Available online at www.sciencedirect.com
ScienceDirect
Journal of Economic Theory 146 (2011) 1009–1041
JOURNAL OF Economic Theory
www.elsevier.com/locate/jet

Power fluctuations and political economy ☆

Daron Acemoglu [a,b], Mikhail Golosov [c,d,*], Aleh Tsyvinski [c,d]

[a] *MIT, United States*
[b] *CIFAR, Canada*
[c] *Yale University, Department of Economics, Box 208268, New Haven, CT, United States*
[d] *NES, Russia*

Received 29 September 2009; final version received 28 October 2010; accepted 19 November 2010

Available online 25 November 2010

Abstract

We study (constrained) Pareto efficient allocations in a dynamic production economy where the group that holds political power decides the allocation of resources. For high discount factors, the economy converges to a first-best allocation where labor supply decisions are not distorted. For low discount factors, distortions do not disappear and fluctuate over time. Most importantly, the set of sustainable first-best allocations is larger when there is less persistence in the identity of the party in power (because this encourages political compromise). This result contradicts the common presumption that there will be fewer distortions when there is a "stable ruling group".
© 2010 Elsevier Inc. All rights reserved.

JEL classification: P16; P48

Keywords: Commitment problem; Dynamic political economy; Olson–McGuire hypothesis; Political compromise; Political economy; Political power

☆ The authors thank the associate editor, Ramon Marimon, and three anonymous referees for useful comments. We also thank participants at the Canadian Institute of Advanced Research, Econometric Society Meeting 2006, Erasmus, EUI, LAEF conference "Dynamic Political Economy and Optimal Taxation", Minneapolis Fed conference "Economics without Frontiers", MIT, New Economic School, University of Pennsylvania, University of Washington, Society of Economic Dynamics, Stanford, Stockholm, and Yale. Financial support from the AFOSR and the NSF is gratefully acknowledged. Golosov and Tsyvinski also thank Einaudi Institute of Economics and Finance for hospitality.

* Corresponding author at: Yale University, Department of Economics, Box 208268, New Haven, CT, United States.
E-mail addresses: daron@mit.edu (D. Acemoglu), m.golosov@yale.edu (M. Golosov), tsyvinski@yale.edu (A. Tsyvinski).

0022-0531/$ – see front matter © 2010 Elsevier Inc. All rights reserved.
doi:10.1016/j.jet.2010.11.002

1. Introduction

In this paper, we investigate (constrained) Pareto efficient equilibria in an infinite-horizon production economy in which political power fluctuates between different social groups ("parties"). These groups may correspond to social classes with different incomes or to citizens living in different regions. The process for power fluctuation is taken as given. Our objective is to understand the implications of political economy frictions/constraints on the allocation of resources. The key to political economy friction in our model is *lack of commitment*: the group currently in power determines the allocation of resources (the allocation of total production across different groups in the society), and there are no means of making binding commitments to future allocations. This political economy friction leads to an additional sustainability constraint for the group in power, to ensure that it does not expropriate the available resources.

We characterize the (constrained) Pareto efficient allocations in this economy.[1] This focus enables us to understand the implications of political economy frictions on "the best possible" allocations, as clearly identifying the role of political economy in production and consumption distortions.[2] These allocations can be identified as the solution to an optimization problem subject to the participation and sustainability constraints, with different Pareto weights given to the utilities of different groups. We refer to allocations that involve full consumption smoothing and no distortions as "first-best" (or as "sustainable first-best" to emphasize that these are achieved despite the sustainability constraints). In these allocations, each individual supplies the same amount of labor and receives the same level of consumption at every date, irrespective of which group is in power. The sustainability constraints resulting from political economy imply that first-best allocations may not be supported because the group in power could prefer to deviate from a first-best allocation. In this case, Pareto efficient allocations will involve distortions (in the sense that marginal utility of consumption and disutility of labor are not equalized) and consumption and labor will fluctuate over time.[3]

We present three sets of theoretical results. First, we characterize the structure of political economy frictions as a function of the preference and production structure, the identity of the group in power and the stochastic process regulating power switches. We show that as long as a first-best allocation is not sustainable at the current date, the labor supply (and production) of individuals who belong to groups that are not in power will be distorted downwards—i.e., "taxed". This downward distortion results from the sustainability constraints reflecting the political economy considerations. Intuitively, an increase in production raises the amount that the group in power can allocate to itself for consumption rather than allocating it among the entire population. Reducing aggregate production relaxes the political economy constraints and reduces the rents captured by the group in power. Since starting from an undistorted allocation, the gain to society from rents to the ruling group is first-order, while the loss is second-order, (non-first-best)

[1] "Constrained" here means that all of these allocations are subject to the *sustainability constraints* resulting from the lack of commitment. To simplify the terminology, we simply refer to the "constrained Pareto efficient allocations" as "Pareto efficient allocations" unless additional emphasis is needed.

[2] An alternative, complementary strategy is to focus on Pareto dominated equilibria that may emerge either in our game or in some related institutional setting. Much of the political economy literature investigates the role of specific institutions and thus implicitly focuses on such allocations. Such Pareto dominated allocations will naturally induce further distortions relative to the allocations we characterize.

[3] Constrained Pareto efficient allocations have a quasi-Markovian structure and can be characterized recursively conditional on the identity of the group that is in power and Pareto weights. Dynamics are determined by updating the Pareto weights recursively.

دریافت فوری ← متن کامل مقاله

ISIArticles
مرجع مقالات تخصصی ایران

✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
✓ امکان دانلود نسخه ترجمه شده مقالات
✓ پذیرش سفارش ترجمه تخصصی
✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
✓ دانلود فوری مقاله پس از پرداخت آنلاین
✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات