

The Politics of Child Support in America

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The Limits of Studying Entrepreneurial Episodes

Americans love individual success stories, especially ones that have a major impact on public policy. The plot lines tend to be very similar. Insightful individuals perceive a problem that they believe the government can help to solve. They wage a long, many times painful campaign to bring about change. Usually there are clearly defined enemies: large corporations, loathsome criminals, corrupt politicians, and so forth. Yet, despite these formidable opponents, the champions of reform manage against all odds to defeat their opponents. When the issue is finally resolved, historians record how the domain of public policy was transformed forever because of their enterprising initiatives.

The emphasis on the crusade of the individual has also seeped into our attempt to map out entrepreneurial behavior in politics in a more formal sense. Social scientists have long struggled to understand how policies are placed on the public agenda. Oftentimes, their accounts have echoed those found in the popular media by focusing on the pivotal group or the unique individual who manages to emerge from the pack and “get things done.” Much of this work has involved intensive case studies and biographical analyses, from which scholars have gleaned insight into the strategies of those individuals who rise above everyone else to solve a critical public problem. In sum, we know a lot about isolated actors and isolated incidents of change.¹

¹ See, for example, Jameson Doig and Erwin C. Hargrove, eds. 1987. *Leadership and Innovation: A Biographic Perspective on Entrepreneurs in Government*. Baltimore: Johns Hopkins University Press; Richard F. Fenno. 1989. *The Making of a Senator: Dan Quayle*. Washington, DC: Congressional Quarterly; David E. Price. 1971. “Professionals and

But we need to know much more. The premise of this book is that we can more effectively increase our knowledge of the entrepreneurial process by focusing on the evolution of a single societal problem over time rather than on the individual or groups of individuals who seek to attack bits and pieces of the problem at any particular point in time. The reasoning is simple. When we focus on the individual, our scholarly interest remains parochial. Our research questions center on exploring how a particular group captures the public's attention, the methods used in translating their ideas into policy, and the ultimate impact of the ideas upon implementation.

Most importantly, by restricting our analysis to the actions of policy entrepreneurs at one particular point in time, we lose sight of the most important function of leaders in the public arena: *that of resource allocation in the long run*. A theory of innovation must be able to highlight the dynamism of this transformative process and can best be developed by examining a long-standing public problem. By definition, long-standing public problems do not respond to quick fixes, easy answers, or magical solutions. Rather than a single individual or group of policy entrepreneurs addressing the issue and then exiting the policy scene, then, a series of entrepreneurs is constantly involved in the process. Under one set of political circumstances, advocates from a certain political party, professional affiliation, or other type of advantageous position, evolve into powerful spokespeople for the specific cause under consideration. With all eyes focused on them, these entrepreneurs influence public policy by shaping the public discourse to match their view of the problem at hand. They are, in essence, successful at reallocating governmental resources away from traditional ways of conducting business and toward their own most preferred policy outcome.

With the passage of political time, new philosophies engage the public debate, different ideologies seize the attention of voters, and innovative perspectives come to define contemporary political culture. This changing environment provides the opportunity for *other* policy entrepreneurs to ascend in importance, overtake their opponents, and present *their* views of the problem at hand. In the end, if they are convincing, they can reallocate resources toward their preferred policy outcome. And, since most policy

'Entrepreneurs': Staff Orientations and Policy Making on Three Senate Committees." *Journal of Politics* 33(2): 548-574; Julian E. Zelizer. 1998. *Taxing America: Wilbur D. Mills, Congress, and the State, 1945-1975*. Cambridge: Cambridge University Press.

problems fail to achieve definitive resolution, this cycle is repeated time and time again.

Understanding the goal of resource allocation as *the* fundamental task of political entrepreneurs allows us to shift our attention away from the personal characteristics and tasks of the entrepreneur and to focus instead on the processes under which these cycles of change take place. We thus can reorient our research questions away from exploring the personal motivations of specific innovators and toward the entrepreneurial activity that occurs before they emerge on the scene of a particular problem and after they have disappeared. From this new, long-run perspective, the internal drive of the particular entrepreneur is less important than the challenges that all entrepreneurs must face in the political arena.²

This book examines this new view of entrepreneurship using the case of child support enforcement, one of the most fundamental social problems facing American society today. Scholars have consistently reported that the likelihood of a child growing up in poverty increases dramatically when the family unit is headed by a single parent, usually the mother.³ In early American history, local charities and churches provided services to these fatherless families. Localized mothers' pension programs at the turn of the century also provided assistance. However, when community groups failed to respond to the massive economic dislocation created by the Great Depression, the federal government stepped in with the Aid to Dependent Children program (ADC) (later renamed the Aid to Families with Dependent Children program [AFDC], and in 1996 transformed once again into the Temporary Assistance for Needy Families program [TANF]). Begun in 1935, ADC provided welfare benefits to single-parent families – primarily widows – in economic need and represented a

² Recent work on the American presidency has moved in this direction as well. Compare Stephen Skowronek's 1993 work on patterns of historical change that influence presidential positioning (*The Politics Presidents Make: Leadership from John Adams to George Bush*. Cambridge: Belknap Press) to Benjamin Barber's 1972 psychological perspective on the presidency (*The Presidential Character: Predicting Performance in the White House*. Englewood Cliffs, NJ: Prentice Hall).

³ Throughout this book, we will be considering the custodial parent to be the mother, usually the recipient of child support collections. The noncustodial parent will be the father, usually the payer of child support. The statistics warrant these generalizations. In the spring of 2000, 85 percent of all custodial parents were mothers, and only approximately 15 percent were fathers. In 1999, taking all families with an agreed-upon child support order in place, 90 percent of the recipients were custodial mothers. See Timothy Grall, 2002. "Custodial Mothers and Fathers and Their Child Support." Current Population Reports, series P60-217, United States Bureau of the Census.

monumental break with past, more localized types of assistance. When the client base began to tip away from widows toward divorced and never-married mothers, the Federal Child Support Enforcement Program was begun in 1975 in order to find and compel fathers to provide for their offspring.

Despite the introduction of a variety of new tools designed to improve support outcomes, program statistics demonstrate the problems inherent in ensuring that all nonmarital children have paternity established and that all noncustodial parents provide financial support for their children. Locating fathers of different socioeconomic backgrounds and then mandating that they pay has proved to be a difficult challenge. At the end of 2000, approximately 17 million families were enrolled in the child support program. Of these 17 million cases, only 61.5 percent had child support orders in place. Data reported at the end of 2000 indicate that out of \$23 billion in current support due, the program collected only \$13 billion, or 56 percent. Of the \$84 billion still outstanding from previous years, only \$6 billion, or 7 percent, was collected.⁴

But before we move into a discussion of the historical treatment of this issue in greater detail, we must first begin building a new toolbox for understanding the trajectory of all entrepreneurial systems using our new, long-run approach. In piecing together this toolbox, the disciplines of political science and economics have had a lot to say. Only recently, however, have they been talking to each other.

WHO ARE POLICY ENTREPRENEURS? ENTREPRENEURIAL MOVEMENTS AT WORK

A theory of policy entrepreneurship must take into account the diversity of actors who are involved in policy change over long periods of time. In fact, while individual stories tend to dominate what is presented to us in popular culture, the political science literature describing who these entrepreneurs are does not necessarily demand autonomous actors. Rather, instead of honing in on definable personality types, major theoretical breakthroughs in political science have tended to describe three entrepreneurial characteristics: *alertness*, *persistence*, and *rhetorical ingenuity*. Notably, each of these characteristics, as we will see, can be displayed by a wide variety of actors. That is, as long as they have these characteristics,

⁴ See the 2001 *FY2000 Preliminary Data Preview Report*. Washington, DC: Office of Child Support Enforcement, pp. 1–5.

policy entrepreneurs can be politicians, interest groups, bureaucrats, parties, or ordinary citizens.

John Kingdon's work is responsible for our most comprehensive knowledge on the characteristics of policy leaders.⁵ In Kingdon's view, there are numerous societal problems and potential solutions "floating around" at a given time. Reflecting his permeable and fluid view of the world, Kingdon contends that each of these problems and solutions can merge at any point in time; the primary issue is when this merger will take place. Policy entrepreneurs act as alert facilitators by appearing on the political scene at opportune times and matching their preferred policy solution to the problem at hand. Inherent in this definition of the policy entrepreneur is the notion of a clearly defined "window of opportunity" for action; the entrepreneur enters the fray by articulating a problem in a specific way, succeeds in establishing his or her program, and then exits from the policy stage.

Other researchers have attempted to formalize the concept of alertness by specifying the exact conditions under which society can expect entrepreneurs to emerge. In these models, there is an identifiable pool of talent that has the potential to exhibit entrepreneurial behaviors. The scope of talent is based on a number of individual factors, including income and education levels. Environmental conditions, however, determine the extent to which such leaders choose to devote their lives to activities in the public rather than the private arena. More specifically, slack budgetary resources in government may encourage entrepreneurs to take their chances on redirecting their energies away from private pursuits and toward their preferred policy goals.⁶

Other political scientists have focused on a second component of entrepreneurial behavior: persistence. Because the opportunities for policy action are uncertain, entrepreneurs must be patient. They must wait for the most opportune time to present their preferred policy alternatives to the public at large. Scholars writing in this tradition point to the need to distinguish policy entrepreneurs from policy opportunists in governmental politics. Entrepreneurs are those individuals respected for their skill set who have been consistently interested in the policy at hand; opportunists, on the other hand, are more likely to associate themselves with the issue

⁵ John Kingdon. 1984. *Agendas, Alternatives and Public Policies*. Boston: Little, Brown.

⁶ Martin Ricketts. 1987. *The New Industrial Economics*. New York: St. Martin's Press; Mark Schneider and Paul Teske. 1995. *Public Entrepreneurs: Agents for Change in American Government*. Princeton, NJ: Princeton University Press.

when they see a chance for a substantial impact on the policy agenda. Entrepreneurs – those who remain firmly linked to an issue over time – tend to be much more effective legislators than their opportunistic peers. Researchers have reinforced these findings across various policy areas, including school choice and women’s issues.⁷

The third task pinpointed by political scientists as critical to entrepreneurship is the proactive use of rhetorical ingenuity. Rhetorical ingenuity refers specifically to the entrepreneur’s ability to frame issues in such a way as to maximize the chance for legislative action. Ingenuity is especially important because of the puzzle articulated in Arrow’s Impossibility Theorem, which states that in a world of diverse tastes and preferences, equilibrium in terms of an established policy outcome is difficult to achieve. More specifically, in the early 1950s, the mathematical economist Kenneth Arrow showed that when individuals rank their policy preferences among three or more alternatives, no single voting procedure can always determine which outcome will ultimately be selected.⁸ And as the number of individuals and alternative situations to be ranked increases, the likelihood that the individuals’ rankings and social rankings will diverge also increases. Instead of stability, then, we should witness only a steady cycling of policy options with no clear outcomes. But empirical observation did not bear these predictions out – decisions were made, and new policies were implemented. The idea that institutions themselves could produce stable outcomes – also known as structure-induced equilibrium – provided the foundation for William Riker’s influential work on the use of language in communicating ideas.⁹

If institutions could produce structure-induced equilibrium with respect to policy outcomes, then when would we witness policy change?

⁷ Carol Weissert. 1991. “Policy Entrepreneurs, Policy Opportunists, and Legislative Effectiveness.” *American Politics Quarterly* 19(2): 262–274; Michael Mintrom. 1997. “Policy Entrepreneurs and the Diffusion of Innovation.” *American Journal of Political Science* 41(3): 738–770; Nelson W. Polsby. 1994. *Political Innovation in America: The Politics of Policy Initiation*. New Haven, CT: Yale University Press; Sue Thomas. 1991. “The Impact of Women on State Legislative Policies.” *The Journal of Politics* 53(4): 958–976; Sue Thomas. 1994. *How Women Legislate*. New York: Oxford University Press; Michael Mintrom. 2000. *Policy Entrepreneurs and School Choice*. Washington, DC: Georgetown University Press.

⁸ Kenneth Arrow. 1951. *Social Choice and Individual Values*. New York: Wiley.

⁹ Kenneth Shepsle. 1979. “Institutional Arrangements and Equilibrium in Multidimensional Voting Models.” *American Journal of Political Science* 23(1): 27–59; William Riker. 1980. “Implications from the Disequilibrium of Majority Rule for the Study of Institutions.” *American Political Science Review* 74(2): 1235–1247; William Riker. 1986. *The Art of Political Manipulation*. New Haven, CT: Yale University Press.

Riker's central insight was that the policy entrepreneur has the ability to destabilize any equilibrium by casting his or her preferred policy option in a new way. Riker described these tactics as "heresthetics," or the methodic manipulation of the policy choice set. To Riker, policy actors are motivated to win, or to ensure that their preferred policy ideas are chosen over all of the alternatives. In order to win, they must behave creatively, employing the written word, oral arguments, and visual strategies to improve their chances of success. A classic example of such tactics is provided by the two sides involved in the abortion debate. Those who favor abortion rights call themselves "pro-choice," setting up their opponents as the enemies of freedom and individual liberty. Those who oppose abortion rights, on the other hand, call themselves "pro-life," implying that anyone who disagrees with them is in favor of death to the unborn. In this case, as well as in others, then, entrepreneurs are those individuals who have the verbal skills necessary to destroy past systems of stability and initiate new ones.¹⁰

Image shaping is an integral part of entrepreneurship, but as Frank R. Baumgartner and Bryan D. Jones point out, venue shopping might be equally important.¹¹ Entrepreneurs must not only be creative in reshaping policy proposals to their advantage, they must also be skilled in shopping for the most advantageous venue in which to present their new ideas. This is especially true in the United States, where the separation of powers as well as federalism generate multiple access points for those seeking to advance a specific agenda. Again, continuing with the abortion example, opponents of abortion have in recent years pursued restrictive laws in their state legislatures, because the Supreme Court has refused to overturn its 1973 decision in *Roe v. Wade*, which permits abortion under certain conditions. Another notable example of venue shopping is the current effort by advocacy groups in many states, such as New Jersey, in favor of greater funding for urban schools. Because their arguments have not been convincing to state legislators, these groups have now moved to the state courts in order to push their agenda forward.¹² Only if the right mix of

¹⁰ For a thorough account of these strategies at work in the area of drunken driving, see Joseph R. Gusfield. 1981. *The Culture of Public Problems: Drinking-Driving and the Symbolic Order*. Chicago: University of Chicago Press.

¹¹ Frank R. Baumgartner and Bryan D. Jones. 1993. *Agendas and Instability in American Politics*. Chicago: University of Chicago Press.

¹² See *Abbott v. Burke*, 100 N.J. 269, 495 A.2d 376 (1985) ("Abbott I"); 119 N.J. 287, 575 A.2d 359 (1990) ("Abbott II"); 136 N.J. 444, 643 A.2d 575 (1994) ("Abbott III"); 149 N.J. 145, 693 A.2d 417 (1997) ("Abbott IV"); 153 N.J. 480, 710 A.2d 450 (1998)

policy images and venues is cast can innovators then reap the rewards of a period of “punctuated equilibrium,” or stability of policy after a sudden disruption.

The primary characteristics of the entrepreneur, then, are fairly well defined. In order to increase the probability for success, entrepreneurs must be alert to new opportunities, persist in advocating their ideas, and employ rhetorical ingenuity to frame their ideas in novel ways. Notably, nothing in these definitions suggests that entrepreneurs must be autonomous individuals. Rather, the skill sets described by these scholars all point to the ways in which various types of groups can influence the public agenda. We can call these groups of unified individuals *entrepreneurial movements*.

This insight is critical, because it can help build bridges of policy research across the various disciplines of social science. For example, we can explore the ways in which legislative caucuses, using these skills in ways that are very similar to those employed by interest groups, form coalitions across issues. We can also be more attuned to the means by which social movements as wide-ranging transforming initiatives also attend to the characteristics outlined earlier in achieving their goals. In sum, broadening the scope of the entrepreneurship research agenda to include legislators, interest groups, social movements, professional organizations, and other mobilized forces enables us to explore more deeply the endless cycle of policy overhaul that is typical of policymaking today.

A Word about Who Is *Not* an Entrepreneur

Broadening the definition of entrepreneur to include entire *movements* of like-minded individuals is not helpful if the term becomes so elastic that it is rendered meaningless. However, simply stating that entrepreneurs can be more than a single individual hardly pushes us in the direction of definitional chaos.

We know that entrepreneurs must be alert, persistent, and able to use rhetorical ingenuity in crafting their arguments. These three criteria necessitate that we exclude certain categories of people as entrepreneurs. Members of Congress who cosponsor a bill after it begins to ride a wave of publicity surely would not be considered entrepreneurial under this definition. Celebrities who meet the president and mention their pet projects in passing are not entrepreneurial. Corporate shareholders who

(“Abbott V”); 163 N.J. 95, 748 A.2d 82 (2000) (“Abbott VI”); 164 N.J. 84, 751 A.2d 1032 (2000) (“Abbott VII”); 170 N.J. 537, 790 A.2d 842 (2002) (“Abbott VIII”).

pass on some of their profits to political campaigns definitely are not entrepreneurs. The local school board that lobbies on behalf of a one-time expenditure to improve the appearance of the high school is not acting in an entrepreneurial fashion.

The important point is that we can distinguish, using our definition, between exactly who is and who is not an entrepreneur. *Being entrepreneurial requires real work*. There must be a true mission, a true passion, and a true higher aim. No one can wake up one day and decide to move a policy mountain. Brief interludes with the power structure simply do not qualify. Entrepreneurs must be in the game for the long run.

WHY DO ENTREPRENEURS INNOVATE?

While political science research on the topic of entrepreneurship has focused on the *who* of innovation, economics has concentrated much more on the *why* and the *how* of new ideas. First, let us consider the *why*. Of pivotal interest to economists is the primary impetus behind entrepreneurial behavior. That is, why do firms behave as they do in the market? Why do they strategize? The answer economists have offered is the profit motive. Firms seek to maximize profits within a particular set of constraints.

Clearly, policy entrepreneurs do not seek out profits in the way that private firms do. Instead, we can think of entrepreneurs as seekers of rents.¹³ Rent seeking is the process by which individuals aim to restructure public policy in ways that are beneficial to their own interests. Gordon Tullock, in his now much-cited essay “The Welfare Costs of Tariffs, Monopolies, and Theft,” and later Anne O. Krueger began work in this direction by exploring the role of government as an economic player in modern society.¹⁴ Building on the insights of the University of Chicago economist George Stigler, Tullock and Krueger argued that government was neither simply a producer of public goods nor a controller of externalities.¹⁵ Rather, government functioned as a distributor of wealth and an allocator of costs.

¹³ For an excellent review of this rent-seeking literature, see William C. Mitchell and Michael C. Munger. 1991. “Economic Models of Interest Groups: An Introductory Survey.” *American Journal of Political Science* 35(2): 512–546.

¹⁴ Anne O. Krueger. 1974. “The Political Economy of the Rent-Seeking Society.” *American Economic Review* 64(3): 291–303; Gordon Tullock. 1967. “The Welfare Costs of Tariffs, Monopolies, and Theft.” *Western Economic Journal* 5(3): 224–232.

¹⁵ George Stigler. 1971. “The Theory of Economic Regulation.” *Bell Journal of Economics and Management Science* 2(1): 3–21.

Since James M. Buchanan, Robert D. Tollison, and Gordon Tullock's seminal work on this topic, *Toward a Theory of the Rent-Seeking Society*, economists have come to understand the nature of this crucial governmental role as an arbiter of rents.¹⁶ Central to this arbitration is the distinction between how the economy as a whole reacts to the creation of waste and how isolated individuals react. Waste in the marketplace occurs when an alternative use of a resource would have produced a higher level of output than its current use. The trigger for waste is imperfect information. Producers may not have the knowledge needed to deploy their resources in more efficient ways. Adding to this complexity is the set of governmental institutions that may delay more efficient deployment of these resources. Yet ironically, while for the economy as a whole these types of institutional barriers might be burdensome, from the perspective of the individual, searching out governmental inefficiencies is a highly rational – and often profitable – act.

In this view, individuals attempt to influence policymakers to grant them special rights or protections so as to shield themselves from heightened levels of competition. Classic examples include the regulation/deregulation of large-scale industries, the allocation of import licenses, and the imposition of tariffs.¹⁷ In each of these cases, there are always potential winners and potential losers. For example, a domestic producer of rice has a strong interest in lobbying the government for protective trade legislation. To the extent that the industry is successful, consumers may suffer a loss in the form of higher rice prices, but the producers gain a “bonus” from the government that shields them from the vicissitudes of free market competition.

Applying these ideas to public policy, we can argue that the primary business of all policy entrepreneurs is rent seeking. All groups aim to promote their ideas as superior to every other group's ideas. Groups strategically position themselves in an attempt to insure that their ideas are ultimately the ones adopted, because if they can attain a legally binding agreement from the government in their favor, then their future stream of policy rewards will be large. They will, in effect, have gained a government-sanctioned monopoly of power over a particular policy realm.

¹⁶ James M. Buchanan, Robert D. Tollison, and Gordon Tullock, eds. 1980. *Toward a Theory of the Rent-Seeking Society*. College Station, TX: Texas A&M Press.

¹⁷ Richard A. Posner. 1974. “Theories of Economic Regulation.” *Bell Journal of Economics and Management Science* 5(2): 335–358; George Stigler. 1971. “The Theory of Economic Regulation.” *Bell Journal of Economics and Management Science* 2(1): 3–21.

But what, exactly, constitutes this future stream of rewards for policy entrepreneurs? Similar to the case in economics, rents may be primarily financial in nature. Entrepreneurs may gain access to new resources, succeed in transferring wealth from one group to another, reduce their tax burden, and so on. However, rents for policy entrepreneurs may also be more psychological in nature. Entrepreneurs may aim to become pivotal leaders, opinion makers, and notable decision makers, changing the course of history over time. In sum, financial as well as psychological rewards serve as strong motivators of rent-seeking behavior in the policy world.

HOW DO ENTREPRENEURS INNOVATE?

Specifying the motivation behind entrepreneurial behavior is the second fundamental component of a more comprehensive theory concerning innovative action; however, we must also consider the tactics used in this battle to come out on top in the arena of ideas. How does one group gain ascendance over another? What factors determine how long a particular group will be in charge of one specific policy area? Are certain strategies more effective than others in achieving policy prominence?

Once again, economics offers several useful concepts that can aid us in mapping out this part of the entrepreneurial strategy. Two key ideas related to the mechanics of innovation are the capacity to endure risk and the ability to induce a “shakeout” of the competition.

Risk

For years, economists have recognized that entrepreneurs, at least in the market for goods and services, represent a unique category of individuals with higher levels of initiative, foresight, and ingenuity than the rest of the population. Entrepreneurs are able to see market opportunities and to seize upon them. Most distinguishable of all, they take chances in the pursuit of innovation, without a guarantee of a future payoff. But because of their drive for an overarching theory of economic behavior that left little room for individual “heroes,” economists have had an uneven history of incorporating entrepreneurial activities into their models of market change.

During the first wave of theorizing in the late eighteenth century, several prominent economists embraced the concept of the risk taker as central to the economic process. Richard Cantillon and Jean Batiste Say first offered

insight into this topic by describing entrepreneurs as individuals with a special role to play in the economy – more specifically, as persons capable of directing resources into more efficient uses.¹⁸ In their writings, the entrepreneur began to take his or her rightful place among the other major actors in the economy: the landowner, the capitalist, and the worker. With a purposeful niche all their own, entrepreneurs were the engines of change in all economic systems, producing new combinations of factor inputs and ultimately contributing to the overall economic growth of society at large.

With the advent of the marginal utility revolution in neoclassical economics during the late nineteenth century, however, the focus of scholarly study became equilibrium analysis and the theory of the firm. In this Walrasian world, the price mechanism methodically moved markets toward stability. Change took place largely exogenously, as increases in the factors of production or the introduction of new technologies temporarily created periods of disequilibrium. While disequilibrium generated economic profits for certain segments of the population, such profiteering was always short-lived. Because neoclassical economics assumed that all economic players had complete information, above-normal profits introduced competition into the market, ultimately driving the initial economic profits to zero. In this model, then, there was little room for the entrepreneur; no one was supposed to have an informational advantage over his or her neighbor and thereby to assume a leadership role in propelling innovation.

There were, however, numerous economists who continued to write about the importance of the entrepreneur and his or her centrality in dynamic market transformations. Interestingly, their arguments were by no means uniform. Theorists alternatively described entrepreneurs as decision makers, arbitrageurs, industrial leaders, and coordinators of resources. Gradually, however, they aggregated into several schools of thought related to the entrepreneurial purpose.¹⁹ For this analysis, the most significant theoretical contribution came from the Chicago School,

¹⁸ For a comprehensive overview of economists' changing views toward entrepreneurship, see Sven Ripsas. 1998. "Towards an Interdisciplinary Theory of Entrepreneurship." *Small Business Economics* 10(2): 103–115.

¹⁹ For example, there are scholars who view entrepreneurs as decision makers (John Maynard Keynes and Francis Walker), as arbitrageurs (Leon Walras and Israel Kirzner), as industrial leaders (Amasa Walker and Friedrich von Wieser), and as coordinators of resources (Ronald Coase and Werner Sombart). In general, the three schools of thought on entrepreneurial behavior are as follows: (1) the Austrian School, which emphasized discovery; (2) the Schumpeterian tradition, which highlighted the importance of innovation; and (3) the Chicago School, which stressed the notion of risk taking.

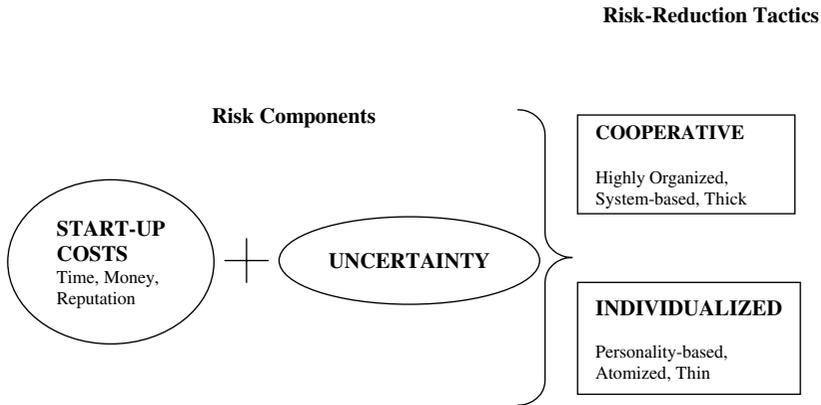


FIGURE 1.1. Risk-reduction strategies.

which began the first systematic treatment of risk bearing in entrepreneurial theory.

For economists from the Chicago School, risk involves both (1) the necessity of underwriting start-up costs for a particular venture, and (2) the ability to endure uncertainty. First, in order to begin any project, an entrepreneur must find a way to fund him- or herself “into the market.” Because of the novelty of the enterprise, these financial investments can be enormous. In addition to fronting start-up costs, the entrepreneur must also be willing to accept a certain degree of uncertainty. Frank Knight of the Chicago School was one of the earliest articulators of the types of risk facing the modern entrepreneur. According to Knight, uncertainty in the market arises from one primary factor: producers simply are not directly familiar with the needs and preferences of all consumers.²⁰ They therefore must forecast, to a certain extent, the degree of demand for the good under production. Not everyone, of course, is willing to assume such a risk. The entrepreneur, as a unique type, embraces this uncertainty.

Applying these ideas to policymaking provides us with insightful new ways of understanding the process by which policy leaders move to enact change (see Figure 1.1). In the first stage of innovation, policy entrepreneurs must decide how much risk they are willing to bear in presenting their ideas. Risk, as defined here, consists of two key components: the necessity of underwriting start-up costs and the capacity to endure uncertainty in order to promote a new idea. In the policy world, start-up

²⁰ Frank Knight. 1921. *Risk, Uncertainty, and Profit*. Boston: Houghton Mifflin.

costs involve the capital an individual or group must expend in order to enter the political fray. This capital could include money, time, reputational concerns, privacy issues, and so forth. At the same time, if we assume that all innovators want to maximize their impact on a specific policy area, a risk-taking position is also one where the chance for success is uncertain. This uncertainty derives from the simple fact that any policy position may be accepted, ignored, or rejected outright by the general public.

One of the key factors, then, in predicting whether or not a policy entrepreneur will be successful is how he or she goes about reducing the risks involved in starting a new venture. We can array potential strategies from the least powerful to the most powerful in terms of producing change. To increase the likelihood of idea passage and sustainability, entrepreneurs can engage in cooperative organization building. This means that from the very inception of their idea, entrepreneurs become focused on spreading the risk of confronting both start-up costs and uncertainty across the widest, most durable set of interested parties. On the other hand, entrepreneurs may select the much weaker individualized strategy for adapting to risk. An individualized strategy signals that the entrepreneur is relying primarily on him- or herself to move the idea forward, without the benefit of an organizational structure to sustain the innovation over the long run. Entrepreneurs selecting this strategy mistakenly believe that the force and power of their personalities alone will be enough to convince others to front their start-up costs and diminish their uncertainty. Entrepreneurs choosing the individualized risk-reduction strategy thus expose themselves to increased threats from the competition vis-à-vis entrepreneurs who select a more cooperative plan of action.

Shakeout

The willingness to undertake risk is only the first step in exploring the *how* of the entrepreneurial process. The second stage of innovation, beginning once again from economic theory, includes tracking the course of competition that emerges once any new good or service becomes an institutionalized component of production. Joseph Schumpeter defined entrepreneurship as a process of “creative destruction.”²¹ In his view, the

²¹ Joseph Schumpeter. 1934. *Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest, and the Business Cycle*. Cambridge, MA: Harvard University Press; Joseph Schumpeter. 1954. *History of Economic Analysis*. New York: Oxford University Press.

entrepreneur succeeds in dismantling any type of equilibrium that may have previously existed by creating a new market combination of inputs and outputs. For firms, the main motivation for creative destruction is the search for above-normal profits (positive economic profits). Ultimately, if these firms are successful, incomes are rearranged, the mix of goods and services that society produces and consumes changes, and the path of economic growth is altered, at least temporarily.

Schumpeter was also quick to note that the upward spiral of accumulation does not go on forever. Instead, competition generated by the free flow of firms into and out of the marketplace gradually chips away at the profits accruing to the market's innovators. After a short period of time, the economy moves back into equilibrium, once again ready for the destabilizing impact of another round of entrepreneurial activity.

Similar to the competition for profits in the profit-seeking world, there is also competition for rents in the rent-seeking world. In economics, there is considerable debate over the magnitude of social waste created by rent seeking, including the resources expended by groups in order to obtain rents, the resources expended by the government in order to determine them, and the distortions created by the introduction of such monopolistic rights over production. There is, however, a fair amount of consensus over how the market for rents reaches equilibrium. Rent seekers will enter the market to the point that the total amount invested in obtaining the rents dissipates the total amount of rents to be received.²²

This leads to a critical question. How do entrepreneurs attempt to gain an advantage over their rivals in the competition over rents? Once again, economists have developed useful ideas related to industrial evolution that can help clarify this process. When an industry is new, many firms enter as producers, product innovation is high, and market shares among firms are extremely volatile. As the industry matures, however, product innovation slows, and fewer firms enter the market. Later, exit dominates entry as less efficient producers lose their economic viability. This process is known as an industry "shakeout." Of course, the goal of each firm is to survive this shakeout process and emerge as an industry leader.

²² This result is based on a number of assumptions, including that (1) rent seekers are risk-neutral, (2) rent seekers are in symmetrical positions, and (3) there is free entry into the rent-seeking market. See Dennis Mueller. 1989. *Public Choice II*. Cambridge: Cambridge University Press, pp. 229–246.

Economists remain divided over the causes of shakeout. For James Utterback and Fernando Suarez, the key to leading a shakeout is developing and exploiting a “dominant design” for a new product.²³ In the early stages of an industry, the market is permeable to new approaches and novel ways of generating a particular good. In addition, because consumer preferences are uncertain, firms are generally flexible as they attempt to craft a new good. Over time, however, the majority of firms begin to converge on one primary model of product development. This model may emerge because of technological insights, regulatory-imposed standards, or first-mover advantages. In the case of the famous QWERTY typewriter, for example, certain firms began producing machines with this odd, yet quickly adopted keyboard design. Despite its awkwardness, the QWERTY setup rapidly became the dominant design for all typewriters.

According to Utterback and Suarez, shakeout occurs when this convergence dynamic – such as in the QWERTY example – gets under way. With industry agreement on accepted standards of production, opportunities for innovation recede, thereby discouraging new entrants. Firms that have already adopted the dominant design begin to focus on capital investment, and those firms that either failed to adopt this layout or lagged in developing the right manufacturing infrastructure eventually drop out of the market. In sum, shakeout occurs as a result of both the decline in firm entry and the rise in firm exit over the course of time.

Other economists, such as Steven Klepper, have emphasized the centrality of continuous change in the industry life cycle in explaining patterns of survival.²⁴ Crucial to Klepper’s theory are two types of research and development, or R&D, strategies: process and product. Process R&D improves the means by which a good is produced, thereby reducing the average cost of production. Since a reduction in the average cost of production is related to a firm’s level of output, larger firms tend to reap the greatest benefits. At the same time, product R&D proceeds apace, independent of a firm’s size. Product R&D relates to improvements in a product’s features, which opens up new submarkets for firms to exploit.

For Klepper, early entrants into the market usually develop advantages over their later counterparts because they are quick to invest in process R&D. Once these systems are in place, the “rich get richer” and the

²³ James Utterbeck and Fernando Suarez. 1993. “Innovation, Competition, and Industry Structure.” *Research Policy* 22(1): 1–21.

²⁴ Steven Klepper. 1996. “Entry, Exit, Growth, and Innovation over the Product Life Cycle.” *American Economic Review* 86(3): 562–583.

early firms become larger, ultimately forcing later entrants to invest in extraordinarily expensive capital equipment. As these early firms experience increasing returns and their costs of production are pushed down even further, smaller and less efficient firms become less likely to enter the market. Additionally, firms that cannot compete with these lower costs eventually drop out. The shakeout process thus gives large, R&D-intensive firms an advantage in survival.

A third set of explanations for shakeout involves the refinement of existing technology. According to Boyan Jovanovic and Glenn M. MacDonald, most new industries go through a period of rapid expansion, as firms attempt to develop a new product and take advantage of above-normal profits.²⁵ In their scheme, all firms produce the optimal level of output, and entry occurs until economic profits are driven to zero. As this process evolves, a refinement in the product occurs, which many firms, but not all, succeed in developing. This is the beginning of the shakeout phase.

At first, the refinement prompts entry into the new market. Firms scramble to enter as quickly as possible in order to take advantage of this new industry niche. However, incumbents already involved in manufacturing the product retain an advantage over these later firms owing to their accumulated experience in production. As all of these firms move into overdrive in order to incorporate the refinement, they increase their optimal level of output, causing prices to fall. Shakeout occurs when a substantial number of firms are unable to react rapidly enough with respect to this product improvement. With prices falling, exit follows, as firms that have failed to innovate leave the industry.

The commonality shared by all of these theories of shakeout is their description of surviving firms' behavior as superior to that of their competitors in the production of a specific good. Winners might propose or quickly incorporate a technological design toward which all firms converge, or they might develop large R&D operations that swamp the technological efforts of their competition. They might even develop or adopt a refinement for a product that other firms have difficulty replicating. In each of these cases, their actions result in a shakeout of less alert firms.

Shakeout in policy entrepreneurship proceeds along a similar trajectory (see Figure 1.2). Each group attempts to control the agenda, in such a way

²⁵ Boyan Jovanovic and Glenn M. MacDonald. 1994. "The Life Cycle of a Competitive Industry." *Journal of Political Economy* 102(2): 322-347.