

Norman Schofield · Gonzalo Caballero · Daniel Kselman *Editors*

Advances in Political Economy

Institutions, Modelling and Empirical Analysis

This book presents latest research in the field of Political Economy, dealing with the integration of economics and politics and the way institutions affect social decisions. The focus is on innovative topics such as an institutional analysis based on case studies; the influence of activists on political decisions; new techniques for analyzing elections, involving game theory and empirical methods.

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Institutions, Modelling and
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Social Sciences / Political Science

ISBN 978-3-642-35238-6



9 783642 352386

► springer.com

 Springer

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Abstract

Previous models of elections have emphasized the convergence of parties to the center of the electorate in order to maximize votes received. More recent models of elections demonstrate that this need not be the case if asymmetry of party valences is assumed and a stochastic model of voting within elections is also assumed. This model seems able to reconcile the widely accepted median voter theorem and the instability theorems that apply when considering multidimensional policy spaces. However, these models have relied on there being a singular party bundle offered to all voters in the electorate. In this paper, we seek to extend these ideas to more complex electorates, particularly those where there are regional parties which run for office in a fraction of the electorate. We derive a convergence coefficient and out forth necessary and sufficient conditions for a generalized vector of party positions to be a local Nash equilibrium; when the necessary condition fails, parties have incentive to move away from these positions. For practical applications, we pair this finding with a microeconomic method for estimating parameters from an electorate with multiple regions which does not rely on independence of irrelevant alternatives but allows estimation of parameters at both aggregate and regional levels. We demonstrate the

effectiveness of this model by analyzing the 2004 Canadian election.

Chapter title **Spatial Model of Elections in Turkey: Tracing Changes in the Party System in the 2000s**

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Abstract The Turkish political party system underwent significant changes during the first decade of the 21st century. While secularism and nationalism remained the defining issues of electoral politics, both the number and the ideological positions of parties in the political system changed considerably. In the 2002 elections, none of the parties from the previous parliament were able to pass the electoral threshold. The new parliament was formed by the members of the Justice and Development Party (AKP)—a new conservative party founded by the former members of Islamist parties—and the Republican People's Party (CHP)—a party with a strong emphasis on a secularist agenda. In the 2007 elections, AKP consolidated their power by receiving 46.6 % of the votes while CHP increased their share of the vote by only 1.5 percentage points to 20.9 %. In addition, the Nationalist Action Party (MHP) and independent candidates supported by the pro-Kurdish Democratic Society Party (DTP) were able to win seats in the 2007 elections. In order to explain these changes, this paper applies the spatial model to the 2007 elections and compares the results to previous analyses of the 1999 and 2002 elections (Schofield et al. 2011). First, we run a pure spatial model to estimate the relative role of the ideological position and the valence of political parties in determining their electoral success. Second, we supplement the spatial model with the demographic characteristics of voters. Finally,

we use simulations to determine whether a Nash equilibrium exists for the position of political parties or candidates.

Chapter title	Do Competitive Districts Necessarily Produce Centrist Politicians?	
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Abstract

Using the first dimension of DW nominate scores for the U.S. House and Senate over the period 1956–2004, we analyze how the degree of ideological polarization between the parties varies as a function of district ideology, defined in terms of Democratic presidential support in the district. We find, as expected, that the more Democratic-leaning the district at the presidential level the more liberal are the representatives from the district, and that for any given level of Democratic presidential support, Democrats elected from such districts are, on average, considerably more liberal than Republicans elected from such districts. However, we also find that—consistent with theoretical expectations of spatial models that have recently been put forward—the ideological difference between the winners of the two parties is as great or greater in districts that, in presidential support terms, are the most competitive—a finding that contradicts the intuitive expectation that the pressure for policy convergence is greatest when the election is most competitive.

Chapter title

A Heteroscedastic Spatial Model of the Vote: A Model with Application to the United States

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Abstract How do candidate policy positions affect the citizen's vote choice? From the Downsian tradition, a common response to this question is that voters identify where contending candidates are located on policy space and then select the candidate closest to them. A well-known finding in current models of political psychology, however, is that voters have biased perceptions of the ideological location of competing candidates in elections. In this chapter we offer a general approach to incorporate information effects into current spatial models of voting. The proposed heteroscedastic proximity model (HPM) of voting incorporates information effects in equilibrium models of voting to provide a solution to common attenuation biases observed in most equilibrium models of vote choice. We test the heteroscedastic proximity model of voting on three U.S. presidential elections in 1980, 1996, and 2008.

Chapter title **Inferring Ideological Ambiguity from Survey Data**

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Abstract The chapter presents a Bayesian model for estimating ideological ambiguity of political parties from survey data. In the model, policy positions are defined as probability distributions over a policy space and survey-based party placements are treated as random draws from those distributions. A cross-classified random-effects model is employed to estimate ideological ambiguity, defined as the dispersion of the latent probability distribution. Furthermore, non-response patterns are incorporated as an additional source of information on ideological ambiguity. A Markov chain Monte Carlo algorithm is provided for parameter estimation. The usefulness of the model is demonstrated using cross-national expert survey data on party platforms.

Keywords Ideological placement – Ambiguity – Bayesian – Latent variables – Missing data

**Part I
Institutions**

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Transaction Cost Politics in the Map of the New Institutionalism

Gonzalo Caballero and Xosé Carlos Arias

1 Introduction

During the mid-eighties, Matthews (1986) affirmed in his presidential address to the Royal Economic Society that the economics of institutions had become one of the liveliest areas in economics. Two years prior to that, March and Olsen (1984) stated “a new institutionalism has appeared in political science” and that “it is far from coherent or consistent; it is not completely legitimate; but neither can it be entirely ignored”. Although sociology had been less responsive than political science, this was quickly changing, and the new institutionalism also became incorporated into sociology (Brinton and Nee 1998).

There has been a considerable and notable increase in research on institutions since then. The different social sciences have begun to assume that “institutions matter” and that they can be analyzed and therefore there has been an ongoing research effort both at the theoretical and applied levels on the subject of notion, role and change of institutions. The New Institutional Economics (NIE) has been developed in economics, based on the contributions of authors such as Ronald Coase, Douglass North, Oliver Williamson and Elinor Ostrom. In as far as political science is concerned, the literature of the new institutionalism includes political scientists such as Guy Peters, Johan Olsen, Peter Hall, Kenneth Shepsle and Barry Weingast. The new institutionalism in sociology is part of this emerging paradigm in the social

An initial version of this paper was presented at the Annual Meeting of the Public Choice Society (USA, 2009). This renewed version was presented in a specialized workshop at the European School for New Institutional Economics (Cargese, France, 2011) and the Second International Conference on Political Economy and Institutions, ICOPEAI (Baiona, Spain, 2012).

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N. Schofield et al. (eds.), *Advances in Political Economy*,
DOI [10.1007/978-3-642-35239-3_1](https://doi.org/10.1007/978-3-642-35239-3_1), © Springer-Verlag Berlin Heidelberg 2013

47 sciences, and it includes the contributions of authors such as Paul Dimaggio, Walter
48 Powell and Victor Nee, among others.

49 Thus, the “return of institutions” has become unquestionable in social sciences,
50 and the focus on institutions as a key concept in social sciences has given rise to
51 a variety of new institutionalist approaches (Nee 2005). This has provided a strong
52 impetus to political economy based on new theoretical foundations thereby boost-
53 ing interdisciplinary relations among the social sciences (Schofield and Caballero
54 2011). This modern political economy of institutions has included relevant advances
55 in issues such as the effect of extractive political and economic institutions (Ace-
56 moglu and Robinson 2011), the modeling of the authoritarian regimes (Schofield
57 and Levinson 2008), the study of social order (Schofield 2010) and the utilization
58 of a higher dimensional policy space in the analysis of different political situations
59 (Schofield et al. 2011), among others.

60 The different institutional arrangements have systematic effects on policy-
61 making (North and Weingast 1989; Haggard and McCubbins 2001). But if we want
62 to have a deeper understanding of the relationships between institutions and policy,
63 we should view public policies as the outcome of political transactions made over
64 time (Spiller and Tommasi 2007). Political life is characterized by exchanges, agree-
65 ments and transactions, which frequently are only an attempt, therefore transaction
66 analysis is a fundamental step for studying political interaction and institutions of
67 governance.

68 The notion of transaction costs was the key concept that the NIE used to un-
69 derstand how institutions affected efficiency in economy. Coase (1937, 1960) and
70 North (1990a) enabled the justification of the importance of institutions and orga-
71 nizations for the economic mainstream and furthermore, the notion of transaction
72 costs surpassed the limits of economic relationships (Caballero 2001). “Modifying
73 the standard rational choice model by incorporating transaction cost theory into it
74 can substantially increase the explanatory power of the model” of political markets
75 (North 1990b, p. 355). In this manner, the new transactional institutionalism has
76 dealt with the study of political institutions and processes through the Transaction
77 Cost Politics research program (TCP) carried out over the past twenty years (Wein-
78 gast and Marshall 1988; North 1990b; Dixit 1996, 2003; Epstein and O’Halloran
79 1999; Williamson 1999; Spiller and Tommasi 2003, 2007).

80 TCP uses political transaction as the unit of analysis, and explains the evolution
81 of political relationships in their condition as transactions and contracts, thereby
82 highlighting the relevance of institutions in political markets, which are character-
83 ized by incomplete political rights, imperfect enforcement of agreements, bounded
84 rationality, imperfect information, subjective mental models on the part of the actors
85 and high transaction costs. If the presence of transaction costs decisively affects eco-
86 nomic exchange then their relevance is even greater for the functioning of political
87 markets. This is so not only for political transactions carried out between citizens
88 and politicians, which both North (1990b) and Dixit (1996, 1998) emphasized, but
89 also for those in which all participants are politicians, as dealt with by Weingast and
90 Marshall (1988), Epstein and O’Halloran (1999) and Spiller and Tommasi (2007). In
91 this sense, TCP allow us to make more sense out of the political markets we observe.

92

93 Transaction Cost Politics (TCP), besides considering the contract as an analysis
94 unit, also studies the enforcement mechanism of contracts, compares the different
95 *governance* structures and adopts the bounded rationality supposition (Epstein and
96 O'Halloran 1999). A first approach to the theoretical bases of TCP is character-
97 ized by the following proposals: (1) The application of the transactional approach
98 to the political field leads us to consider political interaction as a set of (implicit or
99 explicit) contractual relations. In this sense, public policies are the outcome of trans-
100 actions among policy-makers. (2) Institutions are the rules of the political game, and
101 they determine the incentive structure of the agents, and therefore institutions affect
102 public policy *outputs*. (3) Organizational structures of governance are quite relevant
103 when explaining the relations between institutions and outcomes. (4) Transaction
104 costs tend to be higher in the political field than in the economic one and there-
105 fore the design of an efficient institutional structure becomes more complex in the
106 political world. (5) In recent times, we are witnessing the progressive vision of pub-
107 lic policies as a result of a series of inter-temporal political transactions. (6) TCP
108 provides a central role to the notion of credible commitment, which justifies the
109 importance of *reputational capital* and the organizational formulae of the State.

110 This chapter reviews and analyzes the approach of Transaction Cost Politics as a
111 new transactional institutionalism in political economy. Moreover, the paper places
112 TCP within the current panorama of new institutionalism and studies the theoretical
113 foundations and the main contributions of TCP up to the present day. When review-
114 ing the literature, we specify the most relevant contents of the main contributions,
115 and for the rest of references, we only mention its arguments. The main goal of
116 the paper is searching the theoretical sources of TCP, and relates it with other ap-
117 proaches, both close and rivals. TCP is a positive approach of political analysis, and
118 this paper shows the analytical characteristics of TCP in a comparative way.

119 Section 2 presents several approaches of new institutionalism within the social
120 sciences. Section 3 presents the two approaches of new institutionalism that formed
121 the fundamental basis on which Transaction Cost Politics (TCP) was constructed:
122 Rational-Choice Institutionalism (RCI) and the New Institutional Economics (NIE).
123 Section 4 studies the fundamental arguments and contributions of Transaction Cost
124 Politics. Section 5 shows why transaction costs are so high in political markets.
125 Section 6 analyzes the governance of political transactions in Congress as a case-
126 study from TCP. Section 7 compares the TCP approach with that of Constitutional
127 Political Economy. The conclusions are outlined at the end of the chapter.

130 **2 New Institutionalism: An Overview into the Social Sciences**

132 ***2.1 Definitions of Institutions***

134 During the last two decades of the 20th century, institutions have reopened an
135 agenda for research into the social sciences based on renewed theories. The new
136 institutionalism has emerged in economics, sociology and political science, and has
137 led to sizeable progress on how institutions are understood. Nevertheless, there is
138

no unique definition of institutions, and several different views of institutions can be presented. For example, Acemoglu and Robinson (2007) distinguish the efficient institutions view, the social conflict view, the ideology view and the incidental institutions view. According to Kingston and Caballero (2009), we should introduce at least the “institutions-as-rules” approach and the “institutions-as-equilibria” approach. Greif and Kingston (2011) extended that perspective: the institutions-as-rules approach focuses on a theory of how the “rules of the game” in a society are selected, while the “institutions-as-equilibria” approach emphasizes the importance of a theory of motivation and thereby endogenizes the “enforcement of the rules”.

According to the Northian approach, institutions are the rules of the game, that is to say, the humanly devised constraints that structure political, economic and social interaction. Institutions consist of formal rules, informal rules and enforcement mechanisms, and they provide the incentive structure of an economy. This approach assumes a specific reference to transaction cost theory. “In order to lower the costs of exchange, it was necessary to devise a set of institutional arrangements that would allow for exchange over space and time”, and institutions “reduce uncertainty by creating a stable structure of exchange” (North 1990b, p. 359). Institutions determine the level of efficiency of political markets and the level of efficiency “is measured by how well the market approximates a zero transaction cost results” (North 1990b, p. 360).

Following the institutions-as-rules approach, March and Olsen (1989) state that institutions are “collections of interrelated rules and routines that define appropriate actions in terms of relations between roles and situations”. Peters (1999, p. 18) further adds four key characteristics to the concept of political institution: (A) An institution constitutes a structural feature of the society and/or polity. (B) An institution shows some stability over time. (C) An institution must affect individual behavior. (D) There should be some sense of shared values and meaning among members of the institution.

The institutions-as-equilibrium approach defines institutions as equilibrium solutions of a game. Historical and Comparative Institutional Analysis (Greif 1998; Aoki et al. 2001) assumed this view of institutions, although recent theoretical developments in institutional analysis by Avner Greif (2006, p. 39) consider “institutions as systems of interrelated rules, beliefs, norms, and organizations, each of which is a man-made, nonphysical social factor”, and this definition “encompasses many of the multiple definitions of the terms institutions used in economics, political science and sociology”.

2.2 Institutional Approaches

The study of institutions can be carried out using several approaches. The new institutionalism—that has been developed on new theoretical bases during the last two decades of the 20th century—can be distinguished from the old institutional traditions in economics, political science and sociology, although there are several connection points.

- 185 (a) The original institutionalism in economics (Thorstein Veblen, John Commons,
186 Clarence Ayres) rejected the foundations of neoclassical analysis and adopted
187 the methods of holism analysis. The contributions of such old institutionalists
188 was marked by an anti-formalist nature, a tendency to argue in holistic terms
189 and a “collectivist and behavioristic framework”, as well as their rejection to
190 the individualist welfare criterion and their tendency towards a certain economic
191 interventionism (Rutherford 1994). It was centered on distributive consequences
192 of the many institutional structures and devised its theories and analysis based
193 on the conceptualization of power.
- 194 (b) The old institutionalism tradition in political science was made up of a set of
195 multi-approach heterogeneous contributions and assumed certain general char-
196 acteristics such as legalism, structuralism, holism, historicism and normative
197 analysis (Peters 1999).
- 198 (c) The earlier sociological institutionalism pioneered by Talcott Parsons (1937) as-
199 sumed the existence of institutions, but it did not emphasize institutional analy-
200 sis. Just as Nee (1998, p. 5) points out the tradition of comparative institutional
201 analysis established in the classical and modern periods of sociology, provides
202 an appropriate foundation for the new institutional approach in sociology, where
203 Weber (1922—*Economy and Society*) is probably the best example of the tradi-
204 tional sociological approach to comparative institutional analysis.

205 On the other hand, New Institutionalism in the social sciences assumes the
206 choice-theoretic tradition and generally presumes purposive action on the part of
207 individuals, who act with incomplete information, inaccurate mental models and
208 costly transactions (Nee 1998). It tends to move towards methodological individu-
209 alism, the conceptualization of voluntary exchange and the study of the effects of
210 alternative institutional frameworks on efficiency. In this manner, “new institutional-
211 ism” appears to be more formalistic, individualistic and reductionist, it is orientated
212 to rational choice and “economizing models”, and it shows a less-interventionist
213 character (Rutherford 1994).

214 In economics, Coase (1984) sustained that “if modern institutionalists had any
215 antecedent, then we should not be looking for these in their immediate predeces-
216 sors”. NIE therefore did not arise from the old institutionalism but was created
217 thanks to a set of contributions that highlighted the relevance of institutional and
218 organizational aspects, and these contributions arose from different scientific ar-
219 eas such as Property Rights Analysis, the New Economic History, the New Indust-
220 rial Organization, Transaction Cost Economics, Comparative Economic Systems,
221 and Law and Economics (Eggertsson 1990). The analytical framework of the NIE
222 is a modification of neoclassical theory, and it preserves the basic assumptions of
223 scarcity and competence, as well as the analytical tools of microeconomic theory,
224 however, it modifies the assumption of rationality and further adds a time dimension
225 (North 1994).

226 Nevertheless, the idea of a serious rift between the old and new institutionalist
227 economists has been modified in recent times. For example, North (1994, 2005),
228 Greif (2006) and Ostrom (2007) surpassed the limits of the methodological indi-
229 vidualism and the hypothesis of rationality, going beyond the bounded rationality.
230