

WHEN IDEAS TRUMP INTERESTS

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When was the last time you heard:

- I want this policy to be adopted because it is good for me
(my firm / my industry / my kids / my neighborhood / my tribe...)

Canonical perspective in economics, and its shortcomings

- Politically relevant actors have well-defined “interests”
 - fixed by their preferences, endowments, assets, or occupation
- Arguments that appeal to other values (justice, fairness, ...) or the “public interest” are a cover for naked self-interest
- But then, why bother?
- Such arguments are made presumably because they move some people, due to:
 - ignorance?
 - false consciousness?
 - indoctrination?
 - education?
 - persuasion?
- Whatever the reason, we are in a world where ideas can exert an independent influence

Ideas and interests in rational choice models of political economy

- 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.
 - there is no longer a well-defined mapping from “interests” to outcomes
 - this mapping depends on many unstated assumptions about the ideas that agents have
 - we find new roles for: agency, leadership, policy analysis, persuasion
 - in the limit, interest becomes an idea
- Implications for prevailing theories of policy choice in:
 - economic development
 - international trade
 - regulation
 - ...

Outline

1. Making the role of ideas explicit
2. A taxonomy of politically relevant ideas
 - a) ideas that shape preferences (identity politics)
 - b) ideas about how the world works (battle of worldviews)
 - c) ideas about feasible policies (policy innovation)
3. *JEP* article focused on:
 - ideas about feasible policy actions that relax political constraints
 - in the context of political economy models that “explain” inefficiency
4. Today also talk on:
 - ideas as models of the world
 - relation to economic theory
5. Clarify and explore issues rather than present specific approach or model
 - joint work with Sharun Mukand (Warwick)

Preliminaries (1)

There are two states of the world, which yield consumption outcomes $\{\mathbf{C}_G, \mathbf{C}_B\}$.

A policy τ_i induces a probability distribution over the states of the world $\{\pi_{iG}, 1 - \pi_{iG}\}$. These π_{iG} reflect the equilibrium of the underlying political-economic model.

There is a veto player, labeled A , which must approve any policy change. His (expected) utility with policy τ_i is:

$$v^A(\tau_i) = \pi_{iG}u^A(\mathbf{C}_G) + (1 - \pi_{iG})u^A(\mathbf{C}_B)$$

There is a potential challenger, identified as player B . His (expected) utility is:

$$v^B(\tau_i) = \pi_{iG}u^B(\mathbf{C}_G) + (1 - \pi_{iG})u^B(\mathbf{C}_B)$$

Preliminaries (2)

Let status quo policy be τ_0 with

$$v^A(\tau_0) \equiv \bar{v}^A \text{ and } v^B(\tau_0) \equiv \bar{v}^B.$$

Challenger wants to attain $v^B > \bar{v}^B$.

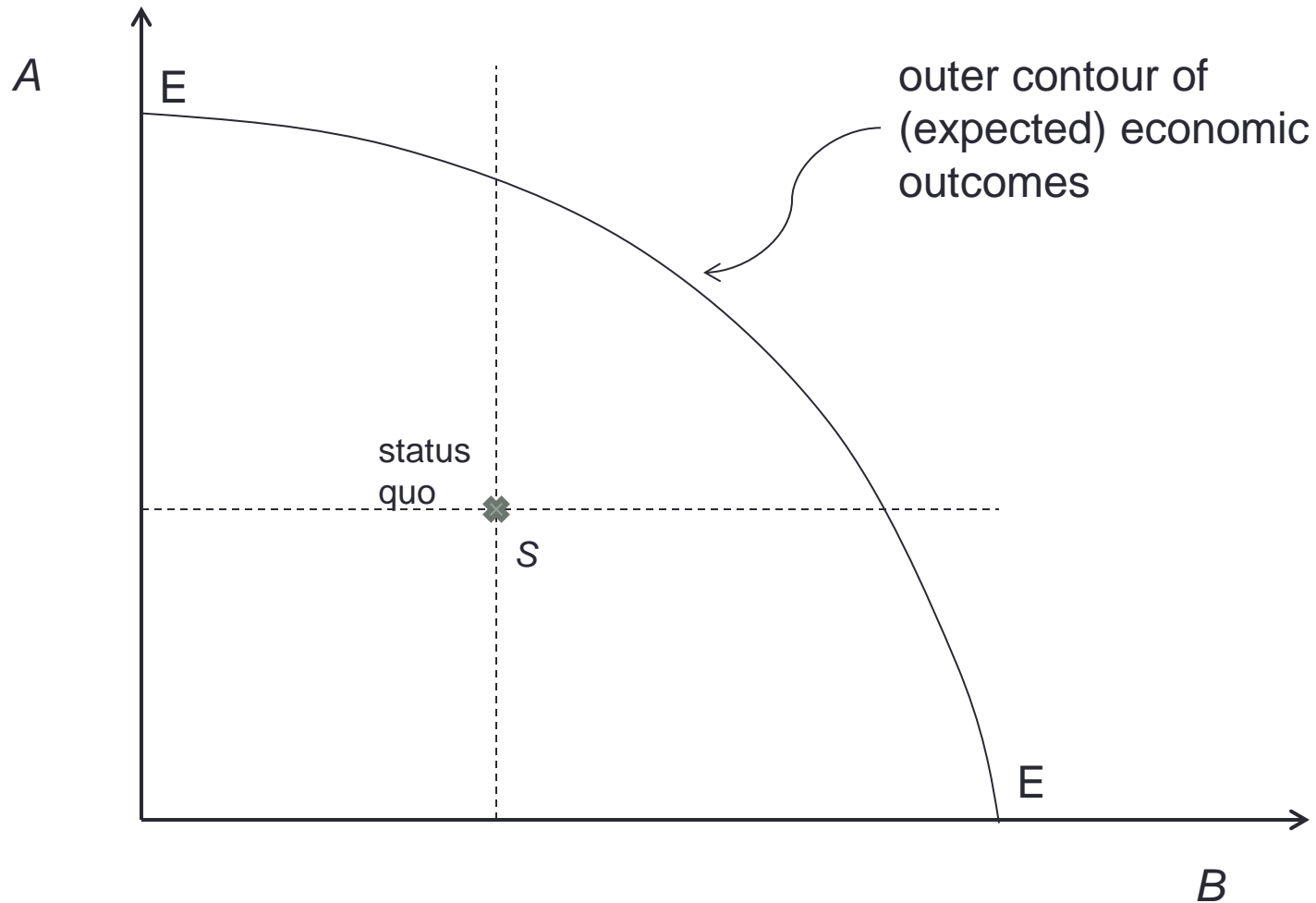
Problem:

$$v^A(\tau_i) < \bar{v}^A \quad \forall \tau_i \text{ s.t. } \tau_i \in \{feasible\} \text{ and } v^B(\tau_i) > \bar{v}^B$$

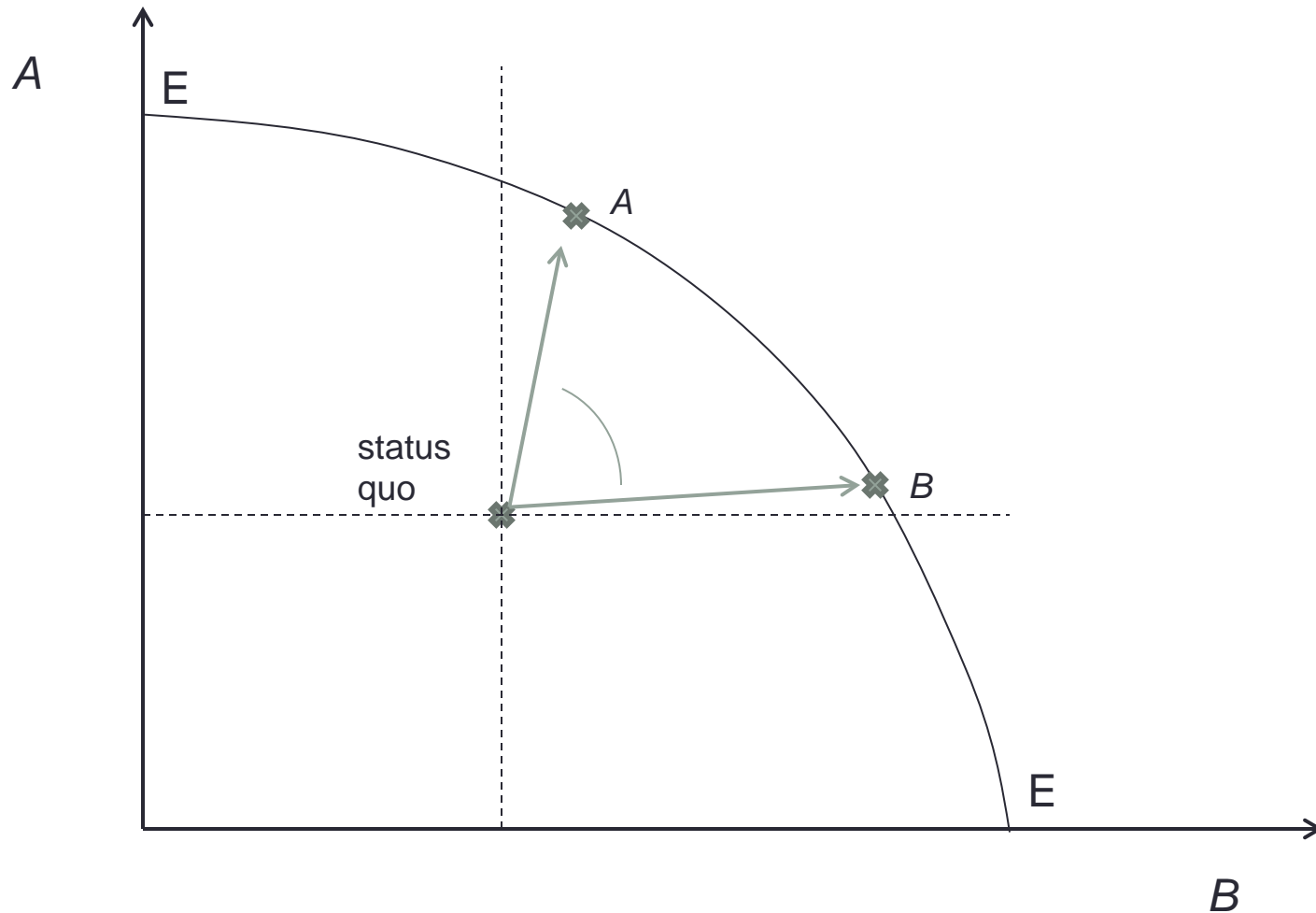
Note how this can explain:

- (a) policy choices that are partial to powerful groups (“elites”)
- (b) policy choices that are inefficient

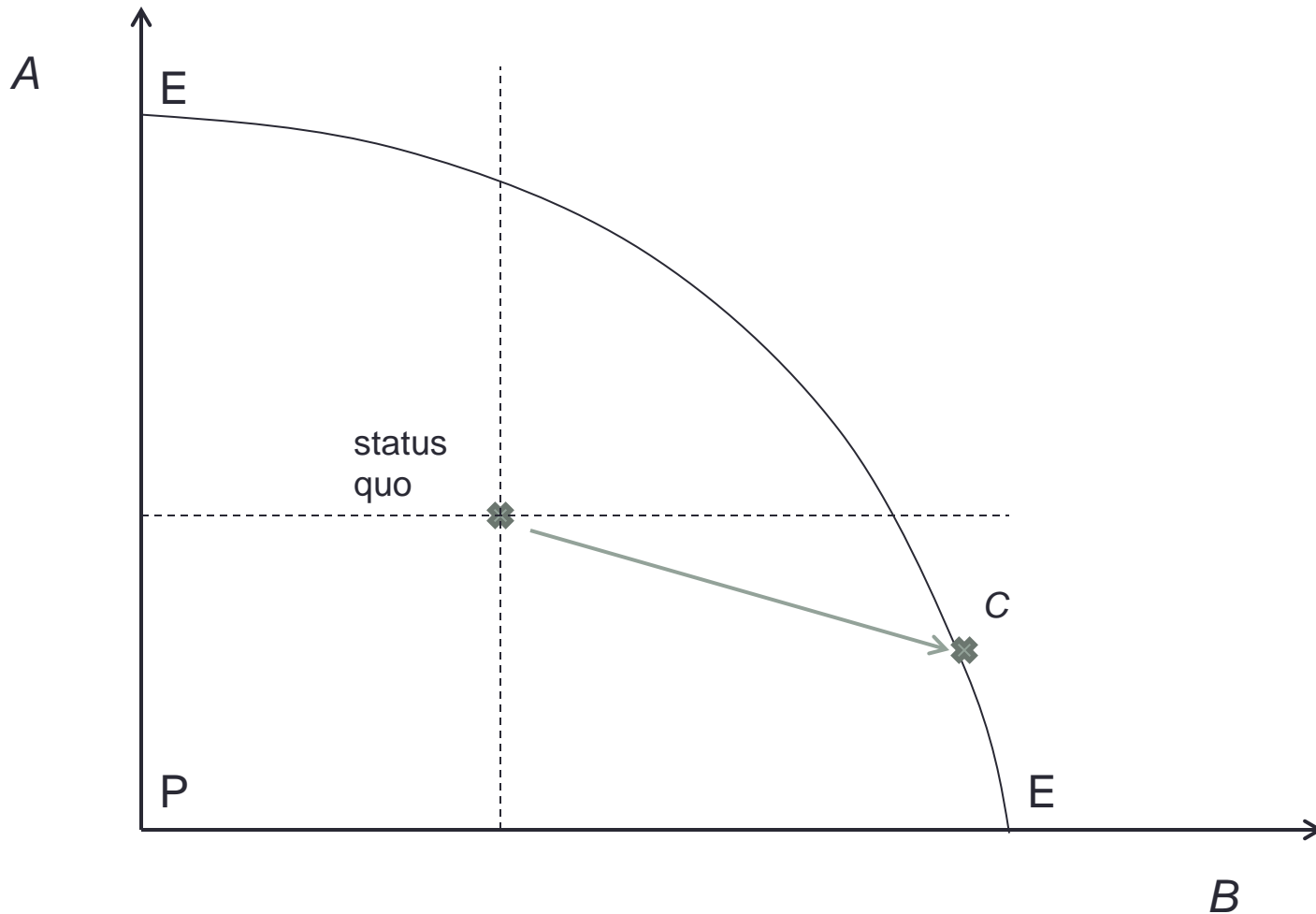
An inefficient political-economic equilibrium



Why not restore efficiency, while making veto player even better off?



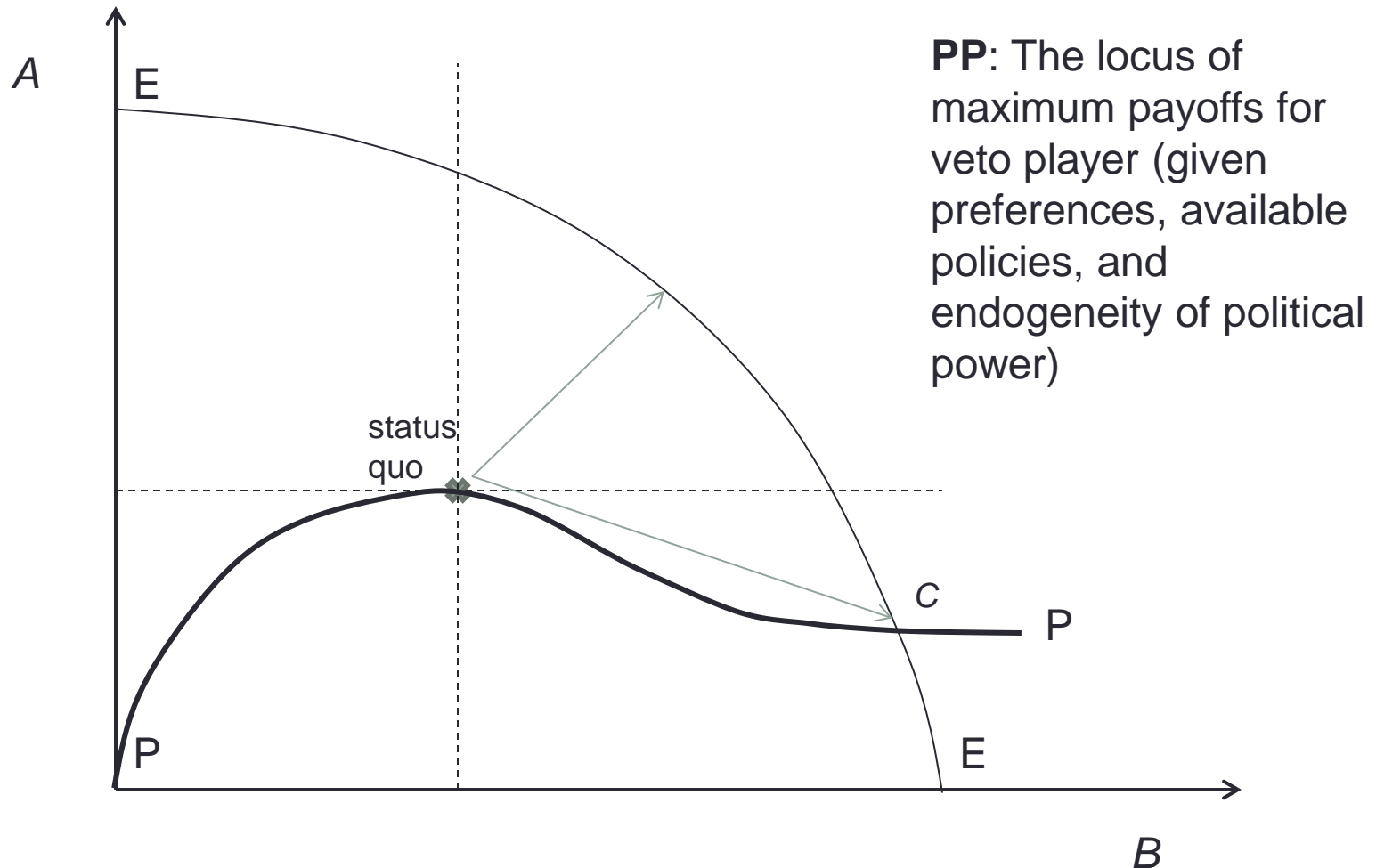
Because (available) efficient policies would harm A, directly or indirectly through politics



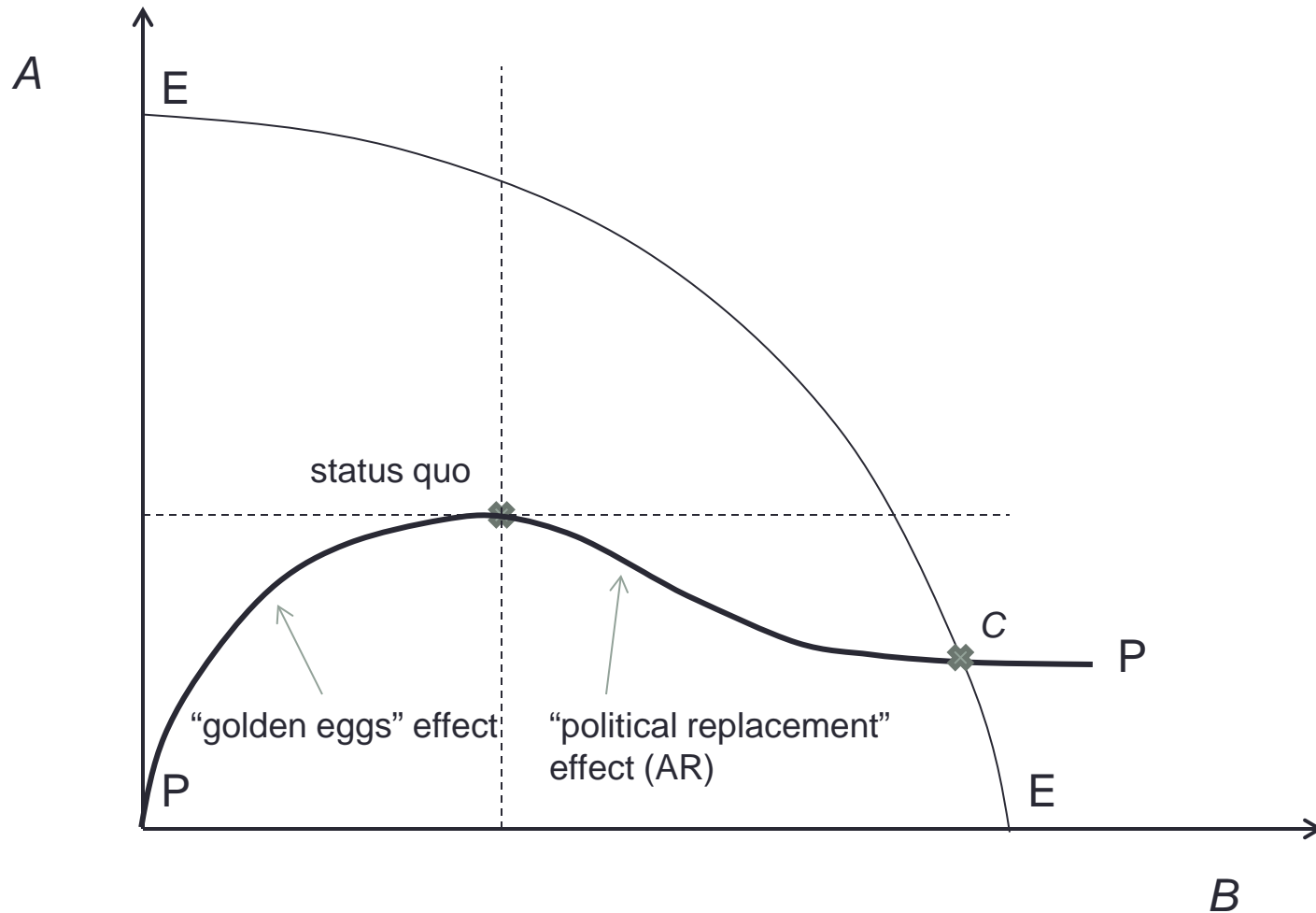
Illustrations

- Most economic liberalizations are not Pareto-improving,
 - battle over repeal of Corn Laws in Britain
 - Chinese price reform (Lau, Qian, and Roland, 2000)
- But what about compensation (e.g., lump-sum transfers)?
- Requisite instruments may not be available (or too distorting)
- Promises to redistribute ex-post may be time-inconsistent, because reform undermines power of veto players
 - economic reform with individual-specific uncertainty (Fernandez and Rodrik, 1991)
 - industrialization and economic backwardness in Europe and Africa (Acemoglu and Robinson, 2006)

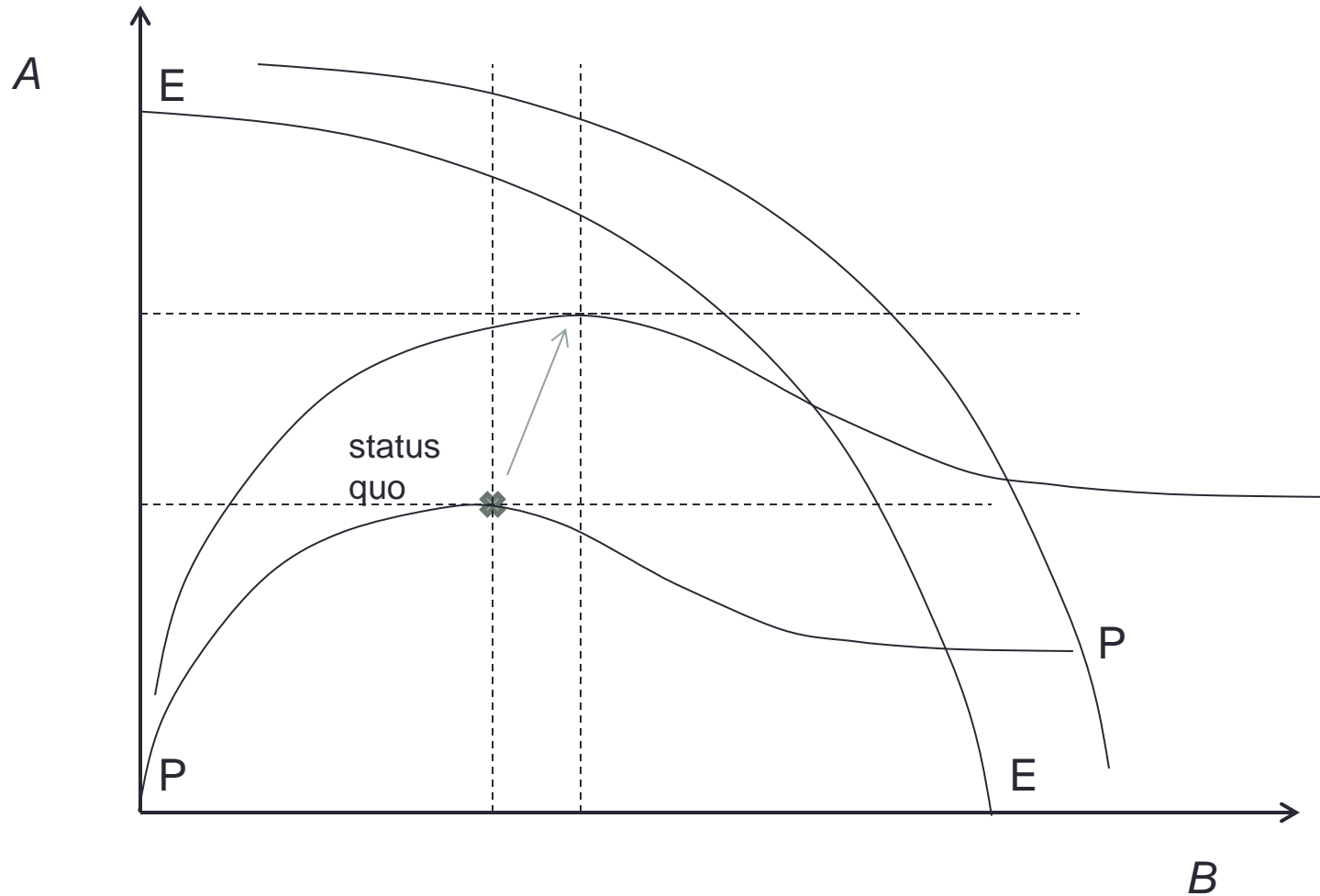
The “political transformation frontier”



The “golden eggs” and “political replacement” effects



Relaxing economic versus political constraints



Ideational politics

How the challenger can use ideas to shift political transformation frontier out:

- Change preferences, $u^A(.)$
[identity politics]
- Change views on how existing policies work, π_{iG}
[battle of worldviews]
- Expand the set of feasible policies, $\tau_i \in \{feasible\}$
[policy innovation]

1. Identity politics

Partition society into a number of potential social groups, indexed by J , based on “primitive markers” such as race, ethnicity, social class, income, neighborhood, etc. Each one of these constitutes a potential source of social identity.

Social identity creates positive “consumption” externalities. So let:

$$u^A(\mathbf{C}) = f(C^A + \sum_{J \neq A} \lambda_J w_J C^J)$$

where λ_J is an indicator variable identifying whether A has social identity ties with group J (and derives utility from outcomes for that group).

Identity politics here consists of making investments that increase salience of those ties, such as appeals based on specific ethnic or social identities.

Can be a successful strategy for B , as long as A shares some primitive markers with B (and the requisite investments are not too costly).

2. Battle of worldviews

The π_{iG} reflect prevailing beliefs about “how the world works,” beliefs about the nature of causal effects.

- based on both a model of how the economy works, and how changes in policies map into political consequences (who has, loses, or retains power).

Ideas can make a difference under different kinds of knowledge imperfections

1. Information is incomplete or asymmetric
 - e.g. effects of improved access to information on politicians' performance
2. There is Knightian uncertainty
 - e.g., indeterminacy of interests a la D. North
3. There is meta-uncertainty: multiple, contending models of the world
 - and beliefs do not converge over relevant time horizon

Economics as a family of models (1)

- Economists often think of themselves as possessors of true/useful knowledge, distinct from others whose worldviews are shaped by a combination of ignorance and self-interest
 - “a battle against ‘bad’ ideas...”
- But economics typically provides multiple descriptions of the world, and rarely provides unique answers
 - “a battle against other economists’ ‘bad’ ideas...”

Economics as a family of models (2)

- Does fiscal spending raise output?
 - yes, in Keynesian model
 - no, in classical model
- Does a minimum wage reduce employment?
 - yes, in perfectly competitive model
 - no, in oligopolistic model
- Do capital inflows stimulate economic growth?
 - yes, when investment is saving-constrained
 - not necessarily, when investment is demand constrained
- Does financial liberalization enhance welfare
 - yes, when incentive distortions are small or well-regulated
 - no, when agency problems and systemic externalities predominate
- Does redistribution retard economic growth?
 - yes, when taxes on capital reduce investment
 - no, when greater equality produces social peace and better policies

... creates different roles for economists

- Economists as ivory tower scholars who fail to communicate their ideas to public
- Economists as hired guns
- Economists as public intellectuals and policy entrepreneurs
 - Finance
 - a succession of models that stress, alternatively, market efficiency and inefficiency
 - Gold Standard => Bretton Woods => financial liberalization/globalization
 - Economic development
 - a succession of models that stress, alternatively, market failures and government failures
 - ISI => Washington Consensus
- Regardless, there is at least some independent role for economists (and other public intellectuals) in shaping public perceptions of how the world really works

3. Policy innovation

The challenger can relax constraint $\tau_i \in \{feasible\}$ through imaginative new policies

Formal parallel in political economy with consumer choice can be quite misleading 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...
 - Social norms that determine acceptable behavior can also be manipulable
 - Political economy models typically restrict the strategy space arbitrarily (or over-structure the political game)

Policy innovation 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.

An analogy with technological progress

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

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

Where do new policy ideas come from?

- “Policy mutations”: unplanned experimentation arising from administrative “failures” or cracks within existing regime (cf. Leitzel)
 - 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.

A parenthesis on social norms

- Norms shape the available action space
 - similar to feasible policy space
- Norms can both
 - restrict the action space
 - e.g., human rights norms that rule out torture
 - and expand it
 - e.g., the “responsibility to protect” doctrine that sanctions interference in sovereign states
- Norms are also linked to constructed social identities
 - “civilized nations do not behave this way...”
- Economists typically think of norms as behavioral patterns that emerge from repeated interactions in game-theoretic settings
- But examples above suggest normative ideas can also turn into norms

Questions for analysis

- When do ideas matter?
 - when will politicians find it pays to “invest” in persuasion?
 - respective domains of “ideas” and “interests”
- What is the “technology” of persuasion?
 - money, packaging, symbolism, framing
- What are the roles of idea generators versus idea disseminators?
 - who are the policy entrepreneurs?
- Are different kinds of ideational politics substitutes or complements
 - ethnic politics versus ideological politics
- Any reason to expect good ideas drive out bad ideas?
 - right vs wrong models of the world

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 reforms often benefit, rather than hurt elites/incumbents that apparently blocked it beforehand
 - Examples (China post-1978, Korea post-1961; RSA post-1994)
 - 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”