ECON4640 – Political Economics, fall 2018

For the short questions, both topics were quite central in their respective lectures so the students should have some grasp of this material. Questions 1) and 2) in part II are relatively easy, the next three have increasing levels of difficulty with II.5 being quite difficult.

To pass the exam, a candidate should show some insight on some of the questions. To achieve a C, almost all questions should be answered with quite complete answers. For an A, all questions (including II.5) should have convincing answers.

I. Short questions

1) Why should reelection possibilities affect political accountability? Explain briefly how Ferraz and Finan (2011) study this effect empirically among Brazilian mayors.
   Typically, threat of non-reelection is a tool to discipline politicians (Barro, Ferejohn). If a politician is in her last period, this tool does not work – argument against term limits. Could also mention that staying in power too long increases possibility if appropriating system – counter-balancing argument. F&F compare municipalities with mayors in first vs second period. Find more corruption in second. Use RDD on re-election, study only re-elected. Potential problem is learning to be corrupt.
2) Explain how regression discontinuity designs can be used to identify the effect of political parties on political outcomes. Why are such analyses more involved in a proportional electoral system with multiple parties than in two party systems?
   Implemented policy a mix of voter preferences and party preferences, hence OLS biased. In close elections, voters similar above and below RDD threshold hence can compare say municipalities if elections close. Can get into some technicalities (choice of bandwidth etc.). With multiple parties and proportional system: Less clear what a close election is. Follow Folke (2014): Close is when on representative is almost won by one party/almost lost by another party. Then +/- 1 representative almost random for the two parties at hand. (can add details on electoral system – St Laguë etc.) Can use this to identify the effect of the strength of different parties.

II. Essay question: Redistributive policies

1) Explain how the level of redistribution is determined in a median voter framework. What is the effect of increased inequality on the level of redistribution?
   Straightforward Meltzer/Richard type question. Usually with deadweight losses from taxation, those with income below average prefer positive tax, higher tax the lower income relative to average. Discuss when median voter theorem applies. Either single peaked prefs or single crossing holds quite generally, hence can use median voter theorem. Increased inequality: If mean preserving spread, median to mean usually declines, reducing redistribution. If inequality only in the tails no effect. If average income affected unclear outcomes.

2) Explain how one can go forth to test these predictions empirically, which empirical challenges one encounters, and how these can be solved.
Discuss required data: Measure of inequality and transfers/taxes for some entities (cross section, time series, panel). Problems: Measuring the right variables, omitted variables, reverse causality. Panel can solve some. Instrument for inequality would be nice, but not easy to find.
3) Explain how Brunner et al. (2011) estimate the effect of an income shock on political preferences. Interpret the main findings from their Table 4, reproduced below:

TABLE 4.—IMPACT OF CHANGES IN PREDICTED EMPLOYMENT ON VOTING OUTCOMES

	Share Voting Democratic on Propositions	Share Voting for Democratic Gubernatorial Candidates	Share Turning Out in Gubernatorial Elections	Share Voting for Incumbent Party Gubernatorial Candidates
Predicted employment index, 1990 weights	−.450**	−.523**	−.380**	−.699**
	(.012)	(.034)	(.111)	(.124)
	{−.011}	{−.013}	{−.009}	{−.017}
	[615,788]	[27,064]	[20,307]	[27,064]
Predicted employment index, 1980 weights	−.450**	−.474**	−.380**	−.238
	(.012)	(.036)	(.108)	(.126)
	{−.012}	{−.012}	{−.010}	{−.006}
	[615,362]	[27,045]	[20,292]	[27,045]

Each cell presents the estimated coefficient on the PEI from a different regression using a panel of metropolitan census tract voting returns. In column 1, each observation is a proposition; in the remaining columns, each observation is an election. All specifications control for tract and County × Year effects. Robust standard errors clustered by tract in parentheses. The figure immediately below the standard errors is the implied change in outcome that results from a 1 percentage point increase in employment. Sample size in brackets. Regressions weighted by tract voting-age population. **Significant at 1%, *5%.

Brunner et al. use Bartik instrument. Should be explained. Some explanation of setting they work in: Californian data on voting tracts, presumably exogenous shock to employment from Bartik approach. Improved economic conditions reduce democratic vote share (employment up 10% leads to 4.5 pct pt reduced democratic vote share), reduced turnout, and reduced support for incumbent.
4) Hassler et al. (2003) present a dynamic extension of the redistribution problem. Explain their model of the economy and political institutions. How does the dynamic (temporal) aspect affect redistributive policies?
Model: Two periods, ex ante identical individuals, can invest in (costly) education, random draw into successful/unsuccessful depending on education level. The unsuccessful want to tax the successful to finance transfers. Because of taxation, less profitable to be successful, hence under-consumption of education (costly). Also (possibly) sustained support for welfare state.
In sum: transfers distort accumulation of human capital
5) What are the empirical implications of this model, and how would you go forth to test them?
One empirical implication is similar to the implication of the static model: composition of voters determines the redistribution. More specifically, the fraction of successful (rich) voters determines the redistribution, slightly different from that in a commonly used static model, where the income inequality determines redistribution. But in the same spirit. We should expect that in countries/states/regions, where there are more successful/rich voters, there should be less redistribution.
A new implication of the dynamic model is that redistribution determines the composition of voters. More specifically, more redistribution results in less effort and fewer successful/rich agents. We should expect that in welfare states, there are less rich people even before tax. Again, though the model is about the fraction of rich agents, the logic also applies to the inequality, i.e., in welfare states, before tax inequality should also be lower (though not surprising that after-tax inequality should be lower).
Both composition of voters and redistribution in this model are endogenous. One can also tests

how exogenous variables, e.g., discount factor beta, affect the equilibrium outcome. The model predicts that if beta is high enough, the welfare states may break down (though not necessary). The logic is that they young may form an expectation that the welfare state will collapse in two periods, and if they are patient enough, this expectation can be the equilibrium outcome. The empirical test can be on the negative correlation between redistribution and patience (or proxies of patience such as saving).

We did not talk too much about the third point in the lecture, so I expect most students will not be able to come up with the third test, but they should be able to come up with the first two. However, if some students read the paper and come up with the third, it should also be right.