Inefficient Lobbying, Populism, and Oligarchy

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Lobbying is likely to create inefficiencies that favor less productive groups at the expense of more productive ones

Does lobbying—using private resources to influence public policy—cause inefficiency? Across the world private groups routinely lobby governments in pursuit of favorable treatment: trade protection, regulatory benefits, lower taxes, or preferred public expenditures. Lobbying is sometimes illegal—through corrupting elected politicians—but legal forms abound in almost all countries.

Does all this (costly) activity simply redistribute resources from a given pie, or are there aggregate efficiency losses resulting from lobbying that reduce the overall size of the pie? Clearly, if the lobby transfers to government agents are seen as a deadweight loss, lobbying is inefficient by definition. But government employees and politicians are part of society too, so perhaps their gains should not be treated as social losses. Lobbying transfers to politicians can be viewed as undesirable, but that does not make them necessarily inefficient.

In fact, a central result in the economics literature on lobbying is precisely that, under a set of assumptions about how lobbying takes place, the outcome is Pareto efficient. In other words, lobbying may redistribute resources among agents in society, but it does not cause an aggregate loss. While influential, this result has also been met with some surprise. After all, lobbying is seen as a more distortionary form of political action than voting, and electoral outcomes have been shown to be generally prone to inefficiency.

Against this background a new article by Campante and Ferreira makes three contributions. First, it shows that the Pareto efficiency of truthful equilibria in lobbying games applies to a production economy only if there are perfect commitment mechanisms. If capital markets are imperfect or if contract enforcement problems exist, lobbying will in general lead to an inefficient allocation of resources.

The intuition is simple: in a truthful equilibrium private agents offer contributions that return to the government agent the full value of the policy actions they are lobbying for. This enables the government to appropriate all the surplus generated by policy. It therefore chooses the policy that maximizes social surplus.

But this requires that private groups are able (as well as willing) to transfer the full surplus. What if they are credit constrained and can make the transfer only after production takes place? If people cannot credibly commit to contributions that exhaust their gains from a particular policy, the government no longer has an incentive to maximize the full surplus, and the Pareto-efficiency result breaks down.

> **Declining sectors will spend more on lobbying than vibrant emerging sectors**

Second, the article characterizes the nature of the inefficiency generated by lobbying. The article shows that the outcome of lobbying under imperfect commitment is not only almost always inefficient; it is also biased against the most productive group. This follows from specialization in accordance with comparative advantage: those who are most productive tend, on the margin, to allocate more resources to private capital and fewer to political contributions. The reverse is true for those who are less productive.

The prediction is a world in which declining sectors spend more resources on lobbying than vibrant emerging sectors, which tend to channel funds toward productive investment. Lobbying would thus be expected from such groups as farmers in Europe, steel employers and workers in the United States, and computer makers in Brazil, but not from farmers or steel producers in Brazil or computer makers in the United States.

Finally, the article considers the implications of this more nuanced understanding of lobbying for the distribution of wealth. While many papers have suggested that lobbying always favors the rich, this article shows that the distributive bias of lobbying depends on why the rich are rich. If they are rich because they inherited their wealth (and wealth and productivity are independent, and the rich have an advantage in politics), lobbying is generally pro-rich.

Alternatively, if the rich are rich because they are more productive, lobbying may distort the composition of public spending against them. On the margin there will be "too much" spending on welfare and on bad public schools and too little on goods valued by the rich (such as security and universities). Such a "populist equilibrium" may be reversed, however, if the rich are better able than the poor to organize themselves.

The upshot is that the reassuring theoretical result that lobbying is efficient is valid only in highly restrictive situations. In general, the existence of lobbying is most likely to create economic inefficiencies—a result with implications for the design of political systems, including governance and campaign finance reforms in developing countries. Those inefficiencies are likely to favor less economically productive groups (such as lagging sectors or regions) at the expense of more productive ones.

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