When Do Governments Buy Out the Opponents of Reform?

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Abstract

Most stalled reforms are of a familiar form. The beneficiaries are dispersed, while the vested interests that stand to lose are concentrated, and thus the only ones to mobilize. The result is that policy measures believed to be Pareto improving are blocked. Trade, environmental protection, and tax reform are common examples. One solution is to delegate power away, as when governments make binding commitments through international treaties. Yet as I show, the data suggest that governments are rarely sufficiently insulated from domestic groups to successfully push through liberalization in the face of domestic mobilization. In a drastic alternative, governments can "buy out" whole losing sectors: they can compensate industries and render them "whole" as a means of overcoming their opposition to reform. Governments exercise this option in some cases, but not in others. Variation is present even within-industry: the US have bought out and liberalized agricultural quotas in wheat, corn and rice, but have come short of doing the same for sugar, peanuts, and dairy. So what explains the variation? I argue that the more concentrated a vested interest is, the more bargaining power it has vis-à-vis the government, but the easier it becomes for the government to negotiate a buy-out. Examining when governments offer to buy out the opponents of Pareto-improving reform offers a fresh look at the gap between economic first-best outcomes and politically feasible ones, and draws attention to an under-utilized policy measure that governments can employ to tackle domestic rent-seekers.

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