A Political Market Explanation for Policy Change

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The study of policy adoption and change has its roots in the comparative analysis of policy outputs. Early work emphasized internal characteristics of jurisdictions including socioeconomic conditions, fiscal capacity and party competition and sought to identify the relative explanatory importance of political versus economic explanations for variations in policy outputs (Lineberry and Fowler 1967; Hofferbert 1974). Although the theory and interpretation of this work centered on policy change, the analysis was often limited to incremental spending changes. The work of Berry and Berry in the early 1990s expanded both the theoretical and methodological scope of the study of policy change (1990, 1992). Theoretically it linked policy change to the larger question of diffusion of innovation and advanced an integrated explanation that included external as well as internal determinants.

The last two decades have also seen the rise of new institutional theories in the social sciences. A central focus of this work has been to develop explanations for institutional development and change (Alston 1996; Eggertsson 1990; Ostrom 1990; Knight 1992; North 1990). Nevertheless, this work has had limited influence on the research and writing on policy change in the public administration and policy fields. This is due in part to a sharp distinction that is often made between the constitutional decisions and policy acts. This paper argues that the distinction between institutional and policy choice should be conceptualized as a matter of degree, and not of kind. A theory of political markets is advanced as a general explanation for institutional and policy choice. This approach is illustrated with three examples taken from the study of local growth management and land use regulation.

Institutional vs. Policy Choice

For the most part, the policy research stream described above developed in isolation from the advances made in the positive political economy approach to institutions and institutional change. This is not surprising in that the former focuses on individual policy actions while the later focuses on constitutional choices. Buchanan's (1975) work drew sharp distinctions between constitutional choice and policy choice. Institutional analysis as associated with the work of Buchanan and Tulloch (1962), North (1990) and Williamson (1985) has focused on constitutional arrangements for economic exchange. The concept of transaction cost is central to this type of institutional analysis because transaction costs influence the efficiency of organizational forms and governance structures for producing outcomes. In recent years, the work of several scholars (Dixit 1996; Lubell et al. 2004; Horn 1995) have drawn attention to the potential power of this approach as an explanation of organizational and policy change.

Dixit (1996) argues that the distinction between constitutions and policies is not nearly as clear-cut in practice as the terminology suggests: constitutions are incomplete contracts allowing for ex post manipulations, and long-lasting policy acts often have many of the characteristics of constitutional rules. Thus he envisions a spectrum of policy making, characterized throughout by substantial transaction costs. Policy acts create constituencies and have long term effects and, once established, policies remain in equilibrium changing only very slowly until some event upsets and shifts the equilibrium. Baumgartner and Jones (1993) describe this as punctuated equilibrium. In between these changes, citizens, governments and political interests operate in a relatively unchanging institutional environment. Similarly Ostrom (2005) delineates three levels at which institutions operate. Constitutional rules define who is eligible to participate in policy making and the rules that will be used to undertake policy making. What she describes as collective-choice rules are policy decisions within the constraints of a set of constitutional rules. These policy decisions then affect operational rules (i.e. policy implementation) to generate outcomes directly in the world.

If the distinction between constitutional and policy acts is one of degree, then transaction costs will be relevant to policy choice, as well as institutional choice. Transaction costs provide a useful analytical tool for integrating a variety of economic models of political processes. For Dixit (1996) transaction costs provide an overarching concept as important in understanding politics and policy making as it is in understanding economics. Government institutions operate under a number of constraints. These constraints include difficulties in reaching agreement on policies, problems in implementation, and problems of durability. These constraints create the transaction costs associated with the overall execution of government policy. Institutional analysis is about legislators, bureaucrats, and other relevant actors choosing among available arrangements to minimize such transaction costs (Horn 1995: 24).

Williamson (1985) contends that contractual arrangements need to be interpreted in light of the real-world transaction costs that characterize particular situations. In the private sector Williamson demonstrates that transaction costs associated with limited information (bounded rationality), ex post opportunism, and asset specificity can be reduced through specific types of contractual arrangements or governance structures Certain institutional arrangements reduce uncertainties by replacing high power market incentives with lower power bureaucratic incentives that help secure the contract and reduce the transaction costs (Williamson, 1985). For example, several scholars have extended this logic to examine local government constitutional provisions (Maser 1998; Feiock 2002; Johnson 2004; Feiock and Yang 2005).

Theories of Institutional Change

Our political market theory of policy choice starts from a property right approach. Property rights theories argue that institutions emerge in response to scarcity and changes in relative prices (Libecap 1989; Alchian and Demsetz 1973; North 1990). The property rights literature provides one of the clearest applications of economics to institutional choice. Demand for property rights is generated by the potential efficiency gains of internalizing externalities (Alchian and Demsetz 1973). This line of argument is frequently used for common-pool resources because the lack of property rights leads to over-exploitation and conflict. Eggertsson (1990) calls these early approaches "naïve" because they only consider the economic demand for property rights, and do not address distributional conflict among groups and interests in society or collective action problems of institutional supply.

The political market addresses these issues by conceptualizing institutional change as the result of a dynamic contracting process between the suppliers and demanders of change in a society (Alston 1996; Libecap 1989). Some interests are better at organizing for collective action than others, and therefore better able to articulate policy preferences and participate in political decision-making (Riker 1982; Eggertsson 1990). Even in cases where Pareto-gains are possible, there are multiple policy equilibria, and every equilibrium distributes the costs and benefits of policy change in a different way. Interests generally prefer policies that make them better off and lead to more efficient outcomes, but each interest prefers to capture the lion's share of any efficiency gain. Hence, the relative political powers of the demanders, and the willingness of government authorities to supply favorable policies to various interests, are important parts of the process (Alston 1996). For example Knott and Miller (1987) chronicle how civil service reforms resulted from the ability of powerful economic actors to lock in distributional advantage through "reformed" institutions. Eggertsson (1990) uses the term "interest group theories of property rights" to describe these more sophisticated accounts of institutional change, because they explicitly take into account the efforts of private interests to secure favorable outcomes in the political arena. Interest group demands are driven by the local economic changes described by the property rights perspective, such as land scarcity. In return for political resources, elected officials will alter institutional rules that affect the utility of different social interests.

Political transactions are characterized by elected official's efforts to deliver durable benefits to supporters. Frant (1996) argues that this type of exchange is characterized by high power incentives--the public sector equivalent of market transactions (Williamson 1985). In this case, electoral support is exchanged for the private benefits that result from a policy change.

Opportunities for government officials to gain electoral support through these political exchanges are limited by several types of transaction costs (Horn 1997). First bargaining or opportunity costs result from the time and effort that needs to be expended in order to reach agreement on policy details. Second, commitment problems result from the uncertainty of long-term benefit flows from policy decisions. Threats to durability of policy benefits result from the potential of future leaders to amend or repeal policy legislation, adversely influence policy administration, or reduce resources for enforcement. Third, agency costs result if administrators may not comply with the intentions of the enacting coalition in implementing the policy. Fourth, information costs reflect constituent uncertainty about the private benefits of costs of policy change (Horn 1997).

> Voluntary investment requires that the expected returns have to be higher the greater the risk. Prospective returns may have to be very high to encourage private investors to risk their capital in an enterprise that owes its continued profitability to special privileges extended to it by the government. The greater the uncertainty about the durability of these privileges, the greater the privileges have to be. (Horn 1997: 143)

Both naive and interest group property rights theories treat political institutions as largely transparent to underlying economic or political forces driving change. The political market perspective adds political institutions as crucial mediators of these political and economic forces (Feiock 2002; Lubel et al 2005). The political market extends property rights theories by assigning a central role to structure of local government institutions as the arena in which political contracting occurs (Feiock 2002; Lubell et al 2005, 2007). Political institutions combine with the structure of interest organization and the economics of a particular policy arena to determine the outcome of political contracting. Different types of political institutions will favor different types of interests, either enhancing or reducing the ability of interests to influence institutional (and policy) decisions.

Three Examples from Growth Management Policy

Local growth management provides an excellent laboratory for studying policy/institutional change. Growth management encompasses collective choice and operational rules which define the property rights governing land-use (Ostrom 1999). Hence, land-use policies help determine who gets what, when, why and where—the essence of politics. Moreover, local governments do not simply create a static system of property rights that never changes. Rather, growth management programs and land-use rules represent policy choices made in the context of local political institutions.

Despite the fact that Ostrom and others explicitly include policy choices within the institutional change framework, this perspective has only recently been systematically applied to the study of local policy. The political market encompasses existing urban politics theories of land-use politics. Studies of local economic development focus on the role of private interests in shaping land use and development decision making. Much of this work concludes that land based development interests either dominate the local agenda or are able to build governing coalitions to overcome opposition to development (Molotch 1976; Stone, 1989; Lewis and Neiman 2002).

The political market account is consistent with the popular explanation of local policy as the product of a "growth machine." Groups that are better able to deliver to political resources to local elected officials are more likely to receive their preferred policies. Growth machine politics is ruled by political alliances between local government officials and development interests (Molotch 1976; Logan and Molotch 1987). Development interests have the upper hand in local politics because they receive concentrated benefits for pro-development policies, and are better organized than diffuse public interests. Of course, public entrepreneurs can often organize diffuse public interests to effectively participate in local political decisions, and local governments are certainly capable of pro-environmental policies (Elkins 1995; Goetz 1994; Feiock 2002).

Conceptualizing land-use choices in terms of institutional change allows us to bring insights from institutional theory to bear on the broader topic of policy change. We illustrate the application of institutional change theory to policy change with examples taken from three recent studies of land use and   growth management policy in Florida. We first examine the adoption of impact fees as a mechanism to finance infrastructure for new development. Second we examine choices among specific policy instruments to contain sprawl. Third we examine the provision of environmental public goods that restrict the supply of developable land.

Impact Fees as a Relational Contract

Maser (1998) argues that, like constitutions, city charters operate as relational contracts that delineating how to make decisions and allocate rights that safeguard participants' interests. In long-term relations a relational contract reduces uncertainties by stipulating procedures to cope with unforeseen events. Under established rules and norms, actors build stable and reliable expectations in a relationship of mutual exchange.

Jeong and Feiock (2006) applied the political market approach to investigate adoptions of development county impact fees and their consequence for economic growth. They build on the contractual approach by focusing on the transaction costs of political exchange. This work departs from the standard political economy model of growth management policy in which regulation is assumed to adversely impact economic development by increasing private production costs. Instead impact fees are hypothesized to reduce uncertainty in project approval and development permitting leading to positive development impacts. Transaction costs in land development are high because of risks private actors confront during the legislative and administrative process to approve and permit new development. Delay or rejection of development permits can force developers to incur substantial economic losses (Feiock and Jeong, 2002; Nelson and Moody, 2003).

Maser (1998) describes how local charters safeguard the interests of citizens and various groups from governmental actions that could harm them. The institutions defined in the charter create reliable expectations in a relationship of mutual exchange. Impact fee adoption can function as an implied contract between local governments and development interests (Jeong and Feiock 2006) because implicit in development interests consent to impact fees is an understanding that development groups should bear in part the costs of infrastructures or public facilities that benefits the development. In return, local governments are less likely to delay or disapprove new development and its permits. For example, earmarked funds from the private sharing of infrastructure costs can work to reduce citizen opposition to new development, relieve financial burdens of local governments, and increase probability of development approval and permits.

In other words, impact fees reduce the risk and uncertainty of permitting and approval for development (Nelson and Moody, 2003; Burge and Ihlanfeldt 2005). The costs resulting from delay and disapproval may be considered transaction costs in this ‘contractual’ relationship. Impact fees provide a safeguard to secure property rights, reduce uncertainty, and reduce potential transaction costs for private investment.

Policy Instrument Choice

The public policy and welfare economics literatures direct attention to the policy instruments or tools that governments employ to purse policy goals rather than specific policy choices (Salamon, 2004; Weimer and Vining, 1999; Peters and van Nispen, 1998; Salamon and Elliott, 2001). Salamon (2004) contends that policy tools share a set of essential features and are generally used to accomplish the same goals. In other words, the tools are alternative means of accomplishing similar governmental policy ends.

Research on the tools of government action classifies a variety of instruments available to address policy problems (Linder and Peters, 1989; Salamon, 2001; Weimar and Vining, 1999). While policy typologies sometimes apply different labels to the various strategies, each describes a limited set of generic instruments used to address failures of markets or governments to deliver goods or services. A growing body of literature explores how context can affect the choice of policy instruments, particularly comparisons of market-based policies with public agencies. By framing policy decisions as a choice of a tool or instrument, this framework is quite compatible with a political market explanation for policy change.

An array of policy instruments is available for pursuing growth management goals. At the aggregate level, land use management combines various generic policy instruments and reflects the interests of multiple constituencies. Certain growth management instruments have been characterized as mitigating production costs by reducing the risk and the uncertainty of private investments (see Feiock and Stream, 2001). A political market model explains choices among growth management policy tools by differentiating these policy instruments according to their economic and political characteristics.   Policy tools differ economically in terms of the benefits and costs accrued to the median taxpayer, thus Pareto outcomes would require local actors choose the policy instrument or combination of instruments producing the largest marginal benefit. Policy instrument choice, however, cannot be reduced to an economic criterion. Political and distributive interests are involved so that policy makers choose the policy tool or combination of tools which minimizes their political transaction costs.

Alternative policy instruments are not neutral means of accomplishing the same objectives. Specific choices may help to officials to maximize the accomplishment of their political goals and to deal with contradictory goals among their constituencies. Given their limited time and resources, local officials will prefer to enact a small number of policies political benefits at minimum visible cost. Distributive pork-barrel type policies targeted at influential interest groups in the community are often preferred because they produce large net benefits and avoid large scale redistribution. Community composition, particularly homogeneity in terms of income, education, and race affects uncertainty and commitment costs of instrument choice. The relationship between officials and citizens is typically characterized by uncertainty, commitment problems and asymmetric information with respect to the benefits and costs of the instruments available to solve a given policy problem.

Empirical analysis provides evidence that transaction costs in local politics affect environmental policy instrument choices made by county governments (Taveras 2003; Feiock and Taveras 2003).   Specific policies and programs fall within two instrumental approaches or tools for land use. The first tool is commonly referred to as growth control or first-generation land use policy.   First-generation policies include zoning, restrictions on housing supply, population caps and containment policies such as urban service boundaries. The second-generation policies encompasses development impact fees, comprehensive planning and market approaches such as incentive or density bonus programs (Navarro and Carson, 1991). The adoption of growth controls is particularly sensitive to both economic and political transaction costs.   Consistent with property rights explanations, growth control adoption is linked to growth rates of a community (Neiman and Fernandez, 2000; Bollens, 1990) as well as income and wealth, social status, tax minimization (Ellickson, 1977).

Supply and demand factors in the political market also shape the political transaction costs of growth control.   Officials balance their preferences regarding growth control with the provision of political benefits to constituents (Dawkins and Nelson 2003). Environmental interests have strong preferences for growth control tools (zoning ordinances, building and population caps, and urban service boundaries etc) but are often strongly opposed by builders and development interests in favor of less restrictive policy tools (Bollens, 1990). Adoption of growth controls entails large administrative costs, not only because command-and-control regulation involves monitoring costs, but also due to rent-seeking costs (deadweight loss) generated by the local interests seeking preferential treatment.   Because growth controls are often exclusionary in nature, local officials find it politically beneficial to adopt them to the benefit of local residents and detriment of newcomers.

Many of the same relationships have been confirmed at the municipal level. Kang and Feiock (2006) found supply side and demand side transaction costs influence choices between first-and second-generation policy instruments.   In addition, choices between these two policy instruments are constrained by form of government, system of election, and home rule status as well as state level constraints.

Regulation of Land Use

The provision of local public goods has been a central focus of the urban political economy literature since Tiebout (1956; see also Schneider 1989; Peterson 1981). Zoning decisions and land use rules define property rights over resources by identifying permitted, required, and prohibited behaviors. Land use regulations are not static and can be frequently amended in response to interactions between political actors in the context of local political institutions. Conceptualizing land use decisions as products of decision-making in local political institutions allows us to bring insights from institutional theory to bear on the broader topic of local government policy change.

Lubel et al (2005) advance an understanding of the role of local political institutions on the local provision of conservation policies. In the language of empirical models, the structure of local political institutions is the central independent variable. Local political institutions determine the rules and procedures for making collective choices. These rules and procedures are embodied in the structure of local legislative and executive institutions, both of which exhibit substantial variance across local governments. Setting aside undeveloped land for conservation effectively reduces the supply of land available for development. Following Clingermayer and Feiock (2001), local political institutions are expected to influence the likelihood of land conservation.

Lubel et al (2005) apply the political market approach to explain the circumstances under which Florida counties supply environmental public goods in the form of land use map amendments to county comprehensive plans to increase or decrease land protected by conservation land use designations. They find that the benefits of environmental public goods are related to the extent to which existing growth patterns increase the scarcity of local land and infrastructure resources. This result is consistent with both "need-based" explanations for policy (Steinacker 1998; Lewis and Neiman 2002) and property rights theory. As growth pressures intensify, citizens begin to demand policies that preserve environmental resources. Thus, population pressure and urbanization lead to conservation amendments. Sentiment for growth management often becomes louder when population density strains public infrastructure, thus congestion and long commute times are anticipated to increase demand for restrictions on the supply of developable land.

They also find that the structure of local political institutions can facilitate or impede the influence of specific demands and community interests on land use decisions. Political institutions affect the ability of interests to articulate their demand in the political market, and the willingness of elected officials and bureaucrats to supply preferred policies. County manager government structure encouraged conservation, but as development interests grew they put more restraints on the discretion of county administrators and push them away from pro-environmental policies. As a mediator of competing policy demands in a political market, manager form of government was found to be vulnerable to growth machine pressures because managers to respond to development interests. However, managers were also capable of more sustainable growth policies when they are not influenced by a strong development sector.

Discussion

The projects described here illustrate the usefulness of a political market approach to local policy that builds upon interest group and property rights theories but emphasizes mediating role of political institutions. Across each of the three policy arenas examined here, the interests of groups seeking particular policies and the interests of government officials who supply these programs are central to policy change, but the outcomes reflect the transaction costs of political exchange, not just the interests of the actors. Political institutions shape the dynamics of the political market.

The larger implication of the arguments advanced here is that the study of policy change should not be divorced from the study of constitutional change. Policy theories can be revised to account for institutional settings, with an eye towards identifying how political dynamics are conditional on institutional structures and transaction costs. This approach is evident in some theories of policy adoption and change, but is not made explicit (for examples see Sabatier 1999). There are several advantages to treating policy change as a form of institutional change. First, to the extent that transaction costs similar to those encountered in constitutional choice are present in crafting specific policies, this approach promises to provide a richer understanding of the dynamics of policy change. Second, such an approach would not require a radical break with more conventional explanations and tests of policy change. In fact some of the factors that that shape the transaction costs for demanders and suppliers of policy change constitute the usual suspects in empirical models of policy adoption. Third, such an approach may facilitate more positive approaches to policy analysis that incorporate formal models with empirical data analysis. Fourth by integrating theories of policy change into the new institutional approaches to institutions and institutional change enhances its relevance to the discipline as a whole. Furthermore the methodological and theoretical innovations in the policy change literature may provide new insights to those studying constitutional change.

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