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“Dealing with Losers: The Political Economy of Policy Transitions”

by

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Note: It is expected that you will have reviewed the speaker’s paper before the Seminar.

Abstract

The workshop paper comprises three chapters from a forthcoming book, "Dealing with Losers: The Political Economy of Policy Transitions", shortly to be published by Oxford University Press. The book argues that much of the existing scholarly literature on transition costs is focussed excessively on Fifth Amendment type constraints on government action where "takings" of property rights require explicit compensation. However, most transition cost mitigation strategies do not involve explicit compensation but grandfathering or phased or postponed implementation of policy reforms as a political (not legal) strategy for muting political opposition to policy changes by losers from these changes, and hence are designed to expand the feasible set of policy options open to government, rather than constrain them. This theme is exemplified in the book in seven detailed case-studies from widely-disparate policy contexts, which suggest that strong corner solutions advocated in the existing "takings" literature - a strong presumption against compensation (Kaplow), or a strong presumption in favour of compensation (Epstein) - are unhelpful in the real world of policy-making.

**DEALING WITH LOSERS:
THE POLITICAL ECONOMY OF
POLICY TRANSITIONS**

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CHAPTER 1. INTRODUCTION: THE PLACES IN-BETWEEN¹

I have spent much of my professional career researching, writing, and teaching about the policy reform process in a wide range of policy contexts. I have also, in many contexts, been an active participant in this process, in one capacity or another. I have repeatedly been struck in many, if not most of these contexts, by the realization that diagnosing the ills of the status quo, and imagining better policy alternatives, at least in their broad contours, are often not especially controversial. However, the real challenges, in many cases, relate to getting from “here” to “there.” Over time, existing policies develop their own encrustations of institutions, vested interests, adaptive preferences, and expectations that render the trajectory of getting from here to there a major part of the policy challenge. This book is about that challenge, which I attempt to illuminate both at a general level and through concrete illustrations developed in seven brief policy reform case studies. As most parents of small children who have embarked on long vacation trips can attest, one of the most recurrent and frustrating questions is “are we there yet?,” to which the common, enigmatic, and no doubt equally annoying answer is typically “we’re getting closer.” This book is about the “here” and the “there,” but most particularly the importance of taking seriously, in political economy terms, “the places in between.”

The long fight to end slavery, led by William Wilberforce, among many others, culminated in Britain with the enactment of the *Slavery Abolition Act* in 1833. This act made provision for a payment of 20 million pounds (almost 40 percent of the British budget at the time) in compensation to plantation owners in many British Colonies - about \$21 billion (US) in present day value. Moreover, only slaves below the age of six were initially freed while others

¹ This phrase is borrowed from the title of the superb travelogue by Rory Stewart, who walked across Afghanistan in 2002, shortly following the fall of the Taliban: RORY STEWART, *THE PLACES IN BETWEEN* (2004).

were redesignated as “apprentices,” who were to be freed in two stages in 1838 and 1840.²

Wilberforce and many other abolitionists accepted that compensation and phased implementation were required to ensure enactment of the legislation,³ particularly by the House of Lords where plantation owners were strongly represented among the aristocracy.⁴

Whenever governments change policies—whether tax, expenditure, or regulatory policies—even when the changes are on net socially beneficial, there will typically be losers. These losers will have made investments of one kind or another, physical, financial, or human, predicated on, or even deliberately induced by, the pre-reform set of policies. Very few policy changes make somebody better off and nobody worse off according to their own subjective valuations (the economists’ concept of Pareto efficiency). Rather, policy changes reallocate social benefits and costs in different ways.⁵ The issue of whether and when to mitigate the costs associated with policy changes, whether through explicit government compensation, grandfathering, phased or postponed implementation, is ubiquitous across the policy landscape.

A few selective, but far from exhaustive, examples serve to illustrate this point. First, take the case of land use regulations or controls. Sometimes relevant levels of government see fit to change these regulations. They may increase building setbacks from property lines or road allowances. They may impose height restrictions on buildings in residential or mixed-use neighborhoods. They may change zoning laws from mixed-use to residential. In most of these cases, existing property owners will be exempted from these requirements, and their existing

² This was later abridged in the face of protests and desertions.

³ See, e.g., WILLIAM HAGUE, WILLIAM WILBERFORCE: THE LIFE OF THE GREAT ANTI-SLAVE TRADE CAMPAIGNER (2007); WILLIAM LAW MATHIESON, BRITISH SLAVERY AND ITS ABOLITION 1823–1839 (1926); HOWARD TEMPERLEY, BRITISH ANTISLAVERY, 1833–1870 (1972); NICHOLAS DRAPER, THE PRICE OF EMANCIPATION: SLAVE OWNERSHIP, COMPENSATION AND BRITISH SOCIETY AT THE END OF SLAVERY (2010) .

⁴ I am grateful to my colleague, Stephen Waddams, for drawing this example to my attention.

⁵ Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further* , 100(5) YALE L.J. 1211 (1991).

uses treated as legal “non-conforming uses.” In a similar vein, in tight residential housing markets, sometimes rent controls are imposed on existing rental properties, but the construction of future rental buildings is often exempted from these controls in order to incentivize new rental construction and alleviate supply constraints.

To take another example, environmental regulations are often subject to change, reflecting new scientific knowledge of environmental risks, or at least public perceptions thereof. Energy efficiency requirements for motor vehicles are but one example where regulations have become more stringent over time. Typically, these do not apply to the existing fleet of motor vehicles but to motor vehicles manufactured in the future, and often with a lead time in order to allow manufacturers to adapt to more stringent requirements. Similarly, in the case of climate change policies, often countries adopt relatively long time horizons for phasing in requirements for renewable energy generation, or carbon taxes, or cap-and-trade regimes on an implementation schedule designed to become more stringent over time, while avoiding disruptive and costly changes to existing forms of production or consumption.

Another example, particularly apt in a contemporary US policy context, relates to proposals to reform gun control laws. Even strong proponents of stricter gun control laws in proposing comprehensive background checks on all purchasers of guns or proposing the prohibition of assault rifles or magazines in excess of a certain capacity recognize that such restrictions can only feasibly apply to prospective purchases of weapons, and not existing owners of weapons, who would be effectively grandfathered under these reform proposals.

A yet further example relates to professional qualifications. In many professions, including law, medicine, and dentistry, entry requirements have become increasingly stringent

over the past century. Yet, in applying these more stringent requirements, existing professionals are, in effect, grandfathered, subject perhaps to continuing professional education requirements.

Another, and quite different, international example is found in post-conflict nation-building exercises, where a major challenge is addressing what should be done with respect to atrocities committed in the past by various antagonists in the conflicts that have afflicted a nation. Here, more or less judicious combinations of truth and reconciliation commissions, lustration policies designed to disqualify certain officials from previous repressive regimes from future public office, and residual classes of cases where the most egregious past atrocities are remitted to either domestic or international criminal tribunals for prosecution, are often adopted. Such combinations of policies are obviously designed to draw a qualified line in the sand between what has happened in the past and new rules of civic engagement and collective governance going forward.⁶

The seven brief case studies that I develop in this book are all designed to illustrate in greater detail, and in widely disparate policy contexts, the central importance of transition cost mitigation strategies, particularly those aimed at specific subgroups of populations, in advancing politically feasible reform options. Although these case studies are, to some extent, idiosyncratic in that (with the exception of mortgage interest deductibility) they reflect areas of public policy in which I have had a previous engagement either as a scholar or policy participant, they are also major contemporary (and in many cases contentious) areas of policy debate.

In the public pension context discussed in Chapter 3, where many countries have in the past adopted pay-as-you-go, self-sustaining public pension schemes, the sustainability of these schemes is or has been threatened, first by significant increases in life expectancy of pension

⁶ See Michael Trebilcock & Mariana Prado, WHAT MAKES POOR COUNTRIES POOR?: INSTITUTIONAL DETERMINANTS OF DEVELOPMENT ch. 4 (2012).

beneficiaries (and hence the scale of their entitlements), and second by declining fertility rates, which have reduced the size of the working age population whose contributions finance current entitlements. Simply reducing entitlements across the board is likely to be perceived as widely unfair by current pensioners and imminent retirees, who have limited or no capacity to adjust to such a reduction in entitlements, while raising contribution rates substantially on existing workers to finance shortfalls in the system would be widely perceived as unfair to them and an implicit tax on new job creation. Raising the existing retirement age incrementally, along with modest benefit reductions and contribution increases, may yield the most politically feasible set of burden-sharing options.

Chapter 4 focuses on the reform or abolition of mortgage interest tax-deductibility in the United States. This policy is widely viewed, at least by economists, as inefficient in over-stimulating demand for homeownership and encouraging over-leveraging by homeowners, as well as being inequitable in conferring disproportionate benefits on higher income taxpayers in higher marginal tax brackets, for whom the deduction is more valuable. However, abolishing or reforming this provision is likely to entail significant direct transition costs for homeowners, given that the value of the deduction has been largely impounded in house prices, as well as imposing indirect costs on the housing sector more generally. A gradual, back-ended phase-out of the deduction, accompanied by a much more finely targeted form of time-limited assistance to first-time home buyers with below-average household incomes may be the most politically feasible reform option. This case study illustrates a broader set of issues with many kinds of tax reforms. Although the starkest forms of retroactivity would be widely rejected as unfair (e.g., raising tax rates on income that has been previously taxed) reforms that raise rates on future

income (or capital gains) have a retroactive effect on investments made prior to the changes and are predicated, at least to some extent, on the existing tax rules.

Chapter 5 addresses the politics of negotiating new international trade liberalization commitments, multilaterally, bilaterally, or regionally. In this context, a significant focus of negotiations will typically be on demands by various of the negotiating parties for exclusions or dispensations for certain sectors or for gradual rates of reduction over time in prevailing levels of protection, such as tariffs or quotas. More generally, gradualism in implementing liberalization commitments over time, safeguard provisions to permit reinstatement of previous protections in the event of unforeseeably large import surges that cause serious injury to domestic industries or their workforces, and reciprocity where contraction of import-competing sectors is offset by expansion of export-oriented sectors that are facilitated by reciprocal liberalization commitments, are all designed to moderate the transition costs, both real and publicly perceived, associated with trade liberalization commitments.

Chapter 6 focuses on a particularly acute manifestation of the centrality of transition costs as an impediment to trade liberalization: agricultural protectionism. This case study focuses on a specific example of this phenomenon—dairy supply management in Canada—but many other countries also provide exceptional forms of protection to their agricultural sectors through trade restrictions and domestic and export subsidies. These forms of protection (like mortgage interest deductibility) tend to be impounded in land or quota values, so that dismantling these schemes is likely to entail very substantial losses for the current generation of farmers. The intractability of the transition cost problem in the agricultural sector largely explains the very limited progress that has been made in international trade negotiations in liberalizing trade in agricultural products. Progress is only likely to be made with credible political commitments to phase out

these forms of protection very gradually over time, but in some cases accompanied by one-time explicit forms of (partial) compensation for losses incurred. The opaqueness and complexity of many of these schemes poses a major challenge for policy reformers in overcoming public ignorance, apathy, and possibly even antipathy, in underwriting such a strategy.

Chapter 7 focuses on liberalizing immigration policy in many industrialized countries, a policy option that shares some affinities with the liberalization of international trade: immigration involves cross-border movement of people, whereas international trade primarily involves cross-border movement of goods (and services). However, liberalizing immigration policy raises some distinctive challenges, including non–wage-related immigration where immigrants are induced to migrate not principally because of greater employment opportunities in the receiving countries, but because of more generous social welfare systems, whose sustainability may be threatened with an unconstrained influx of immigrants seeking to make claims on such programs. More open immigration policies also attract concerns over labor market effects on domestic low-skilled workers, and over the erosion of important cultural, political, or community values in the receiving country as a result of larger influxes of immigrants who do not share these ideals.

Notwithstanding these concerns, over recent decades an increasingly fierce international competition for highly specialized talent has emerged in many sectors, and unduly restrictive immigration policies constrain the competitiveness and innovative potential of the sectors that are hampered by restrictive regulations in their ability to compete for this talent. Hence, progressive liberalization of entry restrictions on highly skilled foreign workers as either permanent residents or temporary workers with a clear path to permanent resident status and

ultimately citizenship would seem the highest priority. In the case of less skilled or unskilled foreign workers who are able and willing to fill gaps in local labor markets, a more cautious process of liberalization would seem warranted so as to minimize the risks to less well-endowed domestic workers of wage erosion or job displacement. In the case of countries with large numbers of illegal or undocumented immigrants, such as the United States with an estimated 11 million such immigrants, deportation on a massive scale seems totally infeasible. In moral terms, this is because of the enormous human costs entailed in many cases for the immigrants in question. Politically, it is because of the enormous direct costs involved for government and its taxpayers in implementing such a program. And economically, such a policy would entail substantial upward pressure on wages due to the elimination of a large pool of low-wage workers. Thus, some form of conditional but realistically achievable amnesty seems unavoidable.

In Chapter 8, I turn to perhaps the most daunting regulatory challenge of our age: climate change policy. In the nature of the problem, concerted action by all countries, developed and developing, that are major emitters of greenhouse gases (principally CO₂) is required in order to ameliorate this problem, but to date a formal international agreement among such countries on appropriate abatement policies has proven elusive. Although unilateral policy reforms, such as increasingly stringent carbon taxes or cap-and-trade regimes, are often advocated and relatively more practicable to implement, concerns naturally arise that these will simply lead to carbon leakage or migration to other countries whose industries are not similarly regulated, or indeed relocation of businesses from countries adopting such unilateral policies to countries lacking such policies. In practice, unilateral action alone is likely to have little or no impact on the environmental problem that motivates it, and it may entail a loss of competitiveness, investment, and employment in countries invoking such policies.

These concerns have led to proposals that unilateral action on climate change, in the form of carbon taxes or cap-and-trade systems, should be accompanied by border tax measures (“carbon tariffs”) that impose similar burdens on imports, in effect “taxing” consumption of carbon-intensive products, wherever the carbon is produced, with a remission of such burdens where countries of origin adopt similar domestic measures themselves, with a view to the evolution over time of an internationally harmonized carbon tax (or cap-and-trade equivalent). Although such proposals raise a number of difficult legal and geopolitical challenges, it is clear that mitigating various kinds of transition costs is absolutely critical to policy progress on the climate change problem.

My final case study (Chapter 9) focuses on institutional reform in developing countries. Over the past two decades or so, scholars, policymakers, and international aid agencies have tended to converge on a consensus that the quality of a country’s institutions—political, bureaucratic, and legal—are a crucial determinant of that country’s future development trajectory, a view captured in the mantra “institutions matter,” or “governance matters.” Unlike the previous six case studies, which were not predicated on fundamental reforms to a country’s institutions, in this context institutional reform is viewed as a predicate to more effective policy formulation and implementation. However, despite the investment of vast resources by the international community in institutional reforms in developing countries, experience to date has been mixed to poor, as exemplified by the faltering efforts to institute democracy and the rule of law in countries such as Iraq and Afghanistan and similar efforts in various Middle Eastern countries (such as Egypt and Libya) following the so-called “Arab Spring.” It is now increasingly recognized that the contingencies of a country’s history and culture—captured by the concept of “path dependence”—delineate both the feasible scope of institutional reform and

its advisable contours. More specifically, various kinds of switching costs from the status quo are likely to impede reforms. In terms of political economy, switching costs may be high for those within and outside existing institutions (however socially dysfunctional) who benefit from the institutional status quo and hence will resist reforms. Switching costs may also reflect individual learning costs in adapting to a new regime and the loss of network effects and institutional complementarities that may have evolved around existing regimes. Switching costs may also reflect the scarcity of financial and specialized human resources required to implement new institutional regimes. Finally, switching costs may reflect deeply embedded cultural beliefs or practices—norms of appropriateness—that are highly resistant to change. Regardless of the salience of any particular factor in a specific context, strategies for mitigating switching costs are likely to be a precondition to major progress on institutional reform in developing countries.

As the foregoing examples and the case study synopses make evident, explicit compensation of losers from policy changes constitutes a tiny proportion of the larger universe of transition mitigation strategies employed or available. Nevertheless, much of the scholarly literature that addresses transition costs from policy change has focused on explicit compensation, largely influenced by the complex and sometimes incoherent case law emanating from the US Supreme Court in applying the Fifth Amendment of the US Constitution (the so-called “Takings Clause”), which provides that private property may only be taken by the state for public use and with just compensation. In legal jurisdictions that lack constitutionally entrenched expropriation procedures, statutory laws raise many of the same legal issues, as do expropriation provisions in bilateral investment treaties (BITS) or regional trade agreements such as NAFTA with respect to the treatment of foreign investors. However, transition mitigation strategies other than explicit compensation are not directly engaged by any of these provisions. Moreover, in

many respects, debates over the scope of these provisions are addressed to the question of appropriate constraints on government behavior, perhaps enforced by courts or similar arbitral bodies sanctioned by domestic constitutions or statutes or international treaties. A much less well-developed body of literature focuses not on the obligation to compensate as a legal or constitutional constraint on government action, but rather as a strategy for expanding the politically feasible scope for socially desirable policy changes by muting or mitigating the resistance of losers to these changes—the principal focus of this book. In the absence of effective transition mitigation strategies, the status quo becomes the default option, which for a broad cross section of the citizenry is likely to be less congenial than various reform proposals that include transition mitigation strategies. My intended audience for this book is politicians and their constituencies, not the judiciary.

In Chapter 2, I sketch the principal strands of both normative and positive theories of the political process as they bear on the full menu of transition cost mitigation strategies, including compensation, grandfathering, postponed implementation, or graduated implementation. Although voters and interest groups in the political process who perceive themselves as material losers from a proposed policy change are likely to invoke arguments from material self-interest, as discussed in the second part of Chapter 2, they are also likely to appeal to normative values (of the kind sketched in the first part of Chapter 2) in order to engage the support of other citizens or interest groups who share their values but not their interests. Hence, normative and positive theories of the political process exhibit significant interdependencies, which are important to illuminate early in this book with a view to exemplifying them in more detail in particular policy contexts in the case studies that follow.

CHAPTER 2. FRAMING THE ISSUES: NORMATIVE DISCOURSES, POLITICAL IMPERATIVES

The range of normative viewpoints reflected in the scholarly literature on the transition cost compensation or mitigation issue, even among scholars who share the same disciplinary or theoretical orientation, is startling. I will describe and comment briefly on the leading normative perspectives in turn. By “normative” I mean perspectives or theories that purport to advise governments on what policies they should adopt in this context as a matter of efficiency, fairness, justice, or some other conception of right or wrong. In contrast, positive theories of government merely purport to explain or describe what factors move governments to adopt certain policies, whether right or wrong in a normative sense. I review such theories in the second part of this chapter, along with their implications for transition cost mitigation strategies.

I. NORMATIVE THEORIES OF THE CASE FOR AND AGAINST COMPENSATION OR MITIGATION OF TRANSITION COSTS

A. Efficiency Theories

An efficiency perspective emphasizes the importance of adopting public policies designed to maximize the total value of social resources, as reflected in the preferences or utility functions of all the members of the society in question. In other words, the guiding criterion is maximizing social welfare.¹ Given problems of accurate revelation of underlying preferences or utility functions, and aggregation of these into a coherent and stable social welfare function in applied policy contexts,² this typically entails a presumption in favor of voluntary market transactions, subject to a reasonably well-established list of caveats pertaining to various kinds of market failure, such as monopoly, externalities, information failures, and public goods. Thus, one

¹ See LOUIS KAPLOW & STEVEN SHAVELL, *FAIRNESS VERSUS WELFARE* (2006).

² DANIEL N. SHAVIRO, *WHEN RULES CHANGE: AN ECONOMIC AND POLITICAL ANALYSIS OF TRANSITION RELIEF AND RETROACTIVITY* (2000).

version of an efficiency perspective on the compensation issue is to inquire whether private markets fail in all or some contexts in allocating the risk of policy changes.

The most prominent proponent of this perspective on compensation issues is Louis Kaplow, who contends that no law or policy should rationally be presumed to be eternal and immutable.³ In his view, the uncertainty of government policy is broadly equivalent to more conventional instances of market uncertainty, such as the success or failure of a new product or the actions of one's competitors. Thus, for Kaplow government transitions warrant the same treatment as market transitions: no transition relief.

Kaplow focuses on the two primary economic consequences of changes in government policy: the effect on incentives to engage in the affected activities and the imposition of risk. An efficient level of investment is induced where investors bear all the costs and benefits of their decisions. Thus, the encouragement resulting from the assurance that compensation or some other form of mitigation will be provided in the event of policy change results in excessive prior investment in the affected activity by shifting part of the long-run costs of private investment to the public, thus distorting an otherwise efficient decision-making process. To the extent that investors are risk-averse, market mechanisms often provide efficient options for striking an optimal risk-incentive trade-off, for example, through discounting the value of assets acquired that may be subject to depreciation in value through future policy changes, or through buying explicit market insurance or through other risk diversification strategies.

Kaplow acknowledges that private insurance markets are subject to failures, such as (1) moral hazard (once insured, parties have incentives to increase their risky behavior); (2) adverse

³ Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99(3) HARV. L. REV. 509 (1986); see also Lawrence Blume & Daniel L. Rubinfeld, *Compensation for Takings: An Economic Analysis*, 72(4) CAL. L. REV. 569 (1984); Lawrence Blume, Daniel L. Rubinfeld & Perry Shapiro, *The Taking of Land: When Should Compensation Be Paid?* 99(1) Q.J. ECON. 71–92 (1984); THOMAS J. MICELI, *THE ECONOMIC THEORY OF EMINENT DOMAIN: PRIVATE PROPERTY, PUBLIC USE* (2011); SHAVIRO, *supra* note 2.

selection (only higher-risk parties are likely to buy private market insurance, which will lead to higher insurance premiums that price less risky parties out of the market); and (3) transaction and information costs (especially for low probability policy contingencies). Nevertheless, it is his contention that governments are unlikely to improve on how markets, including insurance markets, balance risk and incentives, and in many (probably most) cases are likely to strike a less socially efficient balance between risks and incentives. In his view, other transition mechanisms, such as grandfathering, delayed implementation, and phased-in implementation, raise many of the same problems as explicit compensation in distorting risk-incentive trade-offs, while at the same time attenuating the benefits of the policy change in question through exceptions or delays.

Kaplow emphasizes that his analysis assumes that government behaves optimally in undertaking policy reforms in terms of maximizing social welfare and is not influenced in its policy choices by the transition policy in force. In effect, he assumes that all policy changes will be socially optimal.⁴ He concedes that in a complete analysis one would relax these assumptions and consider when government policy is or is not likely to be optimal, how it deviates from optimality when it is not, and how transition policy may affect the choice of underlying substantive policies: “Such is the subject of an entire discipline, political science (or as some prefer, political economy or public choice) and is obviously beyond the scope of this investigation.”⁵ He acknowledges that the analysis of private actors with regard to incentives and risk bearing is substantially more developed than is the analysis of government behavior, including how such behavior is affected by transition policy. In the latter respect, he acknowledges that “most analysis—including by this author—has been fairly black box, and has not taken full advantage of recent decades of work by political scientists and other pertinent

⁴ Louis Kaplow, *Transition Policy: A Conceptual Framework*, 13 J. CONTEMP. LEGAL ISSUES 161 (2003).

⁵ *Id.* at 190.

scholars.”⁶

In contrast to Kaplow, scholars adopting a more political economy-oriented perspective on the compensation issue argue that an expansive case for compensation for transition costs may be justified, precisely in order to ensure that policy changes that governments adopt are in fact social welfare-enhancing. For example, a Kaldor-Hicks conception of efficiency is satisfied when society is, on net, better off from a policy change when the winners from the change are in a position to compensate the losers such that the losers would be indifferent to the change after compensation, and the gainers, even after paying compensation to the losers, would still derive a benefit. However, typically under a Kaldor-Hicks conception of efficiency compensation is not in fact paid to the losers; rather, the scale of the benefits to the winners is compared to the scale of the losses to the losers, and if the former exceeds the latter the policy change should proceed.

Critics of this conception of efficiency argue that policymakers, in undertaking the cost-benefit analysis implicit in the Kaldor-Hicks conception of efficiency, face incentives to undervalue the costs of the policies they are promoting, given that they do not bear these costs, and perhaps to overvalue the benefits. Hence, the concern is that policymaking, in the absence of an actual compensation principle (ideally one that is consensually determined, albeit subject to the “holdout” or monopoly problem that some claimants may present), is likely to reflect a form of “fiscal illusion.” To combat this tendency, some scholars argue that governments should be required explicitly to compensate the losers—something closer to the Pareto conception of efficiency that requires that a policy change only proceed if it makes at least one individual better off without making anyone worse off—and face the political consequences of explicit budgetary outlays on this account. This, it is assumed, would discipline any tendency of policymakers to

⁶ *Id.* at 208–09.

adopt policy changes that are not in fact social welfare–enhancing.⁷ These might be characterized as “Pareto reforms,” rather than “cost-benefit reforms.”⁸

However, as John Quinn and I have pointed out,⁹ and as Kaplow himself notes,¹⁰ policymakers, whether legislators, regulators, or bureaucrats, rarely capture directly most of the benefits of the policy changes they promote, nor are they likely to bear most of the costs. As such, it is not clear that an explicit government compensation requirement is likely to change government behavior. Conversely, it might actually increase rent-seeking behavior by special interest groups as they will be incentivized to promote socially undesirable policies, recognizing that they will be compensated in the event that these policies are subsequently withdrawn or modified.

A more subtle political economy argument for compensation policy argues that in a majoritarian political system, there may be contexts in which a majority of voters (or their representatives) will find it in their interests “to gang up on” or “single out” a small minority of their fellow citizens, who are not sufficiently numerous or well-organized to be politically influential, to bear most of the costs of policies that the majority favor—a form of Tyranny of the Majority.¹¹ On the one hand, this might lead to the adoption of policies that are not socially optimal because they confer modest benefits on the majority at great expense to the minority. On the other hand, even where the policies are socially optimal (in a social welfare framework), a

⁷ See, e.g., JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* 80–90 (1965); Gordon Tullock, *Achieving Deregulation: A Public Choice Perspective*, 2(6) *REGULATION* 50–54 (1978); Blume & Rubinfeld, *supra* note 3, at 620–22; Blume et al., *supra* note 3, at 88–90; Frank I. Michelman, *Property, Utility, and Fairness*, 80(6) *HARV. L. REV.* 1165 (1967).

⁸ ROBERT D. COOTER & HANS-BERND SCHAFFER, *SOLOMON’S KNOT: HOW LAW CAN END THE POVERTY OF NATIONS* ch. 14 (2013) (“The Many versus the Few”).

⁹ John Quinn & Michael J. Trebilcock, *Compensation, Transition Costs, and Regulatory Change*, 32(2) *U. TORONTO L.J.* 117 (1982).

¹⁰ Kaplow, *supra* note 4.

¹¹ See Saul Levmore, *Just Compensation and Just Politics*, 22 *CONN. L. REV.* 285 (1989).

“singling out” policy that requires politically marginal interests to bear most of the costs of these policies is likely to strike many people as an abuse of government power. This is most evident in the classic eminent domain case: a local resident’s house is taken and the land used to build a public school. Even if the social benefits from this alternative land use exceed the costs to the existing resident, it will strike most people as unfair that the local resident should bear all the costs of this policy transition. Kaplow, drawing on Blume and Rubinfeld,¹² considers that this kind of case may justify government compensation on the grounds that private insurance may be unavailable for reasons related to moral hazard, adverse selection, or transaction costs.

However, it is not clear to me that these insurability problems are any more severe in this context than coverage for many other low probability, independent events such as fire or theft.¹³ Moreover, despite Kaplow’s objections to broader compensation commitments for policy change by way of analogy to the poor risk-incentive properties of government compensation for natural disasters,¹⁴ it seems obvious that private insurance coverage is less likely to be available, or at least to be prohibitively expensive, for highly correlated (and undiversifiable) risks that many regulatory changes (and natural disasters) entail.¹⁵ It is also argued that policy changes are often likely to be of a *sui generis* character, precluding pricing based on actuarial experience.¹⁶ Relatedly, Shavell argues that grandfathering may be efficient relative to other risk mitigation strategies if the costs of adapting investments made in compliance with a prior regulatory regime and ongoing compliance costs with a new regime exceed the social benefits (e.g., a municipality

¹² Blume & Rubinfeld, *supra* note 3.

¹³ See also Thomas Merrill, *Rent Seeking and the Compensation Principle*, 80 NW. U. L. REV. 1561, 1581 (1986).

¹⁴ See EDWARD IACOBUCCI, MICHAEL TREBILCOCK & HUMA HADER, *ECONOMIC SHOCKS: DEFINING A ROLE FOR GOVERNMENT* ch. 5 (2001).

¹⁵ See Steven Shavell (Working Paper, Harvard Law School, 2013).

¹⁶ See Jonathan S. Masur & Jonathan R. Nash, *The Institutional Dynamics of Transition Relief*, 85 N.Y.U. L. REV. 391, 421–26 (2010).

increasing the minimum distance a building must be set back from a street).¹⁷ Moreover, adverse selection problems may sometimes favor the mandatory pooling of risks to prevent risk pools from unraveling. Examples might include unemployment, disability, or healthcare insurance.

Thus, concerns over the cost and availability of market insurance appear to have a much broader application than eminent domain, while not directly addressing the issue of “singling-out” as an abuse of government power. Whether or not it is true that markets are relatively efficient in allocating risks of both market and policy uncertainty for either sharply focused or more dispersed losses, through contractual arrangements or explicit insurance, the fact remains that applying Kaplow’s “no compensation” presumption, private parties, one way or another, in the case of policy changes, are left bearing all the costs of policy changes (including where they are insurable or diversifiable), even if one assumes them to be on net socially desirable. Whether it is fair that they should do so moves the discussion into a quite different normative domain. As the economist William Fischel notes, “Why has economics not been especially helpful in resolving the ‘takings’ issue? Part of the answer is that the issue involves fairness as well as efficiency. . . . To move from the conclusion that just compensation promotes efficiency (or inefficiency) to the recommendation that it ought to be paid (or not paid) is to impose the culture of economics on the culture of society at large.”¹⁸

B. Utilitarianism

Although utilitarian perspectives on the compensation issue share much in common with efficiency perspectives, they do not necessarily converge in this context. The most prominent proponent of a utilitarian perspective on compensation for transition costs is Professor Frank

¹⁷ Steven Shavell, *On Optimal Legal Change, Past Behavior, and Grandfathering*, 37(1) J. LEGAL STUDIES 37 (2008).

¹⁸ W.A. FISCHEL, REGULATORY TAKINGS: LAW, ECONOMICS, AND POLITICS 216–17 (1995).

Michelman.¹⁹ Michelman's formula for compensation, while complex, revolves around three elements. First is the idea of Demoralization Costs (D). The costs are defined as the disutilities to uncompensated losers and their sympathizers beyond material losses, and the lost future production from impaired incentives or social unrest that would arise if no compensation were paid. He asserts that individuals who suffer harm as a result of state action experience a special kind of disappointment and anxiety when they have reason to suspect that they have been singled out as the victims of uncompensated losses. Thus, demoralization costs, for Michelman, include both uncertainty costs and disaffection costs. Second, Settlement Costs (S) are the costs, chiefly administrative, of operating a compensation program, that must be borne to avoid demoralization costs, which may in many cases be substantial in tracing out second, third, and fourth order effects of policy changes (much like determining the ultimate incidence of a tax). Third, Efficiency Gains (E) are the excess of the gains produced by government acts over the material losses inflicted by them, not including (D) or (S).

According to Michelman, government should compensate losses if demoralization costs exceed settlement costs; conversely, governments should not compensate losses if settlement costs exceed demoralization costs. Presumably, if demoralization costs exceed both efficiency gains and settlement costs, government should not proceed with the policy reform in question. As Fischel points out, Michelman's approach adopts an intermediate position between Pareto and Kaldor-Hicks conceptions of efficiency. It is more permissive than the Pareto conception in that it would approve some government actions without actual compensation if settlement costs exceed demoralization costs, while it is less permissive than the Kaldor-Hicks conception, which does not, in principle, require compensation at all.²⁰ It differs from Kaplow's perspective in that

¹⁹ Michelman, *supra* note 7.

²⁰ Fischel, *supra* note 18, at 147–48.

Michelman assigns significant weight to the private costs of policy changes, whether insurable or not, which Kaplow is prepared largely to ignore, or by assumption to treat as exceeded by the social benefits of the policy reform in question.

Although Michelman's decision rule has intuitive attractions, operationalizing it presents formidable challenges. Valuing each of the three key components in his formula in robust and defensible ways, and avoiding the political manipulation of these valuations so as to favor particular political constituencies or special interests, raise major institutional challenges.

C. Social Contract Theories

Although there are many different variants of social contract theories, Rawls's version of this theory is the most prominent contemporary representative.²¹ Broadly, the argument is that behind a Veil of Ignorance parties would choose a concept of justice that evaluates possible institutional arrangements in terms of the interests of the least advantaged or worst off members of the community. As no one knows what his or her own personal situation might be under any specific arrangement behind the veil of ignorance, each must consider the possibility that he or she might end up as the worst off individual in the community. Rawls asserts that parties would choose a rule of distribution that permits inequalities only if that rule provided a guarantee that all would be better off than under a rule requiring strict equality in distribution.

Rawls's theory of justice has provoked an enormous body of scholarly literature, which I do not intend to review here. In the context of this project—the issue of compensation or mitigation of transition costs—his theory appears to be of relatively limited application. In the general run of cases that have arisen both in the jurisprudence on takings and in the scholarly

²¹ JOHN RAWLS, A THEORY OF JUSTICE (1971).

commentary, the claimants for compensation can rarely make the case that they are among the least advantaged members of the community (although some past urban renewal projects, for example, have had disproportionate impacts on low-income communities; trade liberalization may prejudice low-paid, low-skilled workers in certain sectors, discussed in Chapter 5; and more liberal immigration policies may similarly put at risk workers with few alternative opportunities, discussed in Chapter 7). Rather, the justification for compensation or mitigation is that these claimants would otherwise have to bear a grossly disproportionate share of the costs of policy change. A prime example of this is the classic eminent domain case, where a government or government agency wishes to acquire an existing resident's home on which to construct a public school. Here, the existing resident's wealth, before and after the taking, is largely, if not totally, irrelevant to his or her claim to compensation. Even if the resident is a multimillionaire, with many other assets, intuitively most people would think that his or her case for compensation is not significantly diminished. Similarly, in a case where a highway service station is demolished for the construction of a new highway, it seems unlikely to be relevant, either as a matter of law or considered normative intuition, whether it is a "mom and pop" enterprise or is owned by a multinational oil company.

D. Communitarianism

Unlike individualists, communitarians see the individual as incomplete and unintelligible outside his or her social relationships and social context. In other words, an individual's identity, preferences, and life decisions are determined in part by community and group affinities. Like proponents of distributive justice, communitarians emphasize outcomes such as equity and economic security. The two outlooks differ, however, in that outcomes are important to

communitarians not because equality is an end in itself, but because it is a means of achieving social solidarity.

Thus, fairness and community solidarity entail sharing broadly both the burdens and benefits of citizenship.²² In particular, policy changes that involve fracturing existing communities are likely to be resisted, at any event, without policies that ease the costs of transition for affected community members, ideally to other options within the same community. Communitarian values have been particularly influential in justifying trade protectionism generally and agricultural protectionism in particular as well as restrictive immigration policies. These matters are discussed more fully in Chapters 5, 6, and 7 respectively.

E. Corrective Justice

Corrective justice, as explicated most prominently by Ernest Weinrib,²³ is a quantitative equality in which one person's gain necessarily entails another's loss, so the doing of injury by one entails the suffering of injury by another. The premise is that all individuals are juridical equals and ends in themselves, whom others cannot treat as mere means or instruments for their purposes or desires. On this view, breach of contract or tortious injury constitutes one individual's interference with the rights of another, creating an inequality in the relation between the doer of the wrong and the sufferer, which can be corrected or rectified by the doer's returning to the sufferer the value of what has been taken, thereby re-establishing the initial

²² For various strands of communitarianism, see, e.g., Alasdair MacIntyre, *Ideology, Social Science, and Revolution*, 5:3 COMP. POLIT. 321 (1973); MICHAEL SANDEL, *LIBERALISM AND THE LIMITS OF JUSTICE* (2d ed. 1998); CHARLES TAYLOR, *SOURCES OF THE SELF: THE MAKING OF THE MODERN IDENTITY* (1989); MICHAEL WALZER, *SPHERES OF JUSTICE: A DEFENSE OF PLURALISM AND EQUALITY* (1983); AMITIAI ETZIONI, *THE MORAL DIMENSION: TOWARD A NEW ECONOMICS* (1990); ROBERT D. PUTNAM, *BOWLING ALONE: THE COLLAPSE AND REVIVAL OF AMERICAN COMMUNITY* (2000).

²³ ERNEST J. WEINRIB, *THE IDEA OF PRIVATE LAW* (1995); ERNEST J. WEINRIB, *CORRECTIVE JUSTICE* (2012).

equality between the two. This initial equality is not defined in terms of equality of resources or status, but by equal rights to noninterference with one's person and property.

For example, drawing implicitly on this normative vein of reasoning, Levmore suggests that compensation is required when government intervention is seen as a substitute for private purchase.²⁴ Hence, when a government tears down a private home in order to build a public school, compensation is necessary because a private party, in a parallel situation, would have had to purchase the right to act in that way even if that party's proposed use has a higher social value than the incumbent's use. The initial equality between the doer (the government) and the sufferer (the private homeowner) is restored through rectification, whereby the doer returns to the sufferer the value of what has been taken. This view seems compelling in a range of compensation cases, although it is less helpful in cases where policy changes do not directly appropriate private property rights but rather diminish their value through regulatory or tax changes, which may alternatively be sharply focused on one or a few investors or a very broadly defined class of investors, and where the private party encroachment analogy is less apt. A corrective justice perspective might also suggest a predisposition against compensation when the conduct of the bearer of the loss from policy change has precipitated the change for welfare-enhancing reasons (for example, hazardous products or "noxious uses" in the "takings" case-law), in contrast to the innocent resident whose home is taken for a public school.

F. Libertarianism

On libertarian theories of the state,²⁵ the role of the state is confined to protecting preexisting private property rights and enforcing voluntarily entered contracts, along with a limited police power to regulate force, fraud, and a restricted category of socially harmful

²⁴ Levmore, *supra* note 11.

²⁵ See, e.g., ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA (1974).

activities, often referred to in the takings literature as “noxious uses.” There may also be a limited role in providing public goods, such as highways and other infrastructure, which on some libertarian theories may justify taxing citizens on the demand side, in order to overcome collective action or free-rider problems. On the supply side, eminent domain powers may be justified as a means to resolve holdout or monopoly problems, especially among multiple landowners affected by the proposed government use (e.g., a highway or railway track).²⁶

The most prominent contemporary proponent of this perspective on the compensation issue is Richard Epstein. In his well-known and controversial book, *Takings*,²⁷ he argues from a Lockean view of private property rights that “all regulation, all taxes, and all modification of liability rules are takings of private property *prima facie* compensable by the state,”²⁸ subject only to a narrowly defined police power justification and a similarly restrictive interpretation of the public use condition that would limit it to classic public goods. On his view, most of the New Deal legislation and regulations adopted by the United States in the 1930s were unconstitutional as uncompensated takings.²⁹ Conversely, policy changes involving the removal of restrictive laws, for example, deregulation of the telecommunications, airline, and trucking industries, would not, presumably, attract compensation (although some libertarians seem to take an opposing view).³⁰

Epstein’s views have been challenged from a number of perspectives—from even more austere libertarians who view his interpretation of the “Takings” Clause as permitting an

²⁶ MICELI, *supra* note, 3 ch. 2.

²⁷ RICHARD ALLEN EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985).

²⁸ *Id.* at 93; for a more austere version of libertarian theory in the takings context, see ELLEN FRANKEL PAUL, *PROPERTY RIGHTS AND EMINENT DOMAIN* (2008).

²⁹ EPSTEIN, *supra* note 27, at 281.

³⁰ BUCHANAN & TULLOCK, *supra* note 7; Tullock, *supra* note 7.

excessive role for the state,³¹ to scholars on the left who view it as negating any redistributive role for the state,³² to scholars who challenge his interpretation of Locke’s natural rights theory of property rights,³³ to scholars who view his interpretation as confusingly and loosely eliding natural rights and utilitarian theories of property rights,³⁴ to constitutional theorists who object to his “originalist” theory of the US Constitution both generally and internally, including his assertion that the Founders actually intended to espouse such a minimalist theory of the State.³⁵

A more sympathetic view of Epstein’s position is that, contrary to Kaplow’s assumption that most policy changes are socially desirable, in a representative democracy factionalism and rent-seeking by special interests may often predominate over the greater social welfare.³⁶ This interpretation of his theory shares much in common with the Pareto efficiency or “fiscal illusion” rationale for a broad compensation principle and reflects a Public Choice view of the political process (as discussed below), but is susceptible to similar objections in the present context. That is, uncertainty as to the impacts on the behavior of government officials of a requirement of on-budget financial outlays for the cost of policy changes, as well as a strong status quo bias in the distribution of welfare resulting from the near-veto that would be held by prospective losers, risks taking some classes of losers too seriously. It also implies a massive role for judicial review in economic policymaking that may be seen as anti-democratic.³⁷ Nevertheless, it is difficult to reject Epstein’s argument that the relatively sharp dichotomy maintained in the US constitutional

³¹ See Ellen Frankel Paul, *Moral Constraints and Eminent Domain*, 55 GEO. WASH. L. REV. 152 (1987).

³² See Mark Kelman, *Taking Takings Seriously: An Essay for Centrists*, 74 CAL. L. REV. 1829 (1986).

³³ See Note, *Richard Epstein on the Foundations of Takings Jurisprudence*, 99 HAR. L. REV. 791 (1986).

³⁴ See, e.g., Merrill, *supra* note 13; Paul, *supra* note 31.

³⁵ See, e.g., Joseph Fox, *Takings*, 53 U. CHI. L. REV. 279 (1986); Rogers M. Smith, *Don’t Look Back, Something Might Be Gaining on You: The Dilemmas of Constitutional Neoconservatives*, AM. BAR FOUND. RES. J. 280 (1987).

³⁶ See Merrill, *supra* note 13.

³⁷ Smith, *supra* note 35. Conversely, a number of scholars have argued that an increased judicial role in the economy and state policy is a necessary step in the evolution of the economy, a means by which to facilitate dispute resolution in an increasingly complex and interdependent global economy. See, e.g., MARTIN M. SHAPIRO & ALEC STONE-SWEET, *ON LAW, POLITICS, AND JUDICIALIZATION* (2002).

case law on the Fifth Amendment between physical encroachments and regulatory takings is indefensible and often incoherent. Taking a substance-over-form approach, clearly physical takings and regulatory takings involve only differences in degree (and sometimes not even that in cases of minor physical encroachments, which are typically compensable, compared to regulatory “wipe-outs,” which often are not).³⁸

Reflecting on this tangled skein of sharply divergent normative arguments as to the proper scope of a compensation principle for transition costs, ranging from Kaplow’s strong “no compensation” presumption to Epstein’s “always compensation” presumption, one can hardly be surprised at the sometimes incoherent jurisprudence on this issue, the sharply divergent scholarly commentary, and the multitude of political responses observable in different jurisdictions. That actual compensation or transition cost mitigation practice in the real world is light years removed from either Kaplow’s or Epstein’s polarities is suggestive of an important range of determinants that their (and other) normative analyses neglect. As Shaviro notes, “The literature’s tendency towards corner solutions, in which [rule] change ostensibly justifies transitional adjustment either almost always or almost never, should excite skepticism.”³⁹

II. THE ROLE OF COMPENSATION AND OTHER MITIGATION TRANSITION STRATEGIES IN POSITIVE THEORIES OF THE POLITICAL PROCESS

A. The Economics of Politics: Public Choice Theory

Public Choice Theory is derived from a series of seminal works by economists,

³⁸ MICELI, *supra* note 3, at 113.

³⁹ SHAVIRO, *supra* note 2, at 3.

including most prominently, Anthony Downs,⁴⁰ Mancur Olson,⁴¹ James Buchanan and Gordon Tullock,⁴² and George Stigler,⁴³ which essentially model the political process as an implicit marketplace for public policies where policies are demanded and supplied reflecting various *quid pro quos*, shaped by an overriding political support maximization imperative. Although economic analysis has traditionally conceived of the role of government as a *deus ex machina* that eliminated one or another unfortunate allocative consequences of market failure, economics became compelled to confront the logic of its own behavioral postulates. If parties to private market transactions are for the most part to be presumed to be rational actors attempting to maximize their self-interest, whether in the form of increased profits or increased utility, then at least two important, albeit obvious, implications are likely to follow from this presumption with respect to collective behavior. First, many, perhaps most, individuals are unlikely to have any *ex ante* preference for market allocations of resources over collective allocations of resources, but will presumably choose to invest resources in pursuing economic self-interest through either market activity or political activity, depending on where their net gains are likely to be the greater. Second, just as with private markets whose functioning is presumed to be dominated by self-interest, so in political “markets” one should assume that relevant actors—voters (demanders), politicians (suppliers), bureaucrats, and the media—tend to be motivated principally by self-interest and not by some collective commitment to the broader public interest.⁴⁴

⁴⁰ ANTHONY DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* (1957).

⁴¹ MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1971).

⁴² BUCHANAN & TULLOCK, *supra* note 7.

⁴³ George Stigler, “The Theory of Economic Regulation,” in *THE CITIZEN AND THE STATE: ESSAYS ON REGULATION* (1975).

⁴⁴ *See generally* THE ENCYCLOPEDIA OF PUBLIC CHOICE (Charles Rowley & Friedrich Schneider eds., 2004); DENNIS MUELLER, *PUBLIC CHOICE III* (2003).

Thus, to attain or retain political office, politicians will find it rational to fashion policies that exploit various political asymmetries: between marginal voters (uncommitted voters in swing electorates) and infra-marginal voters; between well-informed and ill-informed voters; and between concentrated and diffuse interest groups facing differential political-mobilization costs (collective action problems). Moreover, because of short electoral cycles, they will favor policies with immediate and visible benefits that defer costs to later time periods or render them less visible (e.g., by moving them off-budget). Bureaucrats will be motivated to promote policies that maximize their power, pay, and prestige. Regulators will seek a quiet life by coming to accommodations with the interests they are supposed to be regulating and perhaps also by enhancing their prospects of employment in the regulated industry after their tenure as regulators (the “capture” theory of regulation). The media, in order to maximize readership or viewing audiences, thereby enhancing advertising revenues, will trivialize complex policy issues, rely on ready-made sources of information that reflect the biases of established interests, sensationalize mishaps unreflective of systemic policy failures, and turn over issues at a rapid rate with minimal investigative follow-up in order to cater to readers’ and viewers’ limited attention spans (rational ignorance).

B. The Implications of Public Choice Theory for Transition Policies

Public Choice theory suggests various implications for the politics of transition cost mitigation. Reflecting some strains in pluralistic theories of democracy,⁴⁵ political markets contain some implicit adjustment processes that, over time, may tend to offset gains and losses secured or sustained by different interests on particular issues. Where there is a non-uniform distribution of intensities of preferences among the voters on different policy issues, politicians

⁴⁵ Andrew McFarland, *Neopluralism*, 10 ANN. REV. POLITICAL SCI 45 (2007).

are likely to fashion policies that appeal to impassioned or highly mobilized minorities at the expense of less organized, less passionate majorities. Given a whole range of issues that must be addressed by government over time with differing configurations of high intensity and low intensity voter interests surrounding each issue, it may be the case that a group of losers on one issue, because it is a low intensity majority, will win on other issues where it is a highly intense minority—a process often facilitated by log-rolling among citizens' political representatives. However, there is at least one type of collectively imposed loss that is systematically less likely to be washed out by log-rolling over the long run. Losses that are both large in relation to the loser's net worth and substantially larger than the losses that usually result from legislative decisions are less likely to be canceled out by prior or subsequent gains derived from the political market (e.g., the classic eminent domain case such as the taking of a private residence for a public school).

Where the prospective losers from a major regulatory or policy change face a strategic choice between accepting explicit compensation or opposing the change, it will often be rational for them to oppose the change, particularly if *ex ante* compensation is unlikely to address all the uncertainties associated with the particular losses induced by the change. If the gainers from the policy change are required to underwrite the explicit costs of compensation, here the position is reversed: they face a certain up-front cost, in terms of compensation payments, and uncertain long-term benefits from the regulatory change and the possibility of future political reversal (the problem of time inconsistency). Faced with potentially equivocal positions by losers and gainers with respect to an explicit compensation strategy, politicians are likely to ask themselves whether, through a highly visible expenditure policy in some completely unrelated policy context, greater political returns can be realized than compensating losers from regulatory or

other policy changes. To the extent that it is politically desirable to mitigate transition costs, low-visibility, off-budget strategies such as grandfathering or phased or delayed implementation are likely to be preferred, and are generally likely to be biased in favor of concentrated and politically well-organized interests. Conversely, the compensation or mitigation of isolated, widely dispersed, or temporally attenuated losses is less likely to attract political support.

C. The Limits of Public Choice Theory⁴⁶

Public Choice theory offers many valuable insights into the policymaking process and is an important antidote to wishful thinking or utopianism in considerations of democratic politics. It does, however, have a number of important limitations. First, its behavioral postulates are ambiguously specified: does it assume purely self-regarding behavior on the part of all relevant actors, or a broader concept of utility-maximization that might include an almost infinite number of other values, including altruism (albeit at the risk of loss of predictive capacity, or even tautology)? Second, despite the vast differences in institutional regimes across different societies, Public Choice theory takes a jurisdiction's existing institutions as given, and has poorly developed explanations of how particular institutions initially emerged, evolved over time, and may change in the future. Third, and relatedly, Public Choice theory has a poorly developed framework for identifying the factors that may disrupt existing political equilibria and lead to major policy changes over time. More eclectic positive theories of the political process attempt

⁴⁶ For critiques of public choice theory, see IAN SHAPIRO & DONALD GREEN, *PATHOLOGIES OF RATIONAL CHOICE THEORY: A CRITIQUE OF APPLICATIONS IN POLITICAL SCIENCE* (1994); ALBERT BRETON, *COMPETITIVE GOVERNMENTS: AN ECONOMIC THEORY OF POLITICS AND PUBLIC FINANCE* (1996); DONALD WITTMAN, *THE MYTH OF DEMOCRATIC FAILURE: WHY POLITICAL INSTITUTIONS ARE EFFICIENT* (1995); STEVEN CROLEY, *REGULATION AND PUBLIC INTERESTS: THE POSSIBILITY OF GOOD REGULATORY GOVERNMENT* (2008); DANIEL FARBER & PHILIP FRICKEY, *LAW AND PUBLIC CHOICE* (1991); Jerry Mashaw, *The Economics of Politics and the Understanding of Public Law*, 65 KENT L. REV. 123 (1990); Daniel Farber, *Democracy and Disgust: Reflections on Public Choice*, 65 KENT L. REV. 161 (1989); Michael Trebilcock, *The Choice of Governing Instrument: A Retrospective*, in *Designing Government: From Instruments to Governance* (Pearl Eliadis, Margaret Hill & Michael Howlett eds., 2005).

to grapple with these issues, although, it should be acknowledged, at the price of loss of parsimony and explanatory or predictive crispness. I briefly review such theories below.

III. ALTERNATIVE EXPLANATIONS OF POLITICAL BEHAVIOR

In canvassing the myriad approaches to explaining the political and policy process, I have adopted a typology of explanations of political behavior developed by Craig Parsons.⁴⁷ It is one of several possible organizing schemes,⁴⁸ but one that seems well suited to the task at Hand. According to Parsons, explanations of political behavior can be classified as one of four types: structural, institutional, psychological, and ideational.⁴⁹ I briefly discuss each in turn.

A. *Structural Explanations*

Structural arguments largely rely on immutable constraints on policy options, such as geography, natural resources, and the contingencies of history. Although they may also in part rely on dynamic constraints on resources, for the purposes of these explanations, it is assumed that they are not manipulable by participating actors over the temporal scope of the policy issue in question—that is, they are taken as exogenous.⁵⁰ Explaining action as a direct function of

⁴⁷ CRAIG PARSONS, *HOW TO MAP ARGUMENTS IN POLITICAL SCIENCE* (2007).

⁴⁸ Other approaches include: ideas, interests, and institutions (e.g., Geoffrey Garrett & Barry Weingast, *Ideas, Interests, and Institutions: Constructing the EC's Internal Market*, in *IDEAS AND FOREIGN POLICY* (J. Goldstein & R. Keohane eds., 1993); rationality, culture, and structure (e.g., *COMPARATIVE POLITICS: RATIONALITY, CULTURE, AND STRUCTURE* (Mark Irving Lichbach & Alan S. Zuckerman eds., 1997)); and, the “Funnel of Causality” (e.g., Richard Simeon, *Studying Public Policy*, 9(4) *CAN. J. POLITICAL SCI.* 548 (1976).

⁴⁹ As with nearly all aspects of the study of human behavior, the categories are not truly discrete and there is significant overlap and interaction between and among them; many theories plausibly fall within multiple categories.

⁵⁰ This aspect of the argument can lead to a slightly ambiguous, and potentially problematic interpretation of the concept of structure (see, e.g. John Gerring, *Craig Parsons's How to Map Arguments in Political Science*, 7(2) *PERSPECTIVES ON POLITICS* 432 (2009) (book review). Herein, it is not suggested that structural elements have specific, constant, and universal effects (i.e., a strictly positivist understanding). Rather, the matter is somewhat sidestepped by conceptually bounding the scope of analysis such that certain deeply entrenched institutions and values (e.g., representative democracy, liberalism) are taken as constants for the purposes of analysis. At the same time, other structural elements (e.g., factor endowments) do remain relatively constant (or are depleted in predictable ways).

these exogenous constraints implies that there is little role for interpretation and assumes, at the very least, an intersubjective rationality that guides individual decision-making. As these rational decision-making processes are not (as yet) empirically demonstrable, most scholars rely on evidence of behavior supportive of rationality combined with logical claims, and broadly “rational-looking” decision-making. It is within this school of scholarship that a standard Public Choice account would fall, as would a standard Marxist account. Explanations of contemporary economic performance derived from, for example, historical settler mortality rates at the time of conquest⁵¹ or the legal regime transplanted to a colony are also of this type.⁵²

B. Institutional Explanations

In general, institutions are understood as organizations and sets of rules that constrain and channel the behavior of the actors operating within them. By many accounts they shape incentive structures and, in turn, raise the costs of some options to the point of infeasibility and lower others to the point of near necessity. Although treating political institutions solely as external incentive structures leads to a limited understanding of their overall impact on political decision-making, this approach—which can be frequently aligned with Public Choice approaches, via rational choice institutionalism⁵³—has produced a good deal of useful scholarship with respect to institutional design.

⁵¹ Daron Acemoglu, Simon Johnson & James A. Robinson, *The Colonial Origins of Comparative Development: An Empirical Investigation*, 91(5) AM. ECON. REV. 1369 (2001).

⁵² Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46(2) J. ECON. LIT. 285 (2008).

⁵³ See, e.g., Douglass C. North & Barry R. Weingast, *Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth Century England*, 29(4) J. ECON. HIST. 803 (1989); Barry Weingast, *Rational-Choice Institutionalism*, in POLITICAL SCIENCE: STATE OF THE DISCIPLINE (Ira Katznelson & Helen V. Milner eds., 2002); more generally, see Ellen M. Immergut, *The Theoretical Core of the New Institutionalism*, 26(1) POLITICS AND SOCIETY 5 (1998).

A prime example of this perspective is Tsebelis's concept of "veto players." A veto player is defined as "an individual or collective actor whose agreement is required for a policy decision."⁵⁴ This theory suggests that the likelihood of achieving sufficient agreement to enact a change is reduced where there is an increase in the number of veto players in a system, a dissimilarity of policy positions among veto players, or an increase in the cohesion of a given veto player's constituent group. In short, the more actors whose assent is required for a regulatory change, the less likely that change becomes. The number of veto points is affected by institutional design (e.g., executive and legislative organization, the presence and form of federalism, and voting procedures),⁵⁵ as well as less formally by the presence of entrenched interests such as farmers' organizations in the agricultural policy sector (as discussed in Chapter 5) or business associations and labor unions on matters of immigration policy (as discussed in Chapter 6). As the number of veto players increases, so too does the likelihood that compensation or other forms of mitigation will be necessary to effect the desired change.

A more expansive conception of institutions sees them not only as constraining behavior and altering incentive structures, but also as providers of standard operating procedures, behavioral norms, and identities to those who function within them. Conceived of in this way, institutions shape the subjective maps and preferences of those interacting with them, providing internalized logics of appropriateness.⁵⁶ Institutions in this sense are seen as collections of rules

⁵⁴ George Tsebelis, *Decision Making in Political Systems: Veto Players in Presidentialism, Parliamentarism, Multicameralism and Multipartism*, 25(3) BRIT. J. POLITICAL SCI. 289, 293 (1995).

⁵⁵ See, e.g., Giovanni Sartori, *Parties and Party Systems: A Framework for Analysis*, in HOW PARTIES ORGANIZE: CHANGE AND ADAPTATION IN WESTERN DEMOCRACIES 71 (Richard Katz and Peter Mair eds., 1976).

⁵⁶ Similarly, Béland and Cox suggest that politics is not only a struggle for power and control among those seeking to maximize their own interests, material or otherwise, but also a contest among individuals whose communications with one another shape not only what they want, but "what they deem to be appropriate, legitimate and proper." For them, ideas are causal beliefs that are products of cognition, connected to the "real" world via perception, and are more or less formal conceptualizations of causal relationships that serve as guides for action. Daniel Béland &

and routines that define appropriate behavior.⁵⁷ Thus, although “a good deal of behavior is goal-oriented or strategic. . . the range of options canvassed by a strategic actor is likely to be circumscribed by a culturally-specific sense of appropriate action.”⁵⁸ For example, although there may be an argument for adopting a “zero-growth” approach to addressing the challenge of climate change,⁵⁹ it is unlikely that policy analysts will seriously consider it: it does not resonate with fundamental Western precepts of government policymaking.⁶⁰ Moreover, even if it were advanced, the institutional norms of the bureaucracy and political establishment would not be receptive to it. As I discuss more fully in Chapter 8 on climate change policy, a zero-growth policy does not make sense given a basic set of background normative beliefs that include the promotion of economic growth as a central policy goal.

A more dynamic institutional approach suggests that change is at least partially the result of unintended outcomes and randomness, meaning that the results cannot be controlled by fiat or fully predicted.⁶¹ In the most basic sense, it can be expressed as the assertion that “what happened at an earlier point in time will affect the possible outcomes of a sequence of events occurring at a later point in time.”⁶² Inherent in this approach is a rejection of the idea that social institutions, policies, and regulation are, at some level, directly reducible to individual behavior.

Robert Henry Cox, *Introduction: Ideas and Politics*, in *IDEAS AND POLITICS IN SOCIAL SCIENCE RESEARCH* 301–02 (Daniel Béland & Robert Henry Cox eds., 2010).

⁵⁷ *Id.* at 4.

⁵⁸ Peter A. Hall & Rosemary C.R. Taylor, *Political Science and the Three New Institutionalisms*, 44(5) *POLITICAL STUD.* 936, 956 (1996).

⁵⁹ See, e.g., VICTOR PETER, *MANAGING WITHOUT GROWTH: SLOWER BY DESIGN NOT DISASTER* (2008).

⁶⁰ FRANK FISCHER, *REFRAMING PUBLIC POLICY: DISCURSIVE POLITICS AND DELIBERATIVE PRACTICES* 83 (2003).

⁶¹ Jan-Erik Lane, *Public Policy and Implementation*, in *INSTITUTIONAL REFORM: A PUBLIC POLICY PERSPECTIVE* 36 (1990).

⁶² William H. Sewell, Jr., *Three Temporalities: Toward an Eventful Sociology*, in *THE HISTORIC TURN IN THE HUMAN SCIENCES* 245, 263 (Terrence J. McDonald ed., 1996).

As institutions grow they are likely to acquire a certain inertia, leading them to develop resistance to change independent of the logic of their initial formation. This phenomenon, often termed path dependence, is principally attributed to positive feedback mechanisms or increasing returns. In other words, initial steps in a particular direction have self-reinforcing properties.⁶³

The challenges of institutional reform in developing countries, discussed in Chapter 9, provides ample evidence of the importance of historical context and enculturated interests and ideas in conditioning the viability and efficacy of institutional reforms in these countries.⁶⁴ If there is one concrete lesson that can be taken from attempts to foster development through the top-down imposition of “one size fits all” packages of institutional reforms it is that their effects are not constant across jurisdictions.⁶⁵ Moreover, such experiences suggest that the layering of institutions, particularly the imposition of formal change on top of a traditional structure, may have unintended and potentially perverse effects.⁶⁶

⁶³ There are at least four positive feedback mechanisms. First, large setup or investment costs such as specialized infrastructure create a strong incentive to stay the course once the investment is made. Second, as complex systems operate they tend to become more efficient as a result of “learning-by-doing,” resulting in higher returns on investments and rendering the opportunity costs (or “switching costs”) of adopting an alternative policy higher. Third, there is the idea of coordination or network effects—where the benefits an individual receives from a particular activity increase as others adopt the same option (i.e., use of similar technology or the development of mutually beneficial supply chain management systems). Fourth, individuals may begin to tailor their investments and choices to expectations based on the continuation of a given policy or path. Thus, a change in that course may negatively affect the outcome of those choices, provoking individuals or organizations that have a vested interest in the status quo to actively resist change (a central focus of this book). Paul Pierson, *Increasing Returns, Path Dependence, and the Study of Politics*, 94(2) AM. POLITICAL SCI. REV. 251 (2000); see also Mariana Prado & Michael J. Trebilcock, *Path Dependence, Development, and the Dynamics of Institutional Reform*, 59(3) U. TORONTO L.J. 341 (2009).

⁶⁴ With respect to the impact of “policy legacies” (i.e., prior policies in a similar area) on the uptake and development of future policy, see Margaret Weir & Theda Skocpol, *State Structures and the Possibilities for “Keynesian” Responses to the Great Depression in Sweden, Britain, and the United States*, in BRINGING THE STATE BACK IN) 107–64 (Peter B. Evans, Dietrich Reuschemeyer & Theda Skocpol eds., 1985).

⁶⁵ See, e.g., ROBERT D. PUTNAM, *MAKING DEMOCRACY WORK: CIVIC TRADITIONS IN MODERN ITALY* (1993).

⁶⁶ A more fulsome elaboration of the concept of layering and other processes on endogenous institutional change can be found in James Mahoney & Kathleen Thelen, *A Theory of Gradual Institutional Change*, in EXPLAINING INSTITUTIONAL CHANGE: AMBIGUITY, AGENCY, AND POWER (Mahoney & Thelen eds., 2010).

C. Psychological Explanations

Psychological approaches are premised on the existence of more or less hardwired mental processes and emphasize the impact of systematic biases, misperceptions, instincts, or affects.⁶⁷ Several insights of behavioral economics are particularly relevant in this regard. For example, the endowment effect describes the predilection of individuals to value the things they have more highly than the things they do not.⁶⁸ Put differently, individuals tend to feel the loss of something they have more than not gaining something of equal value (loss aversion).⁶⁹ A key implication of this is that individuals are likely to attach greater importance to the loss in value of assets in their possession (at least nominally) as a result of a regulatory or policy change than the prospective opportunities for gain that might be closed off as the result of other public policies.⁷⁰

The availability heuristic describes the tendency of individuals to base their estimates of probability and importance on particularly salient information they can readily call to mind (perhaps because of personal experiences). The problem with this proclivity is that memorable events are often unrepresentative. Relatedly, individuals also tend to improperly weight new information. One manifestation of this is a tendency to excessively privilege information that one

⁶⁷ See, e.g., Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211(448) SCI. 453 (1981).

⁶⁸ Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1108–10 (2000); see also Tversky & Kahneman, *supra* note 67.

⁶⁹ Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93(5) AM. ECON. REV. 1449, 1457 (2003).

⁷⁰ Some recent scholarship disputes the existence of an endowment effect. For example, Plott and Zeiler suggest that the effect is the product of experimental conditions and not a distinct psychological trait. (See Charles R. Plott & Kathryn Zeiler, *The Willingness to Pay—Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530–45 (2005); Charles R. Plott & Kathryn Zeiler, *Exchange Asymmetries Incorrectly Interpreted as Evidence of Endowment Effect Theory and Prospect Theory?*, 97 AM. ECON. REV. 1449–66 (2007). However, Plott and Zeiler’s conclusions have also been challenged; see Andrea Isoni et al., *Comment: The Willingness to Pay—Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedure for Eliciting Valuations*, 101 AM. ECON. REV. 991–1011 (2011); see also Jack L. Knetsch & Wei-Kang Wong, *The Endowment Effect and the Reference State: Evidence and Manipulations*, 71 J. ECON. BEHAVIOR & ORG. 407–14 (2009). For a rejoinder, see Gregory Klass & Kathryn Zieler, “Against Endowment Theory,” 61 U.C.L.A. L. REV. 2 (2013).

first comes into contact with regarding a particular topic or issue, even if the reason that this “anchor” information was encountered first was arbitrary.⁷¹ For example, individuals’ prior attitudes toward climate change play a strong role in their evaluation of the credibility of scientific findings—those with value-based predispositions against global warming are substantially less likely to find compelling scientific evidence supporting its existence than do others, regardless of the source. These biases appear to play important roles in, *inter alia*, debates over climate change and the limited efficacy of policies and international negotiations to date, issues discussed more fully in Chapter 8.

Group dynamics also affect individual attitudes to current policy changes. Much social science literature finds that when people find themselves in groups of like-minded people who perhaps share a moderate predisposition to a particular view of an issue, they are likely to move to more extreme versions of this view through group interactions and reinforcement, often triggering information and reputation cascades.⁷²

Perhaps the most troubling aspect of Public Choice theory is the assumption that self-interest can be generalized into particular sets of self-regarding goals for particular types of actors: politicians seek election or re-election and trade their legislative capacity for money or votes; business organizations seek to prevent regulation that would impose costs on their

⁷¹ Korobkin & Ulen, *supra* note 68, at 1100. For example, one study indicates that the minimum acceptable selling price of a home is heavily influenced by an arbitrarily proposed asking price. Half of the study respondents—real estate agents all—saw a booklet of information on the house, which included a substantially higher-than-the-actual asking price; the other half saw the same information but the asking price was substantially below the actual asking price. The agents were then asked to state their minimum selling price. Although both groups regressed toward the mean the movement toward the actual price accounted for only 60 percent of the difference between the proposed and market prices. That is, the difference between the average acceptable price for those shown the low and high proposed prices was 41 percent of the distance between the low and high proposed prices. DANIEL KAHNEMAN, *THINKING, FAST AND SLOW* (2011), citing G.B. Northcraft & M.A. Neale, *Experts, Amateurs, and Real Estate: An Anchoring-and-Adjustment Perspective on Property Pricing Decisions*, 39(1) *ORGANIZATIONAL BEHAVIOR & HUM. DECISION PROCESSES* 84 (1987). However, it has been suggested that the reverse might be true in other circumstances (e.g., in the valuation of stock prices). SHAVIRO, *supra* note 2, at 23.

⁷² See CASS SUNSTEIN, *GOING TO EXTREMES: HOW LIKE MINDS UNITE AND DIVIDE* (2009); JONATHAN HAIDT, *THE RIGHTEOUS MIND: WHY GOOD PEOPLE ARE DIVIDED BY POLICIES AND RELIGION* (2012).

operations (e.g., caps on carbon emission) and motivate deregulation that would increase their profits (e.g., the removal of health and safety regulations); bureaucrats seek to increase their budgets, power, and prestige; and regulators are captives of the interests they purport to regulate. This understanding of behavior does not map well onto the real world of politics, however parsimonious it may be and however crisp its predictions.

Politicians may make concessions for electoral reasons, but they also take principled stands on some issues. Not all interest groups seek to advance the interests of only their members (e.g., Greenpeace or Human Rights Watch), nor are the interests they advance always material (e.g., the American Civil Liberties Union). Bureaucracies routinely manage (or are compelled) to reduce their budgets, eliminate services, and cut jobs. Regulators often discharge their regulatory responsibilities effectively. As Alan Jacobs has recently noted, politicians in electoral democracies can and do adopt policies that entail short-term costs in return for larger, long-run social gains (e.g., investments in infrastructure, education, research and development, environmental conservation). The controlling factor, he contends, is that they must be able to do so within the constraints of electoral safety while maintaining confidence on the part of policy elites and organized interest groups that the benefits will be of the scale and certainty necessary to justify the risks, and that there is sufficient institutional capacity to implement and sustain such policies.⁷³

Experimental research also suggests that individuals are willing to make personal sacrifices in order to punish what they believe to be unfair or unjust behavior on the part of others. A notable example of this is the Ultimatum Game. One actor (A) is told to propose a division of an amount of money between herself and another actor (B). If B accepts the proposal,

⁷³ ALAN M. JACOBS, *GOVERNING FOR THE LONG TERM: DEMOCRACY AND THE POLITICS OF INVESTMENT* (2011).

it is adopted and A and B receive payment accordingly. If B rejects the proposal, neither actor receives anything.⁷⁴ From a purely rational perspective, A ought to propose a division along the lines of 99 percent for herself and 1 percent for B: B has an incentive to accept the offer as he or she is made better off by it, if only by a marginal amount. Generally, however, this kind of offer is rejected, as are most offers below an 80–20 percent division. In fact, the average proposed division tends to be about 67–33 percent in favor of A. In a similar experiment, the Dictator Game, B has no opportunity to reject the proposal. Nevertheless, B tends to receive a substantial percentage (albeit less than in the Ultimatum Game). In short, “the evidence suggests that, for many people, self-interest maximization can be somewhat tempered by the affirmative desire to treat others fairly.”⁷⁵

D. IDEATIONAL EXPLANATIONS

Ideational claims are particularistic in that they rely on the consequences of prior contingent actions and trace the causes of action to some constellation of practices, norms, and ideas through which individuals interpret the world.⁷⁶ There are, however, limits. As Parsons notes, “people may invent a stunning range of beliefs and practices, but they do not quite do so in infinitely flexible ways.”⁷⁷ Popular and elite beliefs about the appropriate ordering of society and

⁷⁴ Korobkin & Ulen, *supra* note 68, at 1135–36.

⁷⁵ *Id.* at 1136.

⁷⁶ PARSONS, *supra* note 47, at 131. For a more comprehensive review of the role and nature of ideas, see Yves Surel, *The Role of Cognitive and Normative Frames in Policy-Making*, 7(4) J. EUR. PUB. POLICY 495 (2000); John Campbell, *Institutional Analysis and the Role of Ideas in Political Economy*, 27 THEORY & SOCIETY 377 (1998); Grace D. Skogstad & Vivien A. Schmidt, *Introduction: Policy Paradigm Development, Transnationalism, and Domestic Politics*, in INTERNATIONALIZATION AND POLICY PARADIGMS (Skogstad & Schmidt eds., 2011); Béland & Cox, *supra* note 56; Martin Carstensen, *Paradigm Man vs. the Bricoleur: Bricolage as an Alternative Vision of Agency in Ideational Change*, 3(1) EUR. POLITICAL SCI. REV. 147 (2011).

⁷⁷ PARSONS, *supra* note 47, at 97–98; *see also* Skogstad & Schmidt, *supra* note 76; Peter A. Hall, *Conclusion: The Politics of Keynesian Ideas*, in THE POLITICAL POWER OF ECONOMIC IDEAS: KEYNESIANISM ACROSS NATIONS 361 (Peter A. Hall ed., 1989).

role of the state play a pivotal, though not determinative, role in the shaping of attitudes toward particular policy changes and whether or not compensation or mitigation is appropriate.⁷⁸

These beliefs tend to remain relatively static,⁷⁹ and serve as an important foundation to which policy proposals must generally be tied, in one form or another, in order to gain popular acceptance.⁸⁰ However, the generality of these values and beliefs means that concrete policy recommendations require translation and simplification in order to appeal to individuals' senses of fairness and appropriateness. Linking policy proposals to core beliefs and values is not a precise exercise; in many circumstances multiple, potentially contradictory associations can be made through strategic framing and communication.⁸¹

Ideas about cause and effect—based on the recommendations of communities of experts,⁸² the proposals of advocacy coalitions,⁸³ or bureaucratic analysis⁸⁴ — also have a substantial role to play in shaping the type of policy instruments that receive consideration, as

⁷⁸ It is also likely that there will be systematic differences between the way that individual members of the public and decision-makers such as politicians or interest group leaders come to decisions about the desirability of given policies and the type of information available to them in doing so (JACOBS , *supra* note 73). Decision-makers or “policy elites” are likely to have substantially more background knowledge (albeit still imperfect) in a given area than the average citizen. They are also likely to have substantially greater resources available to them to consider, and come to reasonably reliable conclusions about, the long-run costs and benefits of a particular policy proposal for their constituency. In short, although the understanding of policy elites will be far from perfect, it is reasonable to believe that their understanding of the situation will be more sophisticated and, likely, more accurate than that of the average member of the public.

⁷⁹ See, e.g. , Dan M. Kahan, Hank Jenkins-Smith & Donald Braman, *Cultural Cognition of Scientific Consensus* , 14(2) J. RISK RES. 147 (2011).

⁸⁰ In some respects, ideas of this type can be seen as culturally institutionalized—indeed the distinction between ideational and institutional explanations is often somewhat blurry—but normative beliefs of this type can be seen as somewhat more pervasive than institutionalized logics of appropriateness.

⁸¹ A prime example of this can be seen in the construction of narratives surrounding dairy supply-management in Canada, where the idea of a free market can be invoked to support a deregulation of production, and the notion of protecting hard-working farmers can be invoked in favor of the maintenance of existing quota systems. See Chapter 6 for a further discussion of this matter.

⁸² These groups might also be thought of as “epistemic communities,” that is, as “network[s] of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within the domain or issue are.” Peter M. Haas, *Introduction: Epistemic Communities and International Policy Coordination*, 46(1) INT’L ORG. 1, 3 (1992).

⁸³ Margaret E. Keck & Katheyn Sikkink, *Transnational Advocacy Networks in International and Regional Politics* , 159 INT’L SOC. SCI. J. 89–101 (1999).

⁸⁴ Peter A. Hall, *Policy Paradigms, Social Learning, and the State: The Case of Economic Policymaking in Britain* , 25(3) COMP. POLITICS 275–96 (1993).

well as their political feasibility. First, uncertainty may cause decision-makers to be unable to identify their allies or the strategies that will enable them to achieve their goals. Second, the inability of existing institutions to address emergent problems—or the perception that they may not be able to—may make those institutions unworkable and untrusted, leading to a search for new approaches, evaluative criteria, or policy venues. Thus, decision-makers have several incentives to consult experts under conditions of uncertainty: they can provide insight into the likely effects of given actions; they can shed light on the complex interactions of various issues and forces; they can help to define the interests of the state and of individual decision-makers. In politicized situations experts can assist decision-makers in advancing their preferred outcomes, although possibly in a modified form, by justifying or legitimating a desired policy by reference to “expert opinion.” Advocacy coalitions or networks, be they domestic⁸⁵ or transnational,⁸⁶ are identifiable by the centrality of values or principled ideas as a common bond between members.⁸⁷ They can also be characterized as holding a belief in the ability of individuals to “make a difference,” their creative use of information, and their employment of sophisticated and targeted political campaigning. These networks seek to change both policy outcomes and the terms and nature of debate. In doing so, they “‘frame’ issues to make them ‘fit’ with favorable institutional venues.” Further, they “contribute to changing perceptions that both state and society actors may have of their interests, identities, and preferences, transforming their discursive positions, and ultimately to changing procedures, policies and behaviour.”⁸⁸

⁸⁵ Paul A. Sabatier & Christopher M. Weible, *The Advocacy Coalition Framework: Innovations and Clarifications*, in *THEORIES OF THE POLICY PROCESS* 65 (Sabatier ed., 2d ed. 2007).

⁸⁶ MARGARET E. KECK & KATHRYN SIKKINK, *ACTIVISTS BEYOND BORDERS: ADVOCACY NETWORKS IN INTERNATIONAL POLITICS* (1998).

⁸⁷ In many respects, these groups can be seen as operating in a fashion similar to more traditional interest groups (e.g., business associations), albeit with somewhat different goals and arguably, more legitimate appeals to notions of fairness and moral force.

⁸⁸ KECK & SIKKINK *supra* note 86, at 2–3.

The effectiveness of these groups stems from their ability to construct cognitive frames that successfully link their preferred approach to existing values, ideas of fairness, and other underlying currents of political culture. To accomplish this, they employ some combination of four strategies. First, by generating and disseminating alternative information (increasingly through social media), leading to the construction of simple right-versus-wrong frames in order to persuade people or stimulate action. The information must be both timely and dramatic. Second, by invoking symbols and stories to enable actors, who may be quite removed from the actual events or issues in question, to make sense of the situation. Third, by calling upon more powerful actors to employ their influence or power in either material terms—linking the issue to money, goods, or prestige at the international level in order to persuade or coerce more powerful actors to act—or in moral terms, through the “mobilization of shame.” Fourth, by holding more powerful actors publicly accountable to their commitments.⁸⁹

Learning, defined as an evidence-based change of beliefs,⁹⁰ also has a role to play in determining the feasibility of policy changes. Bureaucrats and others are likely to learn from both their own experience and the experience of other jurisdictions—be they bad or good. Such analyses tend to focus on policy impact, although political outcomes (i.e., whether a given policy has been politically popular) may also matter.⁹¹ This learning may occur in a plethora of ways, but the basic insight is that observations of the operation and effects of policies in jurisdictions or situations believed to be similar will shape the perceived feasibility of a given policy option.

⁸⁹ *Id.* at 16–25; see also Sanjeev Khagram, James V. Riker & Kathryn Sikkink, *From Santiago to Seattle: Transnational Advocacy Groups Restructuring World Politics*, in *Restructuring World Politics: Transnational Social Movements, Networks, and Norms* 3 (Khagram ed., 2002)

⁹⁰ Frank Dobbin, Beth A. Simmons & Geoffrey Garrett, *The Global Diffusion of Public Policies: Social Construction, Coercion, Competition, or Learning?*, 33 ANN. REV. SOCIOLOGY 449, 460 (2007).

⁹¹ Fabrizio Gilardi, *Who Learns from What in Policy Diffusion Processes?*, 54(3) AM. J. POLITICAL SCI. 650, 652–53 (2010).

The framing of policy proposals and solutions also conditions the political viability of a proposed policy change.⁹² The ability of a programmatic idea to be framed as congruent with or supportive of central cultural values or public sentiments is, in many cases, an essential component of its adoption. “Every public policy problem,” Baumgartner and Jones argue, “is usually understood, even by the politically sophisticated, in simplified and symbolic terms.”⁹³ It is not uncommon, they suggest, for divergent opinions regarding policy solutions to be understandable predominantly in reference to two competing sets of policy images, which, followed to their respective conclusions, lead to irreconcilable policy preferences. Thus, “[p]rivate problems need to be linked to public causes in order to demand governmental attention. Argumentation and the construction of policy images play a role in this.”⁹⁴ Success in doing so can be conceptualized as creating a form of intellectual path dependence, locking in one’s preferred outcomes by framing the problem in such a way as to make it the “appropriate” solution.⁹⁵

E. The Implications of Alternative Explanations of Political Behavior for Transition Policies in the Political Process

For present purposes, the limitations of the Public Choice conception of the role of the individual are twofold: (1) individuals are not wholly self-interested, and (2) individuals are not fully rational. The ways in which individuals fail to fully conform to these ideal-types is shaped by both inherent cognitive limits and biases and the social and material context in which they

⁹² For a more thorough discussion of the concept of framing, see, e.g., Dennis Chong & James N. Druckman, *Framing Theory*, 10(1) ANN. REV. POLITICAL SCI. 103–226 (2007).

⁹³ FRANK BAUMGARTNER & BRYAN D. JONES, AGENDAS AND INSTABILITY IN AMERICAN POLITICS 26 (1993).

⁹⁴ *Id.* at 27.

⁹⁵ Skogstad & Schmidt, *supra* note 76. This may be particularly successful in light of what Sabatier et al. and others dub the “devil shift” whereby the preferred policy options of alternative advocacy coalitions are perceived to be far more detrimental to the interests and values of members of the first coalition than they actually are. See, e.g., Paul Sabatier, Susan Hunter & Susan McLaughlin, *The Devil Shift: Perceptions and Misperceptions of Opponents*, 40(3) W. POLITICAL Q. 449 (1987); Sabatier & Weible, *supra* note 85.

develop and operate. Because individuals rely on heuristics, habits, and imperfect information to make decisions, those decisions will not always result in the desired outcome, from either the subjective perspective of the actor or from an “objective,” social welfare–based perspective. Because individuals’ normative values, such as notions of fairness and justice, are conceived of as general principles and may often be in competition with one another, the way in which those values are manifested in assessments of the fairness of policy proposals and the justice of (non) compensation or (non) mitigation will vary based on the way in which they are framed. These factors will affect the way in which the interests of particular groups, and the nature of the interests themselves, will be advanced in the political arena. Moreover, the heuristics and cognitive maps employed by individuals to understand and evaluate policy proposals will be systematically shaped by their institutional environments, as will their expectations and, at least to some extent, their preferences.

The boundedness of individual rationality means that although policy proposals may be more or less conducive to framing in a way that will attract support from publics or policymakers, in many instances it will be possible to present a given proposal in ways that resonate with different cognitive and normative beliefs. This means that communication and translation will play an important role in determining feasibility. So, too, will the visibility of an issue. Behind closed doors, justification beyond an implicit desire to extract rents may be unnecessary. But, as public awareness of an issue increases, so too does the importance of issue framing—of persuading attentive publics of the justness of one’s preferred policy option.

What, then, are the practical applications of these insights to the transition cost mitigation issue? In situations where a government regulatory scheme is responsible for creating things of value, particularly where this has been done *intentionally* as in the case of public pension

entitlements (discussed in Chapter 3), the long-standing mortgage interest tax deductibility provision in the United States (discussed in Chapter 4), trade protectionism (discussed in Chapter 5), or the creation of property-like milk production quotas (discussed in Chapter 6), moves to deregulate or otherwise lower the value of participants' investments, are the most likely to require compensation or mitigation for at least three reasons. First, individuals tend to attach greater importance to out-of-pocket losses than to prospective gains. Thus, those whose assets suffer a substantial decrease in net worth have a greater incentive, and are therefore more likely, to mobilize against policy change than those who are prevented from achieving gains of the same magnitude. Second, the need to compensate those who lose investments as a result of regulatory change is more plausibly framed and presented to the general public as an issue of fairness than the loss of opportunities to gain. In turn, this should increase public willingness to accept the cost burden of compensation or other forms of mitigation, reducing the likelihood of mobilization against such measures. Additionally, the longer a program has been in place, the more likely it will have come to form an integral part of beneficiaries' expectations and the more likely those individuals are to identify with one another and mobilize to defend what they perceive as their due.⁹⁶ As individuals live with(in) particular regulatory environments, they are not only more likely to adapt to these situations, but are also more likely to accept them as appropriate. This, in turn, is likely to engender a greater reliance on the policy. Individuals may also form identities based on their shared reliance or experiences, which might also be sufficient to overcome collective action problems. Indeed, this appears to have been the case in France where, as discussed in Chapter 3, widespread protests at the increase in retirement age contributed to the downfall of the government and subsequent repeal of the measure. Third, a failure to provide

⁹⁶ See Charles Reich, *The New Property*, 73 YALE L.J. 733 (1964).

some form of compensation or mitigation weakens the credibility of commitments made by governments and their agents to individuals or organizations, driving up future costs of shaping private sector behavior and the size of incentives (such as subsidies and tax breaks) necessary to induce specific desired private investments, given the risks involved.

It is also likely that the scale of a proposed policy change will shape whether and how compensation or mitigation ought to be provided. In general, the more foundational a policy change, the greater the relative impact of values and principles on the decision-making process. This is particularly true in situations of uncertainty where interests and causal relationships are unclear. In order to be successful in such circumstances, policy proposals must both resonate with core beliefs about fairness and ideas about the appropriate role of the state. In this process, experts can assist not only in providing solutions, but also in identifying problems and interests by drawing out cause-and-effect relationships and explaining the probable consequences of particular courses of action. In so doing, they can also provide political cover by creating narratives that present a given policy change as the only or most logical possible solution. Expert opinion, however, is far from a panacea for overcoming opposition to reforms. In the case of climate change, for example, the scientific community is as close to consensus as is reasonably possible that human activity is affecting the global climate in a way that will have severe future impacts on the environment in general, and particular subsets of civilization. Nevertheless, as outlined in Chapter 8, little is being done on the scale necessary to address these problems.

The framing of a given issue will also condition both elite and popular reactions to particular proposals. Although individuals' normative values are generally stable, the boundedness of their rationality means that the translation of those values into concrete policy prescriptions is an imprecise endeavor, one that is influenced by the sequence of exposure to

information, the content of cognitive maps and heuristics provided by institutions, and the strategic construction and communication of norms, symbols, and narratives. Advocacy coalitions and networks may actively engage in attempts to reframe a given issue or even redefine the nature of the problem by disseminating information, or creating symbols and narratives that frame a change or proposal in a particular way. Additionally, because individuals are often willing to make sacrifices in the interests of fairness, opposition to a proposed change from those with a vested interest in maintaining the status quo may be lessened by convincing them that fairness does not entitle them to compensation or mitigation. Conversely, compensation or mitigation may be made more palatable on the same grounds. This, as Chapter 4 notes, is frequently the case during the negotiation of trade liberalization treaties. An additional example of the importance of framing is evident with respect to immigration policy (as discussed in Chapter 7): on the one hand, labor is not likely to be sympathetic to the liberalization of immigration on the basis of increasing the workforce, as this may cause downward pressure on wages and employment. However, restrictive immigration policies are less likely to gain popular support if liberalization can be framed as an issue of human rights, family reunification, and enhancing access to highly skilled labor that will generate positive employment spin-offs and higher levels of innovation.

The existence of organized interest groups and the possibility of conflict also suggests that the formal and informal organization of the political system and policy area at issue will also play an important role with regard to the provision of compensation or other mitigation strategies. In general, the greater the number of individuals or organizations who could potentially veto a given policy change, the more difficult change will be to implement without compensation or other forms of mitigation. As such, the allocation of authority and responsibility

in a political system and the malleability of a given policy area will affect the ability of actors to shift policy venues and attract public attention to a given issue. Because few, if any, policy issues can be thought of as lying exclusively within the purview of a particular agency or ministry, active attempts to reframe an issue may lead to a change in the composition of a decision-making body or a change in decision-making venue. This, in turn, may bring in new veto players or eliminate others. At the same time, it can also increase the public visibility of an issue, making the justification for or against a proposed change (i.e., the manner in which it is framed) increasingly salient.

Finally, the arrangement and internal logics of institutions in a given polity are intimately connected with public and elite perceptions of the appropriate role of the state in a given area. These arrangements are contingent on historical decisions that establish particular institutional trajectories that affect the desirability of given policies insofar as they condition the capacity of politicians and bureaucracies to provide relevant information and effectively utilize particular policy instruments. This suggests that in practice there are not universally desirable, not to mention desired, policy prescriptions. Rather, the desirability of a given policy will be conditioned by the attitudes and expectations of mass publics and elites as well as by the particular constellation of standard operating procedures and institutional capacities that make up the machinery of a given state apparatus. The importance of these considerations is exemplified by the challenges confronting recent attempts at institutional reform in developing countries (discussed in Chapter 9).

IV. CONCLUSION

Returning to my initial reservations about the existing literature on transition policies,

I believe that there are several issues that limit the overall usefulness of this literature for dealing with whether and when to compensate regulatory losers or otherwise mitigate their losses. Perhaps foremost among these is the overemphasis on purportedly universal prescriptions. For example, Kaplow argues that the simultaneous consideration of risk and incentives leads to the conclusion that government transitional relief is generally undesirable. According to him, market mechanisms—most notably contractual arrangements, insurance, and diversification—permit private actors to make arrangements that provide an efficient trade-off between the benefits of risk spreading and the social costs that result from distorted incentives.⁹⁷ Not only is this proposition contestable in its own terms in many contexts, but it may very well create an environment in which long-run, welfare-enhancing policy changes are not made, as a result of an inability to overcome the opposition of negatively affected interests, substantially exacerbating the risk of policy paralysis.

I also believe that the focus on the US Constitution's Takings Clause and the related idea of explicit compensation, rather than implicit (and much more common) mitigation strategies such as grandfathering, exceptions, and delayed or phased implementation, has led scholarly debate in this area astray. In particular, it focuses attention on the courts as the ultimate arbiter of losses and the determination of "just compensation" (as opposed to other transition cost mitigation strategies). In so doing, it draws attention away from the political institutions tasked with developing and implementing policy decisions: institutions whose decisions—regarding not only transition strategies, but whether to implement a given change at all—play a much more important role in shaping policy. Moreover, judicial decision-making in this area tends to be an all-or-nothing affair, adding additional uncertainty to regulatory change and rendering the type of bargaining or compromises—"politicking"—that would result in a more tractable policy reform

⁹⁷ Kaplow, *supra* note 4.

strategy impossible.

In order to anchor the foregoing discussion of approaches to transition costs in concrete policy contexts, in the balance of this book I briefly describe and critically assess transition policies in seven policy contexts: public pension reform, mortgage interest deductibility, trade liberalization, agricultural supply management, immigration policy, climate change, and institutional reform in developing countries. Although the contexts and challenges of each of these seven policy contexts differ widely, they share in common the centrality of transition costs as a potential impediment to generally socially desirable policy reforms. Only the first two are primarily domestic in their policy focus; the other five combine domestic and international policy issues, which is the way of the modern world. Based in part on these case studies, I conclude this book with some reflections on politically optimal transition policies.

CHAPTER 10. CONCLUSION: TAKING TRANSITION COSTS SERIOUSLY

I. INTRODUCTION

Otto von Bismarck, the first Chancellor of Germany from 1871 to 1890, once famously remarked that “politics is the art of the possible. . . [it] is not a science, as the professors are apt to suppose.” Accepting the wisdom of these remarks (as I do), it is important to emphasize that what is possible in politics is not predetermined, and cannot be reduced to a formal model. It can, however, be fashioned—within limits—by astute political leadership. Although Public Choice theory emphasizes the disproportionate political influence of concentrated interest groups over diffuse interest groups and voters at large, more nuanced positive understandings of the dynamics of political decision-making (such as those explored in Chapter 2) suggest a greater scope for political leadership than more static, “iron triangle” theories of the policymaking process that emphasize the close and often incestuous relationships between legislators, the bureaucracy, and organized interest groups.

On this more nuanced view of the political process, political leaders with a sensitivity to deep-seated cultural beliefs and historical development as well as an understanding of the currents and cadences of political discourse and debates are often able to craft policies that move a generally socially beneficial reform agenda forward. Constructing coalitions of often unlikely interest groups and by appealing to broader unorganized cross sections of voters by framing issues in a way that resonates with their basic normative values, and hence constructing a reasonably broad social consensus in favor of reform, may pave the way for policy change. This perspective also recognizes that citizens can often be encouraged to support policies that do not reflect their direct material self-interest, and may on occasion be antithetical to it, by appealing to

their notions of fairness or related moral reference points. On this view, effective political leadership entails more than a passive reading of the political “tea leaves”; it requires proactively crafting political compromises that move generally socially beneficial reform agendas forward in stages. In private markets, suppliers of goods and services do not assume that consumer preferences are fixed and immutable. Rather, it is accepted that advertising and marketing efforts can induce consumers to try new products or services in substitution for old. The same is true of political markets. Policy entrepreneurs have the ability to shape what is politically possible through advocacy, framing of issues, the provision of new information, and the creation of new fora for public consultation and debate that empower previously marginalized groups of citizens or introduce new perspectives on policy reform options. Addressing squarely and self-consciously the transition costs typically engendered by significant policy changes is central to this enterprise—particularly in increasingly pluralistic societies where a homogeneous set of core values may be absent.

While I have referred to effective political leaders seeking to pursue generally socially beneficial policy objectives by seeking to mitigate transition costs that may yield losers who will obstruct the adoption of these policies, I have largely bracketed what constitutes “generally socially beneficial,” recognizing that these virtues will often lie in the eye of the beholder and may differ, even among reasonable people.¹ However, I am, for the most part, content to adopt, for present purposes, a conventional, utilitarian-based social welfare function (as advanced, for example, by Kaplow and Shavell).² My essential point is that however the objective function is defined, those facing the political imperative of election or re-election in order to effectuate their policies (assuming, for my purposes, a full-franchise, reasonably competitive, representative

¹ See JONATHAN HAIDT, *THE RIGHTEOUS MIND: WHY GOOD PEOPLE ARE DIVIDED BY POLICIES AND RELIGION* (2012).

² See LOUIS KAPLOW & STEVEN SHAVELL, *FAIRNESS VERSUS WELFARE* (2006).

democracy), will need to address transition costs as an essential feature of their political strategies.

This is not to gainsay the possibility that unenlightened (even ill-intentioned) leaders pursuing policies that may ultimately be socially destructive, according to most people's lights (at least with the benefit of hindsight), may attempt to co-opt, buy off, or even dupe political losers from these policies in order to effectuate them, or alternatively offer token compensation to the losers to assuage the majority of their citizenry that the losers are not being treated unfairly. Thus, if the Nazis had bought one-way tickets out of Germany for its Jewish citizens, instead of consigning them to the gas chambers, or Idi Amin had adopted a similar policy for Asians expelled from Uganda, or had Robert Mugabe adopted similar policies for white farmers whose farms he expropriated without compensation in Zimbabwe, it is possible that these token policies may have assuaged a majority of citizens that this was adequate compensation or mitigation for the losers. Although, as Kaplow and Shavell argue, the intensity of the disutilities experienced by the losers may well exceed any gains in utility by the rest of the population, and should in principle be accounted for in a utilitarian calculus, political systems that, at least in theory, are designed to equalize political influence (one person, one vote) are not well adapted to constraining a tyranny of the majority. Hence the case for constitutionally enshrined bills of rights or recognition of international human rights as protections against minority oppression (as adverted to in Chapter 2, although potential majoritarian abuses of minorities are by no means confined to encroachments on private property rights). Authoritarian regimes may, of course, pose the opposite problem of a tyranny of the minority.

Without gainsaying the importance of such protections against abuse of power, the focus of this book has been on the role of compensation or other transition cost mitigation strategies in

representative democracies in forging an effective political coalition (or a reasonably broad social consensus) in favor of generally socially beneficial reforms, where the absence of attention to transition costs is likely to render the policy status quo ante the default option, irrespective of its perversity.

II. THE VIRTUES OF INCREMENTALISM AND COMPROMISE

On occasion, countries will be beset by cataclysmic shocks—economic collapse, military conflict, civil war, or natural disasters—that call for drastic and immediate policy responses without the opportunity to canvas all the possible second- and third-order effects of these responses, where the law of unintended consequences is likely to reveal, over time, a variety of impacts that were not, and perhaps could not, be anticipated at the time of the initial, immediate response. However, most policy reforms lack this cataclysmic character, and are typically more incremental in nature, where unintended consequences can be mitigated by a more cautious and exploratory strategy of policy change. David Lloyd George, prime minister of the United Kingdom from 1916 to 1922, once advised: “Don’t be afraid to take a big step if one is indicated. You can’t cross a chasm in two small jumps. The most dangerous thing in the world is to try to leap a chasm in two jumps.” In many, perhaps most, policy contexts this is not helpful advice. Attempting to cross a chasm in two small steps is likely to be suicidal but the same is often true of attempts to cross a large chasm in one leap. Feasible public policy options may often entail building a bridge across the chasm in stages, or working one’s way around its edges.

I began this book with a reference to William Wilberforce’s role in the enactment of the Slavery Abolition Act in the United Kingdom and its colonies in 1833. After enduring chronic and debilitating illnesses in his later years, Wilberforce died just three days after hearing that the passage of the Act through Parliament was assured. However, the passage of this Act was not a

single cataclysmic event where slavery was pervasive before its enactment, and disappeared immediately upon its enactment. In fact, Wilberforce, a Member of Parliament for much of his career, headed a parliamentary campaign against the British slave trade for 26 years until the passage of the Slave Trade Act of 1807 (and similar legislation in the United States in 1808), which abolished the international slave trade, but not slavery itself—something that took a further 26 years in the United Kingdom and its colonies and much longer elsewhere. But even the enactment of the Slavery Abolition Act in 1833, with its provisions for compensation of plantation owners and a short phase-out period of slavery in British colonies where it then existed, did not, obviously, address slavery in other countries throughout the world, including, perhaps most notably, a former British colony, the United States. Only an enormously convulsive civil war from 1861 to 1865 would achieve this—with President Lincoln’s Emancipation Proclamation in 1863, and the passage of the Thirteenth Amendment to the US Constitution in 1865. However, despite these reforms many of the entailments of slavery persisted. In a landmark US Supreme Court decision in 1896, *Plessy v. Ferguson*,³ the constitutionality of state laws requiring racial segregation in public facilities was upheld under the doctrine of “separate but equal.”

This doctrine promoted racial segregation in public school systems and other public services, and a wide variety of so-called “Jim Crow” laws, especially in the southern States. Many of these persisted until the repudiation of the “separate but equal” doctrine by the US Supreme Court in its famous 1954 decision in *Brown v. Board of Education*.⁴ This decision was followed a decade later by congressional action with the enactment of the Civil Rights Act of 1964 and the Voting Rights Act of 1965. Thus, the formal abolition of slavery, and all its direct

³ *Plessy v. Ferguson* 163 U.S. 537 (1896).

⁴ *Brown v. Bd. of Education* 347 U.S. 483 (1954).

and indirect entailments, in today's developed world spanned a period of more than a century-and-a-half; and, of course, its legacy persists in various ways today.

This brief reprise of the history of the abolition of slavery and its entailments is not in any way an attempt to defend the protracted nature of the political enterprise in ridding humanity of one of the worst moral blights ever to have afflicted it, nor is it to indulge the naturalistic fallacy of arguing that what is (or was) must be optimal because if it was not, things would have happened differently. Rather, it is intended to emphasize that even with an issue as morally indefensible as slavery and all its entailments, its abolition was not a one-time cataclysmic event, but a protracted process of policy evolution, which more generally characterizes most major policy reform processes. As Charles Lindblom argued in his famous essays on the virtues of “muddling through,” analytical and policy incrementalism is the norm, not the exception, in policy change.⁵ In many policy contexts, incrementalism has many virtues in forging and sustaining minimum winning political coalitions (and a reasonably broad social consensus favoring change), while addressing the law of unintended consequences—often manifested in the unexpected nature and scale of adverse impacts on losing interests—as the reform process evolves. I believe that the merits of incrementalism equally hold whether the policy reform in question involves “more state” or “more market.” Although Friedrich Hayek classically emphasized the virtues of markets in economizing on the need for information relative to centralized, collective decision-making,⁶ radical moves to privatize and marketize goods or services previously provided by, or regulated by, the state may equally have unintended consequences. These are exemplified in recent experiences with the sweeping privatization of state-owned enterprises in the former Soviet Union (“shock therapy”), World Bank/IMF

⁵ See Charles Lindblom, *The Science of “Muddling” Through*, 19 PUB. ADMIN. REV. 79 (1959); Charles Lindblom, *Still Muddling, Not Yet Through*, 39 PUB. ADMIN. REV. 517 (1979).

⁶ FRIEDRICH HAYEK, *THE ROAD TO SERFDOM* (1994).

structural adjustment programs in developing countries, in Western countries with the deregulation of aspects of financial services markets, radical austerity programs, the deregulation of some electricity markets, privately provided correctional services, and the deployment of private security forces in foreign wars,⁷ just as with radical moves to “more state” as with Mao Zedong’s catastrophic “Great Leap Forward” or Stalin’s collectivization of agriculture. As James C. Scott has eloquently argued,⁸ centralized collective decision-makers (whether in my view proposing “more state” or “more market”) often lack the detailed local knowledge of complex human, social, and economic interactions that is necessary to anticipate all the consequences of their decisions. Most of us are averse to the risk of major disruptions in our lives, whatever the source.

A closely related political virtue to that of incrementalism is compromise. As political philosophers Amy Gutmann and Dennis Thompson persuasively argue in a recent book, in pluralistic representative democracies (especially those with many checks and balances and potential veto points), compromises of principles and interests among different constituencies within and across political parties will often be necessary to advance generally socially beneficial policy changes: a wide range of constituencies may agree that various aspects of the status quo are unsatisfactory, and that a compromise is an improvement overall on the status quo, even if from a single normative perspective the compromise is contradictory or even incoherent (recalling Bismarck’s famous analogy between law-making and sausage-making).⁹ In other words, shades of gray are often to be celebrated as partial progress, not denigrated as

⁷ See, e.g., JODY FREEMAN & MARTHA MINOW, *GOVERNMENT BY CONTRACT: OUTSOURCING AND AMERICAN DEMOCRACY* (2009).

⁸ JAMES C. SCOTT, *SEEING LIKE A STATE: HOW CERTAIN SCHEMES TO IMPROVE THE HUMAN CONDITION HAVE FAILED* (1998); see also Lindblom, *supra* note 5 (both articles).

⁹ AMY GUTMANN & DENNIS THOMPSON, *THE SPIRIT OF COMPROMISE: WHY GOVERNING DEMANDS IT AND CAMPAIGNING UNDERMINES IT* (2012).

unprincipled compromises measured against an unattainable state of perfectionism (an example of the Nirvana fallacy). As they state in the conclusion to their book: If politics is the art of the possible, compromise is the artistry of democracy. Democracy calls on politicians to resist compromise and to accept it. They may resist it more when they campaign, but they need to accept it more when they govern . . . The compromising mindset focuses on the critical question for governing: is the proposed law better than the status quo? In a democracy, the spirit of the laws depends on the spirit of compromise.¹⁰ Or as political philosopher Michael Walzer puts the same point:¹¹

I don't think I could govern innocently; nor do most of us believe that those who govern us are innocent . . . But this does not mean that it isn't possible to do the right thing while governing. It means that a particular act of government (in a political party or in the state) may be exactly the right thing to do in utilitarian terms and yet leave the man who does it guilty of a moral wrong. The innocent man, afterwards, is no longer innocent. If on the other hand he remains innocent, he not only fails to do the right thing (in utilitarian terms): he may also fail to measure up to the duties of his office (which imposes on him a considerable responsibility for consequences and outcomes).

III. LESSONS FROM EXPERIENCE

I believe that the seven brief case studies and other examples that I have discussed in this book reveal the importance of incrementalism, compromise, and transition cost mitigation strategies in widely disparate contemporary public policy contexts in forging and sustaining minimum winning political coalitions (and a reasonably broad social consensus) supporting generally socially beneficial policy reforms. But is it possible to draw out some general lessons about the politically optimal configuration of transition cost mitigation strategies across various policy contexts?

¹⁰ *Id.* at 204.

¹¹ Michael Walzer, *Political Action: The Problem of Dirty Hands*, 2 PHILOSOPHY & PUB. AFFAIRS 160, 161 (1973).

As I have emphasized throughout this book, transition cost mitigation strategies include not only explicit compensation of losers from policy change (which account for a tiny proportion of all such strategies), but also the much more common strategies of grandfathering, postponed implementation, and phased or graduated implementation. It is to choices among this broader portfolio of transition cost mitigation strategies that I address some brief concluding thoughts.

As I noted in Chapter 2, “ganging-up on,” or singling out isolated individuals to bear all or most of the costs of generally socially beneficial reforms (the classic eminent domain case, where, e.g., a citizen’s home is expropriated for a public school), when this will typically entail complete loss of the enjoyment of the asset in question, will strike many citizens as grossly unfair and engage widespread sympathies (on the reasoning that “there, but for the grace of God, go I”). In the typical expropriation case, there is no adaptive strategy reasonably available to the property owner short of full compensation for the loss of the asset in question, so that he or she is put in a position of being able to acquire a reasonably close substitute elsewhere. Hence, the prevalence of constitutional and statutory expropriation protections in most developed legal systems.

Other cases bear a close resemblance to the classic eminent domain case. For example, revised setback laws requiring buildings to be setback a greater distance from property lines or street allowances may require many existing structures to be demolished. Here policymakers are likely to face a choice between explicit compensation, or grandfathering of existing non-conforming uses if the social benefits of requiring adaptation of existing structures are unlikely to exceed the costs of adaptation.¹²

¹² See Steven Shavell, *On Optimal Legal Change, Past Behavior and Grandfathering*, 37 J. LEGAL STUDIES 37 (2008).

Canada's dairy supply management regime may be another case in point where the existing regime has deliberately induced individual dairy farmers to invest in acquiring dairy quotas worth on average \$2 million per farmer in current market value. To simply cancel this scheme overnight is likely to strike many citizens (beyond dairy farmers) as akin to an expropriation of a major part of dairy farmers' wealth. Hence, a gradual phase-out reflected in commitments in trade treaties to substantially reduce tariffs over time complemented by partial compensation (e.g., for diminution in the book or acquisition value—not market value—of quotas).

The abolition of slavery also entailed large one-time capital losses for slave owners that in the United Kingdom and its colonies attracted substantial compensation, whereas the issue was resolved in the United States by civil war (followed by de jure or de facto segregation in many parts of the country to the present day). Although it would clearly be tendentious to claim that compensation was a viable alternative in the US context (where it was periodically proposed in national and state legislatures and formally endorsed by President Lincoln in 1862), it never attracted broad-based support from either pro-slavery or antislavery constituencies,¹³ underscoring the fact that the political economy of policy transitions is not easily generalizable across polities with very different institutional structures and histories.

Termination of mortgage interest tax deductability in the United States (like termination of dairy quotas in Canada) also entails undermining investments (partially impounded in house prices) deliberately induced by public policies. Although likely to have a much less draconian impact on average homeowners' wealth (and more impact on wealthy homeowners in higher marginal tax brackets, for whom this provision entails a largely regressive wealth transfer), a

¹³ See Betty Fladeland, *Compensated Emancipation: A Rejected Alternative*, 42 J.S. HISTORY 169 (1976).

gradual phase-out perhaps accompanied with more finely targeted time-limited assistance to first-time homebuyers with below-average household incomes (to signify continuing public support for the “American Dream”) may be a politically feasible reform strategy. Phased implementation of policy reforms also seems appropriate in the case of negotiated trade liberalization commitments and implementation of more liberal immigration policies in order to avoid sudden and highly disruptive impacts on job markets to which many workers may have limited capacity to adapt (e.g., by relocation, job training, etc.), at least in the short term. Public pension reform, designed to ensure long-term fiscal sustainability, given increased life expectancies and lower fertility rates, exhibits many of the same characteristics. Reducing benefits to current or imminent retirees who have very limited ability to adapt to diminished benefits will seem to many citizens (not only retirees) as renegeing on the social contract, while burdening younger workers with the entire burden of sustainability through higher contributions will seem to many citizens (not only younger workers) to be grossly inequitable. Hence, the principal feasible policy reform option is to raise the minimum retirement age in gentle stages to avoid sudden and disruptive impacts on workers nearing retirement age with limited adaptation options.

In other policy contexts, postponed implementation may be the optimal strategy for mitigating transition costs. For example, proposals to increase energy efficiency or emission standards for automobiles or industrial or electricity plants might be implemented on a future committed date if the technological adaptations required of producers (and their cost) are reasonably well-known in advance, while at the same time providing consumers with a limited lead time to adapt their consumption patterns. In contrast, in the case of climate change policy, major—even radical—technological breakthroughs (presently, at best, only sketchily

understood) are required in order to render major CO₂ emission reductions both technologically feasible and economically bearable. Thus, a lengthy graduated phase-in period for increasingly stringent carbon taxes or cap-and-trade regimes to incentivize long-term technological innovation may be the most politically feasible option, given the unknown scale of the costs entailed, provided that equivalent burdens are placed on imports (i.e., taxing carbon consumption, whatever its source), with duty remissions for countries adopting similar policies (with a view to motivating the evolution of a harmonized global carbon tax).

In the case of major institutional reforms—in effect, changing the rules of the political game—in developing countries (or elsewhere), path dependency, reflecting the contingencies of history (exemplified in recent reform experiences in countries such as Iraq, Afghanistan, Egypt, Libya, and elsewhere), cautions against abrupt or radical departures from the institutional status quo (however socially dysfunctional), and argues instead (in most cases) for a strategy of incrementalism in the institutional reform agenda, which is likely to be shaped by highly context-specific circumstances that external reformers are often ill-equipped to appreciate.

The disparate nature of the transition cost challenges that arise in a vast range of widely divergent policy reform contexts, of course, precludes strong generalizations, but the case studies and other examples discussed in this book hopefully offer useful analogies (or disanalogies) in many such contexts, even where not discussed explicitly herein.

IV. CONCLUSION

Returning to my review of prominent normative perspectives on transition issues in Chapter 2, Kaplow's strong presumption against compensation or other transition-cost mitigation strategies for adverse impacts of policy changes, on the grounds that these are just another probabilistic risk like any other that will influence risk reduction behavior *ex ante*, is largely

unhelpful in the real world of policymaking, and may often be a prescription for either political suicide or political paralysis by failing to take the opposition of losers and their sympathizers seriously as a matter of political economy. Although it is useful to be reminded that all transition-cost mitigation strategies entail some social costs, and that some strategies entail more costs than others (most prominently in the form of moral hazard and consequential over-investment in the pre-reform activity in question), and of the need to be sensitive to concerns raised by the theory of second-best,¹⁴ where removing one economic distortion while leaving other related distortions unaddressed may actually reduce social welfare, these concerns can hardly justify foreswearing such policies altogether if politically strategic adoption of them is a *sine qua non* for advancing generally socially beneficial policy changes.

Conversely, Epstein's opposing view that all policy changes that significantly impair the value of private property rights presumptively warrant compensation, however foreseeable, risks taking certain classes of losers too seriously by vesting in them (and the courts) something close to a veto power over policy changes, unjustifiably privileging the status quo and paralyzing the political process. A major irony of these two sharply antithetical views of the case for mitigating transition costs from policy changes is that they yield a common policy implication: policy reforms will be difficult to effectuate on both views, either because losers are not taken seriously enough, or because certain classes of losers are taken too seriously. On both views, policy stasis becomes the default option.¹⁵

One hopes that in his dying days William Wilberforce was able to take great pride and solace in the accomplishments wrought by himself and his fellow abolitionists, not because they

¹⁴ Richard Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUDIES 11 (1953). In the context of this book, liberalizing immigration policies while maintaining protectionist trade policies may lead to too much immigration and too little trade from a social welfare perspective.

¹⁵ See more generally on arguments commonly invoked for policy stasis, ALBERT O. HIRSCHMAN, *THE RHETORIC OF REACTION: PERVERSITY, FUTILITY, JEOPARDY* (1991).

achieved nirvana overnight, but because they marked important progress, despite the political compromises involved, in achieving full human equality (racial, religious, and sexual)—a quest that may never end.