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When Ideas Trump Interests: Preferences, Worldviews, and Policy Innovations

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Ideas are strangely absent from modern models of political economy. In most prevailing theories of policy choice, the dominant role is instead played by "vested interests"—elites, lobbies, and rent-seeking groups which get their way at the expense of the general public. Economists, political scientists, and other social scientists appeal to the power of special interests to explain key puzzles in regulation, international trade, economic growth and development, and many other fields. Why does regulation favor incumbent firms at the expense of consumers or potential entrants? Because bureaucracies can be captured by well-organized "insiders" who can shape regulation in their favor (Stigler 1971; Peltzman 1976; Laffont and Tirole 1991). Why are trade restrictions so rampant despite the well-known gains from trade? Because import tariffs and quotas redistribute incomes to politically powerful business groups and lobbies (Krueger 1974; Grossman and Helpman 1994; Rodrik 1995). Why do political elites not favor growth-promoting policies and institutions? Because growth-suppressing policies, such as weak property rights, excessive regulation, or overvalued currencies provide these elites with access to rents that would disappear otherwise (Bates 1981; Acemoglu and Robinson 2006, 2012). Insights from political-economy models in each of these fields exert a strong influence on the way economists think of societal outcomes and the operation of the political system.

Any model of political economy in which organized interests do not figure prominently is likely to remain vacuous and incomplete. But it does not follow from this that interests are the ultimate determinant of political outcomes. Here

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I will challenge the notion that there is a well-defined mapping from "interests" to outcomes. This mapping depends on many unstated assumptions about the *ideas* that political agents have about: 1) what they are maximizing, 2) how the world works, and 3) the set of tools they have at their disposal to further their interests. Importantly, these ideas are subject to both manipulation and innovation, making them part of the political game. There is, in fact, a direct parallel, as I will show, between inventive activity in technology, which economists now routinely make endogenous in their models, and investment in persuasion and policy innovation in the political arena. Once their fluid nature is recognized, vested interests become much less determining and the space of possible outcomes much wider.

While hidden assumptions play a role in all economic models, I will argue that the failure to recognize the role of ideas in shaping interests (and their pursuit) has especially serious implications in political economy. Taking ideas into account allows us to provide a more convincing account of both stasis and change in political-economic life. It provides a way of bridging the sharp divide between policy analysis (what should be done) with political economy (what actually happens). It also yields an explanation for a common anomaly in the real world—the fact that, in practice, many reforms turn out to benefit the elites who previously blocked them.

I begin by providing a taxonomy of the ways in which ideas make their way, more often than not implicitly, into established models of political economy. Next, I focus specifically on models professing to explain economic inefficiency and argue that outcomes in such models are determined as much by the ideas that elites are presumed to have on feasible strategies as by vested interests themselves. A corollary is that new ideas about policy—or policy entrepreneurship—can exert an independent effect on equilibrium outcomes even in the absence of changes in the configuration of political power. I conclude by discussing the sources of new ideas.

Making the Role of Ideas Explicit

Every rational-choice model is built on the purposive behavior of individual decision makers. Typically, behavior is determined by assuming individuals solve a well-defined optimization problem. At least three components must be specified in such an optimization exercise: 1) an objective function (like a consumer utility function); 2) a set of constraints (like a budget constraint); and 3) a set of choice variables (like the quantities of consumption to be chosen). Political economy models in the rational-choice mold translate this framework into the political arena. Political agents—voters, lobbies, elites, congressmen—are represented as rational individuals who solve explicit optimization problems. This means: 1) they maximize a utility function defined over consumption, rents, or political benefits; 2) they operate within constraints imposed by the rules of the game, both economic and political; and 3) they choose a set of actions—which in various models may include votes, political contributions, rebellion, and suppression—that maximize their objection function given the constraints. For example, business lobbies decide how much they should make in political contributions in return for tariff protection, taking into account that politicians value societal welfare alongside the contributions (Grossman and Helpman 1994). Or a dictator decides whether to develop his economy so as to maximize his intertemporal stream of rents, taking into account that his decision affects both economic and political outcomes, including his longevity in power (Olson 1993; Acemoglu and Robinson 2006).[1]

Ideas enter this problem in several distinct ways that are rarely recognized. In fact, each of the three components of the optimization problem—preferences, constraints, and choice variables—rely on an implicit set of ideas. I discuss these in turn below. I emphasize that I am not contesting rationality or the utility of the basic optimizing framework in the political arena. My goal is to explore the role of ideas in shaping how interests are defined and pursued.

Preferences: Who Are We?

Self-interest presumes the idea of a "self"—that is, a conception of who I am and what my purpose is. In many economic applications, the maximand is clear. It is reasonable to assume households want to maximize their consumer surplus and producers their profits, although these assumptions are not always entirely uncontroversial. In the political sphere, the choice of what is to be maximized is much less evident: depending on context, honor, glory, reputation, respect, income, power, durability in office, and "good of the country" are all plausible. As Elster (2000) has written in a critique of political economy frameworks attempting to explain historical political developments, the nobility in 17th-century France may have been interested in honor and glory as much as in material benefits. Much human behavior is driven by abstract ideals, sacred values, or conceptions of loyalty that cannot be reduced to economic ends. Studies by anthropologists and psychologists suggest "humans will kill and die not only to protect their own lives or defend kin and kith, but for an idea—the moral conception they form of themselves, of 'who we are'" (Atran and Ginges 2012, p. 855)—a point that should not be controversial in an age of suicide bombings.

[1] More formally, we can express the canonical political-economy problem as follows. Let $\boldsymbol{a}$ denote the vector of choice variables, $\boldsymbol{c}$ the gross private consumption vector, and α the share of the economy's surplus (or gross private consumption) that political agents can extract. Then the optimization problem that each agent solves takes the following form:

$$\max_{\{\boldsymbol{a}\}} U(\alpha \boldsymbol{c}, .) \qquad \text{s.t.} \qquad \begin{aligned} \varphi(\boldsymbol{a}, \boldsymbol{c}; \boldsymbol{\theta}) &\leq 0 \\ \alpha &= g(\boldsymbol{a}, \boldsymbol{c}; \boldsymbol{\theta}) \end{aligned}$$

where $\boldsymbol{\theta}$ is a vector of exogenous parameters. The agent's utility depends, at least in part (and not necessarily exclusively), on the surplus that the agent can extract. The constraints in this optimization exercise come in two forms, specifying the economic and political model, respectively. The first relationship $\varphi(.)$ describes the economic equilibrium, which is determined jointly by actions and exogenous parameters. The second relationship describes the political mechanism, represented by $g(.)$, that specifies how political actions, along with other endogenous and exogenous variables, translate into rent extraction. While time subscripts are not included, it should be clear how this framework can be extended to a dynamic setting.

How we evaluate different social states and judge whether they advance our "interests" depends crucially on how we define ourselves. We might view ourselves as a member of a social class ("middle class"), ethnic group ("white majority"), religion ("evangelical"), nation ("global citizen"), demographic cohort ("baby boomer"), profession ("educator"), or a myriad of other possible identities. As Sen (2006) has suggested, we might even combine all these identities in varying degrees. In political science, a well-established line of research has long held that interests of political actors are socially constructed rather than determined by well-defined material facts. In this "constructivist" tradition, conceptions of interests arise endogenously from norms, ideologies, and causal beliefs (Wendt 1999; Ruggie 1998; Blyth 2002; Hay 2011). Interests, in fact, are "one form of idea" (Béland and Cox 2011, p. 10). In international law, a parallel discussion pits "legal realists," who argue that behavior among states is determined exclusively or largely by national interests, against scholars who see a significant role for norms of justice or law (Howse 2013; Goldsmith and Posner 2005).

Economists have rarely ventured that far, but the role of ideas in determining preferences has crept into various strands of research in economics. For example, the partisan-politics literature in macroeconomics endows political parties with explicit ideologies, typically represented as different preference weights on inflation versus unemployment (Alesina and Rosenthal 1995). These differences in preferences are typically imposed exogenously, with little explanation. More recently there has been some work, both at the macro and micro level, that looks at the endogenous determination of ideologies: see, for example, Alesina, Cozzi, and Mantovan (2012), Della Vigna and Kaplan (2007), and Yanagizawa-Drott (2012) on the formation of political preferences through exposure to societal outcomes, media, or early childhood experiences.

The work of Akerlof and Kranton (2000; 2005 in this journal) on the economics of identity is particularly relevant here. Akerlof and Kranton consider models where individuals associate themselves with specific social categories and their desired behavior derives from the attributes of those categories. Workers, for example, may acquire identities that moderate the incentive compatibility constraint vis-à-vis their employers (leading them to behave in greater conformity with the objectives of firms). In turn, employers may seek to alter such identities to enhance workplace performance. Such models could explain a range of "anomalous" political action, including voting against immediate material interests. But the possible application of this approach to political phenomena has not yet received much attention.

In each of these frameworks, ideas play a crucial role. Instead of being epiphenomenal, they determine preferences directly, and therefore shape patterns of political behavior. This perspective requires social scientists to engage with the questions of where ideas come from and how they are spread and internalized.

The Model: How Does the World Work?

Policymakers operate under certain working assumptions about how the world works. Their worldviews shape their perception of the consequences of their and others' actions in both economic and political domains. These ideas may fall on either side of some of the biggest controversies in the history of economic thought: Does the economy work better under laissez-faire or planning? Are economic growth and development more rapid under free trade or under protection? Does macroeconomic stability require Keynesian countercyclical policies or Hayekian nonintervention? Each of these positions presumes a particular model of how the economy works and therefore has different implications for political behavior. In recent decades, a succession of economic ideas (think of Keynesianism, monetarism, rational expectations, the "Washington consensus") have served to change elites' understanding of "economic reality" and thereby altered the political equilibrium.

A rent-extracting autocrat is likely to tax subjects to the hilt when he believes they have little choice but to pay up; the same autocrat will be more restrained when he believes subjects can evade the tax or mount an effective opposition. "Elasticity pessimism," the belief that economic activities tend to be unresponsive to prices, lay behind the widespread consensus in support of the *dirigiste* economic development policies of the 1950s and 1960s. Mehta and Walton (2012, pp. 17–18) describe the Nehruvian cognitive map that shaped India's development path in the decades following independence: the need for a big investment push, suspicions over the private sector, emphasis on the leading role of capital goods, and export pessimism (the fear that expansion of exports will run against serious limits) all derived from ideas about how a market system worked (or failed to do so). As research demonstrated that the poor were as responsive to price incentives as the rich, policies in the developing world began to move in a more market-oriented direction (Schultz 1964; Krueger 1997).

Economic research is all about sharpening our ideas about the "right model." Yet actors in political economy models live in worlds where these questions have been effectively resolved. They believe that they know how the world works, if not precisely, at least probabilistically. Rational expectations mean agents base their expectations, and hence behavior, on how the world really works. Even if they disagreed for a time, adherents of this view argue, agents would eventually reach agreement on the "right model" as events and reactions to policy choices unfold. In practice, however, people often downplay evidence that seems inconsistent with their model of the world. Anomalous outcomes are dismissed as a fluke or as the result of insufficiently vigorous application of their preferred policy. Even with rational Bayesian updating, a common signal may exacerbate posteriors—increase polarization—when priors differ (Dixit and Weibull 2007).[2] And divergences in beliefs need not disappear even asymptotically when there is disagreement over the interpretation (that is, informativeness) of the signals received (Acemoglu, Chernozhukov, and Yildiz 2009).

[2] An example provided by Dixit and Weibull (2007, p. 7353): Observing a sudden rise in unemployment, a Keynesian might strengthen his belief that monetary policy is too tight, while a monetarist might infer monetary policy is even looser than he thought and is discouraging employment creation by generating expectations of future inflation.

A more realistic representation may be that cognitive and other limitations force political agents to live in a world of Knightian uncertainty with respect to their understanding of causal relationships (see, for example, Denzau and North 1994; Blyth 2011). Their view of the world could be wrong and could remain so even in the face of new evidence if that evidence is just used to confirm past beliefs. Conversely new information may present realities previously not considered. For instance, voters may discover that an office holder has a long criminal track record, a possibility that may not have entered their calculus earlier. An interesting new empirical literature has begun to document how the provision of such information can influence voters' behavior (Pande 2011).

Consider the experience of the global economic and financial crisis in recent years and the extent to which it has altered beliefs. Many observers, such as Johnson and Kwak (2010), have argued that the policies that produced the crisis were the result of powerful banking and financial interests getting their way, which seems like a straightforward application of the theory of special interests. Still, without the wave of ideas "in the air" that favored financial liberalization and self-regulation and emphasized the impossibility (or undesirability) of government regulation, these vested interests would not have gotten nearly as much traction as they did. After all, powerful interests rarely get their way in a democracy by nakedly arguing for their own self-interest. Instead, they seek legitimacy for their arguments by saying these policies are in the public interest. The argument in favor of financial deregulation was not that it was good for Wall Street, but that it was good for Main Street. Other observers have argued that the financial crisis was a result of excessive government intervention to support housing markets, especially for lower-income borrowers. These arguments were also grounded on certain ideas—about the social value of homeownership and the inattentiveness of the financial sector to those with lower incomes. Again, ideas apparently shaped politicians' views of how the world works—and therefore their interest in acting in ways that precipitated the crisis. Finally, although all parties have observed the same Great Recession taking place, relatively few have altered their fundamental beliefs about whether the financial sector is over- or underregulated as a result.

The Strategy Space: What Can Political Actors Do?

Much politics is about strategy: setting the agenda, making alliances, issuing promises (or threats), expanding or restricting the menu of options, building or spending political capital. Regardless of whether they aim to enrich themselves or further a broader set of interests, politicians must continually ask: "What can be done?" Typically, political economy models restrict the strategy space in arbitrary ways: they overstructure the political game by limiting, for example, the policy choices on the menu. This limitation is usually put in place for tractability, but it is not harmless. New ideas about what can be done—innovative policies—can unlock what otherwise might seem like the iron grip of vested interests. The history of economics is replete with ways ideas can shape politics (see Leighton and López, 2013, for a recent useful discussion).

The formal parallelism between behavior in the political arena and consumer behavior in the marketplace is least useful here. Consumers in a market have well-defined choices to make: how much to consume of each available good, given prices and their budget constraint. The standard utility maximization problem does not do great injustice to their strategy space. By contrast, political agents design their own strategy space. The available instruments are up for grabs and limited only by their political imagination.

In what follows, I will focus on this third aspect of ideas—"ideas as policy innovation"—both because it has received relatively little attention in the literature and because it ties in directly with the kind of policy analysis in which economists often engage. I will illustrate the importance of such ideas in an important subclass of political economy models—those that focus on explaining inefficient policy outcomes.

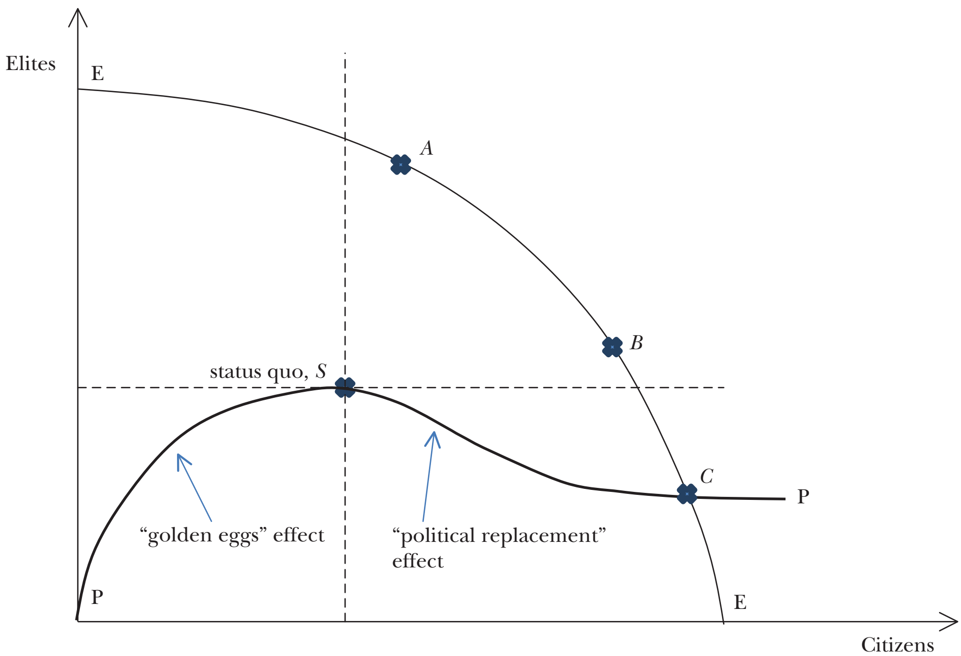
The Political Economy of Inefficient Policy Choice

Explaining why political systems end up making economically inefficient policy choices is a major preoccupation of the political economy literature; it can even be said to be its original raison d'être. Taking ideas explicitly into account, especially in terms of policy innovation, can shed substantial new light on existing approaches. I will show how widely accepted results often rest on arbitrary restrictions on political actors' strategy space. More positively, I argue that an ideas-based perspective allows us to better understand the circumstances under which political systems are, in fact, able to move towards more efficient outcomes.

Political economy models that generate equilibrium policy inefficiency rest on several building blocks: 1) interests determine policy preferences; 2) political power determines whose interests matter (more); and 3) political institutions, or "rules of the game," determine the specific political equilibrium among many. However, while these three postulates can explain redistribution from less-powerful to more-powerful groups, they do not explain inefficiency. Consider Figure 1, which, for the sake of concreteness, divides society into two groups: elites—defined as the group that has both veto and agenda-setting power—and politically powerless citizens. (Ignore the curve PP for now.) At best, the three postulates can help us understand why we are at point like *A* instead of *B*. They cannot explain why we often end up *inside* the economic possibilities frontier at a point like *S*. The equilibrium at *S* violates Pareto-efficiency; it would be possible to improve the incomes of elites without harming citizens. If all elites want is to extract income from society and they are powerful enough to get their way, why do they have to do it by generating inefficiency?

To generate inefficiency, political economy models must add one or both of two additional features, each of which restricts the feasible set of elite actions: 4) more efficient redistributive mechanisms, including lump-sum transfers, are unavailable; and 5) political power is endogenous, and outcomes that move the economy closer to the efficient frontier may reduce the power of elites. The first of these additional assumptions rules out myriads of compensatory policies that can

Figure 1
Redistribution, Inefficiency, and the Political Transformation Frontier



Notes: EE is the economic possibilities frontier. The curve PP is a "political transformation frontier," defined as the set of maximal economic outcomes achievable by those currently in power, the elites. The rising part of the PP curve represents the "goose that lays the golden eggs effect"; along this part of the curve, elites benefit from the enrichment of citizens as a whole, so there is no tradeoff in this region between economic efficiency and political redistribution. The declining part of the curve represents what Acemoglu and Robinson (2006) call "the replacement effect": elites avoid efficient policies because they think these policies will undercut their power and lead to their replacement. When elites act strategically they will select the maximum point on the political transformation frontier. The equilibrium outcome is labeled "status quo," which is far inside the economic transformation frontier.

move the equilibrium from *S* closer to *A*. For example, most forms of economic liberalization, such as removing a tax or an import tariff, are not Pareto-optimal unless accompanied by compensation. Ruling out compensation of elites that lose out from liberalization is an easy way to generate inefficient outcomes. In international economics, for example, policies that restrict trade are third-best for redistributive purposes. So the typical practice in the literature on the political economy of trade policy is to assume away not only lump-sum transfers but also producer subsidies in order to create pressure, within the model, for policies that restrict trade (Rodrik 1995).

A similar strategy is at play in explaining why productivity-enhancing privatizations of state-owned enterprises do not take place: the insiders (workers, managers) would lose out for sure if there is no possibility to compensate them for losses they would experience in a privatized firm. Such restrictions are often rationalized by appealing to an inability to commit to compensation,[3] even though innovative strategies can be often found to get around this constraint, as I will show below.

The other argument, which posits a feedback from economics back to politics, opens up the possibility that elites avoid efficient policies for fear that such policies may undercut their political power and hence their ability to determine future policies. Under this scenario, the only feasible move to the efficient frontier involves traveling to a point such as *C* in Figure 1, where the elites would be worse off.

This type of argument has been invoked in the work of Acemoglu and Robinson (2006, see also Acemoglu 2003) to explain, for example, why some states have blocked policies that would foster industrialization and economic growth during the 19th century in Europe. Because economic growth uproots people from their traditional rural base and facilitates collective political action, it can destabilize entrenched elites. Forward-looking elites will prefer to ensure their power is not challenged, even if that means more inefficiency and less growth.

A different mechanism that produces a similar result is the dynamic inconsistency of compensation policies. In the model we develop in Fernandez and Rodrik (1991), reform is impeded by individual-specific uncertainty combined with the pattern of information revelation over time when reform is implemented. Beneficiaries of today's inefficient policies cannot be made to accept a reform-now-and-compensation-later package because they know reform will reveal the identity of a large group of winners and shift future political power to those winners. After the reform, the beneficiaries will have no need (or incentive) to carry out their promise of compensation.

While the claim that elites block enhanced economic opportunities so that they can maintain their own power seems to make sense, it too may imply an unreasonable restriction on feasible strategies. In particular, it denies elites the creativity to devise strategies that would allow them to take advantage of enhanced economic opportunities without losing power. Unless we posit a highly mechanical relationship between economics and politics, such strategies will exist in general. The restriction on feasible strategies is often relaxed in practice, as we shall see, by innovation in the area of "political ideas." I use the term "innovation" deliberately, as there is a useful analogy here with technological innovation. Just as we think of technological ideas as those that relax resource constraints, we can think of political ideas as those that relax political constraints, enabling those in power to make themselves (and possibly the rest of society) better off without undermining their political power. To develop this point, I introduce the heuristic device of a "political transformation frontier," akin to the economic transformation constraint.

[3] A subtle argument against lump-sum transfers specifically, mentioned by Avinash Dixit in his comments on this paper, is that even atomistic agents will have the incentive to misrepresent their "type" (Hammond 1979). For a good discussion of the political transaction costs that block efficiency, see Dixit (1996, especially chapter 2).

The Political Transformation Frontier and Relaxing Political Constraints

I define the "political transformation frontier" as the set of maximal economic outcomes achievable by those currently in power, the elites. It depicts the maximum level of rents that elites can extract in political-economic equilibrium, taking into account, in particular, the endogeneity of their political power. Return to Figure 1, which depicts a production possibility frontier that shows the tradeoffs between resources consumed by political elites and those consumed by other citizens. The political transformation frontier is depicted as the *PP* schedule in Figure 1. The rising part of the *PP* curve represents what we may call "the goose that lays the golden eggs effect"; along this part of the curve, elites benefit from the enrichment of citizens as a whole and, therefore, there is no tradeoff in this region between economic efficiency and political redistribution. Elites behave here like Mancur Olson's (1993) "stationary bandits," brigands who stay long enough with the farmers from whom they steal that they have an incentive to encourage a degree of prosperity. The declining part of the curve, in turn, represents what Acemoglu and Robinson (2006) call "the replacement effect": enrichment of citizens now comes at the expense of the ability of elites to cling to power and, therefore, their ability to extract rents. When elites act strategically (as Stackelberg leaders) they will select the maximum point on the political transformation frontier. The equilibrium outcome is labeled "status quo," which is far inside the economic transformation frontier.

As the figure is drawn, politics is the binding constraint on this economy. The allocation of resources and overall economic performance are determined not by technological or resource constraints, but by the location and shape of the political transformation frontier *PP*. In turn, the location and shape of the political transformation frontier depends on the set of feasible elite actions—which is determined by the *ideas* that elites have about the range of strategies available to them, including policies, actions, coalitions and so on. Good political/policy ideas relax the political constraint, moving the political transformation frontier (*PP*) outward. Just as technological innovations relax the conventional resource constraint, political innovation relaxes the political transformation frontier. Economists recognize the importance of technological innovation and have made it the centerpiece of their models of long-term growth. In political economy models, by contrast, the working assumption is that there is no room for discovery. Many political innovations are likely to remain ephemeral, inconsequential, or soon forgotten. But some, as with general-purpose technology, may prove substantial and durable: for examples, think of political parties, independence of judiciary, or indeed democracy.

Technological change need not make everyone better off. Similarly, policy innovation could leave the non-elites worse off. (An outward shift of *PP* in Figure 1 may move the new equilibrium to the northwest of *S*.) Some ideas could be bad from the standpoint of society at large and yet gain currency: imagine elites successfully persuading non-elites that they should work harder in this life so they can have redemption in the next, or (closer to home) that an extremely low rate of capital taxation actually benefits them.

Although the idea of a political transformation frontier rarely receives much attention in political economy, practical economists and policymakers do spend considerable effort generating new policy ideas that seek, not always successfully, to work around political constraints. Perhaps the most telling examples of how political innovation can move the political transformation frontier come from the real world. Here are some illustrations that made elites and non-elites both better off.

Achieving Industrialization without Losing Power

Acemoglu and Robinson (2006) discuss how several governments evaded the trap of blocking industrialization for fear of being replaced, and in doing so, they illustrate the feasibility of strategies that shift the political transformation frontier outward. Consider why the Japanese elite decided to spur industrialization and economic development after the Meiji restoration circa 1868. Acemoglu and Robinson note that "the drive for modernization in Japan took a special form, strengthening the centralized government and increasing the entrenchment of bureaucratic elites. In terms of our model, this can be viewed as a strategy to industrialize while also minimizing the probability of replacement . . ." They add that this was similar to what happened in Britain and Germany where "the nonindustrial elites maintained their political power despite the process of industrialization" (p. 128). In Britain, "by adopting a strategy of gradual concessions, [elites] were able to control the political equilibrium and maintain power for at least a century following the onset of the political impact of industrialization . . . [and] the long history of Britain as a trading nation and mercantile power meant that many aristocrats had relatively diversified wealth . . ." (p. 126). In Germany, "the Junkers forged the coalition of 'Iron and Rye' with the rising industrial class to secure their economic interests" (p. 126).

What stands out in each of these explanations is the purposive strategy pursued by elites to mitigate their concern over being replaced as a result of economic change. State-directed industrialization, gradual concessions to the rising industrial classes, diversification into commerce and industry, alliance with industrial interests, and similar choices ensured elites could benefit from industrialization while retaining much of their power. The existence of such strategies raises the question of why similar strategies were not tried elsewhere, in the nonindustrializing cases. More importantly, it highlights the role of (and space for) innovation in relaxing political constraints that might have otherwise appeared irremovable.

Dual-Track Reform in China

During the 1970s, China was a centrally planned economy in which administered prices were a mechanism of generating rents and transfers to groups favored by the Communist regime. Price liberalization and the removal of obligatory grain deliveries to the state would generate significant efficiency gains in the countryside, where the bulk of the population lived. But it would come at the expense of depriving the state of its tax base, and urban workers of their cheap rations of food. By the standards of basic political economy models, these strong redistributive consequences provide an adequate explanation of why efficiency-enhancing reforms were resisted by the Chinese leadership.

But the Chinese government was able to devise a shortcut. Starting in the late 1970s, it made use of policy innovations such as two-track pricing and special economic zones that effectively delinked market-oriented incentives from their usual distributive implications. Consider, for example, how agriculture was reformed. Instead of abolishing the planned grain deliveries at fixed prices, the state simply grafted a market system on top of the centralized allocation system. Once the planned deliveries were made at state-set prices, farmers were free to sell additional amounts at any price the market would bear. As Lau, Qian, and Roland (2000) show, this system delivers allocative efficiency under fairly nonrestrictive conditions. But from a political economy perspective, the main virtue of the dual-track approach was that it shielded the prevailing stream of rents from the effects of the reform. The state did not lose its revenue, and urban workers were not denied their cheap food rations.

China's special economic zones functioned similarly. Rather than liberalize its trade regime in the standard way, which would have decimated the country's inefficient state enterprises, China allowed firms in special economic zones to operate under near-free-trade rules while maintaining trade restrictions elsewhere until the late 1990s. This enabled China to insert itself in the world economy while protecting employment and rents in the state sector. The Chinese Communist Party was strengthened and enriched, rather than weakened, as a result.

Democratization in South Africa

The black majority demanding democracy from the minority apartheid regime in South Africa faced a classic political economy problem. Both sides understood that once the African National Congress (ANC) obtained power, it would come under strong pressure from the black majority it represented to expropriate (or at least severely tax) the white elite. For the latter to accede to political reform, it had to have credible guarantees against expropriation. In view of the international sanctions and the economic decline they faced, the elites would have been better off under democracy—but only provided that moderate future taxation could be assured. In the absence of such guarantees, it remained in the elites' interest to keep suppressing the black majority even at substantial economic cost to themselves and the country.

Nelson Mandela was keenly aware of the problem: "Especially in the first few years of the democratic government," he said in 1991 (as quoted in Inman and Rubinfeld 2012, p. 784), "we may have to do something to show that the system has got an inbuilt mechanism which makes it impossible for one group to suppress the other." In the run-up to the democratic transition of 1994, South Africa's federal institutions were specifically designed to prevent the expropriation of the rich white minority by the poor black majority. Two key provisions were critical. First, critical redistributive services were left in the hands of provincial authorities.

Second, borders ensured at least one important province (Western Cape) would remain in the hands of the white minority. Inman and Rubinfeld (2012) argue these two arrangements together created a "hostage game" in which the incentives of a black national government to tax the white elites were moderated by the implicit threat of the local authorities in the Western Cape to respond by reducing service provision to the blacks in their province. Creative manipulation of the rules enabled both a political transition and a movement closer to the efficiency frontier.

Other Examples

One can greatly multiply these examples. During the 1980s and 1990s, reformist technocrats in Latin America overcame opposition from powerful insider groups by packaging liberalization and privatization (with strong redistributive effects) along with disinflation programs perceived by most—elites included—as inevitable and necessary (Rodrik 1994). In the United States, Trade Adjustment Assistance and other measures that operate as social insurance and compensation are the usual sweeteners offered to labor groups to buy their support for international trade agreements (Destler 2005). The US Congress relented on allowing the auction of radio frequencies only when political strings were devised—limiting the auctions to commercial wireless services and granting special rights to specific groups (women, minorities, small businesses)—to ensure that Congressional members would derive specific advantages from the move. Leighton and López (2013, p. 147) write that "in the end, everyone with a decision-making role in Congress got something, either more revenues or more political oversight."

These strategies represent innovations that shift the political transformation frontier out. They enable the capture of efficiency gains in ways that conserve the power of insiders and elites and protect their rents. Sometimes they enable radical political change, as in the South African case. At other times, they are designed to preclude political change, as in China. And even though I have focused on large-scale policy innovations that changed the course of nations, one can easily come up with a long list of others that are less revolutionary: the income tax, old-age pensions, the most-favored-nation principle in international trade, bank deposit insurance, work requirements for welfare recipients, conditional cash transfers, central bank independence, marketable pollution trading. What these all have in common is that they unblock resistance to change to allow society to move closer to the efficient frontier.

Where Do Policy Ideas Come From?

What determines the development and use of innovative political strategies? Why are some political systems blessed with a greater abundance of political innovations? What explains the timing of their emergence? Just as in the case of technological innovation, we might not be able to provide full answers to such questions. Innovation occurs, in large part, as a result of serendipity, as fundamental scientific discoveries yield unanticipated practical benefits or as experimentation and trial and error result in new products and processes. Similarly, we must presume there is a strong idiosyncratic element in political leadership and political creativity. Nevertheless, as the economic literature on research and development and endogenous growth indicates, certain systematic elements are also in play (Segerstrom, Anant, and Dinopoulos 1990; Aghion and Howitt 1998). For example, technological innovation responds to market incentives—the pursuit of monopoly profits through the acquisition of temporary advantages over competitors. Likewise, policy ideas that relax political constraints can be thought of as the consequence of both idiosyncratic processes and purposive behavior. Taking political ideas seriously opens up an interesting new line of research. Here I sketch, in broad outlines, some sources of new ideas that may be amenable to systematic analysis.

Political Entrepreneurship

Inefficiency creates opportunities for political entrepreneurship. As long as there are unexploited efficiency gains to be had, political agents have *some* incentive to engage in such search, regardless of the specific motives animating them. Economists, for example, develop proposals that they think will enhance economic performance. Sometimes (although not always, as Acemoglu and Robinson 2013 emphasize), these proposals take political feasibility into account. But ultimately, political entrepreneurs are the ones who arbitrage between academic ideas and political inefficiencies. It would be nice to know the circumstances under which such arbitrage actually takes place and political entrepreneurs are actually able to implement their policy innovations; for now, there seems to be little research addressing this question.

In their recent book, Leighton and López (2013) place special emphasis on political entrepreneurship in making policy reform possible. For new ideas to overcome vested interests, they write (p. 134), it must be the case that "entrepreneurs notice and exploit those loose spots in the structure of ideas, institutions, and incentives." They provide four case studies of this process: spectrum license auctions, airline deregulation, welfare reform, and housing finance. In their words (p. 178): "[T]he public face of political change may be that of a madman, an intellectual, or an academic scribbler. But whatever form these leaders may take, they are political entrepreneurs—people whose ideas and actions are focused on producing change." As these authors stress, political entrepreneurship can be socially harmful, as when the pursuit of individual rents comes at the expense of overall inefficiency. But the returns from shifting the political transformation frontier out can be very large as well.

Learning-by-doing

Entrepreneurship is linked to learning. Just as firms travel down their cost curves as a result of accumulated experience, public organizations such as bureaucracies can learn about opportunities to reap efficiency gains. A large literature examines the potential trade-off between learning and obsolescence as organizations age (Sørensen and Stuart 2000). Similarly, politicians might learn from their past successes and failures. The evolutionary approach to economics, based on trial and error by boundedly rational agents, provides a useful complementary perspective on learning, which also remains unexploited in political economy (Nelson and Winter 2002).

Technological learning often spills over to other firms, depressing the incentives for technological innovation. An interesting possibility is that political learning-by-doing is characterized by a similar externality. Political incumbents may be deterred from experimentation because they will bear the full cost of failed policy experiments, but will share the rents resulting from any successes with potential challengers who act as copycats. In this framework, more contestable political systems, allowing freer entry, may have ambiguous effects on political ideas. More competition means more entrepreneurs vying for new ideas. But it also means more copycats—political opponents waiting in the wings—reducing the incentive for experimentation and learning about the strategies that relax political constraints.

Policy Mutations

By "policy mutation," I refer to unplanned policy experimentation that arises along the margins of existing policies. Such experimentation often results from the inability of policymakers to implement prevailing rules to the letter, for administrative or other reasons. As with random mutations, these variations on generally accepted practice can generate new and improved policies by demonstrating better practical results. For example, the idea for dual-track policies in China arose not from the planners themselves, but from black markets in the Chinese countryside where farmers sold grain illegally. Planners were simply wise enough to understand that these markets-at-the-margin enriched farmers without harming the state, as long as the plan quotas themselves were enforced, and then to build public policy on that understanding. Similarly, experiments with "supersaver fares" in California and Texas greatly facilitated US airline deregulation during the 1970s by revealing the sizable price benefits of greater competition and freer entry (Leighton and López 2013, pp. 155–56).

Leitzel (2003) has written insightfully on the reformist consequences of what he calls "rule evasion." As he notes, "evasive behavior in essence presents an experiment, an alternative way of arranging society" (p. 23). Leitzel discusses two reasons why rule evasion paves the ground for new policies. First, the evasion typically becomes common knowledge and conveys a sense that the existing policy is a failure. Second, it creates incentives for reform either by suggesting an alternative to current policy (say, legalizing black markets) or creating a constituency for the reform. In terms of the argument in this paper, it is a source of ideas for policymakers about what can work better within political constraints.

Crises

Times of crises are occasions for reconsidering existing policies. This is both because prevailing interests may lose some of their legitimacy and because incumbents may be open to trying new remedies. The need for a new narrative is greater and so is the willingness to experiment. "In moments of uncertainty," writes Blyth

(2007, p. 762), "crisis-defining ideas not only tell agents 'what has gone wrong' but also 'what is to be done'."

In the United States, the Great Depression proved a veritable laboratory for novel institutional arrangements. Franklin D. Roosevelt (1932) uttered a famous call for "bold, persistent experimentation": "It is common sense to take a method and try it: If it fails, admit it frankly and try another. But above all, try something." To a much lesser extent, the inflationary crisis of the 1970s played a similar role, preparing the groundwork for new ideas in macroeconomics such as rational expectations and central bank independence. The recent financial crisis has made taxation and control of international capital flows more palatable, although the extent to which financial interests have been weakened remains debated.

While the association between crises and new ideas seems plausible, much remains to be explained. Why are some crises much more prone to new ideas? What explains the type of ideas that take hold? The Great Depression spawned the New Deal in the United States, fascism in some parts of Europe, and socialism in some other parts of Europe. Were these outcomes preordained by the structure of interests? To what extent did political entrepreneurship and ideas play an autonomous role?

Emulation

Perhaps the single most important source of ideas and policy innovation are practices that prevail elsewhere. The fact that a policy has worked—or at least is perceived to have worked—somewhere can be a powerful reason to copy it. Social security privatization in Chile, microfinance in Bangladesh, conditional cash grants in Mexico, and special economic zones in China are some examples of policy innovation that gained adherents around the world following implementation in their native settings. Much legal and regulatory reform in the developing world is modeled after existing models in North America or Western Europe. The appeal of "imported ideas" is clear. Ready-made policies eliminate or reduce the cost of home-grown innovation and experimentation. The perception of their success elsewhere can also act as a counterweight to powerful vested interests at home.

Of course, there is no guarantee that policy emulation will result in success. Context matters. Imported ideas can backfire because of ill fit with either the local economic or political landscape. Furthermore, emulation can be driven by bad motives as well as good ones. It may be used to provide aid donors with cover in case of failure, as a signal for new governments that they are the "good guys," and by domestic lobbies to legitimize their own self-interested agenda (Weyland 2008). DiMaggio and Powell (1983) have coined the term "isomorphic mimicry" to denote the pressures that organizations face to become similar, even as they struggle to change. Andrews (2013) documents how reform in poor countries through "isomorphic mimicry" results in the semblance of change, with little real progress achieved: a bureaucracy gets reorganized to look like those from advanced countries, but bureaucratic efficiency hardly improves. In Mukand and Rodrik (2005), my coauthor and I develop a formal model of the incentives for governments to mimic other countries' policies: implementing policies with a poor fit is costly, but so is experimentation—and an imperfectly informed electorate may be more likely to interpret domestic experimentation as an attempt at rent seeking, while being willing to accept emulation.

Conclusion: What Do Economists and Policy Analysts Gain by Considering the Role of Ideas?

The main argument of this paper is that, for all the emphasis placed on them in contemporary models of political economy, vested interests play a considerably less-determining role than appears at first sight. Indeed, because of their neglect of ideas, political economy models often do a poor job of accounting for policy change. There is frequently an after-the-fact feel to this brand of theorizing: if reform happens despite vested interests, it must be because those interests were not sufficiently well entrenched to begin with or reform didn't hurt them. Conventional models of policy stasis are incomplete if they sidestep the ideas that political agents have about strategies they can pursue. And they cannot fully shed light on reform when it does occur.

It is instructive to contrast my argument with that of Acemoglu and Robinson (2013), who argue in this journal that well-meaning reforms often fail or produce unintended consequences because they overlook the changes in political equilibrium the reforms generate. In much of policy advice, they write, politics is "largely absent from the scene." Acemoglu and Robinson maintain that "economic analysis needs to identify, theoretically and empirically, conditions under which politics and economics run into conflict, and then evaluate policy proposals taking this conflict and the potential backlashes it creates into account." I agree with them on the need to take politics into account. But Acemoglu and Robinson take vested interests largely as given, and as a result, they are rather pessimistic about what policy can achieve. In contrast, I have argued that successful policy ideas work precisely because they take politics into account. I suggest that it is possible to do better than simply avoid political conflicts; ideas can be useful to *relax* political constraints. Just as ill-conceived economic ideas can produce disastrous political effects, politically well-informed ideas can move us closer to the efficiency frontier in a manner that is consistent with underlying political realities.

Taking ideas seriously renders the notion of interests slippery and ephemeral. From the conventional political-economy standpoint, it is puzzling to observe instances in which elites resist reforms strenuously until the change actually happens, and then benefit from the reforms. The Korean military dictator President Park Chung-Hee threw the country's leading businessmen in jail when he came to power in 1961; they were released only after Park extracted promises from them that they would each undertake specific industrial investments. Given how the Korean economy prospered, these businessmen were hardly worse off for those investments. Similarly, the Chinese Communist leadership was among the main beneficiaries of the dual-pricing regime and other market-oriented policy innovations that it had refused to consider until Mao's death. The critical change in these instances was not a transformation in the structure of power, but the implementation of new ideas by those in power. Indeed, reform often happens not when vested interests are defeated, but when different strategies are used to pursue those interests, or when interests themselves are redefined.

Raising the profile of ideas in political economy models would also help alleviate the tension that exists today between political economy, on the one hand, and normative economics and policy analysis, on the other. Political economy seeks to explain political-economic outcomes. However, if policy outcomes are pinned down by the structure of interests, it is futile to make policy recommendations: there will be no takers for the recommendations, and such recommendations will be of no consequence. At best, they will constitute ideological fodder for vested interests, used to sweeten their exercise of naked power before the general public. When political economy becomes too enamored of vested interests at the expense of ideas, social science squeezes normative policy analysis out of useful existence. An explicit consideration of the role of ideas would free up some space for policy analysis.

Finally, a focus on ideas provides us with a new perspective on vested interests too. As social constructivists like to put it, "interests are an idea." Even if economic actors are driven purely by interests, they often have only a limited and preconceived idea of where their interests lie. This may be true in general, of course, but it is especially true in politics, where preferences are tightly linked to people's sense of identity and new strategies can always be invented. What the economist typically treats as immutable self-interest is too often an artifact of ideas about who we are, how the world works, and what actions are available.

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