

How to Make Unpopular Policies Popular After Adoption

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May 8, 2003

Abstract

In designing a policy, consideration should be given not only to the factors which affect political support for adopting the policy, but also factors which affect political support after the policy is adopted. This can be particularly important when success of the policy requires firms or consumers to make costly investments, which they will be more willing to undertake if they are confident that the policy will be continued. This paper accordingly discusses conditions which increase political support for a policy after it is adopted. One conclusion is that it can be harder to adopt reform in the first place than it is to maintain the reform. A second conclusion is that policies which require firms or consumers to make investments can make adoption of the policy less likely, but can increase the likelihood that a policy once adopted is sustained.

1 Introduction

Much attention has been addressed to why, or under what conditions, government adopts a particular policy. This paper addresses a related, but different question: under what conditions will government reverse or instead maintain a policy. Examples of both types abound.

Examples of reversed policies Sometimes government explicitly reverses policy. Thus, the U.S. Congress passed catastrophic health insurance in one year, and abolished it the next year. In Britain, successive Labor and Conservative governments nationalized and privatized industries. In the late 1940s, the British Labor government nationalized production of coal, transportation,

*I am grateful to Stef Proost and to Esko Niskanen for their comments.

electricity, gas, iron, and steel. A later Conservative government privatized road haulage and denationalized iron and steel, and still later some Labor governments undid these changes and nationalized the aircraft and shipbuilding industries. The Conservative Thatcher government then reversed Labor policy, privatizing firms such as the British Gas Corporation, British Airways, British Steel, the British Transport Docks Board, and the National Freight Company.¹

Examples of rising support for adopted policies We also observe that support for a policy dramatically increases after it is adopted. Examples include the imposition of cordon in Oslo and congestion tolls in London. Another interesting example is the Japanese constitution imposed by the United States occupation forces in 1947, which in Article 9 included the renunciation of war. After the end of the Occupation, Japan did not revise the constitution.²

The major themes This paper will examine conditions which make a policy more popular after it is adopted,³ looking at two mechanisms. The first is that after the policy is adopted, consumers or firms spend on investments which make the policy more attractive to them.

The second mechanism concerns revelation of information. The adoption of the policy provides information about the preferences or characteristics of politicians or other political actors, which changes the political pressures favoring or opposing the policy.

2 Investments

2.1 Investments which induce political support for policy

Investment decisions can increase the political support for a policy after it is adopted.⁴ Consumers and firms may respond to new pricing policies by undertaking actions to benefit from the policy or to reduce the costs the policy imposes: firms may construct office buildings in less congested areas, consumers may move to apartments located closer to their jobs, manufacturers may add to the

¹Patashnik (2003) gives a detailed analysis of how the Tax Reform Act of 1986 and the Federal Agriculture Improvement and Reform Act (FAIR) were effectively reversed. He discusses feedback effects related to those I discuss, and institutional reforms which I do not. Neither shall I discuss here instabilities that can arise when parties compete for office by proposing policies along two or more dimensions.

²For an insightful analysis of another durable policy—airline deregulation in the United States—see Patashnik (2003).

³Corder (2003) provides data on program termination which is broadly consistent with the idea that support for a program increases the longer it has been in existence. He examines all federal credit programs from 1975-2001. Overall, the data indicate that programs face increasing hazards of failure in the first few years of the program and lower risks of failure over the long-run. Half of the observed terminations occurred when programs were in existence less than ten years, another twenty five percent between ten and twenty years, and remaining quarter over twenty years.

⁴See Coate and Morris (1999).

capacity to build buses or trains, and so on. These actions can in turn increase support for the policy in the future. Relatedly, Brainard and Verdier (1994) explore this mechanism as an explanation for the persistence of protection to declining industries. They argue that if protection is granted in the current period, less adjustment will be undertaken, increasing the demand for protection in future periods. Accordingly, future protection can be expected to increase with current protection.

2.2 Multiple equilibria

When behavior by consumers or travelers generates network externalities, or when economies of agglomeration exist, multiple equilibria can appear. That can make economic agents prefer continuation of whatever policy is in place. Suppose, for example, that a person is more willing to switch from commuting by car to commuting by bus the more frequent is bus service. Suppose further that each traveler bears some fixed cost in making such a change. And suppose, quite naturally, that the frequency of bus service increases with total demand for bus service. Then if consumers expect that many persons will switch from cars to buses, each consumer will expect good bus service, and will be willing to incur the fixed cost of switching. But if each consumer believes that few other consumers will switch, each consumer will not find it worthwhile to switch to buses. Or suppose that economies of agglomeration make productivity higher if about half of all workers are at work at the same time. One equilibrium may have most persons commute during one peak period, creating bad congestion. Another equilibrium could have about half commute in each of two peak periods, generating far less congestion. But to attain this better equilibrium by use of a congestion toll, workers must have consistent beliefs, or must be able to coordinate, on the times at which they will work outside the initial peak period. In short, consumers' expectations can be critical in determining how consumers will react to a congestion toll—in some equilibria the toll will induce much change and will generate political pressures for its continuation; in other equilibria the toll may be ineffective.

2.3 Credibility of policies

The existence of multiple equilibria relates to the credibility of policy, which in turn affects private investments. If a policy is adopted, then consumers may rationally believe that support for it is greater than they had initially thought. If they think that the policy is likely to be continued they may make investments which in turn make the policy more attractive, and thus more likely to be continued. If they expect the policy to be changed, they will be unwilling to make investments which would make the policy effective (for a general discussion of credibility of policy, see Glazer and Rothenberg (2001)). Under some conditions, consumers' beliefs about future government policy may be unpredictable, or may vary with their beliefs about future economic conditions. Nevertheless, some policies will be more credible than others. In particular, a policy will be

credible if, when people expect it to be adopted and make choices accordingly, a government indeed benefits by adopting the policy.

The essential idea that policy may not be credible appears in works on trade protection (see Staiger and Tabellini (1987), Matsuyama (1990), and Tornell (1991)). The discussion of commitment in public policy relates to work by Strotz (1955-56), Kydland and Prescott (1977), Barro and Gordon (1983), and Persson (1988). They show that current decisions of economic agents depend, in part, on their expectations of future policy. Phelps and Pollak (1968) apply the principle to determine optimal savings decisions. Alesina and Tabellini (1988) and Tabellini and Alesina (1990) extend these insights by showing that voters may favor budget deficits which constrain future public policy. Glazer (1989) applies these principles to demonstrate that collective choices will show a bias towards durable projects.

Related studies examine how expectations of a change in policy may change behavior in a way that increases political support for the policy under consideration. Cassing and Hillman (1986) show that a declining industry may suddenly collapse when its small size reduces political support for protective tariffs. Obstfeld (1986) shows that a balance-of-payments crisis can be self-fulfilling if agents expect a speculative attack to set off an inflationary domestic-credit policy. Rodrik (1991) claims that trade liberalization will succeed if it induces the growth of firms that support such liberalization.

Consider congestion tolls. Most analyses of how tolls can solve congestion problems are static, ignoring the consequences of government's incentives to change a toll (see Walters (1961), Weitzman (1974), Small (1992, pp. 107-125), National Research Council (1994), and Verhoef (1996)). Static analysis is appropriate if the demand for travel or the costs of travel (exclusive of tolls) cannot change over time. But dynamics will matter greatly if consumers can make a costly investment in some period that changes the opportunity cost of using the congested road in later periods.

Suppose commuters can choose between using two modes of travel (say a road and mass transit), and who can choose to incur a fixed cost which reduces the future costs of using mass transit. This cost can consist, as previously stated, of the cost of moving closer to downtown or the cost of building apartments near mass transit stations. A congestion toll on the road may serve two purposes. First, it can induce users in the current period to use transit instead of the congested road. Second, users who anticipate the imposition of tolls may be induced to incur the aforementioned fixed cost, thereby reducing demand for use of the congested road in future periods. Glazer (2000) shows that the first-best policy can be time consistent: consumers anticipate a congestion toll, invest with that expectation, and government finds it optimal to impose the toll given these investments. But, alas, other solutions, including a zero toll, can also be time consistent. For if consumers expect no toll, they will not invest, making a switch from cars to buses expensive. Given these high costs, social welfare would decline if government did impose a congestion toll. So a welfare-maximizing government faced with consumers who expected no toll would find it optimal to impose no toll.

This reasoning suggests that once a toll is imposed, people may think that imposition of a toll is more likely in the future than they had previously believed, they will invest accordingly, social optimality will require imposition of a toll, and therefore the toll is imposed in subsequent periods.

Political institutions can also affect expectations. We suspect that popularly elected officials with short terms of office will find it difficult to impose a toll which would hurt consumers. In contrast politicians who are secure in office may be willing to impose an unpopular toll, stick with it, change expectations of consumers, induce investment, and eventually reap the rewards of increased welfare. Government's financing decisions can also affect expectations. Government, for example, may sell bonds with a clause that repayment is financed by road tolls, thereby inducing bond holders to pressure government to impose the tolls.

2.4 Loss aversion

Though we usually suppose that utility depends on levels of consumption rather than on changes in consumption, some evidence, primarily described by psychologists, suggests that people care about *changes* in consumption or in wealth, and that they care more about losses than about gains (see Kahneman and Tversky (1979)). Empirical estimates of such loss aversion find that losses are weighted about twice as strongly as gains (see Tversky and Kahneman (1992), and Kahneman, Knetsch, and Thaler (1990)): the disutility of losing \$100 is roughly twice the utility of gaining \$100.

Such loss aversion can create a status-quo bias, making it difficult both to introduce a policy and to reverse a policy after it is adopted. For our purposes, note that a change in policy will change the wealth or change the incomes of different people. Consider a congestion toll imposed at the entrance to a city. This will increase property values inside the cordon, and reduce property values outside the cordon. Now, if all that mattered was the number of gainers and losers from the toll, then the adoption of the policy would not change the political forces favoring and opposing the toll.

But suppose that the intensity of feeling also matters. Suppose that the toll would benefit a minority of property owners, and hurt a majority (Glazer and van Dender (2002) show how a congestion toll can reduce aggregate property values, and can reduce them even by more than the revenue that is raised by the toll). When wealth gains matter less to an individual than do losses of wealth, the political pressures may oppose the toll. But now suppose that the toll is imposed. Removing the toll would increase the wealth of a majority and reduce the wealth of a minority. If wealth losses matter more than wealth gains, the political pressures may, in the aggregate, favor continuing the toll. That is, we again find a status quo bias.

3 Information

A second class of reasons for why a policy is more likely to be continued than to be initially adopted is informational. These effects mean that the hardest part of policy reform may be the one-time problem of introducing the problem, rather than the continuing problem of generating continual support. The effects described below may also suggest what information, or what ignorance, may be likely to generate support for a policy. The results show that improved information can have counter-intuitive results. Support for a policy can be greater when no one knows the identities of the beneficiaries than when the identity of most is becomes common knowledge. And officials may be less willing to continue a policy the better informed is the public about the competence of officials.

3.1 Updating prior beliefs about political pressures

People who observe that the policy was adopted have new information—the policy was adopted. This should affect their beliefs about the politics surrounding the policy; for example, they may believe that the special interest which favored the policy is more effective than they had initially thought. Given these updated beliefs about the power of the special interest, people may rationally believe that the policy will likely be maintained though initially they thought it was unlikely to be adopted.

I illustrate this effect with a simple model of political pressure. Suppose two special interests compete. One special interest group favors the policy, the other opposes it. The Appendix shows that under some plausible conditions the amount of lobbying by each special interest will not be affected by its belief about how effective its lobbying is, or will be the same after the reform is introduced as before. But adoption of the reform makes people believe that the lobby which favored the reform is more effective than they had previously thought. This in turn means that people believe that political pressures in the future are more likely than before to favor the policy. This change in beliefs can reinforce the investment effects discussed above: if people expect the policy will be continued, they will make investments which are profitable only if the policy is continued, which in turn increases the political support for the policy. This illustrates one theme, that having a reform adopted may be more difficult than generating support for a policy once it has been adopted. This appears to follow the pattern of public opinion in London about congestion tolls.

3.2 Resolving uncertainty about the identity of winners and losers

When some people are unsure about who will benefit and who will lose from a policy, a majority of voters may oppose adoption of the policy, but were it adopted, a majority may favor its continuation. I illustrate with an example, based on Fernandez and Rodrik (1991). Suppose a country has 100 voters. A

proposed reform would benefit each of 51 voters by \$10, and would hurt each of the remaining 49 voters by \$5. Aggregate benefits of the reform are therefore $(51)(10) - (49)(5) = 265$. So the project should be adopted. Suppose further that some voters are uncertain about the identity of who will win and who will lose from the reform. Let 49 voters know for certain that they will be among the 51 who gain. Let all voters know that these 49 people will gain. Each of the remaining 51 voters thinks that he is as equally likely as any of the other 51 voters to be a winner. Since only 2 of these 51 voters can be winners, the expected benefit to an uninformed voter is $(2/51)(10) - (49/51)(5) = -4.41$. Therefore, these 51 uninformed voters, a majority, vote against the reform. Note that they vote against the reform though aggregate benefits are positive. But if the policy were adopted, 51 of the 100 voters would benefit, and each of these 51 people would know that he benefited. Therefore a majority would favor continuing the policy. In short, a majority votes against the reform though it will benefit a majority of voters, and though once adopted, a majority will favor continuing it. The example also illustrates the more general result that more voters may oppose a reform when the identities of many of the winners are known than when their identities are not.

3.3 Reputation

I so far considered the behavior of firms, of consumers, and of special interest groups, but not that of public officials. The concern of public officials with their reputation can exacerbate the status quo bias discussed above. Suppose voters have incomplete knowledge about the effects of implemented policies. But voters do see if a policymaker reverses his previous position. Such reversal can signal to voters that the policymaker had previously erred. More specifically, define the policymaker's competence as the probability that he designs an effective policy. Since a policy failure is more likely to occur under an incompetent policy maker than under a competent policy maker, policy reversal signals low competence (see Dur (2001)).

More explicitly, suppose that an official can be either Smart or Stupid. An official serves for two periods. In each period he estimates the state of nature. If the state of nature is more likely A , then the optimal action is α . If the state of nature is more likely B , then the optimal action is β . A Smart official is more likely to correctly observe the state of nature than is a Stupid official. Let an official correctly observe the state of nature with probability $\pi_1 < 1$ in period 1 and with probability $\pi_2 < 1$ in period 2. The values of π_1 and of π_2 are larger for a Smart official than for a Stupid one.

Suppose the official attempts to take the optimal action in each period. If the state of nature is A , with probability $\pi_1\pi_2$ he will take action α in both periods. And if the state of nature is A with probability $(1 - \pi_1)(1 - \pi_2)$ he will take action β in both periods. The probability that he will take the same action in both periods when the state of nature is A is thus $\pi_1\pi_2 + (1 - \pi_1)(1 - \pi_2)$. The same expression holds when the state of nature is B . For $\pi_1 > 1/2$ and $\pi_2 > 1/2$, the value of $\pi_1\pi_2 + (1 - \pi_1)(1 - \pi_2)$ increases with π_1 and with π_2 .

Thus, the probability that an official who acts sincerely takes the same action over the two periods increases with π_1 and with π_2 . That means that it cannot be an equilibrium for an official who cares about his reputation to adopt the policy in period 2 that he thinks best matches the state of nature in that period; he instead has an incentive to adopt the same policy in period 2 as in period 1.

This generates a general status quo bias—an official who had opposed transportation pricing has a continuing incentive to oppose it. But if the official did impose new taxes or fees on transportation, then he has an incentive to continue those taxes. Moreover, these biases can arise even when one official replaces another, as long as the preceding official was viewed as more likely competent than not.

4 Conclusion

The ideas explored above yield implications about conditions which will make policy reversal unlikely. First, for reasons of reputation or of information revelation, the longer a policy has been in effect, the more likely it will continue to be in effect.

Second, the models suggest a tradeoff between the cost of a policy and its permanence. Opposition to a policy will likely be lower the less costly the policy. But a policy requiring or inducing investment would make reversal of the policy impose large capital losses on economic agents who had made the investments; these people will therefore oppose reversal of the policy. Indeed, as Patashnik (2003) and Shaviro (2000) suggest, measures such as compensation schemes and side payments intended to reduce political opposition to a policy may undermine the credibility of the policy by making special interests skeptical that the policy will continue.

Third, the allocation of responsibility across different levels of government can affect the confidence of consumers or of firms that a policy will be continued. In particular, though joint responsibility of a central and local government, or by different groups within a government, makes adoption of a policy more difficult, it also makes reversal of policy more difficult. (Indeed, detailed studies by Weaver and Rockman (1993) find that parliamentary systems with party governments (rather than with coalition governments consisting of multiple parties) exhibit more policy instability. Lewis (2002) finds that when the U.S. Congress and the president share the same party, the probability that an agency will be terminated is about double what it is under divided government). Policies approved at both the local and central level may be especially effective as they demonstrate a broader political consensus than those produced by a unified regime. Economic actors should form appropriate expectations and be more willing to behave in ways (e.g. investment) that make policy succeed and that also induce added support for the policy. By contrast, economic actors may hesitate in responding to policies passed by unified governments because they may expect large future swings in policy.

Fourth, attention to the credibility of policy also leads to a different view of

whether policies are better enacted at the local or at the national levels. For statistical reasons, local support for policies may, on average, be more stable over time than support for corresponding national policies. For instance, the longevity of a policy may be questionable if it is initiated at the national level as a result of a landslide favoring one legislative party. As comparable idiosyncrasies at the local level may work in opposite directions, they may cancel one another and lead to little change over time in the aggregate effects of such policies. Firms operating in many localities may expect the actions of various localities to lead to a stable demand for their services. Put another way, local policies may be more reliable in the aggregate and, given that such expectations may make policies more successful, such reliability allows local governments to succeed with policies that would fail for the national government. To give one application, regulation of pollution or of noise created by trucks may be more effective when set by metropolitan authorities than when implemented at the national or supranational level.

5 Appendix: Lobbying

Label the two special interests Y (for "Yes") and N (for "No"). If the policy is adopted, Y's utility is $1/2$; otherwise Y's utility is $-1/2$. Thus, Y gains utility 1 if the policy is adopted rather than not. Make symmetric assumptions about N: its utility is $-1/2$ if the policy is adopted, and is $1/2$ if the policy is not adopted. Interest group i spends x_i on lobbying. Let the effectiveness of interest group i 's lobbying be captured by the parameter γ_i . The probability that the policy is adopted is $\frac{\gamma_Y x_Y}{\gamma_Y x_Y + \gamma_N x_N}$ and special interest i maximizes $\frac{\gamma_Y x_Y}{\gamma_Y x_Y + \gamma_N x_N} - x_Y$. It turns out that in a Nash equilibrium, at any solution with positive levels of lobbying, each of the two groups chooses the same level of lobbying, equal to $\gamma_Y \gamma_N / (\gamma_Y + \gamma_N)^2$.

For a numerical example, suppose that $\gamma_N = 1$. Let the prior probability be that $\gamma_Y = 0$ with probability $1/2$, and that $\gamma_Y = 2$ with probability $1/2$. The two lobbyists know the value of γ_Y , but the public does not.

If $\gamma_Y = 0$, then $x_Y = 0$ and x_N is an infinitesimally small number. If $\gamma_N = 1$ and $\gamma_Y = 2$, then $x_Y = x_N = 2/9$. Thus, in period 1 the probability that the policy will be adopted is $\frac{1}{2} \cdot 0 + \frac{1}{2} \frac{2(2/9)}{2/9 + 2(2/9)} = 1/3$. But if the policy is adopted, then everyone knows that $\gamma_Y = 2$. The probability that the policy will be continued is then $\frac{2(2/9)}{2/9 + 2(2/9)} = 2/3$. The probability that the policy will be continued is far greater than the probability that it will be adopted in the first place.

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