

# Chapter 11: Comments on Acemoglu and Merlo

Timothy Besley, LSE

February 28, 2006

It is a pleasure to discuss two such rich and interesting papers. The scope of the two papers is really rather different and they complement each other well.

Antonio Merlo's paper is largely driven by inspecting the tools that we are accumulating to study issues at the intersection of politics and economics. He highlights four main areas where real progress has been made. The first is the

study of voting where he discusses both the decision to vote (the determinants of turnout) and the way in which people vote (particularly whether voting is strategic). Next, he looks at politicians as a unit of analysis. He then pursues the (correct in my view) path towards studying parties as collections of citizens. Finally, he looks at legislative policy making. For the most part, he looks at theoretical issues. As we would expect in this kind of *Econometric Society* address, he gets into some of the modeling details.

Daron Acemoglu's paper is more focused on issues. In fact, he does not get much into the richness of political processes since he is trying to get at broader systemic questions about how politics and economics interact. A feature of his paper is the use of a unified dynamic modeling framework which can be used to illustrate a wide range of phenomena. One of the main ambitions of the paper is to look at different institutional arrangements and their implications for economic resource allocation. He also gets into the question of how to model endogenous institutional change – one of the central challenges of modern political economy.

I will organize my discussion of these papers in three parts. I will begin with a few general comments on things that occurred to me while reading both papers. I will then present some specific comments on each of the papers. These will be selective and specific. Finally, I will return to some themes that were missing in both papers which I will flag for interest's sake and to focus on topics for further work.

Those who have worked in the field of political economy have a variety of ambitions. But broadly, the field as it has emerged in the past ten to fifteen years is aiming to increase the competence of economists in analyzing policy

issues where some understanding of political decision making is necessary. High on the list of relevant issues is the need to be able to evaluate differences between political institutions. These can be the kinds of grand differences that are studied in Daron's paper – democracy versus autocracy. However, more typically, there is a need for advice on specific constitutional reforms – such as whether to introduce some element of direct democracy or to change the term lengths of representatives. For any of these issues, we need a flexible kit-bag of tools that are adaptable and tractable. This is what Antonio reviews. In order to conduct a comparative institutional analysis of the best form of constitution requires a precise normative framework.

One of the crowing achievements of welfare economics has been to develop a normative approach based on equity and efficiency. This stands in contrast to the literature in political science which tends to use less precise normative categories such as how representative or accountable is a political system. While these are useful and important ideas which are often salient in discussions about politics, their normative status is not clear. Does an increase in representativeness map easily into a higher level of social welfare? If so, in what terms? This the economic approach offers the most useful basic tools for studying issues of constitution design.

The need for a normative framework is important when asking whether the positive economics of policy choice yields systematic divergences from normative ideals. Indeed, many discussions about political processes by economists are motivated in terms of trying to understand why some policies that are not ideal (such as trade protection) are implemented. Terms like *political failure* or *government failure* are often used rather loosely in such

debates.

In any debates about institutions, the term efficiency has to be used carefully and consistently.<sup>1</sup> In applications to markets, Pareto efficiency, has been for nearly fifty years the most intellectually satisfactory construct for a rigorous notion of market failure. However, in applied welfare economics, notions of market surplus have had more play. Yet, as is well-known, unless compensations are paid by gainers to losers, the latter is essentially different from Pareto efficiency with an implicit distributional assumption about the relative merits of gainers and losers. The benchmark of social surplus does have the attraction that it seeks solutions that make the pie as large as possible. However, this is a social judgement which is not entirely self-evident to those who might lose out in the process. For similar reasons, it is even less clear that selecting policies that increase economic growth is normatively justifiable. Again this depends on the possibilities for compensation if there are some who lose out in that process.

The social surplus criterion is best thought of as a specific social welfare function. But to call failure to achieve a criterion that trades off the utility of gainers and losers an *efficiency* criterion, does require some kind of defence. In this respect, I would have preferred that Daron used a more qualified notion of good institutions and government inefficiencies than the one that he uses for most of his paper. For the most part, he studies cases where the inefficiency comes in the form of output being “too low” rather true economic inefficiencies. This is an important criterion, but I would prefer to give it a different name rather than using the term “inefficiency” to describe it.

---

<sup>1</sup>See Besley (2006, chapter 2) for a general discussion of the idea of government failure.

Political economy as presently constituted is a young field. This makes it all the more exciting for those that are working in it. There is less need to play by any ground rules and even preliminary steps can seem like giant leaps forward. But this makes the job of the reviewer and synthesizer much harder. One of the lasting contributions of these papers could be to help to set the ground rules and to set the agenda. This means making clear that certain things should be viewed with great suspicion. For example, there are cases where assuming that voting is sincere in multi-candidate settings yields absurd conclusions – for example, if one citizen can switch their vote and get an outcome that they prefer to what is currently on offer. The literature seems also to have been remarkably cavalier in positive models of policy choice when making assumptions about credibility. This has long been discredited in normative models since the discovery of time consistency problems for benevolent governments. Thus there are areas where elements of good theoretical practice still need to be discussed.

A good test of success probably comes from showing that the models we are developing also have explanatory power empirically. Being able to make claims of this sort for the field of political economy at present is probably premature and this may explain why these papers do not enter that terrain too much.<sup>2</sup> Nonetheless, I do predict that the papers will have some kind of agenda setting power.

I now turn to some specific observations on each paper beginning with

---

<sup>2</sup>Books like Persson and Tabellini (2003) are pointing the way forward in studying the empirical consequences of political institutions.

Daron Acemoglu's.

Daron's paper covers a lot of territory. There are some quite specific features of Daron's model for studying interaction between government and the economy. In Daron's model, all government activity is redistributive – there is no role for government in funding public goods or providing social insurance as would happen with redistribution in a stochastic economy. Benabou (2003) shows that such policies can be growth enhancing. Even in Daron's framework, there is no guarantee that reducing taxation leads to *Pareto* improvements even if it does increase income per capita. Thus to describe low growth as an *inefficiency* is somewhat misleading.

The paper focuses initially on three kinds of policy distortion in a model where a particular group holds political office. These are problems of: (i) resource extraction – when tax rates are set to reduce incentives to produce, (ii) factor price manipulation – when changing factor prices serves to transfer rents and (iii) political consolidation – when distorting policies are manipulated to allow the incumbent to remain in office.

The first two of these are really classic problems in dynamic optimal taxation. In fact the revenue extraction argument is a dynamic Ramsey tax problem with limited commitment. The second is an interesting example of a case where there are insufficient instruments for the classic Diamond and Mirrlees production efficiency theorem to hold. Here the outcome would be Pareto dominated if the government had sufficient instruments.

The political consolidation arguments are much more central to the concerns of the political economy literature. Again, however, a more careful

treatment of the efficiency issues is probably warranted. Besley and Coate (1998) shows that even there are concerns about political survival that lead to policy distortions, this does not imply that the outcome is Pareto inefficient even though that may sometimes be true.

The most exciting area in Daron's paper is the discussion of efficient institutions and endogenous institutional change. This an important and novel area of investigation and this paper is helping to lead the way. However, it should be acknowledged that this is also an old tradition, going back to some of the early public choice research, even though the modern tools are making progress. For example, Buchanan (1967) anticipates this line of enquiry when he says:

“Theoretical welfare economics enables us to define the necessary marginal conditions that must be satisfied for an allocation of economic resources to be efficient. Straightforward extension of this analysis to "theoretical institutional economics" should enable us to define a similar set of conditions that would have to be met if an institutional arrangement or rule is to be classified as "efficient." It now seems quite possible that future developments will in fact allow for general statements of such conditions.”

<http://www.econlib.org/library/Buchanan/buchCv4Contents.html>,  
4.19.36.

As Daron points out, what we need in the first instance is a clean mapping from policy into institutions and thence the form of induced preferences over political institutions. Having found this, there are both positive and

normative issues. On the positive side, there is an issue of the right way to model institutional choice? This could itself be a political process – with a constitutional change where individuals vote for the institutions that they prefer. However, it could also be a less internally driven process as when a colonial power endows a country with a constitution or as in the U.S. where a small group of founding fathers got together to draft a constitution. It could also involve a more abrupt change due to a revolution or coup.

The normative issues concern the right way to evaluate constitutional choices. The standard economic criteria of equity and efficiency are fine here. This leaves open the possibility of Pareto dominated institutions being adopted. In fact the issues exactly parallel those considered when studying Pareto inefficient policies. In particular, if a new constitution favors a particular group and no ex post compensations can be paid then a Pareto inefficient set of institutional rules may continue.

In Daron's model democracy is modeled as the dictatorship of the most numerous group. While there are a variety of simple voting models that back this up, it is a quite simplistic view. Political scientists have rightly seen democracy as, in many instances, a vehicle for elites to gain influence. There is a host of contributions that stress that multi-dimensional and single-issue politics are very different.<sup>3</sup> There are also interesting issues of political recruitment – political institutions (such as parties) may be set up to limit the extent to which certain groups gain effective political representation (cite evidence that changing this matters). There is also evidence that the form

---

<sup>3</sup>See, for example, Roemer (1998).

of democracy matters.<sup>4</sup>

Promoting democracy on the basis that it is good for economic performance – either measured in terms of aggregate output or any other criterion is not too plausible from a theoretical point of view. There are many good reasons to be democratic, but the case for growth enhancing democracy is far from clear even on the most simplistic accounts of the difference between democracies and autocracies.

In earlier work and in this paper Daron has emphasized the need to understand the failure of the Coase theorem in order to understand the process of institutional change.<sup>5</sup> The key intellectual issue is to understand the source of second best outcomes in institution design.<sup>6</sup> In particular, we need to understand whether the lack of instruments for redistribution, limitations on credibility of future policies or failures of incentive compatibility due to imperfect information are at the heart of the particular inefficiency being studied. Only then can we make constructive recommendations for institutional change. This has much wider applicability than just to studying the design of political institutions – it applies to any scenario where competing “rules of the game” are being debated.

It is also important to understand the process of institutional change. Daron’s work with Jim Robinson is seminal here (see Acemoglu and Robinson (2006)). They study discrete shifts between democracy and dictatorship. But we also need models of more continuous change in institutions. Some polities experience large abrupt changes in their regime, while others are on

---

<sup>4</sup>See Persson (2005).

<sup>5</sup>See Acemoglu (2003).

<sup>6</sup>See Besley (2006, Chapter 2) for further discussion.

slower more incremental paths. Similarly, we need models that allow for varieties of democracy and dictatorships. There are some dictatorships that have effectively fostered long-run growth or increases in life-expectancy while others have the opposite consequences. Equally there are democracies that have the formal institutions of elections but with repression of the media and the opposition.

The need to bring a more pluralistic approach to studying institutions, while challenging, fits in well with the main theme of Antonio Merlo's paper which is about the heterogeneity of modeling approaches in a broadly democratic setting.

Antonio's has an interesting discussion of the history of the term political economy. A small point on this since he does not mention the work of John Neville Keynes (father of John Maynard Keynes) in his discussion of the history of political economy. Keynes (1891) identifies three branches of economics: positive science (what is), normative or regulative science (what ought to be) and the art of political economy. He characterizes the latter as the branch of economics by which practical maxims are formulated. He notes that

“when we pass ... to problems of taxation, or problems that concern the relations of the State with trade and industry, or to the general discussion of communistic and socialistic schemes – it is far from being the case that economic considerations hold the field exclusively. Account must be taken of the ethical, social, and political considerations ...." (Keynes (1891, page 55)).

This bears note since Keynes seems to be using the term political economy in its contemporary connotation, to describe the interaction between the economy and politics.

The first topic in Antonio’s paper is the study of voters and voting decisions. This is an area where, *prima facie*, I am sympathetic to “behavioral” models. That said, there is good (at least circumstantial) evidence that people are somewhat strategic. However, there is a long tradition of political scientists working with models where voter loyalty towards parties is a key idea.<sup>7</sup> Just how to understand the form that these loyalties take and whether they have an underlying rationale (in terms of economic interests) is an important issue. At one extreme, such loyalties could simply be like loyalties to football teams that defy an easy “rational” explanation. It is clear, that if there are important behavioral elements in voting, this has implications for how we model political competition. It may blunt the ability of electoral competition to discipline politicians on policies and corruption. But I do agree with the thrust of Antonio’s discussion that we need to push rationality as far as we can first before introducing behavioral elements. However, I remain less sanguine about the progress that we have made here using standard economic tools than he is.

One missing theme in Antonio’s discussion of voting concerns how votes aggregate. One key question is how votes translate in seats – since the latter determine political control. The pattern of districting is key here. The seats-votes relationship can be rather different depending on the pattern of voter concentration across districts. This seems to be important empirically

---

<sup>7</sup>See, for example, Green et al [2004] for a useful review on this topic.

give that proportional representation systems have rather different economic policies compared to majoritarian systems. Indeed, Persson and Tabellini (2003) argue persuasively that there are substantial differences between majoritarian electoral systems and proportional electoral systems in terms of policy outcomes.

I very much welcome Antonio's emphasis on politicians as a group. His recent work on understanding careers of politicians is an important and long overdue agenda. More generally, the topic of political selection has not received the attention that it deserves, perhaps because economists are more comfortable with the study of incentives. Political selection can be important as a means of establishing credibility to the extent that some policy positions are supported by "sincere preferences". Selection may also be important because the political class is more honest and competent in some places compared to others. It is important then to see how institutions shape the selection process. One reason for the downfall of hereditary systems of government was surely that bloodline is a poor basis for political selection. But different democratic institutions may work better as filters.

Antonio's paper also discusses models of political parties. One of the big challenges in the field now is to have better models for the internal workings of parties. I was a bit surprised, however, to see that, after the discussion of voting in an earlier section, the model of voter mobilization that Antonio studies is largely behavioral. So there is a bit of a disconnect between this approach and his earlier discussion. It was also not too clear to me how mobilization really differs from a model of campaign spending financed by a special interest. This in turn raises some important issues about the way

that parties coordinate campaign finance and the interplay between party campaigning and special interest influence. This discussion could also usefully be tied to some of the emerging literature on the effectiveness of “get out the vote” experiments. This is a fruitful area where much remains to be done, but it is still evolving. The emphasis placed on this in Antonio’s paper is an important pointer to future research.

The issue of political credibility is central to understanding policy formation. This is an area where the role of parties and institutions play a large role. Alesina and Spear’s (1988) model of overlapping generations of politicians has surprisingly not spawned much subsequent interest in these issues. But surely a key role of parties is to act as long-live players that protect reputations even when politicians themselves are ephemeral.

Parties also play a central role in political recruitment. Just what incentives parties have to recruit particular kinds of political office must affect the kinds of people who enter political life. Some parties appear (superficially) to be more open and democratic, while others are more hierarchical and controlled by narrow elites. The scope for creating a genuine internal organization theory for parties and their role both in selection and incentives is a major challenge. Here, contracting issues seems central in understanding how well parties are able to regulate behavior of their members who hold political office. There is a need for an integration of political agency models with models of party behavior.

To sum up, Antonio shows how we are developing models that give us an understanding of a wide array of phenomena. But there are also so many new and exciting avenues to pursue. In each case, the challenge of bringing

theory and data together is immense. But it is a distinctive piece of the challenge that the new political economy literature is meeting.

Finally, I turn to some of the missing themes in both papers. It is interesting that neither author spends much time on the role of special interests in policy making. This is not a problem, except to note that a lot of time and effort is spent in political economy on this aspect of politics and its consequences for economics (see, for example, Grossman and Helpman (2001)). A more complete discussion of recent progress in political economy would probably have put more weight on such models.

Both papers focus on how political institutions work on their own merits. However, good government flourishes in the context of a wide range of institutions, some of them beneficial and others malign. Examples include the role of the media in monitoring government and providing information, the role of think-tanks in scrutinizing policy proposals, the role of social organization such as religious groups. Also important in many countries is the role of the army in either supporting or hindering the task of government. It may even be that it is the strength of these institutions, rather than of purely political institutions that matters most to effective government. The next generation of work will increasingly study the interaction between these social and economic forces in shaping policy processes. As a result our understanding of how government works will be further enhanced. It will also ideally create a better appreciation of comparative institutional solutions.

I mentioned at the outset that aim of modern political economy is to enhance the competence of economists in studying policy problems. Both of

these papers show how the tools of economics can be used this way. But they also demonstrate that the task is not yet complete. But by taking stock of progress, I have no doubt that these papers will inspire further contributions.

## References

- [1] Acemoglu, Daron, [2003], “Why not a Political Coase Theorem?” *Journal of Comparative Economics*, 31, 620-52.
- [2] Acemoglu, Daron and James Robinson, [2006], *Economic Origins of Dictatorship and Democracy*, Cambridge University Press..
- [3] Alesina, Alberto, [1988], Credibility and Policy Convergence in a Two-Party System with Rational Voters, *American Economic Review*, 78(4), 796-806.
- [4] Alesina, Alberto. and Steven Spear [1988] “An overlapping generations model of electoral competition” *Journal of Public Economics* 37(3): 359-379.
- [5] Benabou, Roland, [2002], “Tax and Education Policy in a Heterogeneous Economy: What Levels of Redistribution Maximize Growth and Efficiency,” *Econometrica*, 70(2), 481-518.
- [6] Besley, Timothy, [2006], *Principled Agents? The Political Economy of Good Government*, Oxford: Oxford University Press.
- [7] Buchanan, James [1967], *Public Finance in Democratic Process*, Chapel Hill, NC: University of North Carolina Press, also at <http://www.econlib.org/library/Buchanan/>
- [8] Green, Donald, Bradley Palmquist, and Eric Schickler, [2004], *Partisan Hearts and Minds: Political Parties and the Social Identities of Voters*, Yale: Yale University Press,

- [9] Grossman, Gene and Elhanan Helpman, [2001], *Special Interest Politics*, Cambridge MA: MIT Press.
- [10] Keynes, John Neville [1891], *The Scope and Method of Political Economy*, London: Macmillan.
- [11] Persson, Torsten, [2005], “Forms of Democracy, Policy and Economic Development”, working paper.
- [12] Persson, Torsten and Guido Tabellini, [2003], *The Economic Effects of Constitutions*, Cambridge, MIT Press.
- [13] Roemer, John E., [1998]. “Why the poor do not expropriate the rich: an old argument in new garb,” *Journal of Public Economics*, 70(3), 399-424