

Nonmarket Strategies in Government Arenas

Political Economy

Prof. Francesco Trebbi

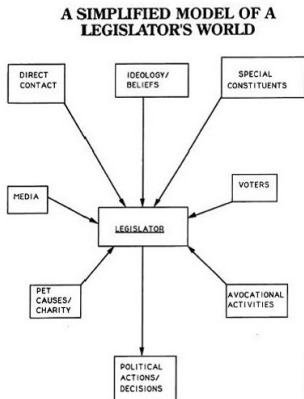
University of California Berkeley– Haas School of Business

Goals

- 1 Lobbying
- 2 Electoral Support and Campaign Contributions
- 3 Charitable Giving
- 4 Grassroots and Coalition Building
- 5 Testimony
- 6 Public Advocacy
- 7 Judicial Strategies
- 8 Models of Informational Lobbying (cheap & costly)
- 9 Lobbying as Policy Buying

Influence Wheel

FIGURE 1



A 1992 Philip Morris document referred to by then-Director of Government Affairs Tina Walls as the “Influence Wheel” during internal company presentation on “grasstop” relations, including the role of donations to legislators’ pet causes and favorite charities.

Source: References 102 and 103.

- Bombardini and Trebbi (2025) “The Political Power of Firms” Handbook of Political Economy chapter.
- Presents an accurate description of all these different tools
- Some quantifiable and monetizable (e.g. campaign donations), others not (e.g. dark money)
- On-equilibrium path payments. All combined the same share of a large firm revenue as what is spent on CEO compensation.
- But there is also the off-equilibrium threat of a corporation: special interest or powerful donor to step up their effort against a politician if their requests are not granted.

Definition

We define lobbying as the strategic communication of politically relevant information.

Targets of lobbying:

- The President
- Members of Congress
- Governors
- Executive branch officials and staff
- Regulatory and administrative officials
- State legislature

Lobbying (cont.)

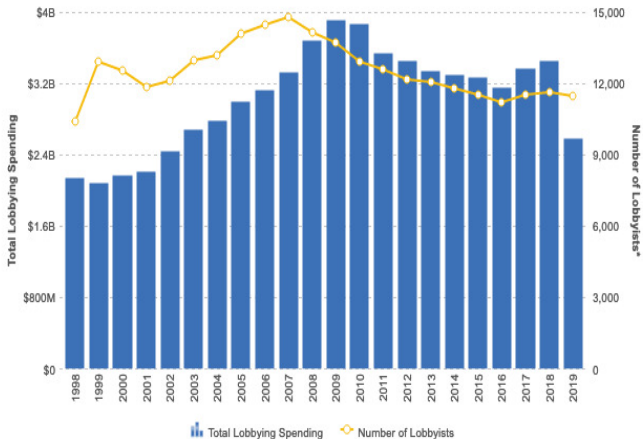
The First Amendment to the Constitution of the US recognizes the right of citizens to petition government to redress grievances.

Lobbying in the US is a 4 billion dollar business [2020]. It influences the political decision making process for trillions worth of government spending and nonmarket intervention.

Lobbying is usually conducted behind the scenes. This makes it particularly difficult to study as a channel of influence.

Data on lobbying is scarce, and hard to obtain. Bombardini and Trebbi (2019)

Lobbying Figures: Trends



Source: Center for Responsive Politics

*Numbers adjusted for inflation

Lobbying by Industry: Top 20

Industry	Lobbying 1998 - 2019
Pharmaceuticals/Health Products	\$4,296,982,621
Insurance	\$2,895,786,610
Electric Utilities	\$2,503,950,485
Electronics Mfg & Equip	\$2,421,734,326
Business Associations	\$2,378,540,342
Oil & Gas	\$2,251,535,111
Misc Manufacturing & Distributing	\$1,816,207,205
Hospitals/Nursing Homes	\$1,738,117,684
Education	\$1,732,516,493
Securities & Investment	\$1,670,912,435
Real Estate	\$1,656,962,474
Telecom Services	\$1,648,911,914
Health Professionals	\$1,577,595,639
Civil Servants/Public Officials	\$1,535,606,259
Air Transport	\$1,535,066,428
Health Services/HMOs	\$1,203,896,453
Automotive	\$1,183,408,291
Defense Aerospace	\$1,150,315,071
Misc Issues	\$1,126,702,894
TV/Movies/Music	\$1,106,851,693

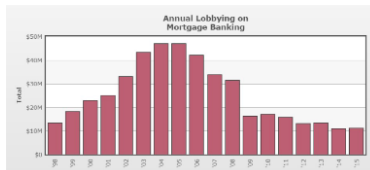
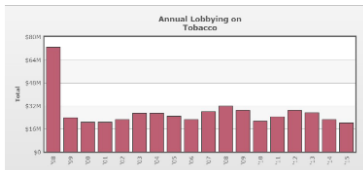
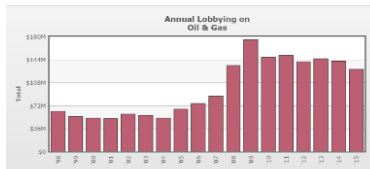
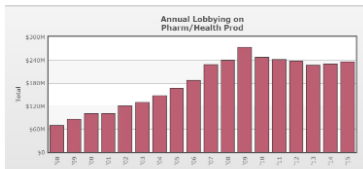
Source: Center for Responsive Politics

Lobbying Figures: Top 20 Contracts 1998 - 2019

Firm	Client	Total
Akin Gump et al	Gila River Indian Community	\$37,710,000
Covington & Burling	Qualcomm Inc	\$33,800,000
Swidler Berlin et al	Asbestos Study Group	\$30,020,000
Ogilvy Government Relations	Blackstone Group	\$22,380,000
Patton Boggs LLP	Mars Inc	\$22,230,000
McGuinness & Yager	HR Policy Assn	\$17,430,000
Venn Strategies	Employee-Owned S Corporations of America	\$16,883,500
Hogan & Hartson	Nissan North America	\$16,260,000
Alcalde & Fay	Cruise Lines International Assn	\$14,820,000
Baker Donelson et al	Toshiba Corp	\$14,347,500
Federal Policy Group	General Electric	\$14,255,000
Dickstein Shapiro LLP	Lorillard Inc	\$14,110,000
Canfield & Assoc	Consumer Mortgage Coalition	\$13,910,000
Dickstein Shapiro LLP	Loews Corp	\$13,640,000
Williams & Jensen	Owens-Illinois	\$13,370,000
Smith-Free Group	Sony Corp	\$13,340,000
Cassidy & Assoc	Boston University	\$13,320,000
Dewey & LeBoeuf	Lloyd's of London	\$12,830,000
K&L Gates	Pitney Bowes Inc	\$12,680,000
Covington & Burling	Pharmaceutical Research & Manufacturers of America	\$11,389,000
Akin Gump et al	PG&E Corp	\$11,310,000
Wiley Rein LLP	Nucor Corp	\$11,190,000
Akin Gump et al	Moody's Corp	\$11,040,000
Akin Gump et al	Mortgage Insurance Companies of America	\$10,870,000
MJ Bradley & Assoc	Clean Energy Group	\$10,810,661

Source: Center for Responsive Politics

Lobbying Figures: Disaggregated Trends



Source: Center for Responsive Politics

Lobbying Legislation and Disclosure

The Lobbying Act of 1946 is the principal bill governing lobbying. It is now integrated with the Lobbying Disclosure Act of 1995 and Honest Leadership and Open Government Act of 2007 (HLOGA).

In *United States v. Harriss*, 347 U.S. 612 (1954), the Supreme Court limited the 1946 Act's jurisdiction only to direct lobbying of Congress by a hired lobbyist.

So, a firm's employees involved in government relations in Washington are required to register as lobbyists.

The Lobbying Act does not pertain consultants, advisors, grassroots efforts and public relations.

Lobbying Legislation and Disclosure (cont.)

Recently the controls on lobbying have been extended heavily, particularly with respect to disclosure clauses.

Lobbyists are required to register with the Clerk of the House and the Secretary of the Senate.

They have to file extensive quarterly lobbying reports, listing:

- The issues and the bills on which they are lobbying
- The amounts involved
- Details about their clients

Example: A Lobbying Report

Clerk of the House of Representatives
Legislative Resource Center
8-158 Cannon Building
Washington, DC 20515

Secretary of the Senate
Office of Public Records
212 Hart Building
Washington, DC 20510

RECEIVED
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LOBBYING REGISTRATION

Lobbying Disclosure Act of 1995 (Section 4)

Check if this is an Amended Registration ☐ 1. Effective Date of Registration August 25, 1999

2. House Identification Number _____ Senate Identification Number _____

REGISTRANT

3. Registrant name Schramm, Williams & Associates, Inc.

Address 517 C Street, NE

City Washington State DC Zip 20002

4. Principal place of business (if different from line 3)
City _____ State/Zip (or Country) _____

5. Telephone number and contact name
202 541-4455 Contact Nancy Williams E-mail (optional) _____

6. General description of registrant's business or activities
Government Relations Consultants

CLIENT

A lobbying firm is required to file a separate registration for each client. Organizations employing in-house lobbyists should check the box labeled "Self" and proceed to line 10. ☐ Self

7. Client name California Association of Winegrape Growers

Address 555 University Ave., #250

City Sacramento State CA Zip 95825

8. Principal place of business (if different from line 7)
City _____ State/Zip (or Country) _____

9. General description of client's business or activities
Growers Association

LOBBYISTS

10. Name of each individual who has acted or is expected to act as a lobbyist for the client identified on line 7. If any person listed in this section has served as a "covered executive branch official" or "covered legislative branch official" within two years of first acting as a lobbyist for the client, state the executive and/or legislative position(s) in which the person served.

Name	Covered Official Position (if applicable)
<u>Nancy Williams</u>	
<u>Anita Brown</u>	

Form LD-1 (Rev. 06/98)
Page 1

Example: A Lobbying Report

Registrant Name Schramm, Williams & Associates, Inc. Client Name California Association of Wine Grape Growers

LOBBYING ISSUES

11. General lobbying issue areas. Select all applicable codes listed in instructions and on the reverse side of Form LD-1, page 1.

TRD

12. Specific lobbying issues (current and anticipated)

H.R. 194

AFFILIATED ORGANIZATIONS

13. Is there an entity other than the client that contributes more than \$10,000 to the lobbying activities of the registrant in a semiannual period and in whole or in major part plans, supervises or controls the registrant's lobbying activities?

☐ No → Go to line 14. ☐ Yes → Complete the rest of this section for each entity matching the criteria above, then proceed to line 14.

Name	Address	Principal Place of Business (city and state or country)

FOREIGN ENTITIES

14. Is there any foreign entity that:

a) holds at least 20% equitable ownership in the client or any organization identified on line 13; **OR**
 b) directly or indirectly, in whole or in major part, plans, supervises, controls, directs, finances or subsidizes activities of the client or any organization identified on line 13; **OR**
 c) is an affiliate of the client or any organization identified on line 13 and has a direct interest in the outcome of the lobbying activity?

☐ No → Sign and date the registration. ☐ Yes → Complete the rest of this section for each entity matching the criteria above, then sign and date the registration.

Name	Address	Principal place of business (city and state or country)	Amount of contribution for lobbying activities	Ownership percentage in client

Signature Nancy E. Williams Date 2/12/00

Printed Name and Title Nancy E. Williams, Secretary

Form LD-1 (Rev. 03/99) Page 2

US Lobbying: Definitions

Lobbyist

A lobbyist is any individual

- who is either employed or retained by a client for financial or other compensation;
- whose services include more than one lobbying contact;
- whose lobbying activities constitute **20 percent** or more of his or her services' time on behalf of that client during any three-month period.

Lobbying Contact

Any oral, written, or electronic communication to a covered official that is made on behalf of a client

Source: [lobbyingdisclosure.house.gov/amended_lda_guide.html#section3]

Lobbying Activities

Lobbying contacts and any efforts in support of such contacts, including

- Preparation or planning activities
- Research
- Other background work that is intended, at the time of its preparation, for use in contacts, and coordination with the lobbying activities of others.

Source: [lobbyingdisclosure.house.gov/amended_lda_guide.html#section3]

Lobbying Legislation and Disclosure (cont.)

In 2008 there were 14,490 registered lobbyists in Washington (Center for Responsive Politics). This includes lobbyists to the executive branch and to the staffers of Congress members.

Both the Lobbying Act as well as Senate and House rules prohibit gifts, dinners and privately paid travel to convention and events. However, they allow

- Grassroots political efforts
- Organization of political support
- Supplemental effort in drafting legislation

Example: The 2008 American Housing Rescue and Foreclosure Prevention Act of 2008 was initially drafted by [Credit Suisse](#).

Lobbying Congress

Given that the House introduces more than 5,000 bills per cycle, the informational needs of each congressman are particularly stringent.

Lobbyists provide the necessary information. However, mind the strategic bent of it.

Lobbyists act strategically to advocate their own position or to counter information provided by the other side.

Lobbying is also strategic in the sense of targeting influential or pivotal officeholders and timing the stages of the institutional process governing the issue (see research by Stratmann 2004).

In the best of cases, it does not involve threat, coercion or vote buying/corruption. However there is a whole set of economists for whom that is the norm (Grossman and Helpman 1996 “protection for sale” approach).

Information Conveyed Through Lobbying (What You Know)

Technical information: data and forecasts about overall consequences of political alternatives.

Political information: probably more important.

- Information about effects of political alternatives on a politician's constituency or policy interests of an officeholder. **Example:** Pizza Hut lobbying against eliminating tax credits for employing disadvantaged youth in 1986.
- Political information is really key to move legislation. Politicians are responsive to changes in electoral prospects.
- To support their lobbying, many firms develop data on their rent chains, including their total employees and supply chain in each congressional districts

Information Conveyed Through Lobbying (cont.)

In my own research (Bombardini and Trebbi, JPubE 2012) I have shown how the the number of employees of a special interests tends to **substitute** political contributions to politicians. Large employers do not have to spend much in political contributions to be influential.

Much of the academic literature has painted lobbying as an information transmission process lobbyists as experts who provide information to legislators.

Information Conveyed Through Lobbying (cont.)

This is the view maintained by the American League of Lobbyists (from the website):

- *“Its principal elements include researching and analyzing legislation or regulatory proposals; monitoring and reporting on developments; attending congressional or regulatory hearings; working with coalitions interested in the same issues; and then educating not only government officials but also employees and corporate officers as to the implications of various changes.”*
- *“Lobbying is a legitimate and necessary part of our democratic political process. Government decisions affect both people and organizations, and information must be provided in order to produce informed decisions.”*

Nicholas Allard, partner at Patton Boggs:

- *“I would not – and you would not – try to do a root canal on ourselves. And, that you turn to an expert [a dentist]. And so, put in those terms, the reason why people have expert advocates – or lobbyists- is that **you need expertise.**”*

Access/Relationships (Whom You Know)

Access to key players (committee and subcommittee chairpersons, party leaders, etc.) is fundamental. The main asset of powerful lobbyists include access to a roster of power players.

Access is offered in exchange of politically valuable resources (campaign contributions, grassroots movements, information on the likely effect of policy on sub-constituencies, etc.)

Access is an asset many large lobbying firms sell explicitly, through enlistment of former cabinet and former Congress members and aides. This is the object of some my ongoing research.

In 2008, there were several former Congressional members working as registered lobbyists and (at least) 2,152 registered lobbyists with direct ties to former republican political positions and 1,842 with direct ties to former democrat positions.

Whom You Know or What You Know?

We answer this question empirically in Bertrand, Bombardini, and Trebbi (2015).

Are lobbyists issue experts, or are they simply well connected? The answer is **both**.

Are connections a key asset in the lobbying process, or are they 'grease' in the transmission of information? **Answer: Key Asset.**

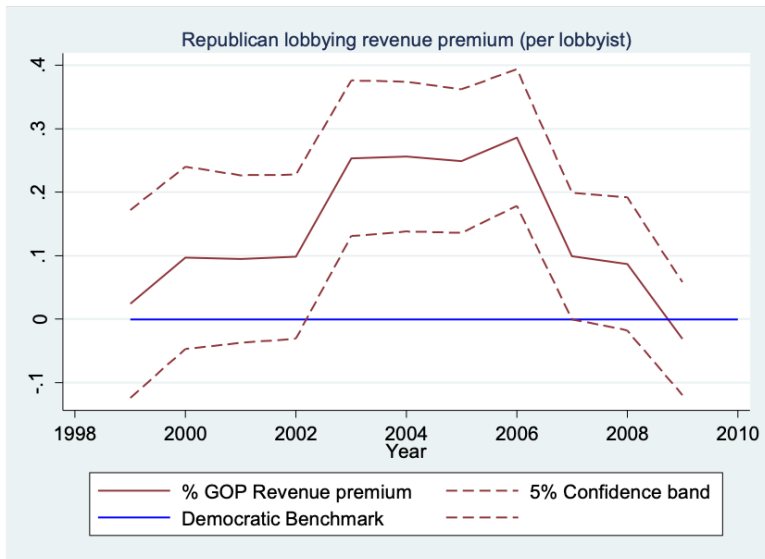
What makes a lobbyist truly valuable?

- Returns to both issue **expertise** and **connections**.
- **Connections are where the money is**

Implications

- Understanding lobbying requires understanding why connections matter on K Street.
- There is no theory on this to the best of our knowledge (possibly with the exception of some work on strategic intermediation).

Average Republican Lobbyist Revenue Premium

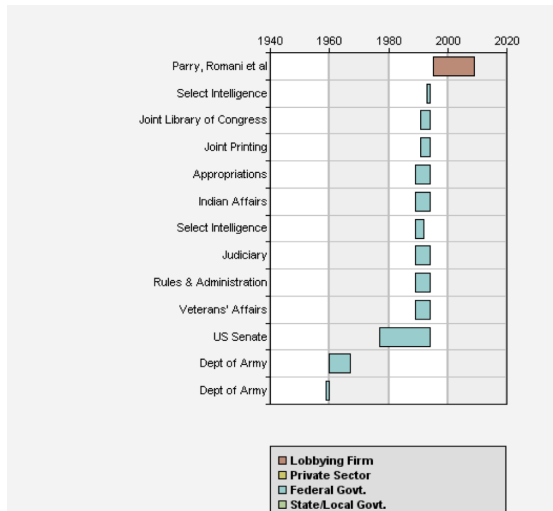


The Ethics in Government Act of 1978 prohibits an immediate “revolving door”, with politician immediately becoming lobbyists after leaving office.

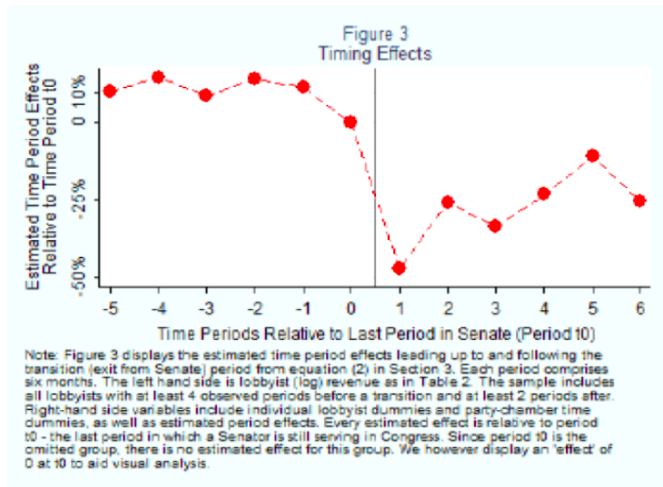
There are “cool down” periods from lobbying their former employer of 2 years for executive branch officials and regulators and of 1 year for

- Members of Congress
- Their aides
- Individuals involved in trade and other organization

Revolving Door: Example Sen. DeConcini

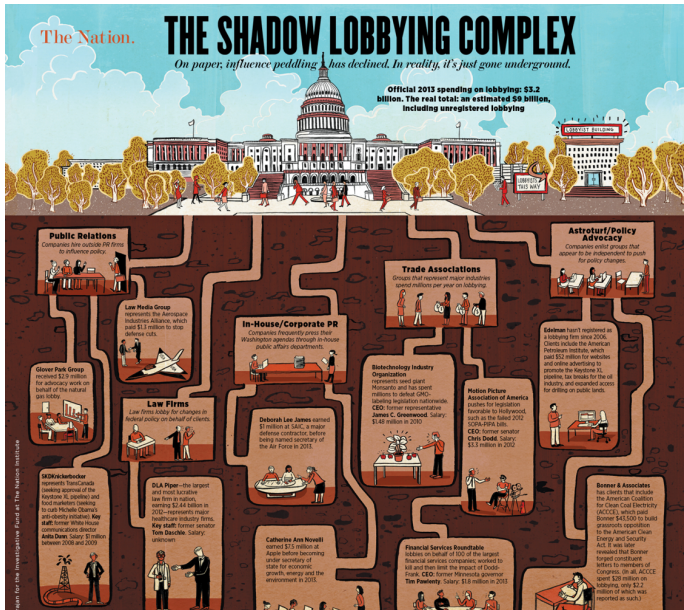


Revolving Door Lobbyists



Source: Blanes-i-Vidal et al. (2012)

(Tom) Daschle Loophole



Shadow Lobbying

- There is evidence of widespread shadow lobbying
- d'Este, Draca, and Fons-Rosen (2023) study the effectiveness of the US Lobbying Disclosure Act (LDA)
- Study the role of ex-Congressional officials who join US lobbying firms without officially registering
- Firm revenues increase by 10-20% when these 'shadow lobbyists' join in
- Because the increase is so large, hard to reconcile with the fact that these new hires should work on lobbying less than 20% of their time
- Unaccounted revenues of unregistered lobbyists can be valued at least \$150 million USD (likely an understatement)

Electoral Support & Campaign Contributions

Electoral support: providing important electoral resources to candidates.

- Endorsements
- Campaign contributions
- Volunteer workers
- Get-out-the-vote campaigns
- Political advertising (for and against candidates)

Electoral Support & Campaign Contributions (cont.)

Some means of electoral support are tightly regulated. For example, campaign contributions are regulated by the [Federal Electoral Commission](#).

Buckley v. Valeo, 1976 : Supreme Court campaign finance decision asserting campaign contributions could be limited [because of the appearance/danger of corruption](#) (places a reasonable burden on free speech).

Magnitude comparison (2008):

- Campaign contributions: \$500M
- Lobbying Expenditures: \$3-4 billion

However, campaign contributions are widely studied.

How much does it cost to run for Congress?

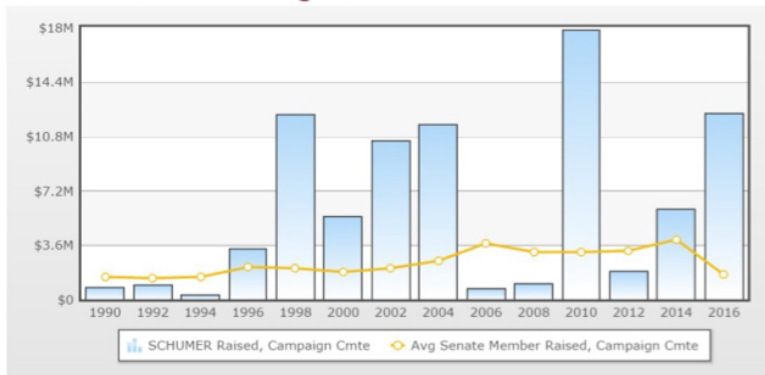
For the 114th Congress (2014 Election), House incumbents raised about \$1 million on average. For the Senate, the amount rises to \$2.6 million.

Notable exceptions:

- Hillary Clinton (D-NY) raised \$41.5 million to run against Rick Lazio, who raised \$40.5 million, in her 2000 New York senate race.
- Senator Chuck Schumer (D-NY) raised \$20 million in his 2016 senate race.

Campaign Spending (cont.)

Total Raised vs. Average Raised



Campaign Spending (cont.)

The Supreme Court has ruled that no limits on electoral spending can be set in accordance to the First Amendment (**Citizens United v. FEC, 558 US 310, 2010**).

- This is about direct spending by nonprofits or corporations that can independently spend on ads and other electoral activities. First amendment rights (freedom of speech).
- It does not refer to campaign donations by nonprofits or corporations to politicians. **These donations have to go through PACs, are limited in amounts and require disclosure.**

Around Election time, the group Citizens United wanted to promote their movie "Hillary: The Movie" on TV, as an attack on Senator Clinton.

In the interest of free speech, the Supreme Court ruled in favor of Citizens United by a 5-4 vote.

A very good online resource for data is the Center for Responsive Politics (CRP)'s Open Secrets website: www.opensecrets.org

Campaign Financing Facts 2012 - Presidency

President

Financial activity for all Presidential candidates, 2011-2012

Party	No. of Cands	Total Raised	Total Spent	Total Cash on Hand	Total from PACs	Total from Indivs
All	16	\$1,368,740,888	\$1,365,792,075	\$5,497,937	\$1,728,563	\$988,737,779
Dems	1	\$738,503,770	\$737,505,368	\$3,301,800	N/A	\$549,580,640
Repubs	10	\$625,415,940	\$623,361,597	\$2,075,152	\$1,728,563	\$435,760,388

Based on data released by the FEC on 03/11/2013.

Campaign Financing Facts 2012 - Senate

Senate

Financial activity for all Senate candidates, 2011-2012

Party	No. of Cands	Total Raised	Total Spent	Total Cash on Hand	Total	Total
					from PACs	from Indivs
All	251	\$699,122,362	\$701,230,385	\$40,082,061	\$81,153,521	\$462,873,099
Dems	81	\$303,637,006	\$309,456,627	\$18,991,813	\$43,814,934	\$245,542,153
Repubs	137	\$377,293,631	\$377,326,816	\$16,825,813	\$36,475,347	\$208,698,194

Based on data released by the FEC on 03/11/2013.

Campaign Financing Facts 2012 - House

House

Financial activity for all House candidates, 2011-2012

Candidates: \$403,701,000

Party	No. of Cands	Total Raised	Total Spent	Total Cash on Hand	Total from PACs	Total from Indivs
All	1710	\$1,119,094,146	\$1,076,199,861	\$188,720,713	\$356,336,214	\$638,071,046
Dems	760	\$485,747,090	\$475,500,346	\$80,372,676	\$157,697,999	\$284,868,410
Repubs	847	\$623,223,341	\$590,691,464	\$108,212,030	\$198,595,053	\$351,987,453

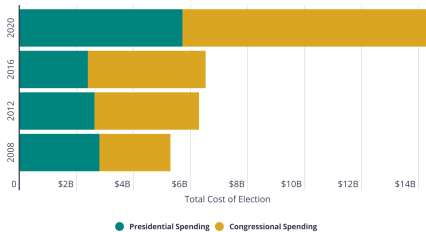
Based on data released by the FEC on 03/11/2013.

Campaign Financing Facts 2020

The pricey presidential showdown between Joe Biden and Donald Trump was funded by an unprecedented number of small donors giving online and billionaires who wielded tremendous political influence over the last decade. Donors also fueled record spending in congressional races, capping off the 2020 election with the all-time most expensive Georgia Senate runoffs.

2020 Election Crushes Spending Records

Federal spending in the 2020 election topped \$14.4 billion, the most expensive election in U.S. history.



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2008 Top 10 Most Expensive House Races

Raised

1 New York District 20	\$11,675,582
2 Illinois District 14	\$9,984,102
3 Illinois District 10	\$8,971,451
4 Colorado District 02	\$7,438,786
5 Connecticut District 04	\$7,438,574
6 Washington District 08	\$7,131,870
7 Pennsylvania District 12	\$6,911,726
8 Florida District 13	\$6,538,310
9 Georgia District 13	\$6,472,814
10 Minnesota District 06	\$6,424,079

Spent

1 New York District 20	\$11,420,001
2 Illinois District 14	\$9,945,364
3 Illinois District 10	\$8,862,693
4 Colorado District 02	\$7,420,409
5 Connecticut District 04	\$7,122,476
6 Washington District 08	\$7,102,614
7 Pennsylvania District 12	\$6,835,219
8 Florida District 13	\$6,664,896
9 Michigan District 09	\$6,424,441
10 Georgia District 13	\$6,318,360

2008 Top 10 Most Expensive Senate Races

Raised

1 Minnesota Senate	\$43,075,183
2 Kentucky Senate	\$31,659,025
3 North Carolina Senate	\$27,926,611
4 Texas Senate	\$23,409,373
5 Georgia Senate	\$21,478,212
6 Oregon Senate	\$19,725,075
7 Colorado Senate	\$18,997,265
8 New Hampshire Senate	\$17,175,952
9 Virginia Senate	\$16,449,948
10 Louisiana Senate	\$16,128,630

Spent

1 Minnesota Senate	\$39,955,026
2 Kentucky Senate	\$31,810,844
3 North Carolina Senate	\$27,839,303
4 Texas Senate	\$22,754,928
5 Georgia Senate	\$20,060,679
6 Colorado Senate	\$19,820,600
7 Oregon Senate	\$19,204,734
8 Massachusetts Senate	\$18,718,009
9 New Hampshire Senate	\$16,960,540
10 Louisiana Senate	\$15,916,360

Campaign Spending by Industry (2007-08 cycle): Top 20

Rank	Industry	Total	Dem Pct	GOP Pct	Top Recipient
1	Retired	\$124682920	55%	45%	Barack Obama (D)
2	Lawyers/Law Firms	\$119994071	78%	22%	Barack Obama (D)
3	Securities/Invest	\$59608746	64%	36%	Barack Obama (D)
4	Real Estate	\$59420553	57%	43%	Barack Obama (D)
5	Health Professionals	\$54276809	60%	40%	Barack Obama (D)
6	Education	\$33600869	88%	12%	Barack Obama (D)
7	Business Services	\$30127521	72%	28%	Barack Obama (D)
8	Insurance	\$28654121	51%	49%	John McCain (R)
9	Misc Business	\$28235486	67%	33%	Barack Obama (D)
10	Misc Finance	\$25364537	54%	46%	Barack Obama (D)
11	TV/Movies/Music	\$23651326	78%	22%	Barack Obama (D)
12	Commercial Banks	\$21676813	52%	48%	Barack Obama (D)
13	Computers/Internet	\$21667720	70%	30%	Barack Obama (D)
14	Lobbyists	\$21597510	56%	44%	Hillary Clinton (D-NY)
15	Leadership PACs	\$20099092	43%	57%	Norm Coleman (R-Minn)
16	Pharm/Health Prod	\$17895352	54%	46%	Barack Obama (D)
17	Oil & Gas	\$15918533	26%	74%	John McCain (R)
18	Democratic/Liberal	\$15609342	100%	0%	Barack Obama (D)
19	Civil Servants	\$15186421	76%	24%	Barack Obama (D)
20	Electric Utilities	\$14331349	50%	50%	Barack Obama (D)

Campaign Financing Law

Under the 1974 Federal Election Campaign Act, the Federal Election Commission oversees the process of political contributions to candidates.

Donors have to disclose the candidate information, the amount of the donation, and some personal information (e.g. their address and their employer).

Political contributions are capped for **individual donors**

- \$2,600 per candidate (presidential and for congress)
- \$32,400 to each party national convention

Firms and other legal entities can only contribute through **Political Action Committees (PACs)**. PAC Political contributions are capped

- \$5,000 per candidate (presidential and for congress)
- \$15,000 to each party convention

From the Center for Responsive Politics (a great source):

“April 2014 Supreme Court decision **McCutcheon v. Federal Election Commission** removed aggregate limits for individual donors giving to candidates, political parties, and PACs:

- There are still **limits on how much any individual may give** to each of those committees.
- **No longer, though, is there an overall cap on how much one person can give to these committees combined in an election cycle**; the last such limit, which was in place until the court's ruling, was \$123,200 [no more than \$48,600 to candidates + \$74,600 to all PACs & parties].”

Campaign Financing Law (cont.)

From the Center for Responsive Politics (a great source):

- “The ruling expands opportunities for deep-pocketed donors to contribute to as many recipients as they want and fuels the creation of "super JFCs" — [joint fundraising partnerships between many campaigns or party committees, which allows them to collect one large check from each donor and split the proceeds.](#)”
- “While JFCs are not new, the pre-McCutcheon limits had the practical effect of keeping them relatively small, since a donor couldn't give to many committees before hitting the cap. Big donors are even more sought after now, and politicians who can draw those donors in on the behalf of their JFC partners have increased clout.”

Campaign Financing Law (cont.)

New Phenomena from **Citizens United v. FEC 2010** & **McCutcheon v. FEC 2014**:

- In the IRS tax code, **501(c)(4)** indicates social welfare organizations (“Civic Leagues, Social Welfare Organizations, Local Associations of Employees”). This classification was previously used to fund Volunteer Firefighters Groups, etc.
- These **politically active nonprofits** can accept unlimited donations without revealing donors’ names.
- 501(c)(4)’s can use only 50% of their funds for political activity. They frame their advertising as “Issue Ads” as opposed to “Candidate Ads” -but that’s what they are.
- Their spending rose from \$5.4M in 2004 to \$300M in 2012.
- Examples:
 - 501(c)(4): Karl Rove’s Crossroads GPS; Americans for Prosperity.
 - 501(c)(6) [for trade associations]: Koch Brothers’ Freedom Partners

Campaign Financing Law (cont.)

New Phenomena from **Citizens United v. FEC 2010** & **McCutcheon v. FEC 2014**

- **Super-PACs** are post-Citizens United entities with **unlimited independent spending capacity conditional on not being coordinated with any campaign committee**.
- Loophole: Candidates use them before declaring candidacy. They then put their best men in charge (e.g. Jeb Bush selecting Mike Murphy for his Super-PAC).
- Super-PACs still **required to disclose all donors**. Most focus on resources, and a lot of them, on negative advertising.
- Example: The single candidate Super-PAC “Right to Raise” supporting Jeb Bush raised \$100 Million in 2015-2016 in relation to GOP primary.

Special interests' influences are the main issue behind the debate on income inequality.

The differential access and political influence of wealthy individuals/groups violates “One man, one vote” principles.

The US Constitution's 14th amendment contains an **Equal Protection Clause**.

So, corruption/appearance of corruption aren't the only thing that justify limitations to free speech.

(Pre-Citizens United) Campaign Financing Puzzles

Ansola-behere, De Figueireido, Snyder (JEP 2003) “Why is there so little money in American Politics?”

- Low amounts of campaign contributions even though caps are seldom binding.
- Low amounts even though very large economic gains can result from government intervention. The rates of return from political contributions are **huge** (called the Tullock's Puzzle –from Gordon Tullock (1972))

Political contributions appear ineffectual in changing policy positions or affecting electoral outcomes.

Some of these puzzles can be resolved when thinking about the problem in further depth...

(Pre-Citizens United) Campaign Financing Puzzles

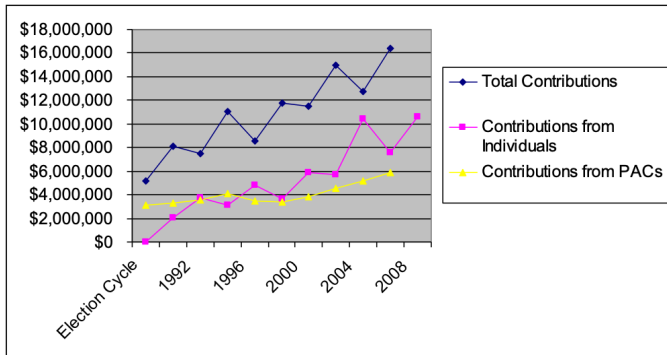
Tullock's puzzle looks at the rate of return of \$1 of campaign contributions on total government benefits from political activities.

Example: The 2000 Farm bill in the US. It includes \$22 billion of subsidies to the US agribusiness lobby vis-a'-vis less than \$3.7 million of campaign contributions from agribusiness special interest groups (PACs).

This is \$6,000 of subsidies for every dollar of political contributions. A rate of return of 600,000%!

This is obviously not economically reasonable (competition in the political market should arbitrage those rents away).

Campaign Financing Puzzles: Agribusiness Contributions



Campaign Financing: Votes and Money

However, this considers political contributions as the **only** channel of influence.

In Bombardini & Trebbi (JPubE 2011) we show that:

- (i) the electoral weight of a special interest group is as important as a channel of influence (its number of employees, that is)
- (ii) the cost of buying a vote is relatively high, about \$200-\$400.

There are 4 million farmers and agribusiness-connected voters in the US.

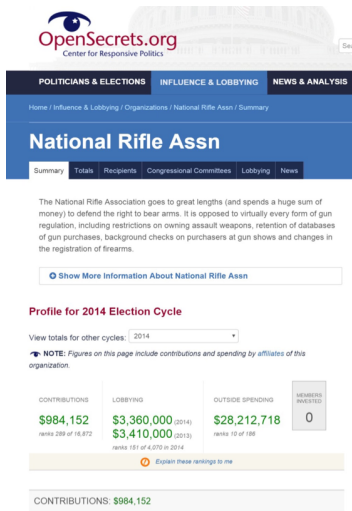
The rate of return to political activity of the agricultural special interest is now:

$$\$22 \text{ B} / (\$3.7 \text{ M} + \$400 * 4\text{M})$$

$$= \$13.7 \text{ for every dollar of political contributions.}$$

It's still high, but more reasonable (not \$6000). Electoral weight of SIGs is multidimensional.

Campaign Financing: Votes and Money



Source: Center for Responsive Politics

Example: NRA

More Thoughts on Campaign Contributions

Ansolahehere, de Figueiredo, and Snyder (2003) suggest that campaign contributions are a form of **consumption**.

Maybe. But I would not bet my life on it.

There is also an important reason for giving money to politicians, even if they do not affect the outcome of elections: **ACCESS**.

Corporate Social Responsibility? Charitable Giving for Political Influence

Bertrand, Bombardini, Fisman, Trebbi (AER 2020)

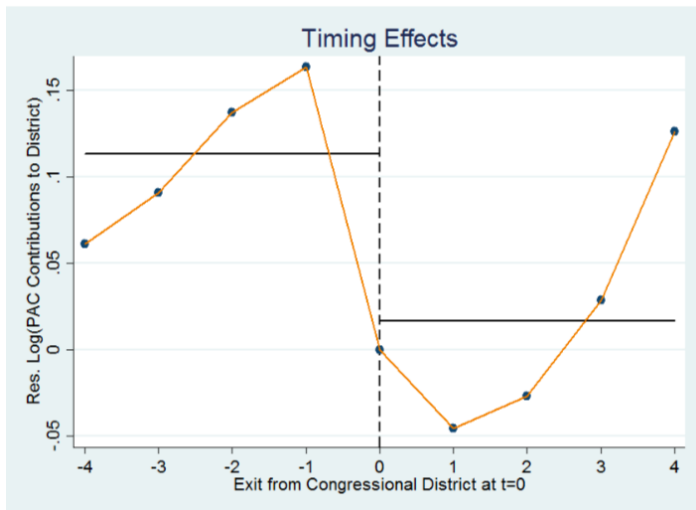
This paper shows that charitable giving, which is not subject to disclosure and it is tax- exempt for 501(c)(3) nonprofits

- Follows patterns similar to campaign contributions
- Underlines a **channel of political influence larger than PAC contributions** (> \$1 Billion of political CSR per year). See “influence wheel” by Philip Morris: they kept track of this

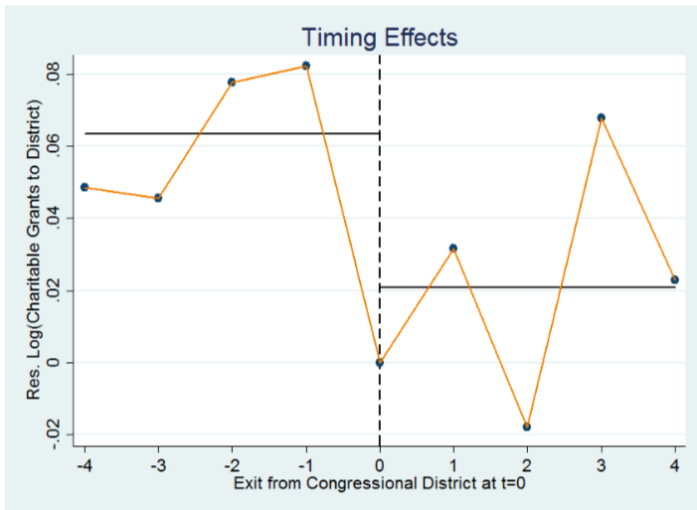
Not all CSR is political, but a share substantial enough to represent a completely new, large channel for money in politics.

Bertrand, Bombardini, Fisman, Hackineen, Trebbi (QJE 2021) on charitable giving “triangulated” to influence regulators.

Corporate Social Responsibility? Charitable Giving for Political Influence (cont.)



Corporate Social Responsibility? Charitable Giving for Political Influence (cont.)



Grassroots Campaigns

Grassroots: strategies of influence based on the electoral connection between constituents and their elected representative.

Both the **breadth** (number of voters mobilized by a certain policy) and the **depth** (intensity of preferences in favor or against a certain policy) matter.

It is a form of **costly signaling** to politicians, who may be uninformed about the **importance of a certain policy for their constituents**.

Example: the NRA has always been a prominent grassroots campaigner given its **effectiveness in mobilizing large, electorally pivotal sub-constituencies** in favor of gun rights and against gun control.

Grassroots Campaigns (cont.)

The basis of grassroots is mobilizing voters.

Grassroots campaigning develops through communication of information to voters (usually SIGs directly contact voters or engage in localized activities of propaganda) and then active mobilization.

Mobilization may be through

- **Writing to congressmen** (by letter, postcard or email). Congressmen tend to weigh the relevance of issues on the basis of the direct response they ingenerate in voters.
 - Ex: After the massive intraday stock market drop following the failure of the Wall Street bailout bill on September 29, 2008, the House email servers were flooded with emails from constituents scared about their 401(k). **The bill passed later in the week.**
- **Direct meeting and lobbying of Congress members** (fly-ins by Unions and other special interests, etc.).

Grassroots Campaigns (cont.)

Example: The National Association of Manufactures has developed the Prosperity program. This program sends alerts to employees of subscribing firms about the policy stance of their elected representatives on issues relevant to the firm. Subscription is available for \$3000.

“During the 2004 election, more than 900 companies, corporations and associations deployed the Prosperity Project. By Election Day, the program reached more than 19 million employees, delivered more than 40 million messages and helped 1.7 million employees with voter registration and early ballot information.”

Source: http://www.bipac.net/page.asp?content=interm_p2&g=nam&parent=NAM

Astroturf Campaigns

The effectiveness of grassroots campaigns revolves around mobilization of blocs of voters.

Lobbyists and special interests sometime operate to **artificially inflate the numbers of policy-concerned voters**.

Fake grassroots campaigns: astroturfing.

- **Example 1:** The National Smokers Alliance, created by Burson-Marsteller (a lobbying firm) on behalf of Philip Morris (a large tobacco and food corporation) to influence Federal legislation during the 1995-1996 cycle.
- **Example 2:** The Save Our Species Alliance was revealed to be a fake grassroots group created by a timber and cattle lobbyist to weaken clauses in the Endangered Species Act in 2006.

More examples at: <http://www.cleanupwashington.org/documents/astroturf.pdf>

There are several forms of coalitions that can be observed in political settings:

- **Peak (Umbrella) Associations:** Multi-Industry Issues.
 - Example: US Chamber of Commerce, National Association of Manufacturers, etc.
- **Trade Associations:** Industry-Specific Issues.
 - Example: Pharmaceuticals Research and Manufacturers Association (PhRMA).
- **Ad Hoc Coalitions:** Single Issues.
 - Example: Clean Air Working Group (2000 businesses and trade associations) opposing stringent environmental regulation in the 1990 amendments of the Clean Air Act.

Coalition Building and Lobbying

Trade Associations are usually considered collective action solvers.

Example of free-riding issues and collective action resolution (Olson 1965).

Take a sector with n firms.

Lobbying the government has a public-good feature. Each firm's private effort produces a gain of b **for each firm in the sector**.

Private benefit from lobbying: b

Private cost of lobbying: c .

But, **public benefit of lobbying** is $n*b$.

*If $nb > c > b$ private incentives won't be sufficient for having firms lobbying even if they would gain from lobbying ($n*b$).*

Coalition Building and Lobbying (cont.)

Bombardini & Trebbi (JIE 2012): We observe 2 modes of lobbying:

- a) Lobbying as an individual firm
- b) Lobbying through a trade association (sector-specific)

Turns out that it's **market structure primitives** that matter.

More "competitive" sectors lobby more as a trade association:

- **Sectors with less differentiated products**
- **Sectors with lower concentration**

Counter-intuition:

- The collective action problem would suggest that there would be **less** political organization in more competitive sectors.
- In our research, we find that competitive economic environments can lead to **more** political organization.
- Preliminary evidence: Controlling for the total amount of lobbying, the higher the ratio of trade association to individual lobbying, the higher the level of protection.

Other channels of Influence: Testimony

Companies and lobbyists routinely testify before congressional committees, administrative and regulatory agencies, and courts.

- Example 1: GM, Ford and Chrysler's bailout hearings in front of the Government Reform Committee in November 2008.
- Example 2: Fed Chairman Bernanke's and Treasury Secretary Paulson's testimonies in front of the Financial Services Committee after the Wall Street bailout of October 2008.

In a regulatory setting, testimony not only provides information, but also creates a record (which can later be used for judicial review).

Testimony of what?

Congressional hearings are particularly interesting phenomena (and a good research topic). Given the amount of lobbying preceding the hearing, little new information is revealed to congressmen.

You will be surprised, most questions are “**zingers**”. A **zinger** is a question whose only reasonable answer would support a congressperson's own position.

Congressional hearing are mostly **employed by committee chairs and members to reinforce their position with voters and to spin/send signals to the electorate.**

- Example: A testimony in favor of the majority view may be scheduled for the morning in order to catch the same evening's news cycle.
- Opposing views may be relegated to the evening, so that it misses the evening news cycle and is old news by the next day.

Public Advocacy

- The process of direct communication to the public by firms or special interests about issues of public policy.
- It is a form of reverse lobbying – lobbying voters on policy issues.
- Example 1: Big Pharma's media tours and initiative to curb concern about high costs of medication.
- Example 2: AARP's United-We-Fail electoral ads operation on Social Security reform.

Usually employed by deep-pocket interest groups and linked to other forms of political influence (grassroots campaign and lobbying).

Judicial Strategies

Implemented in state and federal courts and in regulatory arenas governed by administrative law.

Judicial strategies are employed to

- Enforce rights
- Obtain damages for breach of contract
- Address unfair competitive practices under the antitrust law
- Protect intellectual property
- Plainly scare and handicap adversaries (including regulators) **due to the legal costs involved**.

Example: in 1992 GM filed suit against the Department of Transportation because of its preliminary decision to recall GM pickup trucks with side-mounted gas tanks. The secretary of transportation backed down and did not order the recall.

Judicial action is **extremely costly** and is used in combination with other nonmarket strategies, such as lobbying.

SOME THEORETICAL FORMALIZATION

Now we will try to formalize some of the concepts we just considered.

We will focus on the transmission of information in lobbying. Next, we will also study the policy influence aspect.

Let us start with a model of costless lobbying (cheap talk). Read **Grossman and Helpman (2001, ch. 4; ch. 5)** and **Potters and van Winden (1992)**.

We will show that informative communication can ensue.

We will then investigate how lobbying costs can help in signaling to politicians (costly signaling or costly screening).

Set-Up

Consider a political system with one incumbent politician and one special interest group (SIG).

The **state of the economy** is given by a realization of the random variable θ , which is observed only by the SIG.

The politician derives utility from implementing the right policy τ for the state of the world θ which has realized:

$$G = -(\tau - \theta)^2 \quad (1)$$

Let us assume that SIG has preferences:

$$U = -(\tau - \theta - \delta)^2 - I \quad (2)$$

Where I is the cost of lobbying the government and indicates the SIG's bias.

Note: Preferences U and G are aligned because when θ is high, both prefer τ to be high. However, there is also divergence because **for given θ , SIG prefers τ to be higher ($\theta + \delta$)**.

Timing of the Game

Sequential structure:

- 1 State of θ is realized and Special Interest Group learns it.
- 2 SIG decides to lobby or not (and pay lobbying costs if any).
- 3 Politician updates her prior.
- 4 Politician chooses the policy τ .

Zero Lobbying Costs & Discrete States

Let us solve the simple case of $I = 0$

Consider the case of $\theta = \theta^H$ with probability $1/2$ or θ^L with probability $1/2$, and $\theta^H > \theta^L > 0$

Such distribution is common knowledge.

Consider the realization of $\theta = \theta^H$. The SIG has no incentives to lie about θ to the politician since this is the highest level of policy the politician will be willing to implement.

But what happens in case $\theta = \theta^L$? The SIG may have incentives to over-report about θ to the politician. When?

If the utility from having a policy $\tau = \theta^H$ when the true state is θ^L is higher than the utility from having a policy $\tau = \theta^L$ when the true state is θ^L

Truth-telling Condition

The condition for truth telling, replacing in (2), is

$$-(\theta^H - \theta^L - \delta)^2 \leq -(\theta^L - \theta^L - \delta)^2$$

Or

$$-(\theta^H - \theta^L - \delta)^2 \leq -\delta^2$$

Which can be rewritten as

$$(\theta^H - \theta^L)/2 \geq \delta \tag{3}$$

Truth-telling Condition (cont.)

So if (3) holds, we will have perfect information revelation from the SIG to the politician (and a state-contingent policy $\tau = \theta^i$ when the true state is $\theta^i, i = H, L$).

Otherwise no information is going to be credibly transmitted by the SIG (and a state-independent policy $\tau = (\theta^H + \theta^L)/2$ whether the true state is $\theta^i, i = H, L$).

Intuition: the bias has to be small enough so that it would be more expensive to lie than to tell the truth.

Zero Lobbying Costs & Continuum of States

Let us maintain the simple case of $l = 0$

Consider the case of $\theta \sim [\theta^L, \theta^H]$ and $\theta^H > \theta^L > 0$

Such distribution is common knowledge.

Full separation with costless communication (cheap talk) becomes impossible when the number of states increases. There is always going to be a value of θ close enough to the true realization for every small level of bias.

However, we can show that the lobbyist is still going to be able to provide some information in a credible way. Particularly, the SIG will be able to provide ranges of values of θ within which the realized state falls.

Coarse Partition

Consider splitting $[\theta^L, \theta^H]$ in n non-overlapping intervals (a partition).

The message is going to be j if $\theta^{j-1} < \theta < \theta^j$

We will show that there exists equilibria to this cheap talk game such that the SIG does not lie.

Were such j message credible, the politician should set $\tau = (\theta^j + \theta^{j-1})/2$

We need to make sure the SIG does not have incentives to overclaim (i.e. message 2 : $\theta^1 < \theta < \theta^2$) when $\theta < \theta^1$.

So the utility from telling the truth at the right boundary of $[\theta^L, \theta^1]$ has to especially hold because that's where temptation to lie will be highest:

$$\underbrace{-\left(\frac{\theta^2 + \theta^1}{2} - \theta^1 - \delta\right)^2}_{LIE} \leq \underbrace{-\left(\frac{\theta^L + \theta^1}{2} - \theta^1 - \delta\right)^2}_{TRUTH}$$

Which can be simplified to

$$\theta^2 \geq 2\theta^1 + 4\delta - \theta^L$$

Messages (cont.)

Moreover, we need to make sure the SIG does not have incentives to underclaim 1 when $\theta > \theta^1$.

So the utility from telling the truth at the left boundary of $[\theta^1, \theta^2]$ has to hold as well:

$$-((\theta^2 + \theta^1)/2 - \theta^1 - \delta)^2 \geq -((\theta^L + \theta^1)/2 - \theta^1 - \delta)^2$$

Or

$$\theta^2 \leq 2\theta^1 + 4\delta - \theta^L$$

Messages (cont.)

This pins down the equilibrium value of θ^2

$$\theta^2 = 2\theta^1 + 4\delta - \theta^L$$

We can repeat the exercise for all $j = 2, \dots, n-1$

$$\theta^j = 2\theta^{j-1} + 4\delta - \theta^{j-2} \quad (4)$$

Note: this is a second order linear difference equation.

We simply need to consider that no value higher than θ^H can be claimed, so $\theta^n = \theta^H$ and that $\theta^0 = \theta^L$

With these initial and terminal condition, it is possible to solve (4) explicitly for the partition of credible messages:

$$\theta^j = \theta^H(j/n) + \theta^L(n-j)/n - 2j(n-j)\delta \quad (5)$$

What Type of Cheap Talk Equilibrium?

Is it possible to have a partition as fine as we want? **No.**

First we need to check that $\theta^L < \theta^1$

Which holds if

$$\theta^L < \theta^1 = \theta^H/n + \theta^L(n-1)/n - 2(n-1)\delta$$

This condition is satisfied iff

$$2n(n-1)\delta < \theta^H - \theta^L$$

Which implies that

- ① $n = 1$ equilibrium always exists (babbling equilibrium, i.e. no info transmitted)
- ② If the bias is large enough, no credible exchange of information can take place. Then, the **only feasible equilibrium** will be a “*babbling*” equilibrium with $n = 1$ and **no credible communication**.
- ③ The larger $\frac{\theta^H - \theta^L}{\delta}$ (i.s. small δ) the larger n can be

Equilibrium Selection

If there exists a n -partition equilibrium, then it is also possible to have a $k < n$ partition equilibrium (i.e. if the bias is low enough for a finer communication, it is naturally going to be low enough for coarser communication).

We can rank these equilibria by **checking for welfare**. We are going to show that ex ante welfare is higher for both the politician and the SIG when the partition is the **finest** (highest n).

Let us assume for simplicity that $\theta \sim U[\theta^L, \theta^H]$

$$E[U^n] = -\frac{1}{\theta^H - \theta^L} \sum_{j=1}^n \int_{\theta^{j-1}}^{\theta^j} \left(\frac{\theta^j + \theta^{j-1}}{2} - \theta - \delta \right)^2 d\theta$$

$$E[U^n] = -\frac{1}{12(\theta^H - \theta^L)} \sum_{j=1}^n (\theta^j - \theta^{j-1})^3 - \delta^2$$

Equilibrium Selection (cont.)

Using (5) we get

$$-\frac{1}{\theta^H - \theta^L} \sum_{j=1}^n (\theta^j - \theta^{j-1})^3 = -\frac{(\theta^H - \theta^L)^2}{n^2} - 4\delta^2(n^2 - 1)$$

So

$$E[U^n] = -\frac{1}{12} \left(\frac{(\theta^H - \theta^L)^2}{n^2} + 4\delta^2(n^2 - 1) \right) - \delta^2 \quad (6)$$

Which tells us that ex ante expected welfare is increasing in n .

The largest n for which a credible partition is feasible is $n_{\max}$.

Costly Lobbying: Access Costs

Now let us check how we can easily extend this cheap talk framework into one *when the politician asks the SIG to pay for Access* (before observing the state of the world).

In particular, we will consider a politician caring about the amount of lobbying l (possibly because some of it is going to be used for campaign purposes – i.e. campaign contributions).

Also, let us assume the politician incurs a **cost** in terms of time t if she meets with the SIG (0 otherwise).

As before, the politician derives utility from implementing the right policy τ for the state of the world θ which has realized:

$$\tilde{G} = -a(\tau - \theta)^2 + (1 - a)l - t \quad (7)$$

SIG has the same preferences as before.

Access here warrants the possibility of providing the information later on in the game.

The SIG will decide what is the maximum amount of resources it is willing to pay the politician in order to have the opportunity of lobbying.

The SIG will compare the welfare **with and without communication**.

We will check which SIGs have the strongest incentives to lobby and which SIGs a politician is more likely to grant access to.

Timing of the Game

Sequential structure:

- 1 SIG decides to purchase access or not (and pay lobbying costs l).
- 2 The politician decides to accept or not.
- 3 State of θ is realized and Special Interest Group learns it.
- 4 Politician updates her prior.
- 5 Politician chooses the policy τ .

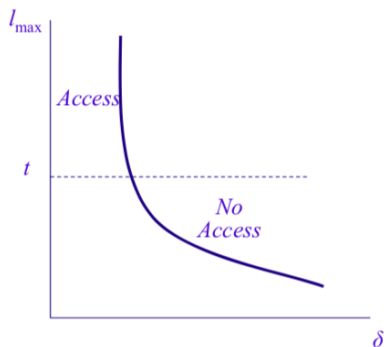
$$E[U^n] = -\frac{1}{12} \left(\frac{(\theta^H - \theta^L)^2}{n^2} + 4\delta^2(n^2 - 1) \right) - \delta^2$$

$$E[G^n] = -\frac{1}{12} \left(\frac{(\theta^H - \theta^L)^2}{n^2} + 4\delta^2(n^2 - 1) \right)$$

$$E[G^{n_{max}}] - E[G^1] = E[U^{n_{max}}] - E[U^1] = l_{max}$$

$$\tilde{G} = a \times -(\tau - \theta)^2 + (1 - a)l - t$$

$$\Delta E[\tilde{G}] = a(E[G^{n_{max}}] - E[G^1]) + (1 - a)(E[U^{n_{max}}] - E[U^1]) - t = l_{max} - t$$



Note: If you wonder why we compare t and $l_{\max}$, notice that $a \times l_{\max}$ is the expected welfare gain for the politician from having cheap talk **plus** the value of direct contributions from the SIG is $(1 - a) \times l_{\max}$. The sum of the two has to be compared to the cost of cheap talk, t .

Maximum Payment for Access

To show how much a SIG is going to be willing to pay for access, just consider the expected welfare **with and without informative cheap talk**.

$$I_{max} = E[U^{n_{max}}] - E[U^1]$$

$$I_{max} = -\frac{n_{max}^2 - 1}{12} \left(\frac{(\theta^H - \theta^L)^2}{n_{max}^2} - 4\delta^2 \right)$$

Notice that I_{max} is strictly decreasing in the bias δ , which implies that only SIGs whose preferences are close enough to the politician will invest in access.

Basically, we have solved a model that justifies the empirical regularity with which SIGs lobby their friends in Congress.

The rationale: only your friends will have sufficient incentives for telling the truth.

Other Examples of Costly Lobbying: Costly Signaling

So far, we have considered the case in which the politician requested an access fee to the SIG and screened them based on that.

However, it is likely that the SIG may decide to use its lobbying in order to provide information to the politician through signaling.

We consider two cases here.

- Fixed exogenous lobbying costs **have** to be paid for lobbying (think about setting up a government relations office in DC).
- Variable endogenous lobbying costs **can** be paid for lobbying (think about hiring a variable number of lobbying firms on K street to argue about the same issue).

Exogenous Fixed Cost

Let us go back to the simple case of discrete states.

Now, the lobbying cost is $f > 0$

We can show that paradoxically, the SIG can do better when it has to pay for lobbying.

First of all, notice that SIG has still an incentive to overreport if $\theta = \theta^L$

Exogenous Fixed Cost (cont.)

Since now lobbying costs money and there are only two states of the world, the SIG can do better by deciding to send its report to the politician only in one of the two states, say state θ^H (saving lobbying expenses in state θ^L).

A candidate equilibrium is one when the SIG pays in the good state θ^H .

Why? So that it costs money to the SIG to claim that it is the good state when in reality it is the bad state.

By not seeing the SIG lobby, the politician will infer $\theta = \theta^L$

Equilibrium

Can we sustain an equilibrium with perfect separation where the politician sets $\tau = \theta^H$ if the SIG pays I and $\tau = \theta^L$ if there is no lobbying?

Is it possible to achieve perfect separation even when there would be none in the cheap talk case (i.e. $(\theta^H - \theta^L)/2 < \delta$)?

- First condition: **It is worthwhile to lobby when $\theta = \theta^H$**

$$-(\theta^L - \theta^H - \delta)^2 \leq -(\theta^H - \theta^H - \delta)^2 - I$$

Or, rearranging:

$$I \leq (\theta^H - \theta^L)(\theta^H - \theta^L + 2\delta) = K1$$

- Second condition: **It is better not to lobby (and not to over claim) when $\theta = \theta^L$**

$$-(\theta^H - \theta^L - \delta)^2 - I \leq -(\theta^L - \theta^L - \delta)^2$$

Or, rearranging:

$$I \geq (\theta^H - \theta^L)(-\theta^H + \theta^L + 2\delta) = K2$$

Equilibrium Intuition

So for $K2 \leq I \leq K1$ it is possible to have perfect separation, even if the truth-telling condition in cheap talk (i.e. $(\theta^H - \theta^L)/2 - \delta$) is violated.

Paying lobbying costs allows the SIG to communicate credibly.

This is because the SIG has to pay to over-claim. When the lobbying costs are large enough the SIG will do less (actually zero) over-claiming. **This makes the SIG honest.**

However, lobbying costs must not be so high that you cannot afford to lobby when it is the appropriate time.

The politician obviously prefers a perfect separating equilibrium (i.e. implementing the right policy in the right state) instead of acting uninformed $\tau = (\theta^H + \theta^L)/2$

The SIG however may be worse off with perfect separation than in the babbling equilibrium, if the lobbying costs it has to pay are relatively high. Check:

$$-\frac{1}{2}(\delta^2 + I) - \frac{1}{2}\delta^2 \leq -\frac{1}{2} \left((\theta^H + \theta^L)/2 - \theta^H - \delta \right)^2 - \frac{1}{2} \left((\theta^H + \theta^L)/2 - \theta^L - \delta \right)^2$$

or

$$\frac{1}{2}(\theta^H + \theta^L)^2 \leq I$$

However, **even if this last condition holds, the perfect separating equilibrium sticks** (try to check what happens if the SIG decides not to lobby).

The SIG will only be able to escape this situation if it has a commitment device not to lobby - Tying its hands before seeing θ .

Partial Learning: Mixed Strategy Equilibrium

Even if lobbying costs are outside the boundaries $K2 \leq I \leq K1$, there is still a chance of learning. I am going to show you there is a mixed strategy equilibrium.

Consider the following strategy:

- If $\theta = \theta^H$ the SIG lobbies with probability 1 .
- If $\theta = \theta^L$ the SIG lobbies with probability $z < 1$.
- Lobbying may occur in either state, so there is no clear separation.
- However, if the politician sees lobbying, the signal of θ^H is **stronger**.

Construction of the Mixed Strategy Equilibrium

1. If the politician observes no lobbying ($L = 0$), then it is for sure $\theta = \theta^L$. The optimal policy will be $\tau = \theta^L$.
2. If the politician observes lobbying ($L = 1$), the Bayes rule implies $\theta = \theta^L$ with probability $z/(1+z)$ and $\theta = \theta^H$ with probability $1/(1+z)$

$$Pr(\theta = \theta^H \mid L = 1) = \frac{Pr(L = 1 \mid \theta = \theta^H) * Pr(\theta = \theta^H)}{(Pr(L = 1 \mid \theta = \theta^H) * Pr(\theta = \theta^H) + Pr(L = 1 \mid \theta = \theta^L) * Pr(\theta = \theta^L))}$$

Where $Pr(\theta = \theta^H) = Pr(\theta = \theta^L) = 1/2$, $Pr(L = 1 \mid \theta = \theta^H) = 1$ and $Pr(L = 1 \mid \theta = \theta^L) = z$

The optimal policy will be $\tau = (\theta^H + z\theta^L)/(1+z)$

Construction of the Mixed Strategy Equilibrium (cont.)

To pin down z just consider that the SIG must be indifferent between lobbying or not when $\theta = \theta^L$ (otherwise there is a dominant pure strategy and would not be randomizing). So z is the value that solves the indifference condition:

$$-\delta^2 = -\left((\theta^H + z\theta^L)/(1+z) - \theta^L - \delta\right)^2 - I$$

There are possible situations in which partial learning is the **only possible equilibrium** with some information revelation.

Note: Recall that a babbling equilibrium always exists too (albeit trivial).

Two Special Interest Groups

What happens when we increase the number of SIGs?

Let us assume that there are two SIGs with preferences:

$$U_1 = -(\tau - \theta - \delta_1)^2 - I$$

$$U_2 = -(\tau - \theta - \delta_2)^2 - I$$

It is important to know if the biases are **like** or **unlike** each other:

- If the two SIGs both prefer the same type of distortion (only in different degrees), they are like each other.
- If the two SIGs prefer opposite distortions (say, one always wants higher tariffs and the other always lower tariffs in every state), they're unlike each other

Let us start with the case of like biases $0 < \delta_1 < \delta_2$

Asymmetric Equilibria with Freeriding: Equilibrium 1

Politician **only** considers a report from SIG 1 & sets $\tau = \theta^H$ if the report says $\theta = \theta^H$

SIG 2 never lobbies and SIG 1 lobbies only in state θ^H

- $I \leq (\theta^H - \theta^L)(\theta^H - \theta^L + 2\delta_1) = K_1$ 1: SIG 1 is willing to pay lobbying costs if $\theta = \theta^H$
- $I \geq (\theta^H - \theta^L)(-\theta^H + \theta^L + 2\delta_1) = K_2$ 2: SIG 1 is **not** willing to pay lobbying costs if $\theta = \theta^L$

Asymmetric Equilibria with Freeriding: Equilibrium 2

Politician **only** considers a report from SIG 2 & sets $\tau = \theta^H$ if the report says $\theta = \theta^H$

SIG 1 never lobbies and SIG 2 lobbies only in state θ^H

- $I \leq (\theta^H - \theta^L)(\theta^H - \theta^L + 2\delta_2) = K_21$: SIG 2 is willing to pay lobbying costs if $\theta = \theta^H$
- $I \geq (\theta^H - \theta^L)(-\theta^H + \theta^L + 2\delta_2) = K_22$: SIG 2 is **not** willing to pay lobbying costs if $\theta = \theta^L$

However, it is likely that the condition $I \geq K_22$ is violated when the bias of SIG 2 is large (SIG 2 is more likely to **cheat**).

Symmetric Equilibrium: Can the Politician Request 2 Reports?

Assume both $K_{12} \leq I \leq K_{11}$ and $K_{22} \leq I \leq K_{21}$ hold simultaneously.

Equilibrium 3:

- The policymaker sets $\tau = \theta^H$ if there are two reports that say $\theta = \theta^H$
- In all other cases (one report or none) the policymaker sets $\tau = \theta^L$

SIG 1 and SIG 2 lobby in state θ^H .

Note: You can check that this is an equilibrium

Symmetric Equilibrium: Can the Politician Request 2 Reports? (cont.)

Note: Here, however, it's important to consider the out-of-equilibrium beliefs of the politician.

Turns out they are not very reasonable in Equilibrium 3.

Suppose actually SIG 2 decides not to lobby at $\theta = \theta^H$. The out-of-equilibrium play we specified is $\tau = \theta^L$.

Is it a “reasonable” belief? Actually, the politician should ask what are the possible situations he is in:

- a. Maybe $\theta = \theta^L$: SIG 1 is lying.
- b. Maybe $\theta = \theta^H$: SIG 2 is trying to save I .

Case **b** is reasonable. Case **a** implies a mistake on the part of SIG 1. It violates $I \geq K_1 2 \Rightarrow$ It's probable that the out of equilibrium belief isn't “reasonable” $\Rightarrow$ Back to 1

Opposite Biases

Suppose one SIG wants to overstate θ and the other wants to understate it.

Let us consider the case of $\delta_2 < 0 < \delta_1$

There is an asymmetric equilibrium where:

Equilibrium 1:

- Politician only considers a report from SIG 1 & sets $\tau = \theta^H$ if the report says $\theta = \theta^H$
- SIG 2 never lobbies and SIG 1 lobbies in state θ^H

It requires:

- $I \leq (\theta^H - \theta^L)(\theta^H - \theta^L + 2\delta_1) = K_1$: SIG 1 is willing to pay lobbying costs if $\theta = \theta^H$
- $I \geq (\theta^H - \theta^L)(-\theta^H + \theta^L + 2\delta_1) = K_2$: SIG 1 is **not** willing to pay lobbying costs if $\theta = \theta^L$

You Lobby for What You Care: Symmetric Equilibrium

However, there is also a symmetric equilibrium.

In this equilibrium each SIG advocates its case in the state where it has more at stake.

- SIG 1 lobbies when $\theta = \theta^H$
- SIG 2 lobbies when $\theta = \theta^L$

You Lobby for What You Care: Symmetric Equilibrium (cont.)

Equilibrium 2:

- Politician sets $\tau = \theta^H$ if she receives a report from SIG 1 that says $\theta = \theta^H$
- Politician sets $\tau = \theta^L$ if she receives a report from SIG 2 that says $\theta = \theta^L$
- Politician sets $\tau = (\theta^H + \theta^L)/2$ if she receives two reports or none.
- SIG 1 lobbies when $\theta = \theta^H$
- SIG 2 lobbies when $\theta = \theta^L$

You Lobby for What You Care: Symmetric Equilibrium (cont.)

Need to check new conditions - the parameter values for which Equilibrium 2 exists:

- First condition: SIG 1 is better off lobbying when $\theta = \theta^H$

$$-((\theta^H + \theta^L)/2 - \theta^H - \delta_1)^2 \leq -(\theta^H - \theta^H - \delta_1)^2 - I$$

- Second condition: SIG 1 is better off not lobbying when $\theta = \theta^L$

$$-((\theta^H + \theta^L)/2 - \theta^L - \delta_1)^2 - I \leq -(\theta^L - \theta^L - \delta_1)^2$$

- Third condition: SIG 2 is better off lobbying when $\theta = \theta^L$

$$-((\theta^H + \theta^L)/2 - \theta^L - \delta_2)^2 \leq -(\theta^L - \theta^L - \delta_1)^2 - I$$

- Fourth condition: SIG 2 is better off not lobbying when $\theta = \theta^H$

$$-((\theta^H + \theta^L)/2 - \theta^H - \delta_2)^2 - I \leq -(\theta^H - \theta^H - \delta_1)^2$$

Endogenous Lobbying Costs

Let us go back to the single SIG case with dichotomous states.

We consider the case a SIG may be able to make I endogenous to signal the importance of its case.

How expensive does lobbying have to be to make the statement $\theta = \theta^H$ credible?

Solution

Same as before. You will spend in the state you care about.

- First condition: **It is better to lobby when $\theta = \theta^H$**

$$-(\theta^L - \theta^H - \delta)^2 \leq -(\theta^H - \theta^H - \delta)^2 - I$$

Or, rearranging:

$$I \leq (\theta^H - \theta^L)(\theta^H - \theta^L + 2\delta) = K1$$

- Second condition: **It is better not to lobby (and not to over-claim) when $\theta = \theta^L$**

$$-(\theta^H - \theta^L - \delta)^2 - I \leq -(\theta^L - \theta^L - \delta)^2$$

Or, rearranging:

$$I \geq (\theta^H - \theta^L)(-\theta^H + \theta^L + 2\delta) = K2$$

- If $I^* = I \geq K2$ full revelation is possible.
- All equilibria for which the choice of I^* is $K2 \leq I^* \leq K1$ are possible.
- However, SIG will try to spend as little as possible
- So, the only equilibrium that is intuitive (*Cho & Kreps, 1987*) is $I^* = K2$

Quid Pro Quo Lobbying

- Move away from *informational lobbying* and towards *quid pro quo lobbying*
- Grossman and Helpman (1994) “Protection for Sale”
- Two approaches to endogenize protection as outcome of political process:
 - explicitly model political competition: elections and trade policy
 - incumbent politicians maximize “political support” (elections are not explicitly modeled, e.g. Hillman, 1989)
- This paper follows second strand of literature
- This model provide a micro-foundation of political support function

Main ingredients (I)

- Small open economy
- Specific factors model of trade
- Interest group = specific factor
- Political organization is exogenous (some interest groups do not lobby the government)
- No electoral competition, interest groups lobby incumbent government

Main ingredients (II)

- Interest groups offer monetary contributions to the government as a function of tariffs
- Government may value monetary contributions for electoral reasons
- Government also cares about general welfare (again, potentially related to re-election concerns)
- Tariffs result from trading off monetary contributions and welfare loss deriving from protection

The economy and preferences

- Small open economy
- Preferences are quasi-linear:

$$u = x_0 + \sum_{i=1}^n u_i(x_i)$$

- $u_i(\cdot)$ increasing, concave and differentiable
- x_0 is numeraire, freely traded
- other goods potentially bear a tariff:
 - p_i^* international price
 - p_i domestic price

- Quasi-linear utility “kills” income effects and makes aggregation easy
- Consumption of good i depends only on p_i
 - consumption of x_i is $d_i(p_i)$
 - rest of expenditure E spent on x_0 : $E - \sum_{i=1}^n p_i d_i(p_i)$
- Indirect utility function:

$$V(p, E) = E + s(p)$$

- Note: throughout maintain assumption that consumption of numeraire good is positive
- This is convenient because it reduces the degree of interaction among sectors

- x_0 is produced using only labor (one to one)
- assume the production of x_0 is positive $\implies w = 1$
- x_i is produced under CRS with:
 - labor
 - sector i specific input (capital, human capital, etc.)
- Return to specific factor $\pi_i(p_i)$
- Using Hotelling's lemma, output is given by:

$$y_i(p_i) = \frac{d\pi_i}{dp_i}$$

- Restrict policy space to tariffs
- Subsidies are more efficient, not allowed here
- Net tariff revenues are redistributed back to N consumers
 - per capita:

$$r(p) = \sum_{i=1}^n (p_i - p_i^*) \left[d_i(p_i) - \frac{y_i(p_i)}{N} \right]$$

- total imports $m_i(p_i) = Nd_i(p_i) - y_i(p_i)$

- Owners of specific factor i have stake in price of good i
- May or may not organize politically
- Set L of sectors organize:
 - within each sector, owners of specific factor form a cohesive interest group
- no modelling of incentives to organize
- no free-riding within sector

Lobbying the government

- Technical innovation of paper is employing menu auction (Bernheim and Whinston, QJE 1986)
- Set of L interest groups (principals) try to induce government (agent) to choose costly action: common agency problem
- Each lobby i submits a contribution schedule $C_i(p)$
 - “menu” in the sense that it associates a monetary amount to each possible price vector
 - no commitment issues (alternative: all pay auctions)
- The government chooses an equilibrium price vector p^0 (which translates into tariffs) and collects contributions
- Joint welfare of members of the lobby:

$$W_i(p) = \ell_i + \pi_i(p_i) + \alpha_i N [r(p) + s(p)]$$

where ℓ_i is labor income of members of lobby i

- Parameter α_i is share of population that owns specific factors in sector i

- Unitary government (no congress/parliament)
- No explicit electoral competition
- Government payoff:

$$G = \sum_{i \in L} C_i(p) + aW(p)$$

- Aggregate welfare:

$$W(p) = \ell + \sum_i \pi_i(p_i) + N[r(p) + s(p)]$$

where ℓ is total labor income in the country

- Bernheim and Whinston (1986) emphasize, among possible equilibria, those sustained by Truthful Contribution schedules
- Truthful contribution schedule:

$$C_i^T(p, B_i) = \max[0, W_i(p) - B_i]$$

- Truthful in the sense of reflecting everywhere the willingness to pay for p (no asymmetric information here)
- Truthful Nash Equilibria have the important property of being coalition-proof and truthful contributions are always in the best-response correspondence

Solution (II)

- Under these contribution schedules the maximization problem for the government is:

$$p^0 = \arg \max_{p \in P} \left[\sum_{i \in L} W_i(p) + aW(p) \right]$$

- FOC:

$$\sum_{i \in L} \nabla W_i(p^0) + a \nabla W(p^0) = 0$$

- Impact of change in p_i on lobby i welfare:

$$\frac{\partial W_i}{\partial p_i} = y_i + \alpha_i [m_i + (p_i - p_i^*) m'_i - Nd_i(p_i)]$$

- Similarly impact of change in p_i on lobby j welfare:

$$\frac{\partial W_j}{\partial p_i} = \alpha_j [m_i + (p_i - p_i^*) m'_i - Nd_i(p_i)]$$

Solution (III)

- Impact of change in p_i on aggregate welfare:

$$\frac{\partial W}{\partial p_i} = \underbrace{(p_i - p_i^*) m'_i}_{N \cdot \partial r(p) / \partial p} + \underbrace{m_i - N d_i(p_i)}_{\partial s(p) / \partial p} + \underbrace{y_i(p_i)}_{\partial \pi(p) / \partial p}$$

$$\frac{\partial W}{\partial p_i} = (p_i - p_i^*) m'_i$$

- Verify that optimal tariff is zero in the absence of lobbying $\implies$ see Grossman and Helpman (JPE 1995) for large country model with interest groups (optimal tariff considerations)
- Substitute in the first order condition and rearrange to find the equilibrium level of protection

Equilibrium level of protection

- Unique equilibrium in the tariff level $t_i = (p_i - p_i^*) / p_i^*$ (multiple equilibria in level of contributions sustaining it):

$$\frac{t_i^0}{t_i^0 + 1} = \frac{I_i - \alpha_L}{a + \alpha_L} \left(\frac{z_i^0}{e_i^0} \right)$$

- where z_i^0 is the inverse import penetration $y_i(p_i^0) / m(p_i^0)$ and e_i^0 is the elasticity of import demand
- I_i is an indicator function that is 1 if lobby i is politically organized and 0 if lobby i is not organized
- “Ramsey rule” for protection
- For politically organized sectors, protection:
 - is decreasing in elasticity of imports (more distortionary if e is high)
 - decreasing in import penetration (more distortionary if imports are a large fraction of consumption)
 - lower if α_L higher (more lobbying to lower tariff)
 - higher if a is lower (lower weight on welfare)

- For politically unorganized sectors: import **subsidy** (α_L share of population lobbying to reduce price of imports)
 - decreasing in import penetration and import elasticity for same reasons
 - larger subsidy if α_L is large (more lobbying)

Political contributions (I)

- Multiple equilibria in the level of contributions supporting tariffs t_i^0
- Given truthful contribution schedule, each interest group i will try to lower contributions as much as possible (increase B_i) without forcing the government to ignore them when setting tariffs
- Imagine without interest group i the government would choose price vector p^{-i}
- The interest group i will lower its contributions to keep government indifferent between p^{-i} and p^0

$$\sum_{j \neq i} C_j(p^{-i}, B_j) + aW(p^{-i}) = \sum_j C_j(p^0, B_j) + aW(p^0)$$

- There might be multiple levels of contributions that satisfy this condition

Political contributions (II)

- The amount of contributions and therefore the way the surplus is split between lobbies and government depends crucially on **competition** among interest groups
- If $\alpha_L = 0$ there is NO competition among lobbies (no one is lobbying to reduce the price on other products);
 - $\implies$ if government ignored sector i it would set tariff to zero (free trade)
 - $\implies$ sector i has to pay enough contribution to keep gov't indifferent b/w eq tariff and zero tariff on good i
- If $\alpha_L = 1$ maximum competition, entire population is lobbying
 - no protection (tariffs are zero)
 - but government is appropriating all rents
 - interest groups are paying just to prevent government to place import subsidies on their product

Evidence on the Protection for Sale model

- Two papers: Gawande and Bandyopadhyay (Restat 2000) and Goldberg and Maggi (AER 1999)
- Follow GB
- Data for 1983 on:
 - tariffs and non-tariff barriers (coverage ratios)
 - import penetration ratios
 - import elasticity
 - PAC monetary contributions

- Use political contributions to classify sectors into politically organized or not: GB try to identify the part of campaign contributions related to trade
- Empirical specification:

$$\frac{t_i}{1+t_i} = \gamma_0 + \gamma_1 l_i \frac{z_i}{e_i} + \gamma_2 \frac{z_i}{e_i} + Z_{1i} + \varepsilon_i$$

- Taking into account that import penetration depends on protection (Trefler 1993):

$$\frac{1}{z_i} = \delta_0 + \delta_1 \frac{t_i}{1+t_i} + Z_{2i} + \eta_i$$

TABLE 3A.—2SLS ESTIMATES FROM AGGREGATE U.S. NTBS:
THREE-EQUATION MODEL [NTB, LOBBYING, IMPORT]
GROSSMAN-HELPMAN SPECIFICATION (PARSIMONIOUS)

	Model 1			
	NTB Eq.		LOBBY Eq.	
	Coef.	s.e.	Coef.	s.e.
NTB/(1 + NTB)	DEP	—	—	—
Ln (PACFIRM/VA)	—	—	DEP	—
z/e	-3.088**	1.532	—	—
$I \times z/e$	3.145**	1.575	—	—
INTERMTAR	0.780**	0.242	—	—
INTERMNTB	0.362**	0.062	—	—
Ln (HERF)	—	—	0.177**	0.068
Ln (IMP/CONS)	—	—	0.298**	0.064
Ln (NTB/(1 + NTB))	—	—	-0.069**	0.027
Ln (ELAST1)	—	—	0.376*	0.247
Ln (DOWNSTREAMSHR)	—	—	0.321**	0.105
Ln (DOWNSTREAMHERF)	—	—	0.278**	0.091
Constant	-0.042**	0.017	-2.195**	0.348
N	242		242	
k	5		7	
R^2	0.234		0.166	
Model F	18.10**		7.82**	
AIC	-1.369		3.047	
SIC	0.648		-1.574	
Ln L	170.7		-361.7	
$\partial \text{Ln (PAC/VA)} / \partial \text{Ln (DWL/VA)}$	—		0.639**	0.250

Endogenizing political organization

- D. Mitra (1999) “Endogenous Lobby Formation and Endogenous Protection: A Long Run Model of Trade Policy Determination” American Economic Review
- Introduces a fixed cost of organization at the level of the interest group
- Posits that lobby will organize if total surplus created by lobbying is larger than fixed cost

Endogenizing political organization

- Bombardini (JIE 2008) “Firm heterogeneity and lobby participation”
- Shift perspective to individual firms
- Empirically, in GB-type regression average firm size and dispersion (s.d.) of firm size affect positively protection
- Model individual firms decision to participate in the sector lobby and pay fixed cost of lobbying
- Obtain a “modified” GH prediction:

$$\frac{t_i^0}{t_i^0 + 1} = \frac{\theta_i - \alpha_L}{a + \alpha_L} \left(\frac{z_i^0}{e_i^0} \right)$$

- Measured θ_i for each sector and tested against GH

- We have explored the institutional features of nonmarket strategies of firms, including lobbying, campaign contributions, testimony, judicial action, etc.
- We have highlighted the main empirical regularities and trends in lobbying and campaign contributions.
- We have developed models of informational lobbying in both a cheap talk setting and a setting where communication is costly.
- We addressed the role of lobbying as “policy buying act”. Somewhat closer to an economist’s view of political influence (i.e. bribing).