit analysis options, choose highest (lowest) perceived net benefit (cost)). Here: Incumbents choose policies that maximize their probabilities of reelection and voters reward / punish the delivery of benefits / costs.

4. Derive conclusions:
   a. E.g., Tufte: there is an electoral-calendar periodicity and timing to economic policymaking in democracies (because incumbent politicians electioneer &/because voters reward that).
B. The Systematic Features of Social World about which we theorize amount to
a set of (probabilistic) relationships between variables:

1. That is, we think of some feature(s) $X$ that make $Y$ more or less *likely* to occur or *tend* to $\uparrow$ or $\downarrow$ amount of $Y$ that occurs.

   a. Examples of hypothesized such relationships

   (1) Comparative-Politics Examples:

   (a) Huntington: Rapid socio-econ change produces political instability, coups, riots, & rebellions in under-dev’d ctys $\Rightarrow$ Probability of Social Strife $= \text{an increasing function of rate of change in society & economy} + \text{other stuff}$

   (b) Right-of-center govts run lower deficits than left-of-center govts do $\Rightarrow$ Budget Deficit $= f(\text{partisanship}, \varepsilon)$

   (2) American-Politics Examples:

   (a) Divided government responds slowly if at all to shocks $\Rightarrow$ Policy Response-Rate $= f(\text{Divided government}, \gamma)$

   (b) Voters “rally around the flag”, supporting president when s/he’s involved in int’l events $\Rightarrow$ Presidential Approval Rating $= \text{some function of how involved is president in international events} + \text{noise & other stuff}$

   (3) International-Relations Examples:

   (a) Ken Waltz: number of great powers affects likelihood or amount of systemic war $\Rightarrow$ Amount War $= \text{some function of # of great powers} + \text{some other stuff (stochastic &/or other factors not considered at moment)}$

   (b) Paul Huth: number of nuclear weapons and latent threat of nuclear use by defender will not increase probability of extended deterrence success when potential attacker is not a nuclear power $\Rightarrow$ Likelihood Extended Deterrence Success $\neq f(\text{function nuclear power of defender if potential attacker also nuclear power})$
2. **Statements are Probabilistic:** speak of likelihoods of events, tendencies, fertile ground for Y to happen being created, *etc.*
   
a. *E.g.,* generally less interested in the particular event that triggered some specific riot, more interested in environmental features which make riots more or less likely (systematic)
   
b. *Analogy:* more actuary than arson investigator – trying understand general features that make fires likely rather than what caused specific fires.

3. **Statements about Relationships:** theories less about predicting *per se*, though that certainly part of product, but rather more commonly about how some X (set of X’s) relates to Y (or not): “X increases” tends to make “Y ↑↓” i.e., statements of \( \frac{dY}{dX} \)

4. **Positive Theories are Simplifications:**
   
a. *No* implicit claim X’s highlighted = everything (or even necessarily most or very important thing) relevant to phenomenon, Y, being predicted. In other words, an implicit *ceteris paribus* (other things equal) statement accompanies any positive-theoretical statement.
   
b. *No* intention explain everything re: Y. World partly random--unless believe *all* systematic-not aiming to explain all of Y, but rather to grasp some of its systematic feature(s).
   
c. *Not* looking for photographic completeness & detail; in fact, would not be particularly useful as *theory* if were. Theory summarizes.
   
   (1) Indeed, if world partly random, then *can explain too much*: i.e., can seem explain, render systematic, what is actually random. Theory that does this generally very bad at “out-of-sample” explication.
The Relationship Between the Degree of Democracy and of Economic Development

Dem=26.1 -2.29(GDP)
s.e. (2.27) (.286)
N = 121, r = .59

V. More examples to help in understanding & interpreting empirical evaluations by regression analysis:
Average Government Partisanship 1950-88

\[ \text{GSpent} = 48.3 - 2.32 \text{GPart} \quad r = +.28 \]
\[ (1.82) \quad N = 21 \]

Soc. Sec. Transfers as % of GDP in 1988

\[ \text{Transfers} = 17.5 - 1.11 \text{GPart} \quad r = +.43 \]
\[ (0.55) \quad N = 20 \]
Aggregate Economic Performance of Developed Democracies in the Postwar Period

Real GDP per Capita Growth Rate

0%  1%  2%  3%  4%  5%  6%

US    Japan    Germany    Italy    Canada    Austria    Belgium    Denmark    Finland    Greece    Ireland    Netherlands    Norway    Spain    Switzerland    New Zealand

Real GDP/Capita 1955 - Real GDP/Capita 1990 - Annual Growth Rate

1955-1990

Real GDP per Capita (in Thousands of 1985 US$)

$0  $5  $10  $15  $20

US    Japan    Germany    France    Italy    UK    Canada    Austria    Belgium    Denmark    Finland    Greece    Ireland    Netherlands    Norway    Portugal    Spain    Sweden    Switzerland    New Zealand
The "Catch-Up" Hypothesis

Correlation = 0.90   # pts = 21

\[ y = 0.178 + -0.0176x \]

(0.0019)
The "Small Government" Hypothesis

Correlation = .27   # pts = 21
y = 0.0391 - 0.0354x
(0.0292)
By the way, the relative performances change radically comparing those first 35 years to the last 20. Most notable thing, though, is how much slower growth has been across the board.

The “catch-up hypothesis” (a.k.a., neoclassical growth model) still has some of the explanation, but it’s a lot less strong than before.

Small-gov’t hypothesis doesn’t fare well at all.
A. We’ll discuss further how to interpret empirical-estimation results like these, and (much) more sophisticated versions of these, as we get to them in the course of the semester.

B. Of course...

1. More than one thing matters... (*multicausality* and *controls*);

2. How things matter may depend on other things... (*context conditionality* and *interactions & nonlinearity*);

3. Correlation does not imply causality... (ubiquitous *endogeneity* and *causal identification* strategies):
   a. The *poor man’s exogeneity* (time)...
   b. System specification...
   c. Instrumentation...
   d. Discontinuity...
   e. Matching...
   f. Experimentation...

VI. [Go to brief intro to interpreting regression analysis...]