Primary submission: 22.05.2012 | Final acceptance: 03.07.2012

Political Economy: Success or Failure?

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ABSTRACT The Political Economy and Public Choice approaches have promoted the study of interactions between the economy and the polity for over 60 years now. The present paper endeavours to provide a critical discussion of this literature and its achievements. In particular, it begins with the different approaches based on empirically tested or politometric models and it then proceeds to discuss different studies of the effects that particular rules of the game have on politico-economic outcomes. The third section of the paper will address studies that take institutions to be endogenous and aims to explain why particular institutions emerge. Finally, the question of whether Political Economy has been a success or a failure will be tackled. While the success in terms of the position it has gained in economic research and teaching is undeniable, a look at one of the most thriving recent areas of economics, happiness research, will reveal that some of its fundamental lessons are all too often disregarded.

KEY WORDS: political economy, public choice, constitutional economics, institutions,

JEL Classification: H10, B25, A11

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Politico-Economic Interactions

Economic activity is influenced by political decisions, and political decisions are influenced by the state of the economy. The interaction of these factors, which is captured by the evaluation and policy functions shown in Figure 1, is so obvious that few people would deny it.

The relationship between these two sectors of society can be illustrated in a more detailed way, as shown in Figure 2:

- The government systematically impacts economic activity via a large number of policy instruments, ranging from taxes and public expenditures to all sorts of regulations. This is the *policy function*;
- Economic activity, reflected by unemployment and inflation rates as well as size of and changes in GNP, determines government popularity and hence the probability of re-election. This is the *popularity function*.

Political Economy and Public Choice approaches have been used to study these interactions for over 60 years (for general surveys on Political Economy, see the fundamental work by Mueller 1979,1989, 2003). It is the purpose of this paper to provide a critical discussion of the literature exploring these topics, which are often referred to as "politometrics".

There are many other aspects of Political Economy that are not treated here. Examples include the following (see Ostrom, 2012):

- Incentive problems connected with *public goods*. Olson (1965) argued that individuals have no incentive to contribute to such goods because they can consume them even if they do not help to provide them. Exceptions arise when the number of individuals concerned is small, so that they can exert pressure on each other to participate, or when there are re-

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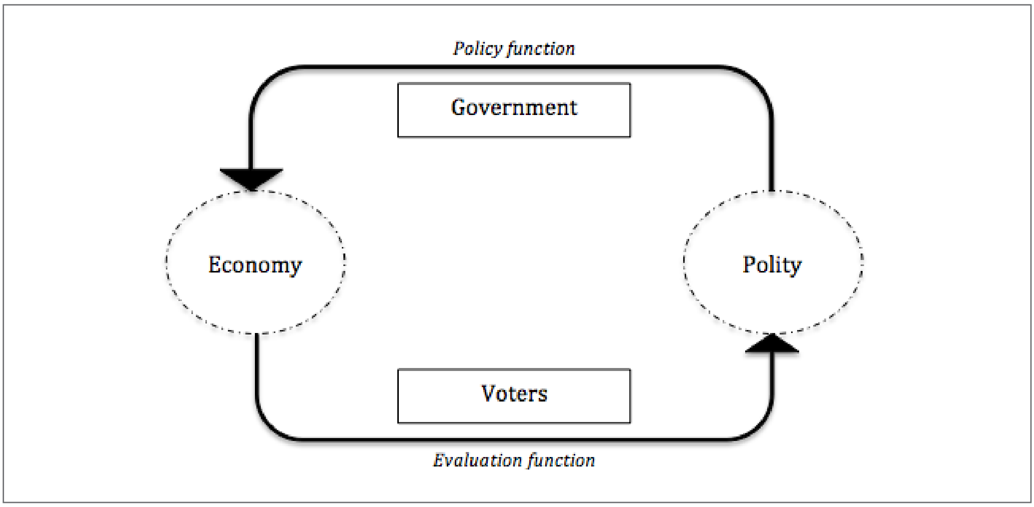

Figure 1. The interaction between the economy and the polity.

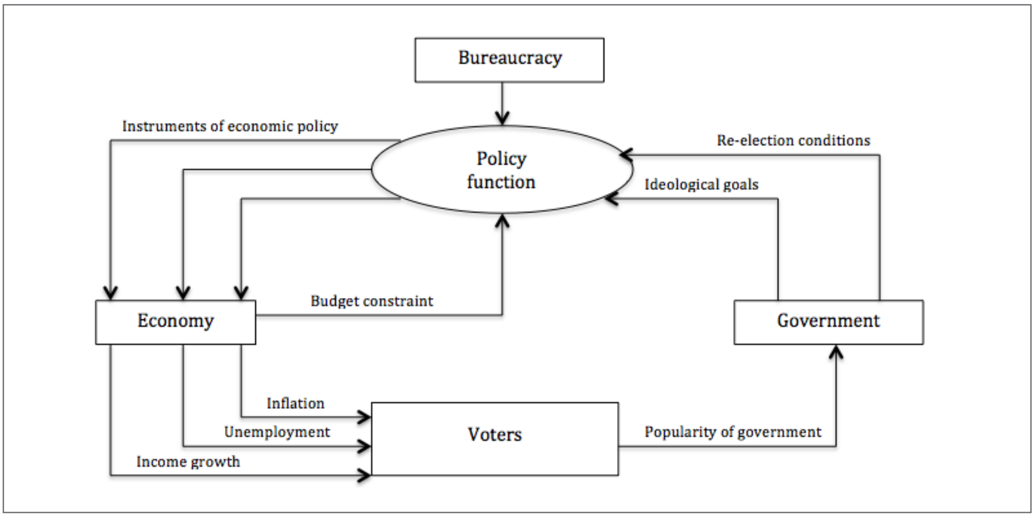

Figure 2. Politico-Economic Model

peated open-ended interactions that may, under favorable conditions, induce individuals to contribute. Most importantly, the government may force individuals to participate by imposing taxes. The fundamental public good problem was later applied to resources and named the "tragedy of the commons" (Hardin 1968, Ostrom, Gardner and Walker 1994). Since then, the conditions under which the supply of public goods is likely to arise has been studied intensively, most importantly by Ostrom (1990), who collected a large data set referring to many different situations involving public goods.

- New Institutional Economics, which originated in Coase's (1937) question of why firms exist. Other important contributions are North (1981), who analysed the structure of institutions and how they change over time, and Williamson (1975), who explored transaction costs as determinants of organisations.
- The structure and performance of *local public economies* and polycentric systems, such as self-governance.

> In this context, a new form of governance built on a web of multiple intersecting jurisdictions, namely Functional, Overlapping and Competing Jurisdictions (FOCJ, Frey & Eichenberger 1999), has been suggested.

Part I of this paper addresses the various approaches to Political Economy that are *based on empirically tested or politometric models*. We will discuss to what extent standard economics takes the mutual interaction of the economy and the polity into account. We will then turn to models that explicitly capture this interdependence, the "politico-economic models". These approaches take the institutional setting of society as given and study how various actors behave within these restrictions.

Part II looks at the *institutional setting*. It is taken to be exogenous; the effect of particular *rules of the game* on politico-economic outcomes will be studied here.

The next section (part III) considers institutions to be *endogenous*. The corresponding studies seek to explain *why particular institutions emerge*. It discusses recent empirical models that explicitly analyse how the political and economic institutions of a society are shaped by fundamental (exogenous) forces and past events.

Based on this overview, the final part of the paper inquires whether *Political Economy has been a success or a failure*. It has certainly been a success in terms of the attention it has received and the position it has gained in economic research and teaching. At the same time, the conclusion is also somewhat pessimistic. In many instances in which the politico-economic interaction is crucial, a significant number of scholars still construct models based on the assumption that governments want, and are actually able, to *maximise social welfare*. Happiness research, one of the most thriving recent areas of economics, will be considered as an important case in point. Leading happiness research scholars wish to charge governments with the task of pursuing, and maximising, the aggregate happiness of the population as an expression of social welfare. In this context, the fundamental lessons and insights of Political Economy are still being disregarded.

I. Politometrics

The interdependence of economy and polity seems to be so obvious that one might think that this interaction is fully accounted for in economic research. However, this is not the case in standard economics.

Standard Economics

We can distinguish various stages in how economists have dealt with this issue:

- Currently, the economy is rarely treated as a *closed system,* though scholars fascinated by the Arrow-Debreu (1954) general equilibrium model still focus solely on economic activity and thus disregard the public sector. The more recent versions of computable general equilibrium models generally include the public sector but model it simplistically.
- Some economic models treat the public sector as *exogenous*. They study, for instance, how changes in public expenditures, taxes or regulations affect the economy. This is, of course, a perfectly legitimate view. And yet, it remains too narrow because it ignores that the public sector reacts to economic activity.
- Most importantly, an approach that has a long history in economics and remains popular today is to start from the assumption that *governments intend to maximise social welfare*. This was the expressed goal of the "quantitative theory of economic policy" that was championed by Tinbergen (1956) and Theil (1964) and is still popular today. For instance, the recent concept of "libertarian paternalism" (Thaler & Sunstein 2003, 2008), based on a behavioural view of human action, particularly decision-making, implicitly assumes that governments would be satisfied by simply "nudging" people in directions that would increase social welfare. However, it may well be that governments attempt to nudge people in a direction that is beneficial to the politicians in power but harmful for society as a whole.

The above approach assumes that governments maximise social welfare. This assumption can be defended by arguing that the resulting socially optimal policy indicates the direction public policy *should* go in. However, this view has to contend with the fundamental theoretical problem that no social welfare function exists if some rather narrow conditions (such as single peakedness; see Black 1948) are not fulfilled. These conditions are certainly violated as soon as distributional aspects are involved, which is nearly always the case in real life policy decisions. As a consequence, the social welfare maximisation approach is based on questionable theoretical foundations and does not indicate how social welfare can be increased. Moreover, the content of the "social welfare function", i.e., its determinants and their weights, has not been measured empirically. It is, of course, possible to simply *assume* the weights of the various determinants – for example, a one percent increase in unemployment reduces social welfare by the same amount as a one percent increase in inflation – and to then derive the government's optimal policy. Such an approach may provide useful information and thus should not be totally dismissed. However, it is also a technocratic approach, which is far from enabling government to truly maximise social welfare. Some scholars argue that happiness research has changed this situation. However, as will be discussed in part IV, such empirical determination runs into yet another problem, namely that governments will have a strong incentive to manipulate reported happiness.

Explicitly Modelling Politico-Economic Interaction

Various branches of economics have endeavoured to account for politico-economic interaction. The classics of economic theory, such as works by Adam Smith and Karl Marx, were about Political Economy and analysed the interaction between the political and the economic sectors. However, because Political Economy was soon equated with Marxism, further developments in the study of politico-economic interaction were re-labelled as Public Choice. This was all the more warranted because Political Economy had ignored processes inside the political sector, the polity. Public Choice filled this gap by modelling the behaviour of politicians and bureaucrats as rational and self-interested. A special part of Public Choice is called "Social Choice". It analyses the problems arising when individual preferences are aggregated to a social welfare or social decision function. Arrow (1951) and Sen (1970) received a Nobel Prize for their respective contributions. Two strands of public choice are usually regarded as most influential.

1. The Virginia School and Public Choice

James Buchanan and Gordon Tullock, two scholars working at the same time at the University of Virginia, constructed a more general model of the interactions between the economy and the polity (Buchanan & Tullock 1962). They employ standard assumptions regarding the behaviour of economic actors to study the behaviour of politicians and public officials. Specifically, they assume that politicians strive for the retention of power, rejecting the notion that they pursue the well-being of their citizens. The Virginia school has produced a large number of analyses of politico-economic interactions based on the assumption that politicians and bureaucrats are self-interested.

An important and widely used model of Public Choice based on the assumption that politicians maximise their own utility is the "median voter model". When the interaction between the economy and the polity is made explicit, the *vote maximisation model* is most often used in the basic form of the median voter model. Two political parties will converge to the same position on a given issue, which is equivalent to the preference of the median voter in the overall distribution of voter preferences. Consequently, in econometric analysis, the median value, rather than the average, of the relevant determinants is taken. To be precise, the researchers should take the income (or any other determinant) of the median voter, which is not necessarily the same as the median income. However, the fact that the median voter model only works under narrow institutional conditions is often overlooked. Most importantly, vote maximisation by each political party only leads to the choice of the median value of the variables if there are strictly two political parties and no additional parties may enter this political competition for votes. There are few, if any, democracies in which this strict assumption holds. Even in the United States or the United Kingdom, with their respective two dominant parties, additional parties or contenders participate in presidential or parliamentary elections. When three or more parties compete, they may take quite diverging positions, depending mainly on the possibility of forming coalitions. Moreover, the median voter model applies only when the number of voters participating in an election is fixed; it may not vary in response to the positions taken by the parties. Such a strict assumption excludes the possibility that some citizens could decide to abstain if a party's programme were too centric. This behaviour would give parties the incentive to move away from the common median position. Consequently, the median voter model rarely applies to actual situations. Its popularity seems to stem from the fact that it leads to a well-defined equilibrium, which allows researchers to derive clear predictions.

Notwithstanding this criticism, the median voter model may be used to *analyse referenda* or initiatives in which there are exactly two possible outcomes: acceptance or rejection (see e.g., Pommerehne & Frey 1976, Romer & Rosenthal 1978, 1979, 1982). However, few countries in the world use this type of direct democratic decision procedure, with Switzerland being the great exception (see Pommerehne 1978). Therefore, the respective empirical research is useful only in indicating what would be in the interest of those citizens who care to participate in such referenda (in Switzerland, the long run average voter participation rate in referenda is approximately 45%). It does not necessarily indicate which policies the citizens, and the population as a whole, desire to see implemented.

While the median voter model is certainly elegant and produces an equilibrium outcome as well as allowing for the testing of empirical implications, its assumptions about the political sector, with respect to both political parties and citizens, are extremely narrow and thus rarely fulfilled in reality.

2. Political Business Cycles

The interaction between the economy and the polity has been analysed in various quantitative and empirical ways. The government is assumed to maximise votes at exogenously determined election dates, subject to the constraints imposed by the state of the economy. Assuming that the probability of re-election depends on unemployment and inflation rates and letting the economy be represented by an extended Phillips-curve results in a *political business cycle* (Nordhaus 1975). After an election, the government undertakes a restrictive policy, raising the rate of unemployment but reducing future inflation expectations. In the run-up to an election, the government undertakes an expansionary policy, reducing the rate of unemployment while still profiting from a low inflation rate. This politico-economic cycle repeats itself infinitely, i.e. there is no learning on the part of voters or politicians.

A number of scholars have used similar models, and some have discovered different types of political business cycles. An empirical study finds that, contrary to the predictions of Nordhaus' model, left-wing governments tend to undertake expansionary policies after winning elections and, over the election term, move to more restrictive policies (Paldam, 1979).

A broader approach uses an econometric model in which the economy is a constraint to government. Political agents are analysed according to the economic model of human behaviour. Politicians maximise their own utility, which consists of ideological goals as well as pleasure derived from being in power, extracted rents and recognition from voters. They are constrained by the need to be re-elected, so only governments that are confident they will be re-elected according to the popularity function can pursue a purely ideological policy. Left-wing parties tend to increase taxes and public spending, while right-wing parties tend to decrease them. If the popularity function of the incumbent indicates that re-election is uncertain, then the politicians in power will undertake popularity-increasing economic policies. These models have been empirically tested for various industrial (Frey & Schneider 1975, 1978a, 1978b, 1979, 1981) and less developed countries (Head 1995, Mendoza 1992a, 1992b, Praschnik 1991; for surveys see Frey 1983, Frey & Schneider 1988). Unlike the models derived by Nordhaus and his followers, these models do not produce pre-determined and identical political business cycles. Instead, the shape of these politico-economic cycles depends on a number of determinants, including economic conditions and the nature of political competition. Political competition, in turn, is determined by the number of parties competing and their respective shares of the vote, as well as by the coalitions that are most likely to be formed.

In the literature based on Nordhaus' model, voters are assumed to be myopic. However, the notion that voters are so extremely myopic that they never learn from their mistakes is difficult to reconcile with the assumption that they are actors with *rational expectations,* which Public Choice is critically based on. Rational expectations were first introduced in the partisan-politics model by Minford and Peel (1982) but the paper by Alesina and Rosenthal (1995) received the most attention. When voters are rational and *forward-looking* there is *no Political Business Cycle*, in stark contrast to the regularly occurring Nordhaus cycle. The cycle reappears only when voters are assumed to be *uncertain* about the timing of elections, as is the case under specific conditions in the United Kingdom and many other countries.

There is a variety of Political Business Cycle models with rational voters and opportunistic politicians (Alesina & Rosenthal 1995, Persson & Tabellini 1990, Rogoff & Sibert 1988, Roof 1990), in which parties or candidates differ in their abilities to macro-manage the economy. These models, which include voters who are *not fully informed,* predict that governments will increase certain categories of spending, run deficits and perhaps create extra inflation just prior to an election. Voters are assumed to be perfectly impartial and without any loyalties.

Consistent with a partisan voter model, Frey and Schneider (1978a) showed that the lower a group's income, the more sensitive their support for the president is to changes with the unemployment rate. Empirical evidence suggests that blue-collar and unskilled workers are more concerned with high unemployment, whereas wealthier people care more about inflation (see Schneider & Frey 1988 for a review).

The next stage of opportunistic voter models consisted in modelling voters as *retrospective* (Fiorina 1977, 1981) and including such voters in models of partisan politics (Hibbs 1987, 1992, 1994, 2000), i.e., where politicians depend on party machines and are ideologically committed to the position of the party to which they belong.

II. Rules of the Game

The politico-economic models discussed so far take the fundamental "rules of the game" – the constitutional or institutional setting which structures human interaction in society – to be given exogenously. This part of the paper reviews the study of the effects that the underlying constitutional setting has on decision-making. The term "constitution" (sometimes also called "institution", see e.g., North 1990, 2005) includes the formal and even informal rules shaping human interaction. The term goes well beyond the written constitution. Constitutional economists are most interested in the rules governing societal proceedings that finally result in collective decisions (Buchanan 1975, Frey 1983).

The Constitutional Approach

The interaction between the economy and the polity can be observed as a game taking place under particular institutional conditions (Buchanan & Tullock 1962, Brennan & Buchanan 1985, Mueller 1996, 2001). The outcome of this process is fundamentally shaped by the rules under which these interactions take place. The rules can be formally written down, as in a country's constitution, or unwritten, in the form of norms, customs or habits. Rules matter when they shape individuals' behaviour. The effects of constitutions on behaviour are not always straightforward; indeed, there are countries where the written constitution looks democratic but reality follows quite different patterns.

According to constitutional economics, institutions influence the interactions and outcomes of political and economic processes. Hence, three different stages may be distinguished:

(1) The most fundamental level at which a *choice is made between the many possible rules of the game*. This choice may occur behind the veil of uncertainty (Buchanan 1976, Rawls 1971,), or may consider new forms of organising economic activity.

(2) The *constitutional stage* where the *consequences of the various fundamental rules of the game* are analysed;

(3) The *current stage* where, taking these rules as given, the participants in the game make political and economic decisions that serve to maximise their utility functions. The current politico-economic process is thus endogenous and cannot be influenced. In particular, advice on matters of economic policy offered to governments by scholars will be disregarded unless it is in the politicians' self-interest, i.e., if it allows for re-election and maximisation of power. In general, politicians know well enough how to undertake self-beneficial economic policies within the given institutional constraints. This conclusion about the ineffectiveness of policy advice stands in stark contrast to the idea that scholars have a notable impact on the economic decisions taken by politicians. Economic advice will only be considered and followed by politicians if they otherwise do not know how to design a policy that is in their own interest. Offering advice to further the "public good" (however it is defined) has no effect on political decisions. This represents a fundamental difference to the standard welfare approach to economic policy, which is rarely noticed and acknowledged. Quite often, analyses start from the idea that governments maximise social welfare and only then introduce some political elements,

> such as the influence of government bureaucracy or interest groups. Such an approach disregards the basic interaction or game played by actors pursuing their own utility. In principle, economic advisers cannot influence the resulting interactions from the outside because each actor is behaving in a way that conforms to his own interests. If this holds, the outcome of the interaction can only be influenced by changes in the rules of the game, or in the constitution shaping these interactions. Thus, effective economic policy advice has to focus on political and economic institutions (see also North 1981, 1990, 2005). Behind the veil of ignorance, economists should offer advice about which institutions lead to outcomes that reflect individual preferences.

The importance of institutional or constitutional rules in determining the outcome of a politico-economic interaction seems to be obvious. Nevertheless, economic analyses tend to disregard not only the current stage with given institutions, as discussed above, but also the constitutional stage.

Most modern textbooks on economics discuss the workings of the economy only *within a given institutional setting*. This was the case in Keynesian economics and it still tarnishes far more recent versions of economic theory. A perfectly competitive market is often assumed to exist and the effects of policies are simply derived from this particular institutional form. Comparative institutional analysis of different rules of the game, e.g. of a competitive market, a market with strong bureaucratic interventions and an economy without well-defined property rights, tend to be disregarded, especially in macroeconomics. The issues associated with this neglect become particularly obvious in the political sphere. To take an extreme example, consider offering economic advice to an authoritarian ruler. This would have very different implications than to do so for a democratically elected government. There is little point in advising the former to undertake a policy designed to further the "common good", as the ruler's interests are quite different. Instead, the interests of the groups upon whose support the ruler relies, often the military, are the ones that count.

"Political Economics"

Over the last few years, a new research direction known as Political Economics has emerged. It studies the interaction of political and economic activities by comparing the different outcomes of institutional rules, i.e., it addresses level (2) described above. Interesting extensions of this direction are among others the fields of Law&Economics or the Economics of Crime (see e.g. Frey, 2011). Usually the approach of Political Economics uses more modern econometric methods than had previously been used but ignores the relevant decades-old Public Choice literature (Mueller 2007). State-of-the-art econometric techniques are used to study the impacts of different constitutional settings on economic outcomes. An important contribution to this literature has been made by Persson and Tabellini (1990, 1999, 2005) who compare the economic consequences of two constitutional choices: (1) majoritarian vs. proportional representation electoral rule and (2) presidential vs. parliamentary form of government.

Persson and Tabellini find that majoritarian electoral rules increase electoral competition, thus resulting in less rent for politicians, less redistribution by the central government, reduced deficits and a smaller central government. Moreover, presidential systems lead to a lower supply of public goods, less rent for politicians, less redistribution and smaller government. They also find that the large electoral districts that are found in proportional representation systems entail more corruption and that parliamentary forms of government are associated with higher productivity. These findings are empirically validated with a large longitudinal data set.

Subsequently, Persson and Tabellini (2005) use a new model to explain the theoretical mismatch they had found with respect to redistribution and proportional elections. The fragmented party system often leads to coalition governments within which there is electoral competition, inducing governing parties to increase spending by the central government. Furthermore, they provide a politico-economic perspective on the nexus between development and democracy by highlighting the importance of sequencing: countries that liberalise their economies before extending political rights fare better.

Clearly, these contributions are noteworthy. What remains questionable is whether this research is, in fact, a new development in the political business cycle literature within Public Choice theory. On a more general note addressed to Persson and Tabellini, Acemo-

 DOI: 10.5709/ce.1897-9254.47

glu and co-authors and the related literature, Mueller criticises the "tendency to re-label public choice and then pretend one has discovered something new" (2007, p. 67).

III. Endogenous Institutions

This section considers how the choice between different institutions is taken, i.e., it refers to level (1) described above. In constitutional economics following Buchanan, there is no *causality issue* because the two stages of choosing a set of rules and making decisions within it are neatly separated and viewed in quite different ways. Constitutional decisions are taken behind the *veil of ignorance*, meaning that the individuals who make the decisions do not know in what type of situation they will be in the future. In reality, such a situation rarely occurs. Instead, many individuals are confident that they will belong to a certain group or class in the future and therefore try to influence the constitutional elements accordingly.

The scholars who engage in "political economics" are aware of the causality problem: Institutions determine policy decisions and outcomes, but these also influence existing institutions. To identify the causalities, however, is difficult and several attempts have proven unsatisfactory (Acemoglu, 2005). A valiant and influential effort has been made by identifying institutions reaching far back in history, which could under no circumstances affect today's economic outcomes (Acemoglu, Johnson & Robinson 2001, 2002). Other approaches consider different exogenous influences such as weather conditions (e.g., Brunner 2003).

Another and even more recent approach inquires whether it is possible to find a new form of economic organisation that has not been explored thus far. As a result, the concept of "seasteading" has been suggested as a way of undertaking economic activities in the seas, similar to the process of "homesteading", which used to exist in the past (The Economist, 2011). Organisations established in the sea, and thus beyond national borders, can choose efficient ways of doing business. High mobility is assured. In particular, firms and individuals who do not agree with the rules of a particular seafaring place may leave at a low cost and join a seafaring place that is better suited to their preferences. While these new forms of organisation seem to be somewhat exotic, organisations performing similar tasks exist; for instance, the ships stationed just outside the national border of the United States that house casinos. Similarly, ships outside the national border of a nation where birth control is prohibited may offer medical and hospital services to women seeking abortions.

IV. Success or Failure?

It may well be argued that Political Economy has made great progress since its initial developments in the 1950s and 1960s. Theoretical models of the polity have become more refined, interactions have been better specified and the role of institutions has increasingly been taken into account. Furthermore, the field has become empirical and has started using the most advanced estimation techniques.

Political Economy has also been a success with respect to the institutions that are devoted to its study. There are American and European *Public Choice Societies* and an *International Society of New Institutional Economics* (ISNIE), which offer yearly conferences with a large number of participants. There are also various journals devoted to the subject, such as *Public Choice, Constitutional Political Economy,* or the *European Journal of Political Economy.*

A further clear success of Political Economy has been the considerable number of *Nobel Prizes* given to its scholars. Arrow and Sen on Social Choice, Buchanan on Constitutional Economics and North and Ostrom on Institutional Economics are undisputed exponents. However, Coase, Williamson and Becker may also be counted in the group of Political Economists. However, some "Anti-Political Economy" scholars, such as Tinbergen or Mirlees, who explicitly base their research on social welfare maximization, also received Nobel Prizes.

Nevertheless, this progress is mitigated by the fact that the basic ideas of Political Economy are all too often disregarded in mainstream economics. One can still find works with the implicit, and sometimes even explicit, assumption that benevolent governments technocratically maximise social welfare. Political Economy is still often captured in overly simplistic models, such as the median voter model, because this allows for easy derivation of equilibrium outcomes. While recent contributions relating the economic and political sectors are impressive, they have, to some extent, remained within a specialist community of scholars. Their effect on general economics is not very large, but compared to the former self-contained economic theory that completely disregarded politics, much has been achieved.

Meanwhile one can well be disappointed. In particular, the fundamental role of institutions in shaping the behaviour of both political and economic actors is often disregarded. This last statement can be illustrated by policy recommendations emerging from one of the most recent and thriving fields in economics, *happiness research*. The suggested policy consequences are still guided by a technocratic benevolent dictator approach.

Modern, empirically oriented economic research on happiness was started by Easterlin (1974) and van Praag and Kapteyn (1973). Since then, the major determinants of subjective reported well-being, particularly life satisfaction, have been identified (for surveys see Frey and Stutzer 2002a,b, 2005, Dolan et al. 2008, Frey 2008). Thus, we now know much about how socio-demographic factors (such as age, marital status and personal relationships), economic factors (such as income and its distribution, unemployment, or inflation), cultural factors (such as race or religion), or political factors (extent of democracy and decentralisation) affect happiness. Several prominent happiness researchers (e.g., Diener 2006, Kahnemann 2004, or Layard 2005) suggest that *governments should maximise happiness*. At last, the dream of economists seems to have come true: the social welfare function has been empirically grounded and thus can and *should* be maximised.

Politicians have been eager to pick up this new science (Layard 2005) because it promotes the impression that they care for their citizens. The King of Bhutan, the French President, the British Prime Minister, the Chinese President and politicians from several other countries have stated that they wanted to pursue policies maximising or increasing happiness. This sounds like an excellent policy worth supporting; it seems difficult indeed to object to making people happier.

However, more careful consideration reveals that a policy of happiness maximisation is doubtful and perhaps even dangerous in a democratic society. It corresponds to an idea where social welfare can and should be brought about by a government assumed to act solely in the interest of its citizens. This top-down policy, by a technocratic, research-informed and benevolent government, stands in sharp contrast to one of the major points of Political Economy: politicians are rational individuals with their own goals and thus act like everybody else: in their own interest. Happiness maximising policies are faced with several other major obstacles (Frey & Stutzer 2010). Respondents' answers to representative surveys on their happiness level tend to be biased when they are aware that the aggregate happiness index constructed with them will be used for political purposes. Moreover, governments have a strong incentive to *manipulate the happiness indicator that is to be maximised*. Happiness indicators are based on surveys and create many possibilities to influence the results in favour of the incumbent government.

At the constitutional level (2), the government's claim of pursuing a happiness maximising policy may make it difficult for opposing parties to argue against the party in power, which in turn undermines the intensity of political competition.

Happiness research and the policy proposal that governments should maximise happiness is just one example suggesting that Political Economy has not been sufficiently integrated into economic thinking.

Political Economy has obtained important results but must more actively seek to enlarge the perimeter of its application.

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Acknowledgments

We are grateful to Vera Eichenauer and Jana Gallus for their useful comments in preparing this paper.