

Introduction to Historical Political Economy

Jesús Fernández-Villaverde¹

September 14, 2023

¹University of Pennsylvania

- Three tightly-linked questions that early Americans asked:
 1. How responsive to popular majorities should governments be?
 2. How government power should be distributed among different territorial levels?
 3. To what extent and in what ways should the government promote economic growth?

From mechanisms to causes

- This class will investigate the mechanisms behind how these questions were answered in the British colonies and the early U.S. and how they laid the foundations for the fast economic growth experienced by the U.S.
- Why? Because saying that a country grows because it has better resources, invests more, or works harder is not particularly deep.
- Instead, we want to study the fundamental causes of growth that lead to accumulate inputs and use them efficiently.
- In particular, we want to study the reason behind institutions and policies adopted by societies.

Our question

Why do some societies choose institutions and policies that discourage growth, while other societies, often otherwise similar to the previous ones, choose growth-enhancing social arrangements?

A framework for analysis

- Political institutions: rules under which individuals interact.
- Economic policies: decisions made under given political institutions.
- Then, we are interested in understanding

$$\Omega \xrightarrow{\mu(\cdot)} \mathcal{P} \xrightarrow{\pi(\cdot)} \mathcal{R} \xrightarrow{\rho(\cdot)} \mathcal{X} \xrightarrow{u(\cdot)} \mathbb{R}$$

where:

1. Ω is the set of possible initial conditions.
2. \mathcal{P} is the set of feasible political institutions.
3. \mathcal{R} is the set of feasible economic policies.
4. \mathcal{X} is the set of allocations.
5. $u(\cdot)$ is a utility function.

Political economy

- Political economy is the formal study of this collective decision-making.
- Closely linked with economics and formal political theory (sometimes called rational choice theory).
- Emphasis:
 1. We want to analyze, not to judge.
 2. We want to explain, not to describe.
 3. Methodological individualism.
- Historical political economy focuses on the historical experience relating economics and politics.
- Motivating example: Providence Island vs. Massachusetts.
- Check <https://broadstreet.blog/>.

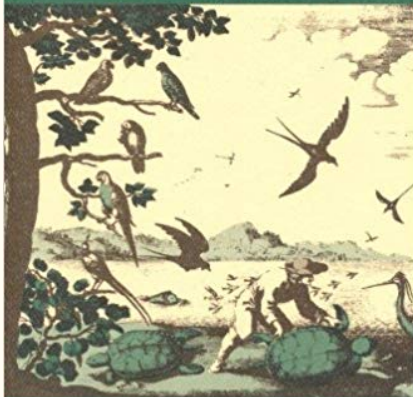


Copyrighted Material

Providence Island

1630 - 1641

The Other Puritan Colony



Karen Ordahl Kupperman

Copyrighted Material

Key themes

- Five key themes:
 1. Social conflict is nearly universal. Nearly all changes to institutions and policies imply winners and losers.
 2. Aggregation of individuals preferences over outcomes is nontrivial.
 3. Commitment problems are pervasive.
 4. Groups with political power will tend to choose distortionary policies.
 5. Asymmetric information.
- How do these ideas apply in Early America?

Key theme 1: social conflict

- Nearly all economic policy decisions will generate winners and losers:
 1. Slavery and servitude.
 2. Tariffs and navigation acts.
 3. Tax changes.
- The position of agents in the social conflict depends on the technology, endowments, distribution of income, and their beliefs.
- We will adopt a *consequentialist* approach: agents only care about the outcomes of the economic policy decision and not about the policy decision per se.

Key theme 2: aggregation of preferences is nontrivial

- Imagine that we have 3 delegates to the Constitutional Convention deciding the size of the U.S. federal government:
 1. Delegates from Virginia (federalist): Big federal government > Small federal government > Medium federal government.
 2. Delegates from South Carolina (anti-federalist): Small federal government > Medium federal government > Big federal government.
 3. Delegates from Connecticut (compromise): Medium federal government > Big federal government > Small federal government.
- After several meetings, the delegates realize that their preferences are fixed. So they decide to vote.
- The delegates first vote using a majority rule. However, each option gets exactly 1 vote.
- They decide to switch to a run-off system. Soon, the delegates realize this is more tricky than it seems.

A Condorcet paradox I

- The delegates from Virginia wants to vote first on Small federal government vs. Medium federal government and then face the winner with Big federal government. Why?
 1. Small federal government vs. Medium federal government: Small federal government is a winner (Virginia+South Carolina vs. Connecticut).
 2. Small federal government vs. Big federal government: Big federal government is a winner (Virginia+Connecticut vs. South Carolina).

A Condorcet paradox II

- The delegates from South Carolina wants to vote first on Big federal government vs. Medium federal government and then face the winner with Small federal government. Why?
 1. Big federal government vs. Medium federal government: Medium federal government is a winner (South Carolina+Connecticut vs. Virginia).
 2. Small federal government vs. Medium federal government: Small federal government is a winner (South Carolina+Virginia vs. Connecticut).

A Condorcet paradox III

- The delegates from Connecticut wants to vote first on Big federal government vs. Small federal government and then face the winner with Medium federal government. Why?
 1. Big federal government vs. Small federal government: Big federal government is a winner (Virginia+Connecticut vs. South Carolina).
 2. Big federal government vs. Medium federal government: Medium federal government is a winner (South Carolina+Connecticut vs. Virginia).

Condorcet winners and cycles

- The choice of voting order is called “control of the agenda.”
- Note that none of the procedures is better or fairer than the others under any reasonable criteria.
- This situation is known as a Condorcet cycle. Why?
- A Condorcet winner is the choice that will defeat all the other alternatives in pairwise contests.
- Condorcet cycles are not pathological. As the number of alternatives goes to infinity, we will have a Condorcet cycle with probability 1.
- Example of infinite alternatives: “divide-the-dollars” game.

Key theme 3: lack of commitment

- Ex ante statements about future courses of action are not credible.
- Example:
 1. The British government wants to promise Native American nations that European settlers will not encroach on their territories (why?).
 2. But European settlers move beyond the 1763 Proclamation Line.
 3. This creates conflicts with Native American nations.
 4. You are the British General, who will you support? (think as a British General of the 18th century, not as you do now!)
 5. Hence, the 1763 Proclamation Line was not (mainly) credible.
- Application in economic policy: taxes on capital.
- Hold-up problem.



Two possible outcomes:

1. Societies find commitment devices (for example, “doomsday machine” in Dr. Strangelove, or Constitutions). Problems:
 - Difficult to implement.
 - Cut flexibility that we may need in the future.
 - Are there real commitment devices?
2. Societies settle down in outcomes that are subgame perfect. Unfortunately, often subgame perfect outcomes are quite inefficient (even Pareto-inferior).

Key theme 4: powerful groups choose distortionary policies

- Revenue extraction:
 1. Decoupling between political and economic power.
 2. Absence of lump-sum taxation.
- Factor price manipulation.
- Political replacement (James Michael Curley, 4 times Boston major).



Key theme 5: asymmetric information

- Basic problem in economics: information is disperse and private.
- Example:
 1. Quality of the good I am selling.
 2. Amount of effort I put into my work.
 3. Preferences.
- Consequently, in general we cannot get to first best.
- Key in all economic systems: evidence of quality problems in Stalin's Soviet Union.
- Political economy:
 1. Provision of a public good.
 2. Quality/true preferences of a politician.
 3. Intensity of preferences for some policy.
- Good design of institutions: mechanism design.

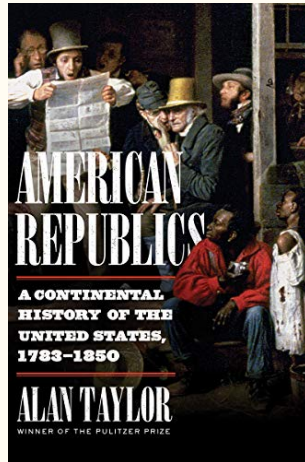
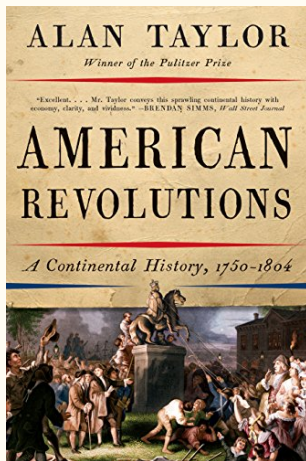
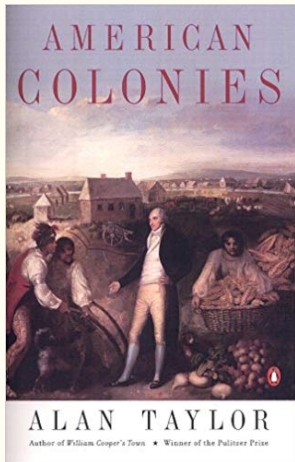
TYPES OF HPE PAPER



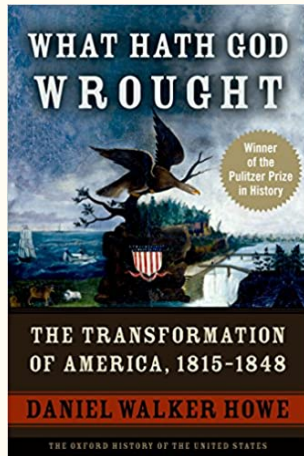
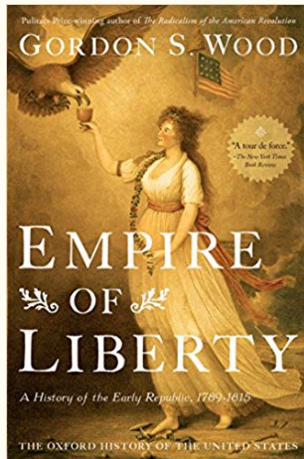
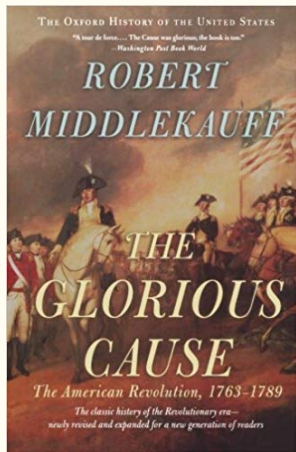
Continental (and Atlantic) history

- I find easier to understand the political economy of early America within a Continental framework.
- Some of the key issues faced by the British colonies and later the new U.S. related to their interactions with Native nations and other European colonial empires (and later Mexico and Haiti).
 - Recall: there are still territories today in North America controlled by Britain and France!
- Also, one appreciates more the risks of breakdown of the Union:
 - A Trans-Appalachian confederacy, a New England federation, the Utah settlement.
- This point can be extended more generally to the Atlantic history and even to the Trans-Pacific world.
- Thus, within our time constraints, I will try to highlight some of these connections.

Some historical background: Alan Taylor's trilogy



Some historical background: Oxford History of the U.S.





A quote to remember

James Baldwin, A Talk To Teachers, October 16, 1963, published in The Price of the Ticket (1985)

“American history is longer, larger, more various, more beautiful, and more terrible than anything anyone has ever said about it.”