

Why Pollsters are Wrong but Lobbyists Always Win



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Special Interest Lobbying

- 1998 retroactive copyright extension from 56 to 96 years – unanimously passed US Congress, upheld by the Supreme Court
- increasing length of copyright in 1998 on books produced before 1978 in no way changes the fact that they already exist
- takes money out of the pocket of the many who do not hold copyrights and put them in the pocket of the rich few who do - with some money lost along the way.
- nobody in the general public voted for this extension



Social Cost of the Copyright Lobby

- perhaps distant heirs of distinguished but long dead people should live off the proceeds of the hard work of their distinguished forebearers rather than earning a living like the rest of us
- as an example of how a law favors the few at the expense of the many copyright extension may seem trivial
- illustrates cleanly how rent-seeking by lobbyists serves to shift money to their own pockets while losing some of the money in the process
- copyright lobbying has other bad consequences : technically feasible to have all book, movies, music, technical research and so forth available freely and nearly instantaneously wherever we might be
- the only reason we do not is because of the copyright lobby

More Bad Lobbies

- other examples less clean
- many AIDS deaths in Africa are directly attributable to lobbying over patent rights
- \$180 billion in taxpayer money was used to bail out Goldman Sachs in 2008
- not news that lobbyists thrive by picking the pockets of the taxpayer
- not news that money has a corrupting influence on government.
- in a democracy why do not the interests of the many outweigh the interests of the few?



Places that Fail

economic failure has occurred across a diverse range of peaceful countries:

- Argentina
- Brazil
- Greece
- India
- Italy
- Zimbabwe

is it because of rent-seeking and the inefficiencies that occur when lobbying and corruption are used to limit markets and restrict competition?

Harms of Rent Seeking

- nationalization of firms
- restrictions on foreign trade in goods and services
- limitation of foreign investment
- restrictions on immigration
- unionization
- subsidies and bailout
- cartelization
- product and price regulation
- restrictive labor contracts
- copyrights and patents

Consequences of Rent Seeking

- political conflicts leading to bad outcomes are themselves costly in resources
- debt arising from rent-seeking leads to financial crises
- economic failure and debt can lead to political instability
- worth remembering the French revolution occurred because of excessive debt

Is it Special Interests?

not all bad policies are due to special interest lobbying

restrictive policies can be the outcome of majority voting

- Brexit
- 2016 U.S. Elections: Donald Trump won on the promise of restricting both trade and competition.
- Bernie Sanders ran on the same platform

A Common Wisdom

1. corruption is a big problem
2. the corrupting influence of money in U.S. politics is because campaigns are financed by rich lobbies

A common solution (Larry Lessig among others)

public financing of political campaigns so that politicians are not dependent on donations.



Is it Campaign Financing?

- U.S. system of expensive and privately financed political campaigns relative unique
- political corruption hardly limited to the United States
- Ireland: political campaigns are publicly financed
- September 2008 the Irish finance minister used 64 billion Euros of taxpayer money to bail out banks that made bad bets
- Italy : public financing of political campaigns introduced in 1973 and abolished in 1993 with a national referendum in the aftermath of “Tangentopoli” - the biggest investigation on political corruption in the Italian postwar period
- public financing of political campaigns reintroduced in 1993 and abolished again in 2013!!

Who is Bribed?

- a great deal of corruption is due to appointed or civil service officials not elected officials.
- Larry Lessig's began his campaign not after the corrupt passage of the copyright extension law by Congress and the President, but after the equally corrupt rejection by the Supreme Court of his legal challenge to that law
- campaign contributions play little role in the corruption of the Supreme Court
- bribing politicians through campaign contributions is only tip of the iceberg

The Nature of Bribery

now and historically a simple and effective form of bribery: give money to the family or give money after departing office

Chris Dodd (aka Senator for Disney)

- famous for carrying the water of the motion picture industry
- if Disney wanted the internet shut down so that their films could not be pirated, he was there to fight for them.
- left office in 2011 to take a several million a year job as the CEO of the Motion Picture Association of America

A 31 year old fresh out of college was offered a \$600,000 a year do-nothing job as “special correspondent?”

- do you suppose this would have been the case if her father was not a former President and her mother was not a Presidential nominee?

Europe

Jose Barroso, Portuguese politician and 11th President of the European Commission

- left office to take position as Chairman at Goldman Sachs International.
- no doubt because of the investment skills he acquired in his years of politics

China

“One popular method used by Chinese export companies constantly is to lobby the Chinese Ministry of Commerce through provincial and local level Chambers of Commerce...According to an economics professor from Shanghai Fudan University, representatives in the local Chambers of Commerce mainly include entrepreneurs from export companies as well as retired governmental officials who previously held senior-level positions in the provincial and local-level Foreign Economic Relations and Trade Commissions. These former provincial and municipal level governmental officials serve as middlemen to pass along the concerns of Chinese export companies to the Ministry of Commerce.”

The Correct Solution

- if lobbyists take the long view it is hard to legislate against them
- do we pass a law that anyone who has ever worked in government, is likely ever to work in government or who is related to such a person is unemployable?

known solution that has been tested and proven effective in the past in Imperial China and in the Ottoman Empire

- high ranking government officials are castrated male slaves separated from their families at an early age

this solution seems unlikely to be acceptable in the current social environment

- (also: it did not work that well in China)

What is Corruption?

- both democratic and autocratic systems are subject to corruption.
- by corruption we do not mean “violation of a law against corruption”
- we mean the purchase of political decisions by money or favor rather than by voting
- often legal - for example offering employment to a state official after they leave office
- as economists we are not concerned with what the law is or how it is written
- our concern is with what it should be
- outlawing bribery is one of many institutional tools that may or may not be useful in improving political outcomes and economic welfare

What do Lobbyists Do?

- what does lobbying have to do with corruption?
- why should not individuals and groups be able to try to persuade state officials to their point of view?
- a literature on lobbying which views lobbying as primarily providing information to government officials
- no doubt this happens.
- message conveyed by Chris Dodd when he takes a former colleague to lunch: “look how rich I am - if you play ball like I did you too can one day be a rich and sleek lobbyist like me?”

Bribery versus Lobbying

range of corrupt bribery

- secret individual action such as directly paying off officials in cash for business licenses or other favoritism
- more open bribery in which subtle hints of future consideration are exchanged for legislation that is public and visible

the latter changes policy and both sides have an opportunity to submit bribes – so a contest between those who favor and those who oppose the legislation

Is Majority Rule Good?

- corrupt public officials may subvert the intention of the voters who directly elect them or are indirectly responsible for their appointment
- democracy has *no* moral claim: what moral principle says the 51% of a particular group of people may enslave the other 49%?
- as economists we are interested in the efficiency of outcomes: do democratic or non-democratic systems with or without corruption lead to good or bad outcomes?
- most constitutional systems are designed to provide some protection against majority rule
- the US Constitution explicitly requires a super-majority for constitutional changes

Voting over an Externality

- $N > 3$ people $i = 1, 2, \dots, N$ in a cold country
- each can light to keep warm but cause others to suffer from the smoke ; benefit of a fire 1 and the cost to each other person $v > 0$
- N regulations $j = 1, 2, \dots, N$; regulation j bans person j from lighting a fire
- sequential voting
- an existing status quo of regulations in force
- one regulation chosen at random
- regulation chosen already in effect vote whether to remove it
- regulation chosen not already in effect vote whether to add it
- majority rule status quo remaining in case of a tie

Equilibrium

Behavior:

- voting is sincere: you vote against being regulated and everyone else votes in favor of you being regulated

Outcome:

- every proposal to remove a regulation defeated by $N - 1$ to 1
- while every proposal to add a regulation will win by the same vote of $N - 1$ to 1
- with probability one after some period of time, all N regulations will be in effect.

Welfare

good or that all N regulations are effect?

The social cost of a regulation is 1 and the social benefit is $(N - 1)v$

$1 < (N - 1)v$ regulation is efficient: everyone agrees that they would be willing to give up their own fire in order to avoid the smoke of the others. Democracy works.

$1 > (N - 1)v$ regulation is inefficient: everyone agrees they would be willing to suffer the smoke of the others in order to keep warm. Democracy fails.

no “invisible hand” for democracy guaranteeing that it delivers good outcomes.

Condorcet Cycle

- suppose whenever all regulations are in effect rather than choosing one at random for repeal the agenda is to repeal them all
- efficient regulation: nothing happens
- inefficient regulation: all regulations are repealed – but then they cycle starts over again
- one additional regulation will always win but when enough regulations are in place no regulation at all will win

Corruption

a corrupt official charged with enforcing the regulations.

can be bribed by an amount b to look the other way and permit a fire

$b > 1$ nobody will pay the bribe; corruption does not matter

$b < 1$ everyone will pay the bribe and regardless of voting everyone will have a fire

regulation is efficient this is unambiguously a bad thing: everyone is worse off, plus they all pay a bribe.

regulation inefficient depends on how we count the bribe money a transfer payment to the public official it should be neutral

without corruption per capita utility 0; with corruption per capita utility is $1 - (N - 1)v > 0$

corruption is good!

Theory and Practice

- often argued that many under-developed nations are over regulated
- corruption is the “grease for the wheels” that keeps the economy from choking to death
- corruption is potentially good because democracy need not work very well

Intensity of Preferences

- majority voting does not allow the intensity of preferences to be registered
- instead of voting use a bidding system
- everyone submits a bid in dollars either for the status quo or the alternative
- whichever alternative gets the highest aggregate bid wins and the winning bidders pay their bid
- proceeds of the bid are divided equally among everyone
- with many people assume that individuals ignore the fact that they may get a tiny amount of the money back
- example of a menu auction
- widely used to study lobbying

Menu Auctions

a finite set of alternatives $k = 1, 2, \dots, K$

finite set of bidders $i = 1, 2, \dots, N$

alternative k gives bidder i utility $u_i(k)$

bidder bids $b_i(k)$ for each alternative

auctioneer chooses alternative that maximizes income $\sum_i b_i(k)$

implicitly an endogenous tie-breaking rule: in case of a tie the auctioneer is free to choose alternative that supports equilibrium.

Truthful Equilibrium

a Nash equilibrium choice k_0 by the auctioneer and bids $b_i(k)$

the bid differential cannot exceed the utility differential

$b_i(k) - b_i(k_0) \leq u_i(k) - u_i(k_0)$ and is equal unless $b_i(k) = 0$

key point: truthful equilibria exist and the outcome is efficient – so better than democracy

The Two Alternative Case

normalize the payoffs so that for each bidder the less favored alternative yields zero utility

Theorem: *The efficient alternative wins, both groups bid zero for their least preferred alternative, the losing group bids its value and the winning group bids the value of the losing group. The division among winners is indeterminate but no winner can pay more than their value.*

with two bidders this is the standard sealed bid first price auction and the same result as for a second price sealed bid auction

refinement of truthful equilibrium has bite: in the two bidder case there are many Nash equilibria - as long as the high valued bidder wins, bidding between the value of the low value bidder and his own value is an equilibrium

in “non-truthful” equilibria high value bidder forced to “over-pay” by the somewhat foolish strategy of the low value bidder bidding above his value

Proof

Nash equilibrium forces every member of the losing group - those that favor the alternative not selected - to bid zero for the winning alternative:

bidding more loses money and cannot improve the outcome

truthfulness forces then each member of the losing group to bid their value for the losing alternative

to win the winning group must in aggregate bid at least this amount, which means that their value must be at least that of the losing group

only efficient alternatives win

aggregate bid of the winning group must equal the value of the losing group: otherwise each member of the winning group should reduce his bid. In the two bidder case this is exactly the same as

no winning bidder can bid more than their value, hence each must bid zero for the less preferred alternative

Common Agency

Berheim and Whinston introduced the notion of menu auctions and common agency at about the same time in different papers and the two are often confused

Common agency:

- no constraints on negative payments
- agents have an outside option

less well suited to analysis of political influence and less widely used for this purpose

Direct Democracy

rather than having decisions made by corrupt elected officials, policies should be decided by referendum

proposal championed by reform parties in Europe such as M5S in Italy and Podemos in Spain

- whatever is decided in a referendum someone has to implement it - and that someone may well be corrupt
- a government like a large business is a complicated organization that acquires many inputs and produces many outputs and few voters have any expertise in running such an organization is foolish
- to know what is a good public policy is not easy and requires a good deal of time and effort

The Curse of Rational Voter Ignorance

- democracies face an enormous public goods problem
- each individual has little influence on the electoral outcome and so has practically no incentive to become informed about issues

the curse of rational voter ignorance is the reason for representative government

- doctors delegate their investments to experts
- voters in democracies delegate policies to politicians
- an agency problem with dishonest financial advisors
- an agency problem with corrupt politicians

does not mean the solution is to get rid of politicians

The Problem for Experts

- even after years of study resulting in a PhD in economics; even after years of academic or practical experience after a PhD, the consequences of economic policies are at best uncertain
- agreement among experts is greater than realized by the general public yet there still is legitimate disagreement.
- not sensible for an individual voter to invest years of effort in hopes of deciding what are the best economic policies
- even those who denounce academic experts and pretend unwillingness to rely on experts, nevertheless follow like sheep their own: Rush Limbaugh, Michael Gove and Donald Trump
- the dilemma: how to know who is a true expert and who is a charlatan?
- requires a lot of knowledge. Perhaps not a PhD in economics - maybe only a MA?!

The Problem for Experts

even if we can distinguish experts from charlatans

- experts have their own agendas
- experts as well as politicians can be corrupted

the famous academic economist Frederic Mishkin accepted \$124,000 from the Icelandic Chamber of Commerce to praise its regulatory and banking systems

two years the Icelandic banks collapsed catastrophically to our knowledge has he not been denounced by his colleagues for this

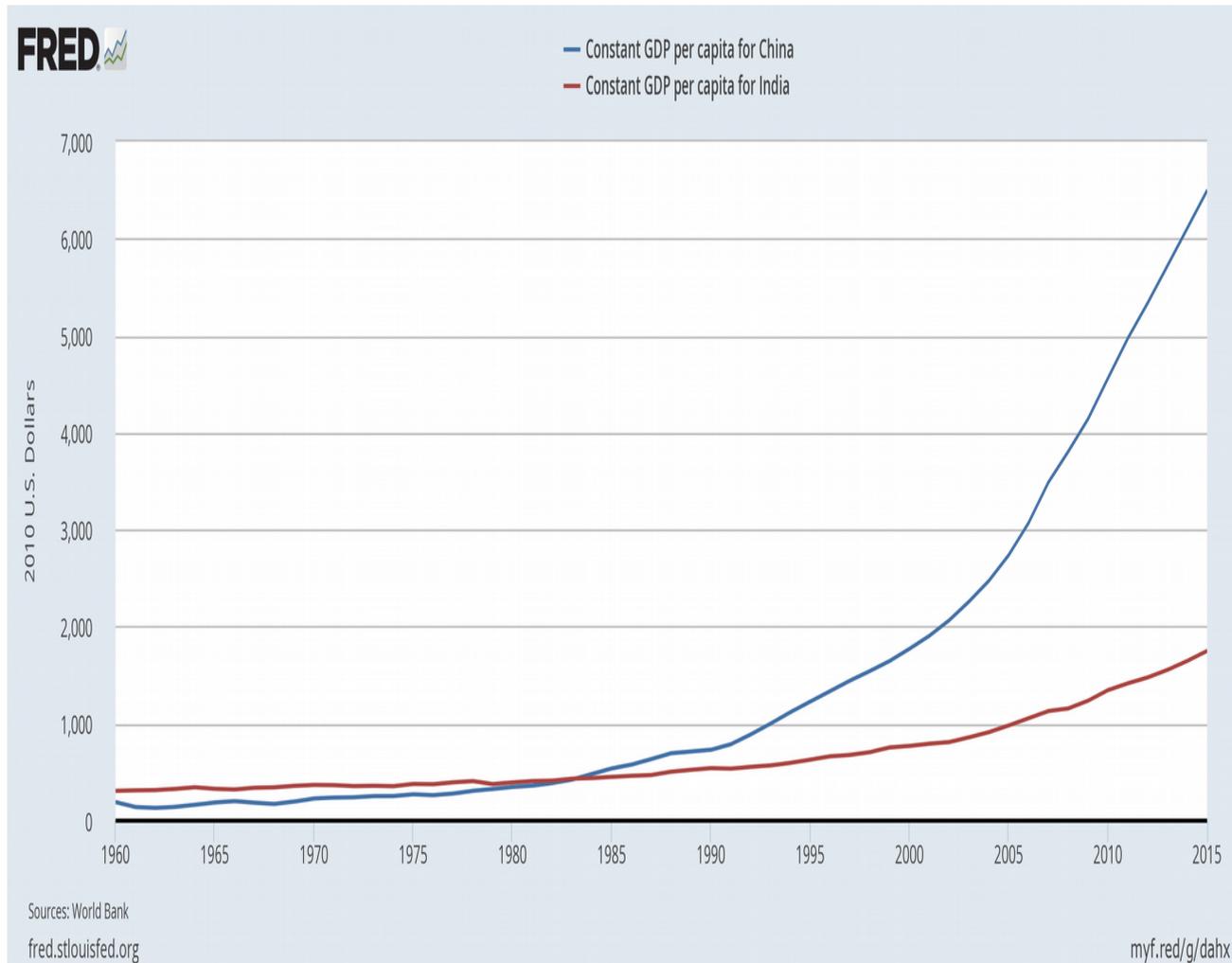
- Owing to social pressure experts - like the police, doctors, or any other professions - rarely discipline within their own social networks
- populist movements are quite right to distrust experts!

The Downside of Democracy

“democracy is the worst form of government except all the others that have been tried” (Winston Churchill)

Acemoglu and Robinson argue that indeed democracy is the solution to problems big and small. They argue that there are two types of institutions: there are inclusive institutions that represent a wide range of interests and there are extractive institutions in which a few steal from the many. Inclusive institutions lead to economic success and extractive ones lead to economic failure. Democracy is good and autocracy is bad - not just for our liberty but for our economic well-being. But we must ask whether this is wishful thinking or if it is true.

Real per capita income in two countries since 1960



Which is the Democracy?

- the economic failure is India: the shining success of democracy among post World-War II newcomer
- the economic success is China: a country which has never known democracy
- these two countries comprise roughly a third of world population
- if you point to places like Hong Kong or Singapore you should reflect on the fact that these are very small and special cases
- no reason to believe that institutions that work well in Singapore - a rich city protected from greedy neighbors by strong geographical barriers - would work well in the hinterland of China

Is Democracy Good?

- China illustrates the strengths and weaknesses of autocratic government
- the good: the greatest increase in living standards in humankind in the history of forever
- the bad: the cultural revolution
- policy matters – “good” institutions can generate bad policy (India) and “bad” institutions can generate good policy (China)
- nor are autocratic governments condemned to short lives due to their inherent contradictions? (“coup proofing”)
- from 605 AD until 1905 AD (1300 years) China was governed by professional bureaucrats who achieved their position through a competitive examination system

Is Autocracy Doomed?

- are autocratic governments are condemned to short lives due to their inherent contradictions?
- does “coup proofing” by autocrats weaken institutions to the point at which they are doomed to fail.
- history of China is a strong (and large) counter-example
- China maintained autocratic rule through a professional bureaucracy for roughly 1300 years from 605 CE (some would argue 134 BC) until 1905 CE a period of generally high prosperity
- far longer than any democratic institutions have survived

Special Interests Sometimes Lose

the Disney Corporation very effective in getting retroactive copyright extensions whenever their Mickey Mouse copyright is due to expire

large pharmaceutical companies have never managed to get retroactive patent extension when their blockbuster drug patents are due to expire

the copyright industry sometimes lose in Congress as it did when it proposed the ``Stop Online Piracy Act?''

if small special interest groups are so effective why did it take decades for minorities such as blacks and gays to succeed with their agendas of equal rights?

Are We Doomed?

Are we - as Mancur Olson who documented the effectiveness of small special interest groups argued - doomed to ever increasing lobbying until the economy is choked and we find ourselves as an Argentina, Brazil or Greece?

Why did the previous gilded age of railroad barons bribing politicians to give them public land not end with a catastrophic collapse?

Most would say our best times came after the gilded age and not before

Is the Subversion of Democracy Catastrophic?

- surely the subversion of democracy by special interests can lead to economic problems
- true that countries that are notably corrupt such as Italy and India are not great economic powerhouses
- hardly describe them as abysmal failures either
- Italy has a standard of living high by world standards
- India as the graph above shows has had slow - but steady – improvement

Populism: the Cure Worse than the Disease?

- the historical antidote to corruption is populism

- Populism is the popular backlash against successful lobbying and rent-seeking

early 21st Century during the financial crisis

- those who were able to do so used taxpayer funds as life-rafts to escape the consequences of their own bad decisions
- the corruption of the banking sector and of experts became painfully clear

populist movements in the U.S. and Europe grew in direct response to this

- populism is political victory through the ballot box and appears as the inevitable consequence of successful rent-seeking by the small special interests groups who dominate lobbying

Populism in the US

in the 2016 US Presidential primary the populist proposals of Donald Trump on the Republican side to a large extent matched those of Bernie Sanders on the Democratic side

- “America First” especially in trade
- the average voter should get some of the protection from competition previously reserved only for rich and successful special interests



Mixed Electoral Success of Populism

success: Greece, UK, US

failure in: Spain, Netherlands, France.

Danger of Populism

- little guarantee that populist movements will achieve their stated goals
- popular remedies are often as harmful as folk medicine is for the genuinely ill patient
- not just metaphorically: the Italian populist movement M5S is anti-vaccine
- Recent examples:
 - Trump far from draining the swamp has deepened it
 - Brexit is on track to crush a thriving British economy
 - Syriza managed the nearly impossible task of adopting economic policies even more harmful than those of its predecessors
 - the oil powerhouse Venezuela lacks basic amenities such as toilet paper

Historical Populism

- Peronism in Argentina: condemned the country to decades of economic stagnation
- Mugabiism in Zimbabwe: condemned an entire nation to poverty

but...

- the US populist Teddy Roosevelt brought antitrust law and other measures against monopoly that mitigated rent-seeking without much harmful side effect

End Populism?

fix lobbying!