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Out Of Work?**

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Brendan O'Flaherty and Jagdish Bhagwati

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Normative Economists Out of Work?

Brendan O'Flaherty
Jagdish Bhagwati
Department of Economics
Columbia University
New York, N.Y. 10027
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ABSTRACT

We resolve the determinacy paradox.

Will free trade with political science put normative economists out of work? Normative economics has traditionally given advice to a "puppet government"--a government "whose role is to echo the policy that the economist, presented with technocratic information on the economy and choosing an appropriate objective function, proposes as the optimal one from a set of policy instruments" [Bhagwati, 1990]. Intellectual free trade with political science forces economists to realize that governments are not puppets--or, at least, not their puppets. Without puppets, is there any job for puppeteers?

Consider, for instance, Tabellini and Alesina's [1990] model of voting on the budget deficit.¹ The current majority of voters is unsure whether it will be the majority in the future; perhaps another group with different tastes about the composition of government will be the majority then. This gives the current majority an incentive to finance its spending by issuing debt, because the burden of paying off the debt will fall on a government that might want to alter the composition of government spending from the one the current majority favors. Ex ante, before anyone knew what her tastes were, everyone would be better off with a balanced budget rule, but once the game has begun and people know who they are, the current majority always wants to run an excessive deficit.

What are the policy implications of the Tabellini-Alesina model? There aren't any. Tabellini and Alesina's goal is to explain public policies, not to rank them. Governments act the way they must; they are not waiting for Tabellini and Alesina to tell them what to do. One can engage in variational exercises, to be sure--

asking, for instance, what the effect of a balanced budget amendment would be.² But variational exercises are not policy recommendations; they are counterfactual explorations like Fogel's [1964] reconstruction of American history without railroads.

Nothing is wrong, of course, with models that don't have policy implications. Neither the meteorite theory of dinosaur extinction, for instance, nor the big bang theory of cosmology has any policy implications that we can discern. No one would criticize them on this account. Like the Tabellini-Alesina model, they invite variational exercises--one can speculate, for instance, on whether dinosaurs would have developed opposable thumbs or differential calculus if the meteorite had missed. Such speculations, however, are not policy recommendations; indeed, they already have a name of their own--science fiction.

But especially for a teleological group like economists, models without policy implications may seem like trips without a destination or tennis games without a score. Many economists like to think of themselves as active participants in history, not as members of a contemplative order trying to understand a world they cannot influence, or even as science fiction writers. We write op-ed pieces and letters to the editor, sign advertisements, appear on television shows, testify before Congressional committees, and sometimes even try to take presidents and presidential candidates under our tutelage. The White House has a Council of Economic Advisers, but not a Council of Paleo-Archeological or Cosmological Advisers. For many economists, what makes economics more

appealing than cosmology is the possibility of drawing policy implications and influencing the course of history.

Once models like Tabellini-Alesina, however, open up intellectual trade between economics and political science, these hopes seem to be futile and the actions they inspire futile. This is the "determinacy paradox" [Bhagwati, Brecher, and Srinivasan 1984, Bhagwati 1984, 1990]. The grand conditions of political-economic equilibrium (whatever they may be) have already determined what will happen. Telling the government to lower tariffs makes no more sense than telling a monopolist to lower prices or telling the dinosaurs to wear overcoats. (Basu [1992] makes a similar point.)

So the unemployment of normative economists that this kind of free trade threatens is not a happy prospect. In this paper we will argue that such unemployment is not inevitable, although most popular re-employment schemes are doomed to failure. Free trade opens up opportunities, but these cannot be exploited if people continue to think and act in the old ways. We are presenting a way to think about retraining normative economists. The chief purpose of this paper will be to outline the new ways of thinking and acting that are appropriate in a free trade regime. The new ways, it turns out, are not really new at all: they are the methods that Marx and Keynes, among others, used to great effect.

Before we can do that, we will first try to persuade readers of the seriousness of the challenge that the determinacy paradox presents. We will do this by showing the inadequacy of the three popular responses to free trade with political science--

protectionism, constitutionalism, and multiple equilibria. There is no easy way out.

In section 3 we begin tackling the difficult problem that the determinacy paradox presents. We start with a fundamental philosophical question: in what sense can we think of our own actions as being freely chosen? The question is fundamental because if all of our own thoughts and deeds are also determined by the conditions of grand political-economic equilibrium, we can have no more hope of influencing the course of events than a rock can. The answer we give to this question will show why giving advice can, under proper circumstances, be a sensible activity.

With this background, section 4 turns to the question of how to give advice. Advice stands a chance of being taken only when it is given by certain people to certain other people at certain times; this section is about identifying those pairs and times. Section 5 concludes.

2. FALSE ESCAPES FROM THE DETERMINACY PARADOX

A. Protectionism

Can unemployment of economic advisers be avoided simply by restricting the flow of ideas from political science to economics? Such an outcome is neither feasible nor desirable.

It is not feasible because economists don't have a government that can coerce them not to trade; there is no way to punish deviations. The genie is out of the bottle: increasing numbers of economists are now in the game of building models where policies are endogenous and governments matter.

Nor is it desirable: governments really are not economists' puppets, and to pretend that they are merely invites derision and wastes intellectual resources. Such ostrich-like behavior can carry a heavy price. In the field of transportation, for instance, economists have known since at least 1952 that peak-hour toll schemes on the Hudson River crossings could make people in the New York metropolitan area a lot better off, and yet we have no idea of why these schemes have not been implemented or what steps could be taken that would get them implemented.

B. Constitutionalism

Buchanan and Tullock [1962], and writers who have followed in the tradition they established, have looked at constitutional design as the key arena in which normative economists can make a contribution. Once a constitution is in place, political-economic equilibrium is determined and there is no longer any room for advice. So what economists (and political scientists) need to do is devise a constitution that will lead to a good equilibrium. To this task Buchanan, Tullock, and their followers have devoted considerable wisdom, ingenuity, and effort.

This approach is in fact only a slight modification of the traditional practice of advising puppets; the only difference is that it takes constitutional conventions to be the puppets instead of everyday governments. It takes the actions of constitutional conventions to be exogenous, rather than the actions of governments.

There is, however, no reason to believe that constitutional conventions are autonomous, unmoved movers, any more than

everyday governments are, or that they are any more receptive to economists' advice than the San Andreas fault is.³ Anyone who has read the section of the New Jersey constitution dealing with senior citizen bingo games [article IV, section VIII, paragraph 2.A] or the section of the Pennsylvania constitution dealing with police and fire collective bargaining [article III, section 31] would be hard pressed to think that these provisions emerged from any process qualitatively different from normal legislation.⁴

C. Multiple equilibria

Often, economists will give the impression that multiple equilibria can fortuitously provide the freedom that policy intervention requires. They will show that a certain model has multiple equilibria, and then (usually in the paper's conclusion) argue that this multiplicity gives the government or some other benevolent entity an opportunity to intervene and kick the system to one of the more desirable equilibria. A *deus ex machina* appears at the end of these stories, and the authors argue that its actions are plausible because nothing else in the story contradicts anything about it. Thus even though the equilibria might arise from solving an endogenous policy model, normatively the economist is still left with a function: she can rank order two or more equilibria, and resurrect the role of policy adviser.

Why aren't multiple equilibria a good way to escape the determinacy paradox? Because multiple equilibria are signs of incomplete modelling, not of actual freedom. In reality, only one thing happens. Multiple equilibria say something about the logical

structure of a model; they say nothing about the reality that the model is trying to capture.

Consider a classical symmetrical battle-of-the-sexes game. Under any popular refinement, such a game has two equilibria--both players go to the ballet and both players go to the football game. By that statement is meant that both outcomes are fully compatible with everything stated in the model--the payoff functions, the temporal sequence, the rationality description, the information structure, and so on. However, the couple will either go to the ballet or they will go to the football game; they will not go to both. Whatever it is that determines which they go to is something we have left out of the model--perhaps who is stronger or more persistent. All we know now is that the information the model uses is insufficient to answer the question, "Where will they go?" As a way of answering this question, the model is a failure.

But the fact that a particular model fails to answer this question doesn't mean that no model can answer this question or that the couple is waiting around for a benevolent economist to tell them what to do. Something left out of the model matters. This particular model's failure doesn't give us the freedom to impose any answer we want. Having a calculator that doesn't take square roots does not entitle you to assert that the square root of 7 is 5.

An example with a model not usually thought of as having multiple equilibria can make the point clearer. The theory of human capital is compatible with the president of General Motors wearing a red tie and also compatible with his wearing a blue tie; so there are (at least) two equilibria. We conclude from the existence of these

multiple equilibria that the theory of human capital is not very useful if we are interested in tie color--but no one ever claimed it was. We do not conclude that the president's tie color is indeterminate or that we can tell him what color tie to wear. We conclude only that to answer tie color questions we need another model. The same conclusion should be reached whenever multiple equilibria are encountered.

3. FREE TO ADVISE?

Thus the determinacy paradox is a real problem. Better models endogenize more actors and explain more actions, and so a demand that some actor be considered exogenous or some action be unexplained seems to be a demand for poorer models. Normative economics seems to be simply bad economics. "*Tout comprendre, c'est tout pardonner,*" and so how can the drive to understand the world be reconciled with the urge to improve it?

We think there's a way to make this reconciliation. Normative economics can make a difference in the world, or, at least, we ought to act as if it could.

To understand how, we need to begin at a very rudimentary level. Consider the decisions we make about how to conduct our personal lives--what we will eat for breakfast, what order we will eat it in, how we will travel to work, what papers we will write, what we will say in those papers, what order we will say it in.

For a social scientist who had constructed a very good model of the Columbia economics department, our actions would be completely endogenous. Something caused us to drink orange juice

before milk, and such a social scientist could explain what that something was. Private life seems to be prey to the same sort of determinacy paradox that bedevils public life.⁵

And yet when we think about whether to drink orange juice or what article to write, we believe we are making real decisions--decisions that are neither foreordained nor ineffective. We pause and scratch our heads and wonder, "What should I do?" We believe these decisions are effective in the sense that if we decide on a feasible action, then we will do it. Friedman wrote a book about decisions like these and called it Free to Choose [1980].

In what sense, then, are we really "free to choose" in private life? Answering this question will start us on the track to understanding normative economics.

In private life, we think of ourselves as free to choose because the hypothetical social scientist studying the Columbia economics department makes no difference to the actual conduct of our lives. Whether or not such a social scientist is around, we still have to think about what to eat for breakfast, what sentence to put next in this paper, what conclusion to come to in the next paper. Knowing that a book of our lives might exist makes no difference if we cannot read it and find out what we are going to do. Even if we could read the book of our lives we would have to decide whether to believe it--whence Newcomb's problem [Nozick, 1969].⁶ As Levi [1991, chapter 4] argues, we cannot predict our own decisions before we make them; otherwise we would have already made them. Thus worrying what to eat for breakfast is compatible with having a

scientific world view. We might as well act as if we were free to choose.

Giving and receiving advice, too, are compatible with a scientific world view. Since it makes sense to worry about what to eat for breakfast, it makes sense to learn about nutrition, cooking, and the prices in various supermarkets. Since it makes sense to worry what to write in a paper, it makes sense to read articles, analyze data, and talk to colleagues. Of course, to the social scientist studying the Columbia economics department, the nutritional and professional advice we get is just as endogenous as anything we ourselves do, and so is our reaction to it. Once again, however, this endogeneity does not concern either our adviser or us. Our adviser had to decide what advice to give without consulting the book of her life, and we didn't know what the advice would be until we got it.

In summary, we should treat ourselves as exogenous in everything we do, including giving and seeking advice. This conclusion applies to public as well as private life. We have met the degree of freedom, and it is us.

4. HOW TO GIVE ADVICE

The first rule of giving advice is you only give it when it's sought. It's rude to go around giving advice to people who haven't asked for it. And it's futile, too, because they won't take it. It's more than a rule of etiquette. It's a rule of practicality.

--Miss Manners (Judith Martin),
quoted in Rosenbaum [1992].

The traditional activity of normative economics, giving advice, can thus be rescued from the determinacy paradox. The practical question remains: how should economists give advice? to whom should they give it?

Let us begin by considering two polar cases. Telling the San Andreas fault to be quiet is silly. But if a friend you are eager to see and who is eager to see you calls and asks for directions, you should obviously comply. What distinguishes these two cases?

On one level the answer is simple: whether it is possible to construct a good model with the content of your advice as exogenous (as it should always be), and in this model you can rank the outcomes that follow different kinds of advice. By a "good model" we mean just a model that meets the usual criteria we use for judging models--predictive ability, generality, simplicity, and so forth. By "rank" we mean a nontrivial ranking where some outcomes are better than others. Advising the San Andreas fault is not sensible because there aren't any good geological models where that advice makes a difference. Giving directions to a friend is sensible because there is a good model where the friend follows the directions and the result is happy.

On the next level, the problem is more difficult: what sort of situations satisfy these criteria? Fortunately, Basu [1989, 1992] has investigated this game-theoretic question at some length, and Srinivasan [1989, 1992] has pointed out that some of Basu's results lack robustness, but two conditions that tend to make advising

sensible emerge from the analysis. These conditions agree with common sense.

The first condition is asymmetric information. An adviser has to know something the advisee doesn't know. Otherwise the adviser couldn't give advice. Here we are using "know" in the colloquial sense that implications of known propositions are not necessarily known (you can know the rules of arithmetic without knowing the 10,000-th digit of pi, even though it follows from the rules of arithmetic). This condition is fairly easy to meet.

The second condition is coincidence of interests. Players in zero-sum two-person games don't exchange information. Coincidence doesn't have to be exact (perhaps you want to see your friend but not until after the ball game is over), and, at any rate, one of the things about which an advisee is most likely to be unsure is an adviser's true motivation. Still, people don't take advice from their antagonists--Saddam Hussein is unlikely to revise the Iraqi agricultural price system just because some American economists tell him that doing so would be nice. As Basu points out, some asymmetry is involved here: you can get a friend to do what you want by telling him what you want, but you generally can't get an enemy to do what you want by telling him what you don't want. If American economists tell Saddam to raise the price of wheat, he'll ignore them; he won't lower it. Unless the would-be advisee is truly dim-witted, an adviser's cleverness is not a good substitute for a true coincidence of interests.

Here we see another reason why free trade with political science raises the specter of unemployment for normative

economists. If the "government" our would-be adviser wants to influence is something other than a puppet, its interests are likely to be substantially different from those of economists, and giving advice to the government will be a waste of time. Short of engaging in an extraordinarily elaborate swindle, an economist in a country ruled by a vicious autocrat whose aims she does not approve of should see no value-added advising the government; an elitist economist in a democratic, populist country may find herself in a similar position.

Even if a particular economist cannot advise a particular president or minister at a particular time, however, all is not lost. Sometimes the economist will find her goals are close to the goals of some government officials, or to the goals of some members of another branch of government like Congress. Then advice about what the government should do can be freely given and happily received. More often, though, things will not work out so well, as political science constantly reminds us. Sometimes there may be no one to listen to a particular economist's advice. At other times, especially in developed countries, other opportunities for advising can easily be found--but only if economists look to citizens rather than governments as advisees.

The advantages of advising citizens rather than governments are several. First is information asymmetry: citizens are more likely to differ from economists in their knowledge than government officials do, and so can gain more from hearing what economists have to say.

The second advantage is a closer coincidence of interests. Many economists judge a policy proposal not by what it does for them but by what it does for a lot of the people in society; criteria like Pareto optimality and distributional equity are basically "public-regarding." One doesn't win an argument for free trade in a university seminar by saying, "I like Japanese cameras," and to a large extent economists have internalized the public-regarding values that win arguments at university seminars. To this extent, then, there is some coincidence between what economists say is good for the public and what really is good for the public; and this coincidence forms the base for effective advising. If economists do in fact seek the goals they profess to be seeking when they devise policies, then those policies should serve the interests of the public better than they serve the interests of government officials.

Advice that a great deal of the public accepts can make a difference. Public opinion matters in many good models of politics—in the Western democracies at least. If most of the public believed that AIDS victims were immoral scum who deserved to suffer, government policies towards AIDS would be different from what they would be if most of the public believed AIDS victims were unlucky losers of life's lottery. Economists who influence public opinion can change government policies.

Advice to citizens is not necessarily advice to all citizens. Often only a portion of the public is in position to understand or accept what an economist is saying. More importantly, often only a portion of the public will find its interests aligned with those of the

economist. Not all policies that economists advocate result in Pareto improvements.

The idea that the role of normative economists is to advise citizens rather than governments has had a distinguished history; it is not original with us. Marx and Keynes both saw their job as advising citizens, and it is difficult to think of more influential economists.

Marx clearly was not advising the governments of his day--the coincidence of interests was conspicuously missing. Instead he was advising the working class--a portion of the public. Keynes, too, was advising a portion of the public. Even though he sometimes worked for one government or another, he states in his famous conclusion to The General Theory [1936] that his goal is to influence future generations of citizens (and perhaps also madmen who hear voices in the air). We are advocating a return to the tradition of Marx and Keynes.

5. CONCLUSION

Whether it is sensible to give advice--the question we addressed in this paper--is not the only question that free trade with political science poses for normative economics. When we look at the government as something other than a puppet oozing inchoate benevolence, whatever ethical significance could be ascribed to its objective function--the social welfare function--vanishes. For if, as Srinivasan puts it, "the level of a policy instrument is determined along with the price of chapatis in one grand politico-economic general equilibrium" [1992, p. 5], the objective function of policy

makers can have no more ethical significance than the objective function of chapati makers. On what, then, can normative economists base their policy recommendations?

This is a large question that needs to be answered in further work. The implications of endogenous policy making are varied and deep. In this paper we have examined only one set of implications, but in that set are conclusions are not surprising: as usual, free trade is better.

NOTES

1. A great deal of other recent work in public finance, trade, and macroeconomics also endogenizes government decision-making. See, for instance, in international economics, Brock and Magee [1978], Findlay and Wellisz [1982], Feenstra and Bhagwati [1982], Sapir [1983], Mayer [1984], Dinopoulos [1983], Mayer and Riezman [1987, 1989], Lohmann and O'Halloran [1991]. Endogenous policy models in macroeconomics have included Nordhaus [1975], Kydland and Prescott [1975], Hibbs [1977, 1987], Barro and Gordon [1983], Canzoneri [1985], Alesina and Sacks [1988], Rogoff and Sibert [1988], Rogoff [1990], Lohmann [1992], and Harrington [1993]. Work in public finance includes Peltzman [1980], Becker [1983, 1985], Oates and Schwab [1988], Glazer [1989], Taylor [1992], Kristov, Lindert and McClelland [1992], and Gersbach [1993]. And of course, practically all of the articles in Public Choice, European Journal of

Political Economy, and Economics and Politics include models of government decision-making.

2. The uses of these variational exercises are discussed at greater length in Bhagwati, Brecher, and Srinivasan [1984] and Bhagwati [1989].

3. Occasionally, of course, constitution writers for, say, a newly independent society, may find themselves behind a truly thick veil of ignorance about what their roles in the new society will be. See, for instance, Bhagwati [1989] for a discussion of some of the possibilities. But the rarity and the artificiality of these exceptions shows that they can form no basis for normative economics.

4. Tabellini-Alesina [1990] make a similar point about balanced budget amendments.

5. Similarly, positive economics is just as susceptible to the determinacy paradox in this form as normative economics is. To the hypothetical social scientist studying us, the content of all the positive articles Columbia economists will write is also endogenous, and so positive economists are at best plagiarists. Endogeneity is no reason to elevate the positive over the normative.

6. Newcomb's problem is the following: A marvelous being has appeared on Earth and claimed to be able to predict what people will

do. This claim has been put to the test a fabulously large number of times in all manner of circumstances and has always been confirmed. The predictor has even predicted your own actions faultlessly on an incredibly large number of occasions.

One day while you are out the predictor comes to your house and leaves two boxes and a note. One box has a clear plastic lid and in it you can see \$100. The other box is sealed and you can't see what's in it. The note says: "You may take either both boxes or the sealed box alone. If I predicted you would take both boxes, I put nothing in the sealed box. If I predicted you would take only the sealed box, I put \$1 million in it. Choose wisely."

The argument for taking both boxes is the sure-thing principle: no matter what the predictor put in the sealed box, you're always going to be \$100 better off if you take both boxes. The argument for taking one box is the principle of maximizing expected utility: if you take only one box you're almost certain to end up with \$1 million while if you take both boxes you're almost certain to end up with \$100. The philosophical interest in Newcomb's problem comes from the conflict between the sure-thing principle and the expected utility principle.

In our context, Newcomb's problem shows that relations with a being who can almost certainly read the book of your life are very far from trivial.

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