Inefficient Redistribution*

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First Version: July, 1998

Abstract

There are many well developed theories that explain why governments redistribute income. There are very few theories, however, that can explain why this redistribution often takes an inefficient form. In this paper we develop a theory of why redistribution is made inefficiently. Inefficient redistribution makes staying in or entering a group that is receiving subsidies relatively more attractive than efficient methods of redistribution. The form of redistribution is therefore a tool to sustain political power in situations where; (1) political institutions cannot credibly commit to future policy, and (2) the political influence of a group depends on its size. We argue that the mechanism we propose may account for the choice of inefficient redistributive policies in agriculture, trade and the labor market.

Keywords: Democracy, Redistribution, Efficiency.

JEL Classification: D72, H21, J38.

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*We are grateful to Jeff Frieden for his encouragement and suggestions, to Parnab Bardhan, Miriam Golden, Dani Rodrik, and to seminar participants at Northwestern Political Science Department, particularly Michael Wallerstein.

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1 Introduction

There are many normative and positive theories that explain why governments redistribute. For example, most positive theories of politics typically involve some group redistributing resources and income away from other groups to themselves. Alternatively, redistribution may be undertaken because of normative reasons, for example, because the distribution of income and welfare generated by market outcomes may be judged unfair or undesirable by some ethical criterion. We lack a satisfactory understanding, however, of why the redistribution that we observe so often takes an inefficient form.

A common example of inefficient redistribution is farmers’ receiving price supports or input subsidies, which distort relative prices and discourage the reallocation of productive resources to other sectors. Similarly, despite economists’ conviction that free-trade is typically efficient, domestic industries are often protected via tariffs and quotas. A particularly interesting and relatively neglected example in which the form of redistribution appears to be inefficient is labor market regulation. Firing costs and other restrictive labor practices, such as closed shop arrangements, are widespread in most countries but are thought to be highly inefficient. In all of these cases, it is difficult to argue that the particular form of the policy is correcting a market failure. Rather these policies seem aimed simply at redistributing income. This suggests that a simple transfer of income raising the income of the beneficiaries by as much as the inefficient redistributive policy would constitute an actual Pareto improvement.

In this paper, we present a theory of inefficient redistribution which builds on two basic assumptions. First, the political system cannot commit today to what future policies it will choose, since these will be determined by whoever has political power in the future. Second, at least over some range, political power is increasing in group size. Under these conditions, we show that inefficient redistribution may arise as a way of expanding or maintaining the size of the group in order to guarantee its future political power.

Consider the example of price support for farmers. Imagine that farmers have sufficient political support to induce the government to redistribute income to them, and that

\footnote{See Rodrik (1996) for a detailed discussion of trade policy where he explicitly notes the prevalence of inefficient redistribution as a major puzzle in need of an explanation, writing “saying that trade policy exists because it serves to transfer income to favored groups is a bit like saying Sir Edmund Hillary had to climb Mt. Everest because he wanted to get some fresh air. There was surely an easier way of accomplishing that objective!”}
this can take the form of a simple transfer of money to current farmers or a price subsidy. The latter is relatively inefficient as it potentially avoids the reallocation of resources to sectors where they can be utilized more productively.\(^2\) Our key observation is that the political equilibrium may nonetheless entail price subsidies because the form of redistribution affects farmers’ decisions to remain in farming, and encourages new agents to enter, in a way that lump-sum transfers would not. Everything else equal, farmers would not want to encourage newcomers, as this will create competition for transfers and in the marketplace. Nevertheless, if farmers’ future political power and ability to extract further redistribution depends on their numbers, price subsidies may be preferred. In some sense, our analysis extends Becker’s (1985, p. 338) insight that “a satisfactory analysis of the choice of method must consider whether the influence function itself depends on the methods used.” In particular, to ensure future transfers, it is necessary for farmers to retain their political power, and they achieve this by choosing a relatively inefficient method of redistribution, which discourages other farmers from changing sectors, and encourages new agents to enter farming. The same argument may apply to other instances of inefficient redistribution such as trade policy and labor market regulation, and suggests that these inefficient methods of redistribution may have also been chosen to preserve the constituencies in favor of the redistributive policies.

In addition to providing an explanation for the choice of inefficient methods of redistribution, our analysis leads to a number of interesting comparative static results. First, we find that inefficient redistribution is more likely to arise when the political power of influential groups is contested, for example, when an industry and its voting power are declining. This result is consistent with the notion that declining industries receive the most distortionary transfers (see Baldwin (1985) and Rodrik (1994) for evidence). Second, and most important, when factors of production are less specific to a sector, there may be more inefficient redistribution. Existing theories suggest that specificity of factors should increase lobbying and rent-seeking behavior (e.g. Brainard and Verdier (1994), Alt et al (1996), Coate and Morris (1999)). Although these theories do not explain why redistribution is made inefficiently, they suggest that redistribution, and hence inefficient redistribution, should be more prevalent when factors are more specific. Paradoxically, however, in many of the common examples of inefficient redistribution, there does not appear to be much specificity. For example, consumer goods industries, such as textiles,

\(^2\)Notice, however, that in a dynamic world the expectation of future “lump-sum” transfers also makes farming a more attractive profession and may inefficiently keep resources there. Nevertheless, other types of redistribution keep more resources in farming, and are therefore more inefficient.
often receive more trade protection than other industries (e.g. Rodrik (1994), Ray (1991)). Our model suggests that because less specific factors are more mobile, redistribution needs to be more inefficient to prevent their relocation.

The two building blocks of our analysis are plausible and receive empirical support. First, the fact that the political system today cannot commit to future redistribution policy seems to be an intrinsic feature of democracy. While constitutions place restrictions on some types of policies that can be used, they seldom constrain taxes and subsidies.3

Second, the notion that group size, at least over some range, increases political power is also intuitive and consistent with the body of empirical evidence. Although Olson (1965) has emphasized the free-rider problems affecting the political organization of large groups, his analysis does not imply that small groups have more power. Rather it implies that small groups find it easier to solve the collective action problem. But, if large groups can solve the collective action problem, by creating private goods or other specific incentives to induce potential members to join,4 they may well be more powerful. What we require for our theory to apply is that size should be an asset, at least over some range, for groups that solve the collective action problem. A range of evidence from democratic societies supports this assumption.5 Although some studies find that smaller groups get larger transfers, the majority of empirical work finds size to be an asset (e.g., Becker (1986), Kristov et al. (1995), and Sloof (1998)). The history of some notable interest groups also supports this conclusion. Both the National Rifle Association and the Christian Coalition became powerful national forces subsequent to increasing their membership significantly. In the case of the NRA, Davidson (1993) shows that the period under Harlon Carter, when membership rapidly increased from 1 million in 1977 to 2.6 million in 1983, was

3There are many examples in the literature which illustrate this commitment problem. For instance, Weingast (1998) points out that the Missouri compromise of 1819 was intended as a commitment to protect the slave economy of the South by maintaining the balance of political power in the senate. This was an institutional response to the fact that Northern states could not directly commit not to raise the anti-slavery issue in congress. Marshall and Weingast (1988) discuss how many congressional institutions help to mitigate commitment problems.

4Moe (1980) and Green and Shapiro (1996) discuss various ways in which large groups are able to circumvent free-riding by providing different sorts of incentives. Another interesting idea, due to Arnold (1990) and Wittman (1995), is that political entrepreneurs have an incentive to solve the collective action problem of large groups and there are many examples of this. To mention just one, Bates (1997) shows that the national coffee growers association in Colombia was created in the 1920’s as a result of political entrepreneurship, and this overcame the fact that the coffee growers were mostly smallholders facing considerable collective action problems, giving them significant political power subsequently.

5In contrast, in undemocratic societies, size may be a liability because large groups provide potential tax revenues for the rulers. This may have been why farmers were heavily taxed in Soviet Russia (see for example, ) and some African countries (see Bates, 1981).
precisely when it obtained national influence. He writes “the advertising campaign was just one part of an all out NRA effort to boost membership.” In the words of John Aquilino (NRA director of public information for ten years) “Harlon [Carter] saw that power is in numbers.” Davidson (1993, p. 49).

The consensus view among political scientists and economists also seems to support the view that size is an asset in political conflict. For example, Cameron (1988) writes, “size represents an important resource in the struggle and conflict amongst groups...individuals may have more incentive to form groups if the potential membership is large and thus allows them to anticipate greater power and hence greater collective rewards.” In the farming context scholars have continually stressed this point. For instance, Hansen (1991, p. 7) argues that “the farm lobby [in the US] as a whole...suffered a marked setback in the sixties, seventies and eighties. As people migrated away from farms, the agricultural organizations represented fewer and fewer constituents,..., and the responsiveness of the Agriculture Committee and the Congress declined.” Kindleberger (1951) and Tracy (1989) suggest that the greater numbers of voters in farming groups in France and Germany compared to Britain explains why farmers obtained tariff protection in these countries in the 1880’s, while in Britain they did not. The success of the large Scandinavian unions and the relative failure of the smaller U.S. or British unions is also consistent with the hypothesis that size matters for political power.

Two previous arguments that may account for the prevalence of inefficient redistribution have been suggested in the literature. Rodrik (1986), Wilson (1991), and Becker and Mulligan (1999) argue that if the amount of redistribution is endogenous, then politicians might want to commit to use inefficient methods in order to reduce total redistribution (see also Staiger and Tabellini (1987), Grossman and Helpman (1994), and Dixit, Grossman and Helpman (1997) for models with related results). However, this theory rests on the arbitrary assumption that politicians can commit to the form of redistribution, but not to the level. The frequent changes in the composition of taxes in the U.S. goes against this assumption.

Coate and Morris (1995), partially building on an argument by Tullock (1983), offer the most compelling argument for inefficient redistribution. In their model, politicians who care about a certain group exploit voters’ uncertainty regarding which policies are efficient. While lump-sum redistribution to farmers would reveal that a politician cares about farmers at the expense of other groups, a price subsidy can be disguised as a Pigouvian subsidy aimed at correcting some market failure. There are two potential
problems with Coate and Morris’ interesting explanation, however. First, only inefficient policies which might in some state of the world be efficient can be used otherwise, the voters would see through it (see Austen-Smith (1991)). Second, it must be the case that neither the party in power nor a rival are able to tax farmers after giving the price subsidy and thereby reveal that they are redistributing truly for efficiency reasons, not because they care about farmers.\(^6\)

Other related papers include Dixit and Londregan (1995) who construct a model in which the inability of politicians to commit to future transfers prevents efficient reallocation of agents: farmers who currently receive transfers, e.g. because they are the swing voters, realize that if they switched to manufacturing, they will lose these transfers. Dixit and Londregan therefore explain why redistribution might lead to inefficiencies, but not why the form of redistribution is inefficient. In the same spirit, Alt et al. (1996) argue that when policy is endogenous, agents can take actions (e.g. specific investments) that induce future redistribution, thus preventing exit from a declining industry. Finally, Saint-Paul (1992) notes that insiders may oppose two-tier wage systems which would remove firing costs for newcomers, anticipating that this would reduce future political support for firing costs. He does not, however, pursue this idea to develop an explanation for inefficient redistribution.

The plan of the paper is as follows. We first outline a simple two-period model where inefficient redistribution occurs as a political equilibrium. Section 3 shows that the extent of inefficient redistribution may increase when a sector requires less specific skills and investments. In Section 4, we discuss a range of real world redistributive policies and argue that inefficient methods of redistribution arise, at least in part, because of the reasons emphasized in our model.

\(^6\)Two other potential explanations for why redistribution is made using inefficient means are as follows. First, inefficient methods of redistribution may be harder to reverse; hence in situations where the political system cannot directly commit to future decisions, inefficient methods of redistribution may act as a method of commitment. Second, inefficient methods of redistribution may help certain groups solve the collective action problem. For example, Nugent (1989) shows that Tunisian manufacturers lobbied for quotas instead of tariffs (despite their relative inefficiency) because they could influence the allocation of quotas and thus provide selective incentives to overcome the collective action problem. While the first explanation is related to ours, we find both explanations less relevant than the one we pursue in this paper.
2 The Basic Model

2.1 Fundamentals

Consider the following two-period economy (periods 0 and 1) with a single consumption good produced by one of two sectors, farming and manufacturing. In the first period there are \(1 - \delta\) agents with a fraction \(n_0\) in farming and \(1 - n_0\) in manufacturing. These agents cannot change sector. All agents are risk neutral and discount the second period by a factor \(\beta \in (0, 1)\). In each period, a farmer produces an output of \(B\) and a manufacturer produces output \(A\), with \(A > B\). We assume that farmers cannot be taxed (e.g. they can hide their output costlessly), while manufacturers can be taxed a maximum of \(T\) (e.g. they can hide their output at a cost of \(T\)) where \(T < A\). At the beginning of period 0, \(\delta\) new agents arrive and choose which sector to enter. This decision is irreversible. There are no new agents in period 1. Let \(\tau_0\) and \(\tau_1\) denote the tax on manufacturers in periods 0 and 1 respectively, where \(\tau_t \in [0, T]\), for \(t = 0, 1\). The tax revenue, if any, can be redistributed to farmers in two distinct forms. The first is a transfer to agents who are in farming at the beginning of the period, denoted by \(\theta_t \geq 0\), for \(t = 0, 1\). The second is a general price subsidy which all farmers receive, denoted by \(\mu_t \geq 0\). The difference between \(\mu_0\) and \(\theta_0\) is that only those who were initially farmers at \(t = 0\) receive \(\theta_0\), whereas \(\mu_0\) is also paid out to young agents who enter farming at time \(t = 0\). \(\theta_0\) therefore approximates an efficient transfer as it is conditioned on characteristics outside the agents control. In contrast, \(\mu_0\) subsidizes farm output and encourages new agents to enter farming, and so, is an inefficient method of redistribution (\(\mu_1\) will be redundant since only in period 0 is there a distinction between existing farmers and potential new farmers, so we ignore it in the rest of our analysis).

It is clear that, ignoring political economy considerations, existing farmers prefer \(\theta\)-transfers to \(\mu\)-transfers, because they do not have to share the former with newly arriving farmers. Our key result in this section will be to demonstrate that political economy considerations may nonetheless encourage existing farmers to choose \(\mu\)-transfers.

To discuss these issues in the simplest possible way, we assume a reduced form political process which determines the current tax rate on manufacturers as a function of the

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7 These two sectors can be thought of as producing different goods which are perfect substitutes. The case of imperfect substitutes does not alter our results, but complicates the expressions.

8 In the model output per-farmer is exogenous, so a per-capita subsidy to all farmers, new and old, is the same as a price subsidy. More generally, in a model with variable production there would also be a difference between price subsidies and per-capita subsidies to all farmers.
number of farmers. More explicitly, the tax rates in the two periods are

\[ \tau_0 = \tau(n_0) \in [0, T] \]
\[ \tau_1 = \tau(n_1) \in [0, T]. \]  

The assumption \( \tau \geq 0 \) incorporates the fact that farmers cannot be taxed. Notice that the tax rate in period \( t \) is only a function of the fraction of the population in farming at the time. To simplify the discussion we assume that the function \( \tau \) satisfies the following two conditions.

1. if \( n \leq n^- \) then \( \tau(n) = 0 \)
2. if \( n \geq n^+ \) then \( \tau(n) = T \)

The function that maps from the fraction of farmers into taxes on manufacturers, \( \tau(\cdot) \), could be locally increasing or decreasing, though we have assumed that it takes a higher value at \( n^+ \) than at \( n^- \). This is reasonable since when there are very few farmers, they will not have political power to impose taxes on manufacturers. Finally, we assume that the division of the tax revenue between \( \theta \)- and \( \mu \)-subsidies is decided only by farmers.

The timing of political and economic events is as follows. First, in period 0, the political economy process determines \( \tau_0 \), then the farmers decide \( \theta_0 \) and \( \mu_0 \). Young agents are born, they observe the policy vector, and decide which sector to enter. Then production takes place and the policy is implemented. At the beginning of period 1, the political process determines \( \tau_1 \) and \( \theta_1 \). The model ends following production and implementation of the chosen policy. Defining \( x \) as the fraction of new agents going into farming at time \( t = 0 \), the government budget constraints in the two periods can be written as:

\[ (1 - \delta)(1 - n_0)\tau_0 = (1 - \delta)n_0(\theta_0 + \mu_0) + \delta \mu_0 x \]  
\[ (1 - n_1)\tau_1 = n_1\theta_1. \]  

In equation (2), \( (1 - \delta)(1 - n_0)\tau_0 \) is total tax revenue, \( (\theta_0 + \mu_0) \) is the total per capita transfer to the \( (1 - \delta)n_0 \) existing farmers, and \( \mu_0 \) is the inefficient transfer that the \( \delta x \) newcomers who enter farming receive. In equation (3), \( (1 - n_1)\tau_1 \) is total tax revenue, and is distributed among \( n_1 \) farmers. Note that young agents who go into manufacturing do not get taxed in period 0, and they may also not receive any transfers when they go
into farming (that is, if \( \mu_0 = 0 \)). Although the political process can discriminate between young and old farmers in period 0, this is not possible in period 1.\(^9\)

Let \( V^f \) and \( V^m \) be the expected utilities (at time 0) of old farmers and manufacturers. Let \( W^f \) and \( W^m \) be the expected utilities (at time 0) of new agents who choose farming and manufacturing. Then,

\[
V^f(\theta_0, \mu_0, \theta_1) = B + \theta_0 + \mu_0 + \beta [B + \theta_1],
\]

\[
V^m(\tau_0, \tau_1) = A - \tau_0 + \beta [A - \tau_1],
\]

and

\[
W^m(\tau_1) = (1 + \beta)A - \beta \tau_1,
\]

\[
W^f(\mu_0, \theta_1) = (1 + \beta)B + \mu_0 + \beta \theta_1.
\]

Newcomers make their occupational choices after observing \( \mu_0 \), a variable relevant for their payoffs. Their strategy is therefore conditioned on \( \mu_0 \), and we write the fraction of new agents who go into farming when the subsidy is \( \mu \) as \( x(\mu) \). Then the optimal sectoral choice of new agents in period 0 is:

\[
x(\mu) = 0 \quad \text{if } W^m(\tau_1) > W^f(\mu, \theta_1)
\]

\[
x(\mu) = 1 \quad \text{if } W^m(\tau_1) < W^f(\mu, \theta_1)
\]

\[
x(\mu) \in [0, 1] \quad \text{if } W^m(\tau_1) = W^f(\mu, \theta_1).
\]

\( x(\mu) \) defines the best response function (correspondence) of newcomers for all possible levels of subsidies. Observe in particular that this function determines newcomers’ best-responses not only for the level of subsidy along the equilibrium path, \( \mu_0 \), but for all \( \mu \), and helps us determine optimal behavior off-the-equilibrium path.

The fraction of farmers in the population at time \( t = 1 \) is then

\[
n_1 = (1 - \delta)n_0 + \delta x,
\]

A pure strategy subgame perfect Nash equilibrium is a tuple, \( \{x(\mu), n_1, \tau_0, \theta_0, \mu_0, \tau_1, \theta_1\} \) such that equations (2), (3), (9) hold, \( \tau_0 = \tau(n_0) \), \( \tau_1 = \tau(n_1) \), and the function \( x(\mu) \) is defined by (8), \( \{\theta_0, \mu_0\} \) maximizes \( V^f \).

The fact that \( \tau_1 = \tau(n_1) \) at time 1 builds in the assumption that the political system cannot commit to future redistribution. This is a crucial ingredient in our explanation for

\(^9\)In period 0, the system discriminates between incumbents and the newcomers. In period 1, there are no newcomers, and all farmers are incumbents.
inefficient redistribution because it provides a reason for the farmers to wish to increase their numbers in period 1 to achieve greater political power.

To simplify the discussion, we assume;

**Assumption 1** \((1 + \beta)(A - B) > 2\beta T\),

which implies that the maximum tax rate is small relative to the productivity differential between the two sectors, and ensures that it is not worthwhile to go into farming only to receive future transfers.

Let us start with the case in which \(n_0 \leq n^-\), so that \(\tau_0 = 0\), hence \(\theta_0 = \mu_0 = 0\). In this case, there are too few farmers at date \(t = 0\) for them to have any power, so there is no redistribution. As a result, there exists a unique equilibrium in which all young agents go into manufacturing. Specifically, with \(\tau_0 = 0\), \(\mu_0 = 0\), so Assumption 1 ensures that \(W^f(\mu_0 = 0) \leq (1 + \beta)B + \beta T < (1 + \beta)A - \beta T \leq W^m(\tau_0 = 0)\). Therefore, we have:

**Proposition 1** Suppose Assumption 1 holds and \(n_0 < n^-\), then there exists a unique equilibrium with \(n_1 = (1 - \delta)n_0\), \(\tau_0 = \tau_1 = \theta_0 = \theta_1 = \mu_0 = 0\), and \(x(\mu = 0) = 0\).

Next, consider the case where \(n_0 > \frac{n^+}{1 - \delta}\). Farmers have large enough numbers so that even when \(x = 0\), they retain maximal power. Therefore, they choose \(\tau_0, \tau_1, \theta_0, \theta_1, \text{ and } \mu_0\) to maximize \(V^f\), which gives \(\tau_0 = \tau_1 = T\), \(\mu_0 = 0\), \(\theta_t = \frac{(1 - n_t)T}{n_t}\), for \(t = 0, 1\). To completely characterize an equilibrium, we only have to determine \(x\) and \(n_1\). Notice that in this case

\[
W^f = (1 + \beta)B + \beta \left[\frac{(1 - n_1)T}{n_1}\right], \quad \text{and} \quad W^m = (1 + \beta)A - \beta T,
\]

Assumption 1 implies that \(W^m > W^f\), and \(x(\mu = 0) = 0\) (though in this case, \(x(\mu)\) would be positive for \(\mu\) sufficiently large).

**Proposition 2** Suppose Assumption 1 holds and \(n_0 > \frac{n^+}{1 - \delta}\), then there exists a unique equilibrium such that \(\tau_0 = \tau_1 = T\), \(\mu_0 = 0\), \(\theta_0 = \frac{(1 - n_0)T}{n_0}\), \(x(\mu = 0) = 0\), \(n_1 = (1 - \delta)n_0\) and \(\theta_1 = \frac{(1 - (1 - \delta)n_0)T}{(1 - \delta)n_0}\).

In both Propositions 1 and 2, the equilibrium maximizes output and *the form of redistribution is efficient.* Although there is redistribution, no production or occupational decisions are distorted. The reason for this efficient form of redistribution is that political
power is not contested. When \( n_0 < n^- \), manufacturers have total political power and this can never be transferred to farmers. Similarly, when \( n_0 > \frac{n^+}{1 - \delta} \), farmers have maximal political power and always retain it, even if all newcomers were to go into manufacturing. This highlights the main conclusion of our analysis that inefficient redistribution will arise in order to control political power.

Now consider the most important case for our analysis: \( n^- < n_0 < \frac{n^+}{1 - \delta} \). Farmers have some political power in period 0, and the extent of their political power at date 1 depends on the actions of newcomers. It is straightforward from the analysis in Proposition 2 that if \( \mu_0 = 0 \), newcomers will prefer to go into manufacturing. Therefore, farmers may want to use \( \mu_0 > 0 \), i.e., inefficient redistribution, in order to attract newcomers into farming, and increase their political power.

Substituting from (2) and (3) into (4), the utility of old farmers can be written as

\[
V^f = (1 + \beta)B + \theta_0 + \mu_0 + \beta \phi(n_1)
\]

where

\[
\phi(n_1) \equiv \frac{\tau(n_1)(1 - n_1)}{n_1} = \frac{\tau((1 - \delta)n_0 + \delta x)(1 - (1 - \delta)n_0 - \delta x)}{(1 - \delta)n_0 + \delta x}
\]

is per capita redistribution at \( t = 1 \).

For the farmers to attract newcomers, they need to provide them with at least as much utility in farming as in manufacturing, hence

\[
W^f \geq W^m,
\]

where \( W^m \) and \( W^f \) are given by (6) and (7). Let us now define

\[
U^f(x) = (1 + \beta)B + \beta \phi(n_1) = W^f - \mu_0
\]

as the utility of a new agent entering farming when a fraction \( x \) of newcomers enter farming and there is no inefficient redistribution (i.e., \( \mu_0 = 0 \)). Also define \( U^m(x) = W^m \) as the utility of a new agent entering manufacturing when a fraction \( x \) of newcomers enter farming. Now \( x > 0 \) requires that \( \mu_0 \geq U^m(x) - U^f(x) \) so as to convince newcomers to enter farming. Moreover, existing farmers would never want to pay more than necessary to newcomers, so we first start with the case where\(^{10}\)

\[
\mu_0 = U^m(x) - U^f(x) = (1 + \beta)(A - B) - \beta(\phi(n_1) + \tau(n_1)).
\]

\(^{10}\) If \( \mu_0 \) is greater than \( U^m(x) - U^f(x) \), all newcomers will enter farming. We discuss this case below.
Solving (2) for $\theta_0 + \mu_0$, we can write the return to old farmers when they ensure that a fraction $x$ of new farmers enter farming, $\hat{V}^f(x)$, as

$$
\hat{V}^f(x) = (1 + \beta)B + \beta\phi(n_1) + \frac{(1 - \delta)(1 - n_0)\tau_0 - \delta x [U^m(x) - U^f(x)]}{(1 - \delta)n_0}.
$$

(12)

Let $\nabla^f$ be their utility when $\mu_0 = 0$. Notice that $\hat{V}^f(x = 0) = \nabla^f$ because when $\mu_0 = 0$ and no new born agents are entering farming, $x = 0$, so the fact that $\mu_0 = U^m(x) - U^f(x)$ does not matter. Whether farmers prefer to use inefficient methods of redistribution, and so attract newcomers, depends on

$$
\frac{d\hat{V}^f(x = 0)}{dx} = \delta \left( \beta \phi'((1 - \delta)n_0) - \frac{U^m(x = 0) - U^f(x = 0)}{(1 - \delta)n_0} \right).
$$

(13)

The first term in parenthesis is the benefit of attracting some of the newcomers, while the second term is the cost of doing so per existing farmer. If this expression, (13), is positive, then the utility of old farmers can be increased by attracting some of the young agents into farming. In this case farmers will design the redistribution system to be inefficient specifically to increase their numbers.

This expression also makes it clear that farmers will only want to use inefficient redistribution when increasing their numbers leads to greater per capita transfers, $\phi(n_1)$. This implies that taxes imposed on manufacturers should increase sufficiently in $n_1$ to ensure greater transfers to farmers.

We can now state a key result:

**Proposition 3** If

$$
\phi'((1 - \delta)n_0) > \frac{1}{\beta(1 - \delta)n_0}[U^m(x = 0) - U^f(x = 0)]
$$

(14)

then there will be inefficient redistribution, i.e. $\mu_0 > 0$. In equilibrium,

$$
\mu_0 = U^m(x^*) - U^f(x^*),
$$

and a fraction $x^*$ of newcomers enter farming such that

$$
\beta ((1 - \delta)n_0 + \delta x^*) \phi'((1 - \delta)n_0 + \delta x^*) - \mu_0 - \beta \delta x^* x'((1 - \delta)n_0 + \delta x^*) = 0,
$$

(15)

or $x^* = 1$ if (15)>0 when evaluated at $x^* = 1$.
The first part of this proposition is proved in the text. The second part follows by noting that \((\mu_0, x^*)\) are chosen to maximize (12). Substituting for \(\mu_0 = U^m(x^*) - U^f(x^*)\), 
\[dU^m(x^*)/dx = -\beta \tau'(n_1),\]
and \[dU^f(x^*)/dx = \beta \phi'(n_1),\]
and simplifying, we obtain (15).

This proposition implies that for a range of parameter values, redistribution therefore takes an inefficient form. The underlying reason is that farmers are attempting to maintain political power and they realize that this can be achieved only by attracting new agents into farming in order to remain a large group. Inefficient redistribution achieves this because it rewards potential farmers, not only those who are already locked into farming. Expressed differently, because \(\theta_0\) in our model is a lump-sum transfer, it does not distort the decisions of marginal agents. Precisely for this reason, however, the political process may choose to redistribute via \(\mu_0\) not \(\theta_0\).

That commitment to future redistribution is impossible is important. An intuition based on the Coase Theorem would suggest that this type of inefficient redistribution should not arise as there are gains to (political) trade (see for example Whitman (1989)). This would be true in this economy if all existing agents could jointly commit to \(\tau_1\) and \(\theta_1\) at time \(t = 0\). Such an arrangement is not possible, however, because of the constraints imposed by political economy considerations. Since the political system cannot commit to future redistribution, the only way for the farmers to ensure future transfers is to maintain their political power. They achieve this by remaining a large group, and inefficient redistribution is the instrument they use for this purpose. In Section 4, we discuss a number of examples where the concern of farmers and other groups to maintain political power seems to be a factor in the choice of inefficient methods of redistribution, suggesting that the forces highlighted by our analysis may be important in a variety of circumstances.

When condition (14) is satisfied, there does not exist an equilibrium without inefficient redistribution. To see this, notice that (14) ensures \(dV'(x=0)/dx > 0\), so farmers can always choose a level of price subsidy, \(\mu_0\) to attract some newcomers. Therefore, the situation with \(x = 0\) cannot be an equilibrium. It is interesting that newcomers who enter farming are exerting a negative externality on manufacturers. To see this in a simple way notice that as more newcomers enter farming, aggregate output falls since these agents would have been more productive in manufacturing. Newcomers are indifferent between entering farming and manufacturing. Moreover, farmers benefit from entry by construction—since they are encouraging it—, so the whole cost falls on manufacturers, who pay sufficiently high taxes that are used to subsidize farmers.
In contrast, when (14) does not hold, there could be multiple equilibria. Such multiplicity would arise when there exists a level of \( x \), say \( x' \), such that when a fraction \( x' \) of newcomers enter farming, farmers are better off, even though \( \frac{d\tilde{V}^f(x=0)}{dx} < 0 \), i.e.,

\[
\tilde{V}^f(x') = (1 + \beta)B + \beta\phi((1 - \delta)n_0 + \delta x') + \frac{(1 - \delta)(1 - n_0)\tau_0 - \delta x'[U^m(x') - U^f(x')]}{(1 - \delta)n_0} > \tilde{V}^f(x = 0) = (1 + \beta)B + \beta\phi((1 - \delta)n_0) + \frac{(1 - \delta)(1 - n_0)\tau_0}{(1 - \delta)n_0}
\]  

(16)

The reason for the multiplicity is the nonmonotonicity of per capita transfers to farmers. For example, when transfers are determined by voting, farmers will have enough power when they have a certain fraction, say \( n' \). When newcomers enter but the number of farmers does not reach \( n' \), per capita transfers decrease (that is, \( \tau_1 \) remains constant while per capita transfers, \( \phi(n_1) \), decrease). In contrast, when enough newcomers enter to take the number of farmers above \( n' \), per capita transfers increase. In this case a natural multiplicity of equilibria arises. When newcomers expect others to enter farming so that there will be a sufficient number of farmers, returns to farming are high because of the resulting transfers, and newcomers are willing to enter farming. However, because (14) is not satisfied, there also always exists an equilibrium in which all newcomers expect others not to enter farming, and do not do so themselves for any level of the transfer \( \mu_0 \).

Interestingly, there may also exist equilibria with different levels of inefficient redistribution. If we have

\[
\tilde{V}^f(x = \delta) > \tilde{V}^f(x = 0),
\]

farmers will be better off when all newcomers enter farming rather than no newcomers entering. In this case, the following strategy for newcomers supports an equilibrium; \( x(\mu) = 0 \) for all \( \mu < \mu' \), and \( x(\mu') = \delta \). That is, newcomers enter only when price subsidy is high enough, say at some level \( \mu' \geq U^m(x = \delta) - U^f(x = \delta) \). Their actions are best responses because when others do not enter, each newcomer prefers not to enter.

The fact that future political power depends on the coordinated actions of newcomers is the cause of the multiplicity of equilibria. This multiplicity is of some interest as it highlights that the amount of inefficient redistribution can be quite large, in particular, larger than the amount that farmers would prefer to maximize their per-capita transfers. Since among the multiple equilibria with inefficient redistribution, farmers prefer those with lower \( x \), i.e. those where fewer newcomers enter farming, they may have an incentive to limit entry, for example, by methods such acreage controls. This highlights that existing farmers have non-monotonic preferences over entry; they want a sufficient number of
newcomers to enter farming to increase or maintain their political power, but not too many to share the revenues with.

Next, notice that when $U^m(x) - U^f(x)$ is smaller, condition (14) is more likely to be satisfied, so inefficient redistribution, $\mu_0 > 0$, is more likely to arise. However, conditional on there being inefficient redistribution, a greater $U^m(x) - U^f(x)$ will imply a larger amount of inefficient redistribution, since $\mu_0 = U^m(x) - U^f(x)$. A number of comparative static results follow from this observation. A range of variables that increase $U^m(x) - U^f(x)$ make inefficient redistribution less likely, but increase the amount of inefficient redistribution when there is any. For example, an increase in the amount of redistribution in period $t = 1$, caused by a shift in $\tau(n_1)$, will reduce the gap between $U^m(x)$ and $U^f(x)$, making inefficient redistribution more likely. Similarly, a decrease in $A - B$ will make inefficient redistribution more likely.

A natural, and more important, comparative static is that inefficient redistribution is more likely when $\phi'(n_1)$ is larger, implying that a given increase in the number of farmers will translate into greater per capita transfers. This is intuitive since the point of inefficient redistribution is to attract newcomers in order to increase political power and per capita transfers. This comparative static also implies that in practice we should see inefficient redistribution in situations where political power depends crucially on group size. We discuss some examples in Section 4.

Perhaps, most interestingly, as noted above, redistribution is more likely to be inefficient when the political power of an influential group is contested, i.e. when $n^- < n_0 < \frac{n^+}{1-\delta}$. This is because the purpose of inefficient redistribution is to prevent the influence of the group from declining. Many examples of inefficient redistribution are from declining industries (e.g. Baldwin (1985) and Rodrik (1994)), which is consistent with this implication.

## 3 Specific Factors

In this section, we show how our framework may account for a potentially puzzling pattern in the political economy of redistribution. The existing literature suggests that when skills and investments are more specific to a given sector, agents will have more to lose from relocating and their incentives to lobby for protection will be greater (see for example, Alt et al (1996) and Becker (1985), and the formalizations of Brainard and Verdier (1994))
and Coate and Morris (1999)). It is difficult to see the importance of specific factors, however, in many of the most pronounced cases of trade protection, such as textiles or farming, which are commonly viewed as sectors with limited specific investments by capital and labor. Similarly, many cases of labor market policy involve protection for groups of workers with limited specific skills. We will now show that contrary to conventional wisdom, our model predicts that sectors with less specific factors may create room for more inefficient redistribution.

Consider a modified version of the economy of Section 2 where there are no young agents ($\delta = 0$). But, in period 0 a fraction $\gamma$ of the farmers can switch to manufacturing at some cost $C$. A high level of $C$ corresponds to a situation in which switchers fail to employ their skills effectively in manufacturing, so we think of it as a situation where farming uses highly specific factors. We continue to assume that those who switch produce $A$ in the other sector. To focus on the case where it is still socially efficient to reallocate agents into manufacturing we assume that $(1 + \beta)(A - B) > C$.

The timing of events is as follows. First, taxes are determined as in (1), and at this point a farmer does not know whether he will have the opportunity to switch. Next, farmers find out whether or not they have this opportunity and decide whether to switch (if they switch, they do not pay taxes until period 1). Finally, in period 1, taxes are determined as in (1) (but no switching) and the world ends. The difference between $\theta_0$ and $\mu_0$ now is that farmers who decide to switch in period 0 still obtain $\theta_0$, but since they do not produce in farming, they do not receive the price subsidy $\mu_0$. Therefore, once again, $\theta_0$ is a non-distortionary transfer, whereas $\mu_0$ is an inefficient form of redistribution, encouraging agents to stay in the less productive sector.

Equation (3) still determines $\tau_1$, about (2) is now modified to

$$
(1 - n_0)\tau_0 = n_0\theta_0 + ((1 - \gamma) + \gamma x) n_0\mu_0.
$$

That is, at $t = 0$, there are $1 - n_0$ agents in manufacturing, and $n_0$ farmers; and a fraction

\footnote{This idea is commonplace in the literature on the political economy of trade policy. Alt et al. (1996, p. 700) argue, “a crucial determinant of the incentives of an economic agent to seek trade protection (or, more broadly subsidies) for his or her economic activity is the degree to which the agent’s assets are specific to this activity.” Similarly, Baldwin (1989, p. 124) claims, “one also expects vigorous efforts to secure protection in the face of significantly increased import competition by those industries [with] substantial...industry specific physical and human capital.”}

\footnote{The empirical literature on trade finds that labor intensive and low skill industries receive more protection (see Rodrik (1994) for a succinct overview, and also Baldwin (1985) and Ray (1981, 1991)). Moreover, consumer goods industries receive more protection than industries which produce intermediate goods (Ray (1991)). It is precisely these industries, for example, textiles, apparel, furniture and fixtures, and toys and sporting goods, which are thought to have relatively unspecific factors of production.}
(1 − γ + γx) of farmers receive both types of transfers, while the fraction \( γ(1 − x) \) who quit only receive the efficient transfer, \( θ_0 \).

The number of farmers in period \( t = 1 \) is then given by

\[
n_1 = ((1 − γ) + γx) n_0
\]

Let \( W^f \) and \( W^m \) denote the expected utilities of potential switchers, and \( V^f \) and \( V^m \) denote the utilities of immobile agents. As before, we have

\[
W^f = V^f = (1 + β)B + θ_0 + μ_0 + βθ_1, \tag{18}
\]

\[
W^m = (1 + β)A − C + θ_0 − βτ_1. \tag{19}
\]

Also, define \( U^f(x) = W^f − μ_0 \) as the utility of an agent who can switch, but chooses not to, when a fraction \( x \) of potential switchers stay in farming and when \( μ_0 = 0 \). And define \( U^m(x) = W^m \) as the utility of an agent who does switch when a fraction \( x \) of potential switchers stay in farming.

We denote the fraction of farmers who switch sectors by \( 1 − x \). We concentrate on the part of the parameter space which is of most interest, namely where \( n_0 \in \left(n^−, \frac{n^+}{1−β}\right) \).

We also make the analogous assumption to Assumption 1, which ensures that it is not worthwhile for a potential switcher to stay in farming just to get future redistribution.

**Assumption 2** \( 2βT < (1 + β)(A − B) − C. \)

This condition ensures that if \( μ_0 = 0 \), potential switchers would all go to manufacturing. As in the previous section, to increase their political power, or prevent it from declining, farmers therefore need to set \( μ_0 > 0 \).

Consider now the utility of an old farmer before he knows whether he will have the opportunity to switch. The ‘ex ante’ expected utility of this farmer is

\[
V^A = (1 − γ)V^f + γ \max \{W^f, W^m\}.
\]

Since farmers decide the form of redistribution at this stage, \( μ_0 \) and \( τ_0 \) simply maximize this ex ante expected utility. Now notice that if \( W^f > W^m \), then \( x = 1 \), and if \( W^f < W^m \), then \( x = 0 \). Our interest is to see under what circumstances \( x = 0 \) will not be in equilibrium, i.e. under what circumstances farmers will use \( μ_0 > 0 \), resulting in inefficient redistribution. So suppose that \( W^f \leq W^m \), in which case, we can write

\[
V^A = (1 − γ)V^f + γW^m
\]

\[
= (1 − γ) ((1 + β)B + βφ(n_1)) + γ ((1 + β)A − C − βτ_1) + θ_0 + (1 − γ) μ_0
\]

16
where second line substitutes from (18) and (19).

Now solving (17) for $\mu_0 + (1 - \gamma) \mu_0$, and substituting, we have

$$V^A(x) = (1 - \gamma) ((1 + \beta)B + \beta \phi(n_1)) + \gamma ((1 + \beta)A - C - \beta \tau_1) + \frac{(1 - n_0) \tau_0}{n_0} - \gamma x \mu_0. \tag{20}$$

As in the previous section, suppose that $\mu_0 = U_m(x) - U_f(x)$, and substitute from (18) and (19) to obtain

$$\mu_0 = (1 + \beta) (A - B) - C - \beta (\phi(n_1) + \tau(n_1)), \tag{21}$$

Differentiating (20), evaluating it at $x = 0$, and substituting for (21), we obtain that there will be inefficient redistribution, i.e. $\mu_0 > 0$, if

$$\frac{dV^A(x = 0)}{dx} = \gamma ((1 + \beta) (B - A) + C) + \frac{(1 - n_0) \tau_0}{n_0} + \beta \gamma n_0 \{(1 - \gamma) \phi'((1 - \gamma) n_0) - \gamma \tau'((1 - \gamma) n_0)\} > 0. \tag{22}$$

Intuitively, if $\frac{dV^A(x=0)}{dx} > 0$, a small increase in $x$ will raise the ex ante expected utility of farmers. This expression highlights once again that for inefficient redistribution to arise $\phi'$ and $\tau'$ need to be positive. If $\tau'((1 - \gamma) n_0) \leq 0$, then keeping some of the potential switchers will reduce taxes, and so $\phi' < 0$, and $\frac{dV^A(x=0)}{dx} < 0$. Therefore, $\tau' > 0$ is necessary—but not sufficient—for inefficient redistribution. Also, notice that potential switchers always prefer ex post not to have implemented a policy of inefficient redistribution to keep farmers in political power (they would prefer to move to manufacturing and not be taxed).

The novel comparative static result here is with respect to $C$. Recall that when $C$ is high, farming skills are more specific. When $C$ is high, (22) is more likely to be positive, and so inefficient redistribution is more likely to arise. However, conditional on there being inefficient redistribution, a smaller $C$ implies more inefficient redistribution. Intuitively, when $C$ is lower, the skills of potential switchers are less specific to farming, so they are more willing to move into manufacturing. This implies that farmers need to choose a more inefficient mix of redistributive policies to convince the potential switchers to stay. Contrary to conventional wisdom, therefore, our model, which derives inefficient redistribution from micro foundations, implies that a lower degree of specificity may increase the extent of inefficient redistribution.
Applications of the Model

4.1 Agricultural Policy

The first application we discuss is farming subsidies. Gisser (1993) argues that “most economists have by now abandoned the belief that the main purpose of regulation is to correct for failures in private markets. The U.S. farm commodities program is no exception since it is designed to transfer income from taxpayers, and sometimes from consumers to farmers”. This quote reflects the consensus view that farm policy cannot be explained as correcting market failures. Although a number of authors have argued that the form of redistribution to farmers is relatively efficient (see the discussion in Gardner (1987) and Gisser (1993)), it is difficult to imagine that more efficient forms of transfers than price supports and quantity controls do not exist. For example, most economists believe that the Common Agricultural Policy in Europe is a highly inefficient program, transferring resources to farmers, and that direct subsidies to existing farmers could save considerable resources (e.g., Moyer and Josling (1990)).

In fact, most studies analyzing agricultural subsidies take it for granted that lump-sum redistribution cannot be used. Our theory suggests that this is due to the desire to keep a critical mass of farmers in the industry. There is evidence supporting this notion. Wright (1995, p. 14) echoes this view in noting that “making farming permanently more attractive to the young by means of price supports...is a goal that appears embodied explicitly or implicitly in the farm policies of most developed economies.”

When in the early 1960’s the French government attempted to reduce farm prices and promote the consolidation and modernization of small farms, there was substantial opposition from the larger, more powerful, farmers who controlled the FNSEA (Fédération Nationale des Syndicats d’Exploitants Agricoles). Franklin (1969, p. 103) explains this as follows: “On the one hand, by supporting such price [subsidy] policies they [capitalist farmers] achieved an apparent common purpose with the large mass of the peasantry; on the other, any success such policies might register, by helping to maintain the peasantry rather than diminish them, would, at the same time, help to sustain the peasants’ electoral importance, and by extension increase the pressure which the capitalist-led federations might bring to bear upon various governments.” It appears that farmers in France were aware that the form of transfers would influence their numbers and their future political power, and may have consequently preferred inefficient methods of redistribution.

The same considerations appear to be important today. Following the McSharry
reforms to the Common Agricultural Policy in 1992, pressure by French farmers induced the government to pass the Loi de Modernisation de l’Agriculture in January 1995. Part of this law was to introduce the goal of establishing 15,000 young farmers per year, and in general, lowering the costs of doing business as a farmer to encourage entry (see Coleman et al. (1997)). The reaction of farmers to agricultural reforms was quite similar in Germany and the U.S.. The Mansholt plan in Germany was defeated by farming interests in 1968 on identical grounds (see Averyt (1977, pp. 16-17)). The Brannan Plan in 1958 was also defeated by the American Farm Bureau for similar reasons (see Hansen (1991, p. 120), and Christenson (1959)).

Overall, therefore, on a number of occasions farmers themselves have campaigned for inefficient redistributive policies. Our model suggests that this is because farmers want to encourage newcomers in order to maintain their future political power.

4.2 Labor Market Policy

Most European labor markets are heavily regulated and characterized by institutions such as firing costs, making it prohibitively costly for continuing firms to layoff workers (e.g., Lazear (1990)). Although severance pay may be useful as it provides insurance to laid-off workers who would otherwise remain uninsured, the majority of the costs incurred by firms are administrative and do not benefit workers. Therefore, these policies appear highly inefficient. It is often argued that the main role of these costs is to increase insiders’ bargaining power and wages (e.g. Saint-Paul (1996), Lindbeck and Snower (1988)). Within this same category are many pieces of legislation enhancing the ability of workers to unionize and engage in collective action to raise their wages (e.g. closed shop agreements). Many economists believe that these policies have been designed to give workers market power, and are also responsible for high unemployment. The same criticism as above can be raised: it would be much cheaper and efficient to make direct transfers to insiders, while also allowing the necessary worker and job reallocation. The prevalence of firing costs and legislation, which increases the ability of workers to combine and engage in collective action in Europe, is therefore quite puzzling from a theoretical perspective.\footnote{One could argue that these labor market interventions increase the incentives of workers to invest in human capital (see, for example, Acemoglu and Pischke (1999), Robinson (1997)). Other labor market interventions can do this much more efficiently than administrative firing costs and closed shop arrangements, however.}

Our model provides a simple answer. Suppose $n_0$ of workers are in a high wage sector, for example in manufacturing, and wages are determined by union-firm bargaining. There
is a critical mass of workers \( \pi \), such that for all \( n < \pi \), the union loses its ability to push for higher wages. Suppose also that a fraction \( \gamma \) of the workers in the sector are in loss-making firms. In the absence of firing costs, these firms will layoff their workers \( (\gamma n_0 \text{ of them}) \), and many of these workers will find jobs in other sectors, reducing union membership to \( n_1 < \pi \). The union and manufacturing workers will therefore campaign for firing costs in order to prevent their numbers from shrinking. Even though other methods of redistribution are more efficient, only firing costs and similar restrictive work-practices ensure that unions maintain their power in the future.\(^{14}\)

There is a body of evidence suggesting that our approach to labor market institutions and regulations is along the right lines. Many authors have pointed out that the design of labor market institutions, such as the welfare state and wage determination systems, are important for their political sustainability. Esping-Andersen (1990) writes “the social rights, income security, equalization and eradication of poverty that a universalistic welfare state pursues are necessary preconditions for the strength and unity that collective power mobilization demands,” (see also his 1985 book). He further argues that universalistic welfare states dynamically sustain the political coalitions that create them in a way that means-tested systems, which create divisions within workers, do not. In a related argument Rothstein (1985, 1992) has shown that a central factor in explaining the cross-country strength of trade union movements is whether or not they manage the national unemployment insurance scheme. When they do, as in Belgium and Scandinavia except Norway, they are able to reinforce and sustain their bargaining power by determining the criteria under which unemployed people must accept jobs. This allows them, for example, to prevent the unemployed from undercutting their bargaining power. Pontusson (1992, p. 28) also supports this viewpoint. He points out that there are “instances in which welfare reforms directly strengthened union organization. Most notably, the public unemployment insurance system introduced by the Swedish Social Democratic Party in 1934 subsidized union administered unemployment funds and thereby provided a direct incentive for wage earners to join unions.” These examples therefore suggest that the form of welfare state intervention is often inefficient, precisely because it is motivated by a desire to maintain future political power and to sustain the ability of workers to engage in collective action.

\(^{14}\)Moreover, firing costs reduce turnover and therefore stabilize the composition of the workforce, making it easier for unions to mobilize workers. Similar argument can be developed to account for pro-union legislation: unions would support the policies that sustain their future influence, which rests on their ability to organize collective action.
The same issues manifest themselves in unions’ regulating job losses. Golden (1997, pp. 4-5) argues that “even unions that appear radically to resist market forces accept that there are circumstances in which the enterprise must reduce the size of its labor force. But what no union can accept...is that the firm take advantage of such a situation to break the union itself. If too many shop floor union representatives are included amongst those to be let go, or if so much of the union’s membership is slotted for expulsion as to jeopardize the very future of the union as an organization...the union responds with industrial action. The aim of such action is to restore the union organization, not to prevent job loss. Strikes over workforce reductions... are rational, self-interested responses on the part of labor organizations to threats to trade unionism.” In the same vein, Slichter (1941) notes “if the union has no closed shop, restrictions on the employer’s freedom to lay off may be a matter of self-preservation, because if union members are always the first to be dropped, the men will not remain in the organization.”

These arguments therefore suggest that, as with agricultural and trade policies, a number of the redistributive labor market policies are chosen to be inefficient, at least in part, to preserve their constituency. In this way, they ensure continuity in the political power of these policies’ beneficiaries.

4.3 International Trade Policy

Most countries use tariffs and quotas to protect domestic industries. This is sometimes justified by infant industry protection arguments or similar externalities. Most economists, however, view tariffs and quotas as inefficient methods of transferring resources to special interest groups, in this case firms and workers in sectors that are subject to foreign competition.

To apply our analysis to the case of international trade policy, it is useful to consider two sectors, manufacturing and farming, as producing imperfect substitutes, and all consumers having the utility functions, $y_m^\alpha y_f^{1-\alpha}$, with $\alpha \in (0, 1)$. The world relative price of farming output in terms of manufactures is $p$, so $pB$ replaces $B$. $\theta$ is still equivalent to a lump-sum transfer by current farmers, while $\mu$ can now be interpreted as a tariff at the rate of $s = p\mu/B$. So a $\mu$-transfer increases the return to farming to $pB(1 + \mu)$, but also distorts relative prices. This inefficient method of distribution may be preferred to a $\theta$-transfer, however, precisely because it attracts newcomers, who would be more

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15 Or the actual return is, $pB(1 + \mu)/(p(1 + \mu))^{1-\alpha} = B\theta^{\alpha}(1 + \mu)^\alpha$, since the prices of farming goods increases for farmers too.
productive in manufacturing, to this sector.

We do not have direct evidence suggesting that the mechanism we propose was an important factor in the choice of inefficient trade policies. Nevertheless, there is some evidence consistent with our approach, in particular, suggesting that numbers are important in securing trade protection. Caves (1976) originally argued that the number of votes an industry could mobilize increased trade protection. Tosini and Tower (1987) found that the proportion of textile and apparel workers in the workforce of a congressional district or state was the most significant determinant of the pattern of voting on the 1985 Textile Bill. Baldwin (1985) presents other evidence of the importance of voting in the determination of U.S. trade policy, and Harper and Aldrich (1991) provide similar evidence on legislation affecting the sugar industry.

5 Conclusion

In this paper we have developed the idea that in political systems that lack the ability to make commitments to future policy, the dynamics of group power is crucial. Groups wish to take actions not just to raise their welfare today, but also to sustain their power so that they will be able to influence policy in their favor in the future. In order to do this, they may need to take current actions which would not be optimal if there was no concern for the future. We have shown that favoring inefficient methods of redistribution may be precisely such an action in situations where the political influence of a group depends on its size—a natural assumption in democratic systems. This is because inefficient redistribution makes staying in, or joining a group, relatively more attractive to marginal agents than methods of efficient redistribution do. We argue that this explanation is consistent with a variety of evidence on the political economy of redistribution from agriculture, trade and labor market policy.
6 Bibliography


