

Ideas and interests

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The strange absence of “ideas” in modern models of political economy

- Dominant role of “vested interests” in prevailing theories of policy choice
 - economic development
 - international trade
 - regulation
- I want to challenge the presumption that there is a well-defined mapping from “interests” to “outcomes”
- In particular, I want to argue that this mapping depends on many unstated assumptions about the ideas that agents (in particular the elite) have
- Every rational choice model has specific ideas embedded in it about what agents should be maximizing, how the world works, and what tools they have at their disposal to further their interests.
- Once these assumptions are recognized, vested interests become much less determining and the space of possible outcomes much wider.
 - Roles for: agency, leadership, policy analysis
 - An explanation for the “anomaly” that many reforms benefit the elites who blocked them
- An analogy between ideas that relax resource constraints (“technological progress”) and ideas that relax political constraints

Outline

- Making the role of ideas explicit
 - a taxonomy of ideas
 - relationship to existing literature
- Particular focus on:
 - political economy models that “explain” inefficiency
 - ideas about feasible actions

The canonical political-economy problem

$$\begin{array}{ll} \text{Max}_{\{\alpha\}} & U(\alpha c; \cdot) \quad \text{s.t.} \quad \varphi(a, c; \theta) \leq 0 \\ & \alpha = g(a, c; \theta) \end{array}$$

- Political actors' utility depends (perhaps only in part) on share (α) of the economy's surplus (c) that can be extracted
- Actors choose a set of actions or policies (a)
- Economic equilibrium is determined jointly by actions and exogenous circumstances (θ)
- Ditto with the political equilibrium (i.e., α)

Where ideas enter (1)

$$\underset{\{a\}}{\text{Max}} \quad U(\alpha c; \cdot) \quad \text{s.t.} \quad \varphi(a, c; \theta) \leq 0$$
$$\alpha = g(a, c; \theta)$$

1. Preferences: “who are we and what are we trying to do?”
 - Ideas are not epiphenomenal; they determine interests
 - Literature:
 - PS: constructivism in IR; “Ideational analysis” (Wendt, Ruggie, Blyth, Hay)
 - Partisan politics literature in macroeconomics (Alesina)
 - Economic literature on identity (Akerlof and Kranton)
 - Political preference formation thru exposure to info (David Y-D; della Vigna and Kaplan)
 - Ideas about “fairness in distribution” (Alesina, Cozzi, and Mantovan)
 - Elster: 17th century French rulers may have cared as much for honor and glory as material ends. Atran and Ginges: Humans will kill and die not only to protect themselves or defend kin, but for an idea, a conception of who they are.

Where ideas enter (2)

$$\begin{array}{ll} \text{Max } & U(\alpha c; \cdot) \text{ s.t.} \\ \{\alpha\} & \varphi(\alpha, c; \theta) \leq 0 \\ & \alpha = g(\alpha, c; \theta) \end{array}$$

2. The model: “how the world works”

- Economic and political outcomes are determined in part by our beliefs about the nature of causal effects
- Literature:
 - Improved access to information, e.g. on politicians’ performance (Pande review)
 - Knightian uncertainty and indeterminacy of interests (D. North)
 - Debates about austerity versus Keynesianism, markets versus planning, free trade versus industrial policy are all about how the world works
 - New economic ideas (Keynes, Friedman, rational expectations) changed elites’ understanding of “economic reality” and facilitated move to different policies

Where ideas enter (3)

$$\begin{array}{c} \text{Max } U(\alpha c; \cdot) \text{ s.t. } \varphi(a, c; \theta) \leq 0 \\ \{a\} \end{array}$$

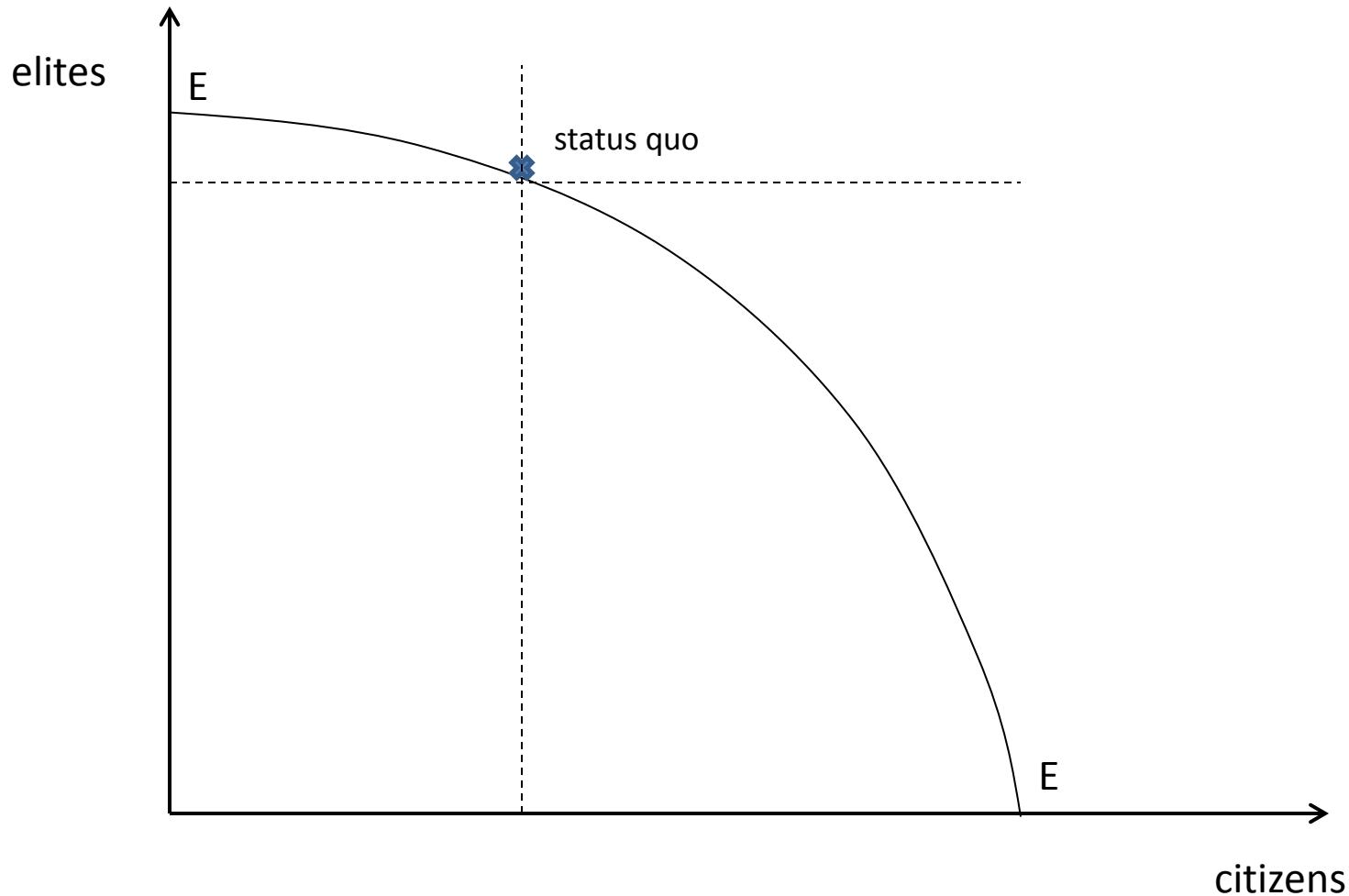
3. Actions: “what can be done?”

- Set of feasible actions (policy choices) is limited only by our imagination
- Parallel with consumer choice least useful here
 - Consumers have well-defined choices to make: how much to consume of each available good
 - Political agents design their own strategy space
 - politics is about choosing strategy: setting the agenda, making alliances, expanding/restricting menu of options, building/spending political capital...
 - Political economy models typically restrict the strategy space arbitrarily (or over-structure the political game)
- I will focus on this aspect of ideas below
 - Both because it has received little attention and because it ties in directly with policy analysis

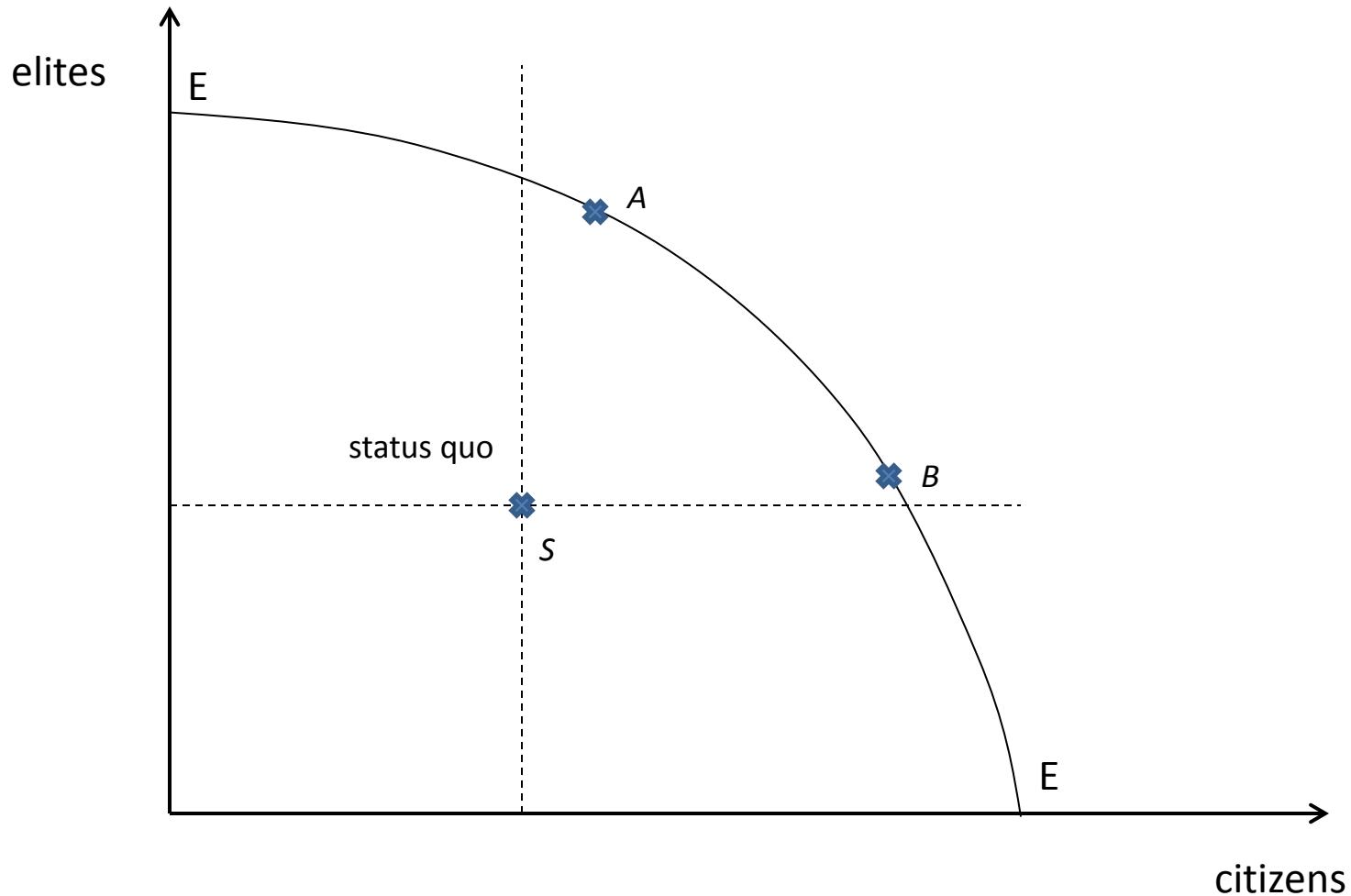
The political economy of inefficient policy choices

- Policy is endogenized by assuming
 - interests determine policy preferences
 - politics/power determines whose interests matter
- These two can explain redistributive policies, but not inefficiency
- To explain inefficiency, we must add direct restrictions on feasible set of elite actions (policies/strategies)
- Either directly
 - e.g., rule out lump-sum transfers or myriads of compensatory policies
- Or indirectly
 - by assuming economic outcomes determine who has effective political power, and
 - restricting the ability of elites to pursue strategies that may alter the relationship between economic outcomes and political power
- Good political ideas are those that relax these restrictions

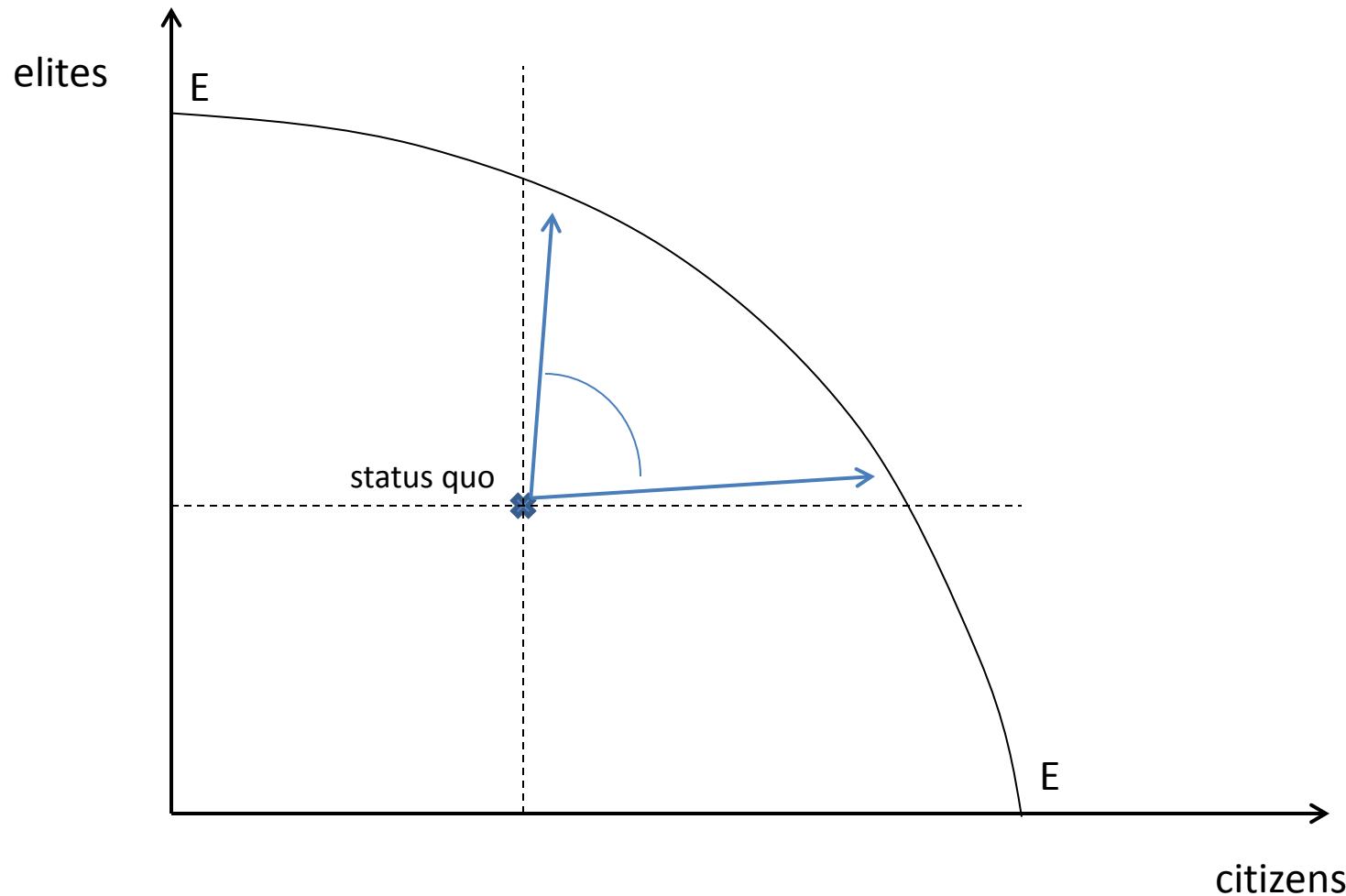
How politics matters: distribution



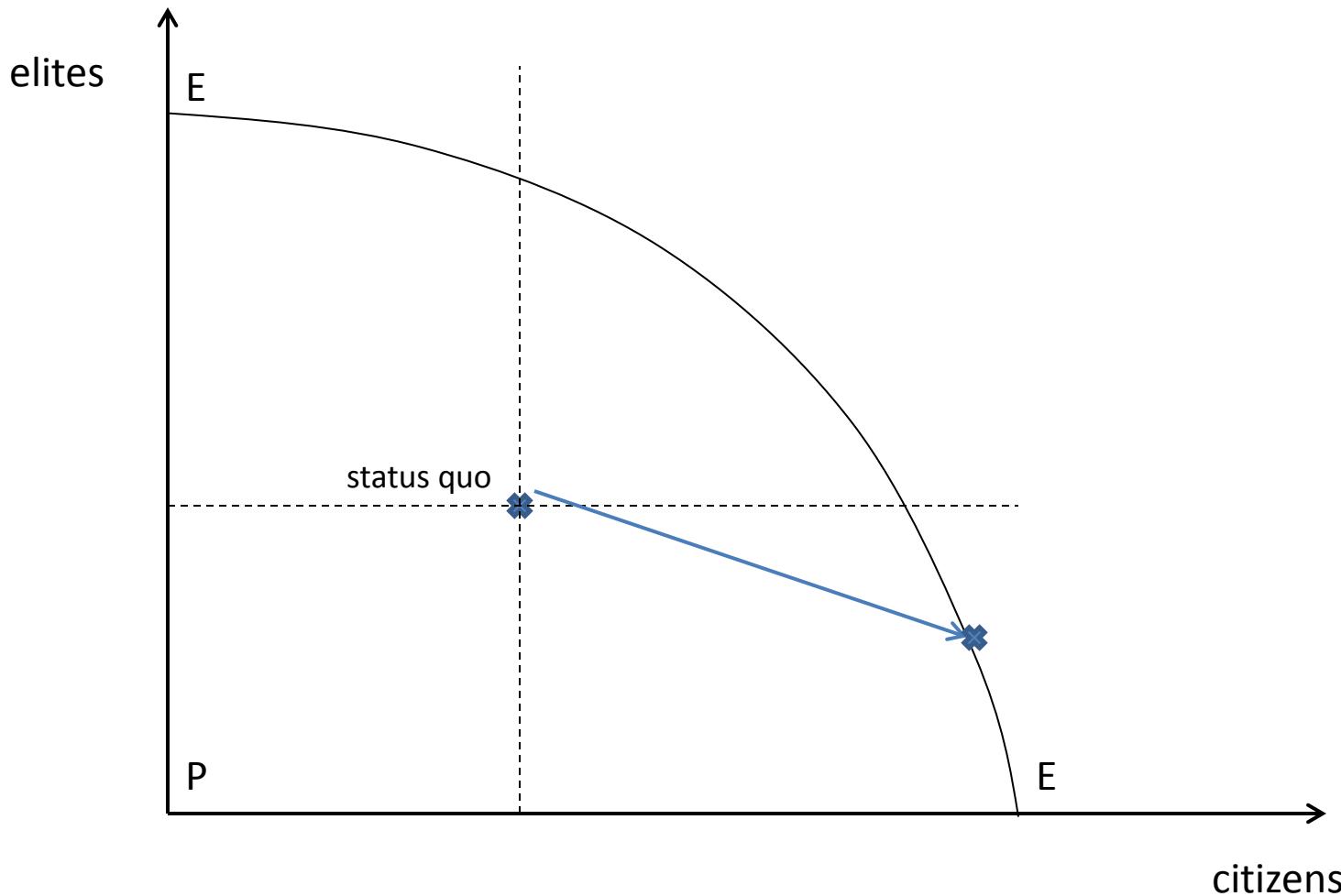
How politics matters: inefficiency



Puzzle: why not restore efficiency, while making elites even better off?



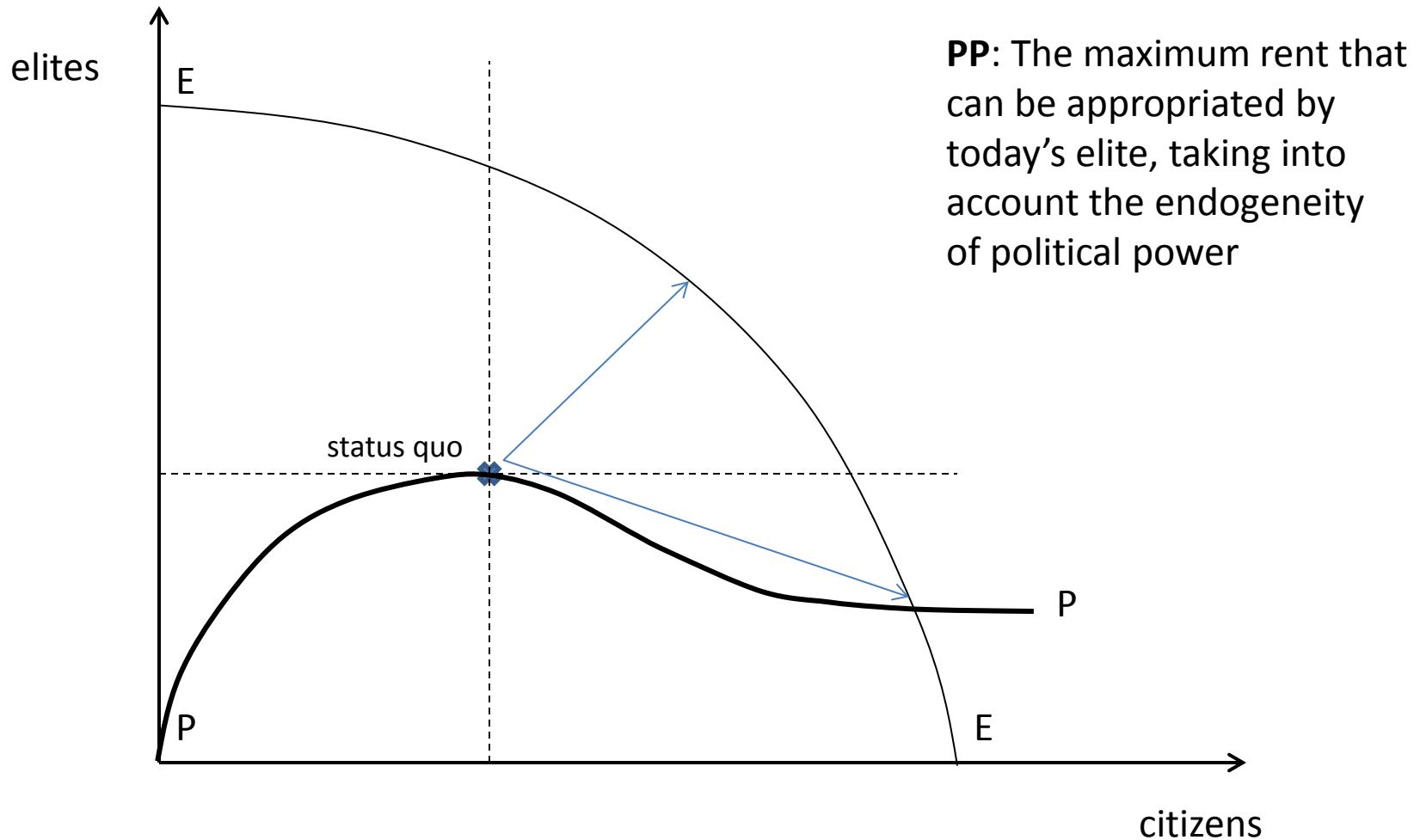
Answer: because efficient policies would alter political equilibrium, reducing ability of elites to redistribute



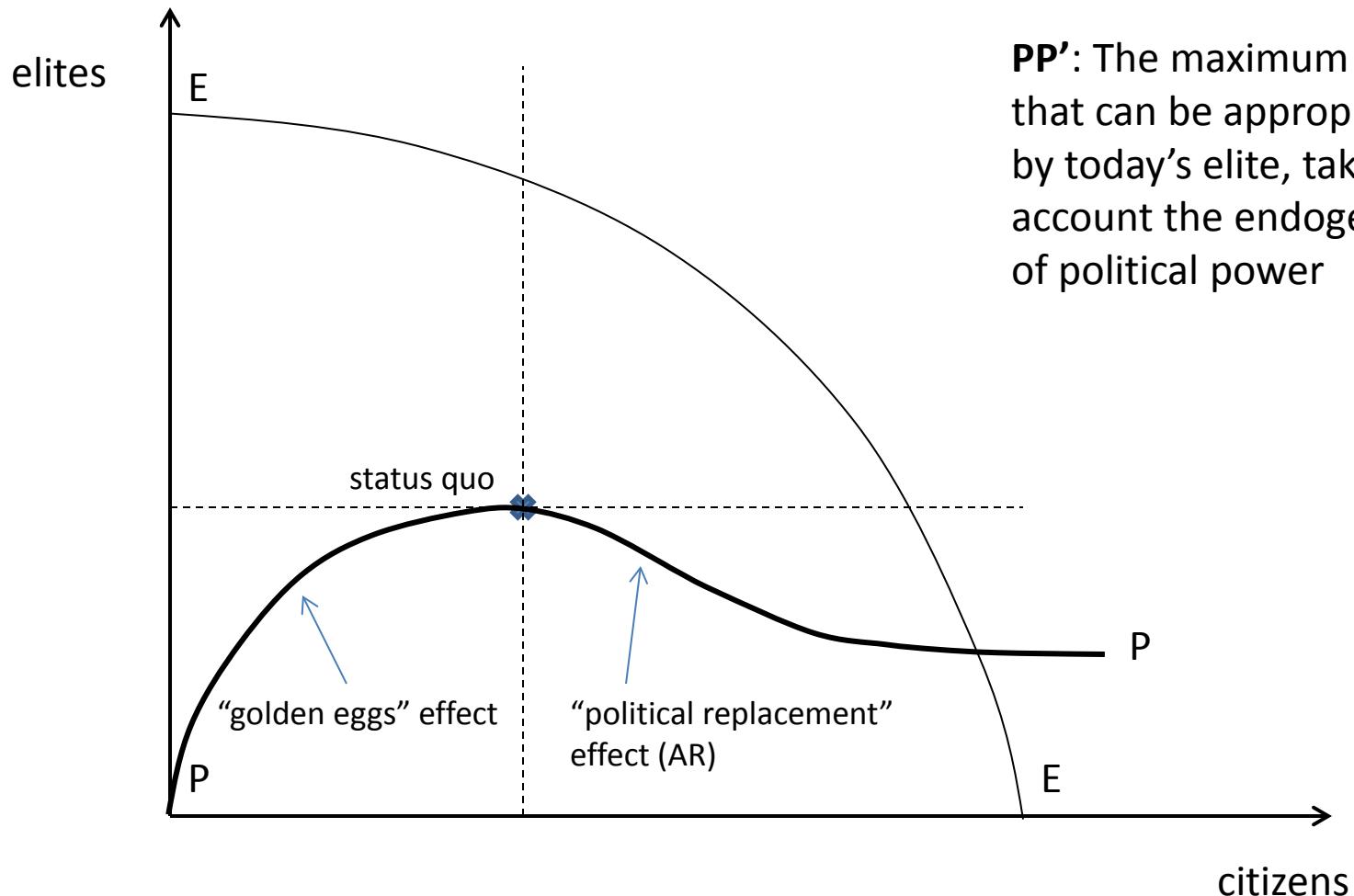
Illustrations

- Industrialization undermines the power of incumbents
 - Economic backwardness in Europe and Africa (Acemoglu and Robinson, 2006)
- Most economic liberalizations are not Pareto-improving, and lump-sum transfers are typically unavailable
 - Chinese price reform (Lau, Qian, and Roland, 2000)
- Promises to redistribute ex post are time-inconsistent
 - Economic reform with individual-specific uncertainty (Fernandez and Rodrik, 1991)

The “political transformation frontier”



The “golden eggs” and “political replacement” effects



Making ideas explicit: an analogy with technological progress

The location of PP depends on $\{a\}$ – the set of feasible actions on the part of the elite

... which in turn depends on **ideas** that elites have about the range of strategies (policies, actions, coalitions, etc.) that is open to them.

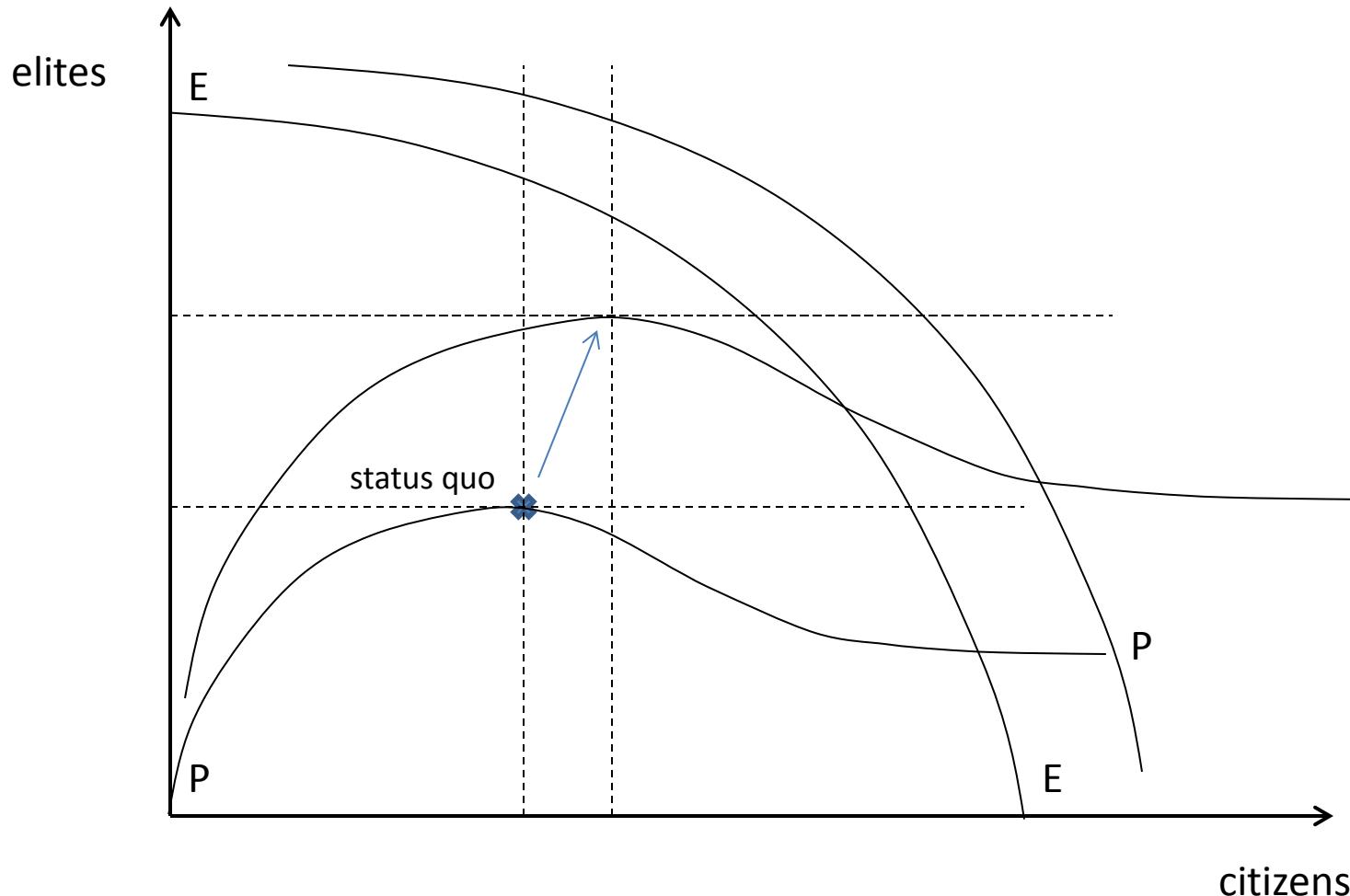
Good political/policy ideas relax the political constraint

... just as technological/economic ideas relax the resource constraint.

Ideas of the second kind are part of economic literature (IO, innovation, endogenous growth);

... while ideas of the first kind are largely outside

Relaxing the economic and political constraints



“Political ideas” in practice

Examples of strategies that relax political constraint:

- State-directed industrialization that strengthened power of state elites (Japan)
- Diversification by rural elites into commerce and industry (Britain – both of these examples are given by AR, 2006)
- Two-track pricing, EPZs and other examples from China
- Federal institutions to prevent the expropriation of the minority by the majority in South Africa (Inman and Rubinfeld 2012)
- Spectrum sales with political strings in the U.S. (Lopez and Leighton 2012)
- Bundling of market-oriented reforms with macro stabilization (as in LA, Rodrik PCBR)
- Trade liberalization combined with TAA as compensation

These are innovations in the same sense that technological innovations are: they enable the capture of efficiency gains without necessarily undercutting the power of elites.

Radio frequency spectrum sales:

“...if they were going to give up political control (a valuable asset to a politician), the commerce committee members would need to get something in return. They did. Most notably, they retained control of license assignment in ways that mattered politically. Licenses to use spectrum for broadcasting, for example, would not be auctioned. Rather, auctions would apply to spectrum used for commercial wireless services like mobile telephony, where their value would bring big revenues to the U.S. Treasury. Yet even with commercial wireless services, commerce committee members remained relevant. Special allowances were granted to give a financial incentive (bidding credit) to auction participants who were women, minorities, or small business owners. In the end, everyone with a decisionmaking role in Congress got something, either more revenues or more political oversight. The country got an efficient way to help pay for government and a much more efficient way to assign spectrum use rights.”

López and Leighton, Madmen, Intellectuals, and Academic Scribblers: The Economic Engine of Political Change, 2012, p. 147.

Where do new ideas come from?

- “Policy mutations”: unplanned experimentation arising from administrative “failures” or cracks within existing regime
 - e.g., illegal rural markets in China; airline super saver fares prior to deregulation
- “Learning by doing”? Organizational learning vs. obsolescence
 - Local searches a la Nelson & Winter
- Role of crises: sense that existing ideas are not working makes agents more open to consider new ideas
 - e.g., great depression, inflation crisis of 1970s (Blyth, Weyland)
- Role of emulation: introduction of new instruments elsewhere
 - Chile in LA
 - CB independence (K. Thelen)
 - “isomorphic mimicry” (DiMaggio and Powell 1983)
- Political entrepreneurship
 - freer political entry (e.g., greater democracy) allows political entrepreneurs to arbitrage between academic ideas and political inefficiencies (Lopez and Leighton).
 - this can also be seen as political leadership, which does not necessarily require competition.

What do we gain by considering role of ideas?

- Avoid problems with post-hoc style of theorizing
 - If reform happened despite interests, it must be because it didn't hurt them... (Germany, Japan examples in AR 2006)
- Efficiency-enhancing policy reforms often benefit, rather than hurt elites/incumbents that apparently blocked it beforehand
 - Examples (China post-1978, Korea post-1961)
 - reform often happens not when vested interests are defeated but when different strategies are used to pursue those interests
- With current approaches, the better we “explain,” the less we can prescribe
 - social science versus policy analysis
- A new perspective
 - “interests are an idea”