

## Acceptance speech

20 June 2023

### **Torsten Persson**, awardee in the Economics, Finance and Management category (15th edition)

Does the level and composition of public spending depend on how a country's government is appointed, or how its legislators are elected? Which economic and political forces pin down a state's capacity to tax its citizens, or provide them with different services? Tim, Guido and I get this year's award for research on hard questions like these, at the crossroads of economics and politics. It is an honor and a privilege to speak for all of us.

Being Ph.D. students and young economists in the 80s and early 90s, we ran into two kinds of shifts that would greatly sway our research.

First, we saw our discipline change. Game theory produced new, powerful instruments to probe strategic interactions, like market competition among firms, or electoral competition among parties. Further, empirical research became sharper, as new quasi-experimental tools and practices spread from labor economics to other fields. In fact, previous BBVA Foundation awards have recognized both these developments.

Second, we saw widespread, real-world, mess-ups in economic and political affairs. Sweden grappled with high inflation, a devaluation cycle, and large recurring government deficits. Italy was rocked by repeated government crises, while its public debt rose from 30 to 120 percent of GDP in 25 years. The UK suffered mounting social strains, as the government tried to clamp down inflation from a peak of 25 percent. It seemed lame to see such episodes as random policy mistakes, but systematic explanations did not really exist.

Inspired by real-world problems, I wrote some early papers with Lars Svensson and others, on credible monetary and fiscal policies, and on the political roots of deficits. Guido worked on related issues with Alberto Alesina – who might have shared our award, but for his premature death just three summers ago. Meanwhile, Tim analyzed choices of policies and selection of politicians, with Steve Coate and Anne Case.

Of the contributions cited by the committee, let me just bring up two specific strands of research; one joint with Guido, one joint with Tim.

Our early work stressed how voters, who care about government services or redistribution, choose among politicians, who will choose these policies. But then, the rules of the political game should be critical, as they shape choices by both politicians and voters. Following this logic, Guido and I tried to uncover how constitutional rules map into economic policies. Our simple game-theory models predict that lawmakers elected by proportional representation, rather than first past the post, tax and spend more overall – especially on broad programs like social security. Quasi-experimental estimates square well with these hypotheses. With proportional elections and all else equal, the GDP-share of total public spending is about 5 percent higher, and of social security 2 percent higher. Likewise, our theory predicts that presidential governments spend less than parliamentary ones – in the data, levels are lower by some 5 percent of GDP.

In that work, we treated constitutional rules as given, at least in the theory. But in a bigger picture, political institutions are chosen – or built – so we wanted to investigate their drivers. Tim and I took this next step in our research on effective states. Our studies span the state's capacities to collect tax revenue, to support private markets, and to provide collective services. Because investments in any of these state dimensions augment the incentives to invest in the other two, state capacities should develop jointly, and their economic and political drivers should be common. Indeed, clusters of strong and weak states stand out clearly in data – both for histories of today's developed nations, and for broad cross-sections of current nations. Moreover, in our theory and in data, development clusters more broadly: stronger states are also richer and less violent than weaker states.

To conclude, it is just awesome to share this award with Guido and Tim – they are terrific scholars and my close friends. We are very grateful to the BBVA Foundation and the prize committee for honoring political economics, and to all other researchers who helped advance this field. But our deepest thanks go to our families for their unconditional and unwavering support.