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Institutions and Interest Groups: Economic and Political Performance

Institutions are not necessarily or even usually created to be socially efficient; rather they, or at least the formal rules, are created to serve the interests of those with the bargaining power to create new rules. In a zero transaction cost world, bargaining strength does not affect the efficiency of outcomes; but in a world of positive transaction costs it does--and it thus shapes the direction of long run economic change.   Douglass C. North (1992: 4)

1. Introduction

Benjamin Franklin famously declared that in this world nothing can be said to be certain, except death and taxes. But interest groups seem similarly inexorable. Wherever there is government there is redistribution and consequently groups trying to capture the potential benefits and avoid the potential costs that intentionally or unwittingly result from government policy.[1] Whether government action corrects a social cost (market failure) or creates a deadweight loss in the form of inefficiencies, it will generate benefits to some groups in society and costs to others.[2] Knowing this, groups and individuals don't passively wait for their draw in the redistributive lottery, simply hoping for the best. Rather, groups actively and often preemptively engage in actions to influence outcomes.

But though death and taxes are certain, the actual form that they take is not predictable. The same is true of interest groups. They can take many different forms and pursue their objectives through a wide array of strategies and channels. The statement that interest groups heavily influence government policies and outcomes is not controversial. It is a perception widely held across experts and the lay public alike. But, what is the extent of influence and what are the channels through which it operates? More importantly, what is

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[1] In Part III we treat interest groups as part of government but in Part II we disaggregate the demand side of government from the supply side of government.

[2] We use the Coasean term 'social cost' instead of 'market failure' to highlight the notion that it is not that the market fails, but rather that it 'would cost too much to put the matter right' (Coase, 1960: 39). We address this distinction in more detail below.

the impact of interest group influence on society`s welfare and that of different groups in society? Interest groups are so pervasive across countries and time, and the efficiency and distributive issues that they give rise to are so important, that the specialized literature is huge and spans the social sciences. Guilds, professional organizations and trading companies were early manifestations of interest groups. In a famous passage in *The Wealth of Nations* Adam Smith (1776, Book I, Chap. X) notes that "(p)eople of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." Whereas this might seem as a reference to the dangers of collusion among firms, and not directly related to interest groups, in the less remembered continuation to this passage Smith recommends that; "(i)t is impossible to prevent such meetings … but though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to render them necessary." Smith recognizes that the propensity of interest groups (factions) to form and to seek private benefit at public expense will naturally gravitate towards the most effective means to do so, which is through the law and government policy.

Given the myriad ways that interest groups seek to influence policy, many of them covert and hard to measure, there are no good estimates of the size of the efforts relative to GDP to ascertain whether the general suspicion about their pervasiveness and magnitude is accurate (Del Rossal, 2011). Nevertheless data on some of the more well-documented channels of influence - lobbying expenditures and campaign contributions - can give us a notion of the magnitudes involved. According to the non-partisan research group Center for Responsive Government that 'tracks money in U.S. politics and its effect on elections and public policy', lobbying expenditures in the U.S. have exceeded $3 billion every year since 2008.[3] The mid-term elections of 2014 witnessed the lowest voter turnout since World War II and the highest level of lobbying expenditures ($3.8 billion), suggesting a possible shift over time in the relative influence of voters versus organized interest.[4] The number of registered lobbyists has fluctuated from approximately 10 thousand in 1998 to nearly 15 thousand in 2007, with the global Depression bringing the number back down to 11 thousand in 2014. Table 1 gives a notion of the diversity and identity of interest groups in

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[3] Extensive data and reports on lobbying and interest groups in the U.S. is made available by the Center for Responsive Government in their website https://www.opensecrets.org.
[4] http://www.opensecrets.org/about/donor_report.php .

the US by listing the top 20 interest groups giving to members of Congress in the 2016 cycle. The table also shows that from 2000 to 2016 the rankings have not changed very much.

[Table 1 here]

The data capture only a fraction of the actual pressure that interest groups apply on governments and policymakers. Not only are there other levels and powers of government, but there are also non-registered transfers as well as non-pecuniary support, such as providing information or obfuscation, swaying public opinion, and probably many other creative ways. There is no reason to suspect that pervasiveness of interest groups in countries outside of the U.S. is much different, though the forms of organization and channels of influence are highly idiosyncratic.

The notion that interest groups are simultaneously inevitable and unpredictable can be illustrated by an example; the recent move in some American states to legalize marijuana. The traditional approach of treating cannabis as an illegal drug has long proved ineffective to prevent its production, distribution and consumption. The "War on Drugs" has failed miserably to achieve its objectives on regulating marijuana, and has generated huge costs of enforcement and a host of side-effects and unintended consequences, such as violence, gangs, over-crowded prisons, consumption of poor quality product, and overdoses, *inter alia.* Despite this dismal policy performance, which probably fails any cost-benefit analysis, few people predicted that the US would be one of the first countries to move towards legalization as an alternative strategy. In November 2012 voters in Colorado and Washington approved initiatives that legalized the recreational use of marijuana, setting a precedent that may be followed by most other states and the federal government. Although a few other countries have already implemented the legalization of marijuana, such as Uruguay since 2014, the American experiment will probably be the bellwether that will guide many other countries.

As with any other policy, the legalization of marijuana is redistributive, creating winners and losers. Some of these winners and losers will form groups that will try to influence the policy, depending largely on their cost of organization and ability to overcome within-group free-riding. The standard approach to identify which groups lose and which groups win from a given policy change is known as an incidence analysis. It

tries to work out all the consequences of a given policy tracing out who is benefited and who is harmed. These groups are then potential interest groups in the sense that they have a motive to try to influence the policy, promoting or blocking its passage or changing its content. Which groups actually form and which are more successful depends on many different characteristics of the groups, such as size, homogeneity, and level of organization, as well as the type of policy and the current political institutions, as we will detail below. It is often the case that the final winning and losing coalitions are quite unexpected. Although most policies typically have some obvious direct beneficiaries and losers, there are often many unexpected indirect ramifications of policies that impact apparently unrelated groups. Also, it is often the case that groups that otherwise have very little in common with each other may suddenly find themselves on the same side of an issue, giving rise to the 'Bootleggers and Baptists' phenomena. This term refers to the support of both religious groups and of illegal producers of alcohol to legislation restricting the sale of alcohol during prohibition in the US (Yandle, 1983).[5]

Both of these hard-to-predict characteristics of interest group emergence are observed in the case of marijuana legalization. Although the movement is still new and geographically restricted in the US, there is already intense activity by interest groups to influence the details the legislation will take as it unfolds. A report by the Center for Responsive Politics on this issue describes the groups that have already mobilized.[6] The National Organization for the Reform of Marijuana Laws (NORML) has existed since 2002, having since contributed over $109,000, mostly for candidates supporting legislation that increases access to medical marijuana and to protect state marijuana laws. Another organization, the Marijuana Policy Project (MPP) has been in activity since 1998 and organizes state ballots to liberalize marijuana laws, backing candidates that support the cause. A third organization is the Drug Policy Alliance (DPA) that has spent over $ 4.2 lobbying in opposition to the War on Drugs. Then there is the National Cannabis Industry Association (NCIA) created in 2010 to represent the interest of state-sanctioned marijuana producers. One of their interests is to protect banks that have marijuana-related businesses

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[5] A current example is nuclear energy and natural gas companies siding with environmentalists on restrictions for carbon emissions.
[6] Center for Responsive Politics (2105) "Money in Marijuana" Nov.
http://www.opensecrets.org/news/issues/marijuana/

as clients from being prosecuted at the federal level. Finally, there are the cash-strapped state governments for whom the prospect of new tax revenues from legalized pot is a strong temptation; in 2014 Colorado collected $44 million in sales and excise tax.

On the other side of the issue are some perhaps more surprising interest groups. The first are Police unions that have come to depend on the financial resources that come from the War on Drugs, both in the form of direct funding as well as from seizures in the course of enforcing the laws. These unions include the national Fraternal Order of Police, the National Association of Police Organizations, the International Union of Police Associations, and the International Association of Chiefs of Police. Private prison companies are another group that has opposed drug legalization. These companies benefited significantly from the high incarceration rates that result from the War on Drugs and stand to lose from any change that might reduce arrests and imprisonment. According to the Center for Responsive Politics Report, one of the largest private prison companies, the Corrections Corporation of America has spent almost one million dollars annually since 2008 in lobbying efforts. For similar reasons, prison guard unions have also opposed the trend towards legalization. The CPR report registers that the American Federation of State, County and Municipal Employees (AFSCME), which represents many prison guards, has lobbied actively against the cause.

Pharmaceutical corporations and producers of alcoholic beverages, Big Pharma and Big Booze, have also fallen on the same side of the issue as police, prisons and guards, in a manifestation of the Bootleggers and Baptists theory.[7] The first is concerned with the competition that marijuana poses for some important blockbuster drugs, and the second with the competition for wine, beer and other drinks.[8] Both are major lobbyers responsible for massive spending in contributions and influence, though not focused solely on marijuana.

The data and the examples above show that interest groups are pervasive and can have important impacts on the economy and society. The examples also show that which interest groups form, how they operate and their impact is not at all obvious. In this chapter

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[7] Oddly the CPR report does not cite Big Tobacco as having lobbied this issue.
[8] In Colorado the legalization of marijuana consumption in bars and restaurants (in addition to residential consumption) is currently being considered, though it is not obvious what will be the position taken by the industry's groups and associations.

we focus on two basic questions about interest groups. First, what form does the competition between interest groups take and what determines who wins and who losses from that competition? Second, to what extent do interest groups affect economic performance and social welfare through their impact on policy? Although the evidence above suggests that interest groups have a big impact, there is not even consensus in the literature whether that impact is positive, enhancing social welfare by allowing for voice and plurality, or negative, by biasing political representation and generating distortions, deadweight losses and inefficiencies. The point in this chapter is that a proper analysis of both of these issues can only be done by explicitly incorporating the institutional detail that necessarily surrounds the case. Interest groups act in real world situations where organizations, e.g., legislatures, committees, courts, agencies, voters, the press, interact in specific arenas, i.e., Congress, the media, the streets, and smoke-filled back rooms, under very specific formal and informal rules of the game - the political institutions of that place and time. General analyses of interest group competition that purposefully leave most of the institutional detail in the background can yield some useful insights and regularities. But this has several shortcomings. Many of these shortcomings can only be overcome by making the analysis institutionally rich and specific, even if this leads to some loss of generality.

The chapter starts with self-interest theories of interest group competition, and shows how they improve on public interest theories by adding politics. We then show how the explicit attention to information asymmetries and institutional detail can add further value. A simple spatial model is used to underscore three important results from the interest group literature. First, interest group competition takes place in a web of multiple principal-agent relations with the upshot that low-powered incentives often predominate. Second, although interest group competition is subject to cycles and instability inherent in social choice, structure induced equilibria tend to narrow down the possibilities and promote stability and predictability. Given this important role played by political institutions, interest groups do not limit themselves to compete for influence under the extant institutions, but also to change the rules of the game.

1. Public Interest and Simple Capture Theories

What determines government policies and the pattern of interventions it chooses to regulate the economy and society? A review of how different theories have answered this question provides a good guide for understanding the many different ways that interest groups have been conceptualized in the literature.[9] Early theories focused on whether government policy favored primarily the public interest or private interest, but shortcomings in these approaches eventually led subsequent theories to incorporate the interest of other groups such as politicians, bureaucrats and voters.

An early way of understanding government policy was through the lens of Pigou who argued that markets are fragile and inefficient. The view that government action is basically a response by government to public demands for the remediation of social costs is known as the Public Interest Theory.[10] Because this theory makes a positive statement that what governments do is the normative recommendation from economic theory for correcting market failures, it has also been called Normative Analysis as a Positive Theory (Joskow and Noll, 1981). The pervasiveness of interest groups in practically every area of government policy, noted in the introduction, already suggests that this theory is wrong. It just seems too simplistic that interest groups are unrelated to many of the policy inefficiencies we routinely observe. More sophisticated theories – such as Becker's (1983) model of interest group competition - partially rehabilitate some of the expectations of the Public Interest theory.[11]

A reformulation of this theory to account for its obvious incongruence with observed reality posits that government policy does seek the public interest but its endeavors are often not successful because of the complexity and intractability of many of the necessary tasks, together with lack of experience and expertise. While this reformulation is a bit less naïve than the pure Public Interest theory it still seems an

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[9] For a more detailed review of this literature see Viscusi, Harrington Jr. and Vernon (2005).

[10] Pigou was perhaps the most influential along with Samuelson's exposition in his textbook. Coase argued strongly against the "externality" view of markets. Coase maintained that all costs are reciprocal and it was a matter of assigning property rights such that the least social harm occurs whether or not the transfers are made to the harmed party.

[11] Perhaps the most extreme statement compatible with the Public Interest Theory is Wittman's (1989) *Journal of Political Economy* article "Why Democracies produce Efficient Results." He argues that: "Behind every model of government failure is an assumption of extreme voter stupidity, serious lack of competition, or excessively high negotiation/transfer costs. Economists are very suspicious of similar assumptions regarding economic markets. This skepticism should be carried over to models of government behavior. (1989, 1421)"

unsatisfactory explanation of the pattern of government intervention in the economy and society.[12]

On the other side of the spectrum there are a series of theories that presuppose that government policy is not guided by the public interest at all but rather by private groups that capture the policymaking process in order to promote the interests of their members. Posner (1974: 335) notes that these 'capture' theories have been "espoused by an odd mixture of welfare state liberals, muckrakers, Marxists, and free-market economists," in what might be considered an academic example of the Bootleggers and Baptists phenomena. The motivation for these theories is clear. Many businesses are big and influential and have much to gain and lose from government policy, so it is not surprising that they use this power systematically to assure the policies they want. Whereas this view of the world seems at first blush to accord well with the evidence around us, of patently biased and inefficient policy, it is nevertheless just as naïve as the Public Interest Theory, for it gives no reason why it would be that some groups are able to capture the government rather than others. Consumers are greatly affected by government regulation and they have the power to vote, so why is it that business interest should always prevail? Furthermore, a closer look at the evidence shows that in many cases the interest of customers and other apparently weaker groups are in fact often promoted by government policy, so that a view that postulates that only one set of groups has influence, does not explain observed outcomes.

The timing of the creation of state commissions to regulate Electric utilities in the US in late 19th and early 20th century provides a thoughtful test of whether public or private interest are the main determinant of government intervention. Jarrell (1978) shows that the first states to create state commissions were those where the utilities faced more competitive markets and where prices and profits were consequently lower. This evidence suggests that the regulatory reforms that removed the power to set rates and entry from the municipalities and passed them to the state commissions were not motivated by market failures in the form of monopolies or concentrated markets, but rather were demanded by

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[12] (Posner, 1974) provides a highly detailed critique of the Public Interest theory. Stigler and Friedland (1962) is an early paper showing evidence that even the regulation of natural monopolies often does not lead to lower prices.

the utilities themselves so as to deter entry and protect higher tariffs. He cites J. Allen Smith, former Dean of the University of Washington, who in 1914 wrote:

> No other proposed reform in recent years has had so much influential support, or encountered so little opposition from sources which usually offer more or less determined and effective resistance to every legislative proposal designed to increase popular control over corporations of this sort. … It is also significant that this movement, though ostensibly designed to give cities more effective protection against public utility abuses, has not had its origin in any popular demand from urban communities. The initiative in this matter seems to have come very largely from the public utility interests. (Smith, 1914)

Yet though the evidence seems to suggest the ubiquity of interest group influence, Capture theories, like Public Interest theories, are not really proper theories but rather coarse hypotheses that seek to explain some stylized facts without really going into the actual interactions between the interest groups and the government to characterize the process through which the choices are made by the interest groups of how and how much pressure to exert, and by the government on how to translate that pressure into policy. The first approach to interest groups based on more solid theoretical foundations was that associated with George Stigler and the Chicago School.[13]

2. Demand for Government Intervention

Stigler's important insight was to treat the redistribution that is inherent in any government policy not as something that happened as a mere side-effect of the government's actions, but rather as an economic good that was purposefully demanded by interest groups and supplied by the government.[14] If these transfers are economic goods, standard microeconomic theory can be used to generate hypotheses regarding which transfers actually get made. In particular this approach yields a negatively sloped demand curve for redistribution which shows how much the different groups are willing to 'pay' for the policies they want through the provision of direct and indirect contributions to politicians as well as other forms of support. Faced with the bids from each of the interest groups the government can then choose the specific form of the policy that yields the set of

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[13] By starting with the Chicago School we do not mean to imply that there were no other important self-interest theories of government intervention. The literature on interest groups is just so large that our account cannot be comprehensive and we have to focus on some contributions to the detriment of others. An influential early reference was Bentley's 1908 The Process of Government. Also, the Public Choice approach pre-dates many of the references highlighted in this section, but will be commented upon later.
[14] Stigler's insights were extended and formalized by Peltzman (1976).

transfers from some groups to others that 'clears the market' and maximizes the government's net political support.

In this view politicians determine taxes, subsidies, tariffs, rates, entry, prohibitions, and all other sorts of policies and regulations, not based on their inherent merit to the economy and society, but based on the levels of political support they will elicit from those that are benefitted net the opposition of those that are harmed. The politician has no inherent preference for any kind of policy, no ideology, and no preference towards any particular group or class in society. All that matters is to maximize political survival. It may seem a cynical and simplistic portrayal of the motivation of political actors, but it yields powerful hypotheses.

Which groups benefit and which groups are harmed? As in standard economic markets those with more wealth and stronger preferences for the transfers are able to bid more for the redistribution, but there is also another important consideration that strongly advantages some groups over others. Groups that are more readily able to overcome problems of collective actions and avoid the free-riding of its members will be better placed to generate the support for the politicians and assure favorable redistribution (Buchanan and Tullock, 1962; and Olson, 1965). The ability of groups to organize and generate contributions, support, votes, and information is a key characteristic in determining which interest groups prevail. It means that often size is a disadvantage and that organization and unity are decisive.

Although simplified this model is built on more solid theoretical foundations than its predecessors, making the objectives of actors explicit and incorporating the cost and benefits of different choices. This buys us four hypotheses about which interest groups will tend to benefit from government policies and the form the transfers will take. The first of these hypotheses is similar to the main expectation of the simple Capture Theory and is somewhat intuitive. But the other three hypotheses that emerge from the model are more subtle and unforeseen, and provide important insights into the nature of interest group competition that can then be tested.

The first hypothesis is that government policy will tend to redistribute to small, homogeneous and well-organized groups that are better able to provide support to politicians. Or, in Stigler's words; "as a rule, regulation is acquired by the industry and is

designed and operated primarily for its benefit."[15] Large, heterogeneous and dispersed groups like consumers may have the numbers to potentially offer votes and contributions, but the high cost of collective action make it extremely hard for them to actually overcome the free-rider problem to deliver that support. Although their stake in the final form taken by the policy is collectively large, it is individually small (e.g. a reduction in $20 in your utility bill) so it is often not even worthwhile to become informed, much less to actually join the fight. Yet for the producers – Adam Smith's 'people of the same trade who seldom meet together even for merriment or diversion' – the cost of organization are lower and the stakes worth investing to try to influence policy.

The second hypothesis is that the policies that result from the interest group competition will not produce corner solutions, providing all the benefits it could to the winning groups and taxing the losers as much as possible, but rather only to the point where the marginal support elicited from the winners by an additional unit of transfer is greater than the marginal opposition elicited from the losers. Because the level of support from the winners grows at lower rates the greater the level of transfers, and the level opposition from the losers grows at increasing rates, the final policy will settle on an intermediate level of redistribution from losers to winners. Once stated this seems very intuitive: interest group competition does not result in all-or-nothing transfers. But previous theories essentially predicted that either public or private interests would take the whole bounty, i.e. the public interest theory or capture theory. Furthermore, the model allows for interesting comparative static results. When an interest group acquires greater capacity to become organized and to offer support or opposition, this will lead *ceteris paribus* to a realignment of policy to reflect those changes, resulting in greater transfers if the group was in the winning coalition, smaller taxes if it was in the losing coalition, or even a switch from being a net loser to a net gainer.

The third hypothesis states that politicians in search of support will tend to focus their efforts reforming sectors or industries where big consequential changes can be made, like breaking up a monopolized or highly concentrated industry, or conversely, creating a monopoly in a previously competitive sector. This is because such changes hold the potential for achieving much greater net gains in political support for politicians than

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[15] Stigler (1971: 3).

changing sectors or industries that are already in an intermediate situation where the opposing interest are well balanced so that any gain in support is quickly offset by increased opposition. This prediction seems to be well borne out by evidence, with government intervention often concentrated on competitive sectors, such as agriculture and taxi-cabs, and on concentrated sectors such as utilities, and not so much on intermediate sectors where there is some but not perfect competition.

Finally, the fourth hypothesis is that rather than leading to coarse separation of groups affected by the policy, such as consumers versus producers, or employers versus workers, policy will fine-grain the policy to separate within each group which sub-groups are better able to provide support and opposition. Thus, instead of catering only to the interest of industry at the expense of consumers, policy distinguishes a vector of attributes, e.g., firms in the industry according to size, location, technology, origin of capital, unionization, or level of population, and consumers according to income, preferences, corporate vs. individuals, geographic location, and political views. The coalition that will be net benefitted by the final policy will contain both firms and consumers. The better politicians are able to make these distinctions and fine tune policy to these configurations the greater the net support they will be able to extract. The prediction is: government policy will tend to be complex and detailed and not favor a single homogeneous group.

Competition among Interest Groups

The view of interest groups and government policy based on the "demand" for redistribution came to be known as the 'Economic Theory of Regulation.' It was further refined when Gary Becker wrote *A Theory of Competition Among Pressure Groups for Political Influence*. Becker added to the Stigler/Peltzman model something that had been conspicuously missing (Becker, 1983). In the standard model to political behavior politicians were assumed to design policies with an eye only to the marginal support and opposition that different configurations of transfers elicited from the different affected groups. But any redistribution through taxes and subsidies also necessarily entails deadweight losses that reduce efficiency. Like a leaky bucket to take water from one group to give to another, deadweight losses mean that one dollar that is taxed will allow less than a dollar to be given as subsidy. The more inefficient the design of the policy the greater will be the hole. Because politicians want to maximize their net support they have an incentive

to choose methods of taxing and subsidizing that avoid high deadweight losses. With this additional consideration Becker`s model added four additional testable hypotheses to the economic theory of politics.

The first is that what matters in determining which groups will be taxed and which will be benefited, and by how much, is the **relative** ability of each group to produce pressure, not the absolute ability. The competition between interest groups is zero-sum in influence and negative-sum in taxes and subsidies, due to deadweight costs. Thus if both groups, taxed and subsidized, increase their level of pressure this might not lead to much change in net influence and consequently little change in the equilibrium amount of transfer. It also implies that when we observe a group that seems to be ineffective at producing political pressure being benefited by governmental policy, it probably means that the taxed groups are even worse.

The second hypotheses is that if marginal deadweight losses increase, the taxed group will apply more pressure against the policy and the subsidized group will reduce their pressure, leading to less of the transfers. It's as if the higher deadweight losses have made the transfer more expensive, so less of them are realized in equilibrium. Increases in deadweight losses reduce the amount of redistribution resulting from the competition among interest groups. Becker (1983: 381) interprets this to imply that when we see wasteful programs in real life, it means that these "politically successful programs are 'cheap' relative to the millions of programs that are too costly to muster enough political support."

The third hypothesis states that the politically successful groups will tend to be small relative to the groups that are taxed to pay for those transfers. This comes about because deadweight costs increase at increasing rates, so that it is better to fund a given transfer by taxing a large group with a small less-distorting tax than to get the same amount through a larger highly distorting tax on a smaller group. For example, when agriculture is a large portion of GDP, as in many developing countries, it is common to for agriculture to be taxed, e.g. through price controls, or exchange rates, to benefit industry which is a smaller part of the economy. In countries where agriculture is a small part of GDP, like the US and France, it is subsidized by taxes on other sectors.

Finally, the concern over inefficiencies in the transfer of resources means that the competition among interest groups has the effect of leading the most efficient method of taxation to be used, as both groups can be made better off with more efficient forms of transfers. This leads Becker (1983: 396) to conclude that "this analysis unifies the view that governments correct market failures with the view that they favor the politically powerful by showing that both are produced by competition among pressure groups for political favors." Thus, strangely enough, the Chicago approach to interest groups ends up partially rehabilitating some of the conclusions of the public interest theory, even though its premises and outlook are completely different.

Public Choice and Rent-Seeking[16]

While the Chicago approach tended to ignore the "supply" side of government, the Public Choice approach embraced it, though both approaches are founded on the very similar premise that people and groups will naturally try to seek rents for themselves through the political arena. The point of departure for Public Choice is the assumption that people who act in their own self-interest in usual market situations, do not stop doing so once they step into office or administrative positions, so that politicians and bureaucrats must be similarly modelled as self-interested rather than public-spirited servants of society. But, although this is very close to the Chicago School premise that politicians set policies so as to maximize their net support, the conclusions about the policymaking process differ. For the Chicago School political competition assures that arrangements that arise and persist are as efficient as can be expected, so that any reform to try to eliminate existing forms of redistribution and transfers among interest groups will probably make matters worse. Faced with proposals to reform current policies to eliminate perceived inefficiencies, a typical Chicago response would be that probably some important cost is being ignored in the proposal.[17] The Public Choice approach, on the other hand, sees no efficiency-enhancing properties of political competition but rather that due to imperfect information that makes voters and citizens poorly informed, politicians will often opt for inefficient "sneaky" methods of redistribution over more transparent efficient methods

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[16] For more details on the Public Choice literature see Mueller (2003) and Rowley and Schneider, eds. (2004).

[17] Lott Jr (1997: 224) puts it this way: "If an economist had a model of how to design a perpetual motion machine, the normal response would be that he has left out some important frictions (costs) out of his analysis. A Chicago School response to an economist who produces a new optimal tax is "if it is so optimal, why don't we see it?" In other words, what important costs have you left out of your model?"

(Coate and Morris, 1995: 1212). As a remedy for these pathologies the approach believes that constitutional rules and better methods for aggregating preferences, e.g., voting mechanisms, legislative rules, or bureaucratic structures could be designed so as to curb rent-seeking behavior. James Buchanan, for example, famously argued in favor of balanced budgets amendments (Buchanan, 1985).

In a sense the difference boils down to how sensitive the demand for the transfer is to the increase in deadweight loss when a reform prohibits a given method of transfer from being used. The next best transfer method will entail a larger deadweight loss, but it may still lead to approximately the same level of transfers, if the demand for redistribution is insensitive (inelastic), or to a great reduction if it is sensitive (Lott Jr, 1997). For example, Alston and Mueller (2006) have studied the use of pork by the Brazilian Executive to gain support for its projects in Congress. The Executive has great discretion whether to implement or ignore small amendments to the budget made by individual congressmen that involve resources for minor public works or geographical distribution in their districts. These transfers are of great local electoral value to the congressmen and many are willing to vote in favor of the Executive's programs so as to have their transfers approved. There is great criticism of this exchange of pork for support under the argument that legislators should vote the public interest and not their own personal or constituents interests: the Executive should use the budget for the greater social good and not for buying political support. Several reforms of the system have been suggested, in particular removing the Executive's discretion whether to implement budget amendments and thus its ability to use them strategically as a political currency. Alston and Mueller (2006) maintain that doing so would only lead to the same political negotiation of support to be realized through more costly and distorting methods. They see the original method as a relatively 'cheap' means of attaining the support that the Executive uses to approve important reforms that the country direly needs. From a societal view it is better to put pork (the political currency) in the hands of the Executive who ought to have voters at large in mind versus members of Congress who cater to the demands of their constituents. Moreover, the total value of the individual amendments is a very small fraction of the total budget and the pork that is given generally goes into local projects that generate social value, even if not the optimal social use of those resources. Alston and Mueller's position is compatible with the Chicago

School view that the demand for redistribution is inelastic and will persist even if the existing method of effecting transfers is prohibited. Those who propose reforms that eliminate the current method of redistribution expect that the level of rent-seeking will be reduced once it becomes more expensive, in terms of deadweight losses, to make the exchanges of pork for support. Which view is right turns out to be an empirical issue and highly contextual (Lott Jr. 1997).

For the Public Choice perspective the form chosen by politicians to redistribute resources is often not determined by efficiency considerations, but rather to conceal what is going on from voters. Thus rather than using direct cash transfers or other transparent methods politicians often use large public projects, such as building an airport or developing a new military technology, which indirectly benefit selected interest groups, but may or may not also benefit the rest of society (Coate and Morris, 1995).[18] Citizens usually have less information about whether the project will benefit them than the politicians do, and even after the fact they cannot perfectly observe whether the project was in their interest. Military technology, for example, benefits the defense industry for sure, but benefits to citizens depends on future event such as war or peace, which may be endogenous to expenditures. Because these types of public projects could be undertaken by public-spirited politicians, self-interested politicians can take advantage of the incomplete information to redistribute resources in a concealed manner without harming their reputations, something that would not be possible with transparent methods such as cash transfers.

Empirical evidence of the ubiquity and increase in size of megaprojects throughout the world in the past 100 years seems consistent with this view of transfer choice. Flyvbjerg (2014: 6) defines megaprojects as "large-scale, complex ventures that typically cost US$1 billion or more, take many years to develop and build, involve multiple public and private stakeholders, are transformational, and impact millions of people." The Joint Strike Fighter aircraft program, China's high-speed rail project, the Burj Khalifa building in Dubai, or the Rio Olympic games are examples of megaprojects. Flyvberg (2014) shows that total global spending in megaprojects is currently of the order of 8% of total global GDP and with

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[18] Coate and Morris (1995) is actually a critique of Public Choice approaches for not being more explicit about what are the sources or the imperfect information that allows inefficient redistribution to take place.

strong growth in size and frequency over time, so that we may soon be entering an era of trillion-dollar projects. What drives this megaproject boom, according to this author, are the 'four sublimes' – technological, political, economic and aesthetic - that make them appealing to a broad coalition that stands to gain and thus support the projects; engineers and technologists, politicians, business people and trade unions, and designers and people who love good design. The 'Iron Law of Megaprojects': o*ver budget, over time, over and over again,* makes megaprojects convincing evidence of the notion that they may be a form concealed inefficient transfers to interest groups (Flyvberg, 2014: 11). Cost overruns, for example are frequently large, and happen in all countries irrespective of income, geography, political system: e.g., overruns amounted to 1900%, the Suez Canal; 1,600% the Scottish Parliament Building; 1,400%, the Sydney Opera House; 560%, the Medicare system in the US; 440%, and the Bank of Norway building, just to name a few. By analyzing the 70 years of available data he comes to the following dismal assessment:

Success in megaproject management is typically defined as projects being delivered on budget, on time, and with the promised benefits. If, as the evidence indicates, approximately one out of ten megaprojects is on budget, one out of ten is on schedule, and one out of ten delivers the promised benefits, then approximately one in one thousand projects is a success, defined as "on target" for all three. Even if the numbers were wrong by a factor of two—so that two, instead of one out of ten projects were on target for cost, schedule, and benefits, respectively— the success rate would still be dismal, now eight in one thousand.

Empirical Tests of Interest Group Theories

Interest group theories yield many testable implications of how and when rents are created, how they are distributed and what is the impact on economic efficiency, so naturally there have been many attempts to tests these implications against real world data. Crude tests simply try to detect changes in prices, profits, entry, exit, and other variables. after policies have been changed and then attempt to associate these changes with the interests of different groups. But this kind of test tells us very little about the mechanism and channels through which interest group pressure operates. More rigorous tests focus on specific events where a new policy is being considered, such as a roll-call vote in Congress or a reform imposed by a regulatory agency. The proposed policies can be used to perform an incidence analysis of which groups stand to win and to lose from each of the competing propositions. This allows the test of whether the final form taken by the policy, after interest groups have competed to influence the outcome, conforms to what is expected by

the theory, e.g. that the new policy favors small, homogenous and well-organized groups. A standard empirical strategy is therefore to regress the votes by congressmen on a given bill that has clear redistributive consequences against measures of the size, strength and cohesion of affected interest groups in each legislator's constituency, controlling for other factors that might also influence their votes. Although this empirical strategy is relatively straightforward, in practice it has been plagued by many problems.

The first is that is hard to actually measure the strength and level of organization of different interest groups, which is the crucial explanatory variable. Typically crude proxies and broad socioeconomic measures are used which are expected to correlate with the characteristics of the actual relevant constituency. These can be things such as the value of an industry's production as a measure of its capacity to produce pressure, or the number of members of special issue groups, such as environmental organizations. Often a legislator's constituency is controlled for simply by means of party affiliation or ratings produced by political organizations (such as ADA scores, a measure of political liberalism).[19] These broad measures may capture some of the more obvious pressures suffered by most legislators, but individual legislators also face myriad other idiosyncratic constituencies that are hard to detect and control for in a regression, so one can never be quite sure what is being left out in the error term.

The second problem in most of the tests of interest group theories relates to the problem of identifying the effect of the treatment (interest group pressure) on the shape of the final policies. Most of the tests in this literature were done before recent advances in empirical methods that have tightened the standards for claiming causality rather than simple correlation. As such they show little concern for establishing an empirical strategy that can rigorously capture the causal impact of interest groups on outcomes. Many studies simply assume that the causation runs from interest groups to policy outcomes. But in many cases it may be that the causality also stems from policies, that by redistributing to some groups make them stronger and more influential. In the same vein, there are frequently omitted variables that haven't been measured or can't be measured, that may be the actual

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[19] ADA scores are calculated by the Americans for Democratic Action (http://www.adaction.org/) based on key past roll-calls, with a zero indicating conservatism and a 100 indicating liberalism. These scores are widely used in academic work to measure legislator's ideology, record and constituencies.

underlying determinant of both the distribution of interest groups and of the policy, for example beliefs or ideology.

A third problem that tests of interest group theories are prone to is what Roger Noll (1989b: 1277) has called the "lurking danger of tautology, i.e. of attributing causality to an inevitable consequence of any policy action". Because every policy leads to some redistribution there are always winners and losers, so it is very tempting to ascribe to those interests that win the key role in having pursued and approved the change. Such functionalist accounts appeal to intuition but are often misleading due to the complex nature of policy change, which is not fully controlled by any of the parties and commonly full of surprises and unintended consequences.

A final concern with the empirical literature on interest group impact is the possibility that a publication bias that prizes positive results may be selecting primarily those studies where interest groups have been shown to have been key determinants of policy change while underrepresenting or ignoring cases where interest groups were not found to matter. To illustrate this concern take the book edited by George Stigler "Chicago Studies in Political Economy" (Stigler, 1988). Part III of this book contains eight articles that display empirical tests of the Stigler/Peltzman/Becker approach. These tests cover the 1962 Drug Amendments[20], automobile safety[21], public ownership of urban transit facilities[22], discrimination in the Department of Health, Education and Welfare[23], the 1973 Mattress Flammability Act[24], no-fault automobile insurance laws[25], redistribution through commodity markets[26], and environmental regulation.[27] All of these studies are well-done

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[20] Originally published as Peltzman, Sam. (1973). "An Evaluation of Consumer Protection Legislation: The 1962 Drug Amendments." *The Journal of Political* Economy, Vol. 81, No. 5 (September/October): 1049-91.
[21] Originally published as Peltzman, Sam. (1975). "The Effects of Automobile Safety Regulation." *The Journal of Political* Economy, Vol. 83, No. 4 (August): 677-726.
[22] Originally published as Pashigian, Peter P. (1976). "Consequences and Causes of Public Ownership of Urban Transit Facilities." *The Journal of Political* Economy, Vol. 84, No. 6 (August): 1239-1259.
[23] Originally published as Borjas, George J. (1978). "Discrimination in HEW: Is the doctor Sick or are the Patients Healthy?" *The Journal of Law & Economics*, Vol. 21, No. 1 (Apr): 97-110.
[24] Originally published as Linneman, Peter. (1980). "The Effects of Consumer Safety Standards: The 1973 Mattress Flammability Standard." *The Journal of Law & Economics*, Vol. 23, No. 2 (October): 461-479.
[25] Originally published as Landes, Elisabeth M. (1982). "Insurance, Liability, and Accidents: A Theoretical and Empirical Investigation of the Effect of No-Fault Accidents," *The Journal of Law & Economics*, Vol. 25, No. 1 (Apr.): pp. 49-65.
[26] Originally published as Gardner, Bruce. (1983). "Efficient Redistribution through Commodity Markets." *American Journal of Agricultural Economics*, Vol. 65, No. 2 (May): 225-234.
[27] Originally published as Pashigian, B. Peter. (1985). "Environmental Regulation: Whose Self-Interest are Being Protected," *Economic Inquiry*, Vol. XXIII, October: 551-584.

and are, to a greater of lesser extent, convincing that interest groups played crucial roles in shaping policy changes. One may wonder, however, in how many instances were interest groups not determinant and therefore the case was not subject to academic inquiry. There are possibly at least as many cases where no impact from interest groups could be found. When is it that interest groups will play a role and when is it that they will not? It is likely that there are situations and circumstances related to a country's political institutions that affect when interest groups will be more likely to matter. This chapter argues that in order to answer this question it is necessary to take an institutionally rich approach to analyzing interest groups.

Clearly, all the critiques of empirical tests of interest group impact presented above can be ameliorated by effort and hard work to, for example, get better data, use better statistical methods and empirical strategies, and avoid functionalist explanations. But given the nature of interest groups as inextricably embedded in a specific institutional context that determines the rules of the game for how policy gets created, changed and implemented, it proves foolhardy not to bring that context into the center of the analysis and instead strive for general results such as establishing the primacy of private or public interest. Much of the literature on interest groups purposefully seeks to be general and not tied to institutional detail. Yet even those authors were aware that this approach comes at a cost. Gary Becker states in the conclusion of his seminal 1983 paper: "I recognize that progress has been obtained at the expense of various simplifying assumptions that should be modified. These include a neglect of voting, bureaucrats, politicians, and political parties."[28] Similarly Peltzman (1989: 7) notes how Chicago School models purposefully suppress the "details of the machinery of politics." Even later influential models such Grossman and Helpman (2001) strive to minimize the institutional details insofar as such a thing is possible when trying to model lobbies and government in a representative democracy (Baron, 2002: 1227). The next subsection shows what can be some of the costs of abstracting from the underlying institutional context. Then, in subsequent sections we will give examples of research on interest group impact that is careful to control for how political institutions mediate the relationship between interest groups, policies, and economic performance.

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[28] Becker (1983: 396).

When Predictions Fail: Deregulation and Interest Group Theories

In the early 1970s a strong movement towards deregulation of various sectors gained momentum in the US and subsequently spread across many other countries in the world. In the US this started with deregulation of rail and truck transportation, and was followed by airline, energy (especially gas and electricity), telecommunications and finance, generally reducing barriers to entry and increasing competition. At the same time there was an increase in other types of regulation, particularly environmental, product and workplace safety, and labor contracts. The trend was not simply ideological or partisan as it was pursued by Presidents as diverse as Nixon, Carter and Regan.

The strong move toward deregulation presented many problems for both interest group theories and for public interest theories, as the natural prediction that emanates from both these theories is of high levels of regulation and not deregulation. Public interest theories expect high levels of regulation because governments are modelled as seeking to correct market failures. Unless market failures had suddenly started to sort themselves out on their own, there should be no reason under this view for deregulation to expand at such a strong pace. One could argue that after decades of regulation it had become apparent that most of the perceived market failures that had justified the regulation in the first place had never really existed and that deregulation was a trend to correct those misperceptions, but this does not seem to have been the case, and many sectors that have few market failures remained regulated nevertheless. It is true however that the increase in social regulation, as opposed to economic regulation, is compatible with public interest theories.

Self-interest theories also do not sit well with deregulation, but for different reasons. One of the main predictions of these theories is that regulation will tend to favor small, homogenous, well-organized groups, such as firms in concentrated sectors, at the expense of large, diffuse and unorganized groups like consumers. Yet deregulation seems to do exactly the opposite. Of course, here too one could argue that changes in technologies, demand, information available to voters, organizational technologies (facilitating collective action), etc. could explain the changes as a shift in the equilibrium that arises from the competition among interest groups. But although many of these changes were real, they don't seem to salvage the theory. The shape and scope of deregulation were so antithetical to what self-interest theories would expect that in 1989 Sam Peltzman, one of the main

proponents of the Chicago School approach, was compelled to publish an article called "The Economic Theory of Regulation after a Decade of Deregulation" where he takes stock of the performance of the Chicago School approach in the light of the evidence.[29] In this article he is extremely candid about the theory's shortcomings and limitations when confronted with the facts,[30] though he does try to argue that in many ways the theory remained useful and at least had fared better than public interest theories.[31]

4. Bringing Information and Institutions into Interest Group Research

The inability of the early self-interest theories to adequately account for events such as the trend towards deregulation and the strengthening of social regulation in the 1970s in the US hints at what crucial elements might have been missing from the analysis. Although research on interest groups has spawned many different branches focusing on different central elements, we will emphasize the approach we deem to have been the most successful in producing insights on how and why interest groups emerge, how they behave and what is their impact. This approach is centered on two elements that were conspicuously missing from the earlier public interest and self-interest theories: information asymmetries and institutions.[32] The main point of this chapter is that explicit consideration of these elements is the best avenue for understanding interest groups and their impact on economic performance.

Information Asymmetries and Principal-Agent Problems

The Chicago School theories place incredible informational demands on politicians. They are expected to know all the groups that have an interest in a given policy issue, how well organized these groups are and how each would react to every possible configuration of policies, anticipating in detail how each possible policy will redistribute costs and

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[29] Peltzman, S. (1989). "The Economic Theory of Regulation after a Decade of Deregulation." *Brookings Papers on Economic Activity*. Special Issue, pg. 1.

[30] For example, when reviewing the changes in trucking regulation he admits that "here then is an industry in which substantial and sustainable rents received the fullest measure of organized support from the beneficiaries. There is simply no way I know of to square the wholesale elimination of these rents by political action with any current version of the ET" (economic theory).

[31] The same issue of the journal brings comments by Roger Noll and by Michael Levine, as well as by assorted other participants in the meetings where the paper was presented, assessing Peltzman's defense. The general tone is highly critical.

[32] Two other important elements for this research are beliefs and leadership. Both played crucial roles in the US move towards deregulation. Both of these elements will be examined in detail in Part III of the book.

benefits across all groups in society and how this translates into support or opposition from each group. Then, after calculating the exact optimal policy that maximizes net political support, this policy has to be communicated to a perfectly subservient bureaucracy for implementation. Even understanding that models necessarily have to simplify reality, the complexity of real-world politics suggests that such informational requirements and control may be too much. Information asymmetries are simply too central to interest group competition to be assumed away. Outcomes are crucially determined by how much information politicians, interest groups and voters have about each other's preferences, information sets and actions.

Principal-agent theories (and information theory more generally) have been the major way through which the literature has tried to incorporate informational constraints into the analysis. Interest groups can be seen as taking part in a web of principal-agent relations that involve politicians, legislators, voters, bureaucracies, citizens, courts, and media, among others. Each relation involves a principal who delegates a task to an agent, who in turn receives some form of compensation – such as a payment, votes, praise, campaign contributions – to perform that task. However, the agent has her own preferences regarding how the task should be done, and information asymmetries make it costly for the principal to fully monitor the effort put in by the agent in pursuing the task. The incentives offered by the principal cannot be made contingent on effort, which is unobservable, but must rather be made contingent on outcomes, which are affected by effort but also by many other elements not under the agent`s control, including chance and serendipity. The upshot is that the contract between the principal and the agent is plagued with problems of moral hazard and adverse selection that might cause the relationship to break down thus foregoing the gains to trade from the delegation.[33] What one observes is that when confronted with the problems posed by information asymmetries, rather than simply giving up on the potentially fruitful relationship for both parties, they have an incentive to structure the relationship in ways that the agent's interests become at least partially aligned with those of

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[33] Moral hazard refers to behavior where the agent exploits his informational advantage by performing the task differently than what was accorded in the contract with the principal, for example shirking. Adverse selection happens when the agent misrepresents her type/ability when establishing the contract with the principal, for example when a utility inflates the cost it declares to a regulator. Moral hazard thus takes place *ex-post* to the contract and adverse selection *ex-ante*.

the principal, so that when pursuing her own interest the agent will, even without monitoring, be simultaneously also forwarding the interest of the principal.

This can be done by trying to design an incentive mechanism into the contract between both parties, as pursued in the mechanism design literature (see for example Myerson, 2008). Yet, although high-powered (second-best) optimal solutions to the principal-agent problem are highly elegant, one does not really observe a high incidence of such incentive schemes in the real world; rather low-powered contracts tend to prevail (Dixit, 1996). Particularly in political relations, as opposed to more economic relations such as labor contracts and relations among firms, low-powered incentives seem to be the norm. These do not try to control agents by getting their marginal incentives precisely right so as to induce the desired behavior, but rather rely on blunter methods that simply prohibit some actions, rely on costly and imperfect monitoring or simply tolerate many obvious inefficiencies. These are situations where Coase's (1960: 39) dictum applies, that "it would cost too much to put the matter right." In general the incentives that permeate the many principal-agent relations in the political realm are determined by the specific institutions that are the rules of the game played by politicians, voters, interest groups, courts, etc. These institutions are built into the electoral rules, the legislative rules, partisan rules, judicial rules, the Constitution, and many others, including both the formal codified institutions and the informal, *de facto*, manifestations. The solutions to the principal-agent problem imposed by these institutions are usually far from the second-best optimum that a high-powered mechanism could achieve, but they are robust and give the relationship stability and predictability.[34] Some examples will be given below.

One often comes across relationships between economic or political agents that have been structured in a way that may seem odd or unusual because it seems to generate wasteful behavior or leave profitable opportunities unrealized. Typically one would expect a relationship that involves a delegation between a principal and an agent to be structured through a standard contract that establishes a payment by the principal for the agent to complete a pre-specified task, possibly contingent on many states of the world. When

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[34] 'Second-best 'is the most efficient outcome possible given that there is an information asymmetry (or other social cost). The first-best is the absolute most efficient outcome, but it requires completely removing the source of the social cost, e.g. the information asymmetry, which is generally not possible. In real applications the second-best is usually the best one can hope for. The point being made is that even the second-best is often not attained.

instead of a simple payment one encounters an apparently unusual arrangement structuring the relationship, it is tempting to conclude that this is inefficient or irrational behavior. However, often the unusual arrangement may have a hidden purpose; to solve or ameliorate the principal-agent problems imposed by information asymmetries. Especially if the apparently senseless arrangement has existed for a long time, it bears considering whether it is not fulfilling some non-obvious function of aligning incentives or inducing cooperation. For example, in some circumstances employment relations can include, in addition to the contractually determined wage, an element of paternalism where the employer provides nonmarket goods in exchange for faithful service. At first blush paternalism might seem as unusual or provincial behavior, but in some circumstances it serves the purpose of aligning the interest of employer and employee, reducing monitoring costs and turnover and making the relationship viable despite the hazards that originate from the information asymmetry (Alston and Ferrie, 1993).

Interest Groups in a Web of Principal-Agent Relations

Information asymmetries are an inescapable element of the interaction of interest groups with other actors, so it is only natural that a focus on who knows what about other players' preferences, types and actions would come to be a central part of the study of interest group competition. In addition, the real world process of social choice through which legislation is made and policy implemented, is obviously much more complex than abstract models that have politicians on one side and interest groups on the other. This process involves a wide variety of different actors, each with different preferences and different capacities to influence outcomes, as determined by the formal and informal institutions. Politicians aren't a uniform group; there are presidents, representatives, senators, committee's, parties, among others. The chosen policies are implemented by agencies, departments, regulators, ministries, secretariats, among others, each with different preferences and powers. Courts at different jurisdictional levels can be invoked by other parties or may proactively intrude. In addition there are voters with widely varying preferences and different levels of information and willingness to participate in the process. The media can play an important role by giving certain issues more salience and affecting the quantity and quality of information had by other parties, often in non-disinterested ways. A further complication is that many of these actors are aggregates of different

individuals, even though we may refer to them as a single entity, such as 'the court', the 'committee' and 'the median voter.' Although it is sometimes a useful simplification to treat an aggregate group as a single actor, it is important to keep in mind, and sometimes to explicitly consider, that each group must have an underlying process of social choice that determines the aggregate's preferences and action.[35]

How do interest groups fit into this complex web of relations? The fact that there are so many different players involved in any specific policymaking event means that an interest group that wants to influence an outcome has many different points of entry into the processes each of which requires different instruments of influence and has different prospects of success. An interest group can, for example, focus on lobbying the President using campaign finance. Alternatively it may opt to use the courts and judicial review to change a piece of legislation has been passed and implemented by the legislative and executive. It can also do both simultaneously and even explore other channels of influence. Different strands of research have emerged focusing on different strategies adopted by interest groups to influence the process through which policy choices are made. Instead of simply listing the main strands, we seek to provide some structure to the discussion by couching the exposition in a simple spatial model that highlights the role of information asymmetries as well as the network of relationships. The model stresses the importance of political institutions in determining the relative power of the players as well as the sequence and locus of play for each actor.

One of the most influential early applications of the principal-agent model to political relations argued that apparently inefficient designs of the structure and process of government agencies serve as a means for political principals to control the agencies without having to incur in constant costly monitoring (McCubbins, Noll and Weingast, 1989). Here we extend this example to include committees, courts, voters and other players in order to illustrate how the web of principal-agent relations in which interest groups take part affects how these relationships get organized and what outcomes ensue. Figure 1 Panel

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[35] New Institutional Economics generally presupposes methodological individualism, which is the view that all explanations of economic and social phenomena must be in terms of individuals and the relations between them (see Hodgson (2007) for a discussion on different definitions of the term). Most other approaches, such as Public Choice, Law and Economics, and even neoclassical economics are also generally founded in methodological individualism, though the focus on organizations such as firms and households mean that often the basic element is not the individual.

I shows the preferred position of the President (P), House (H) and Senate (S) on a two-dimensional policy space. Here we assume that each legislative body is homogeneous and can be treated as a single agent (this unrealistic assumption will be relaxed below). The two policy dimensions could be, for example in the case of Marijuana legalization lobbying, the price of the drug to consumers on the horizontal axis and how hard it is to access the drug on the vertical axis. The initial legislation is at point Q_0. The relevant portions of indifference contours (I_j, for $j=P, S, H$) are drawn for each of the political actors showing which points they prefer to the status quo.[36] The lines between each pair of actor's preferred points, forming a triangle, are the contract curves which show for each pair the locus of points where there can be no Pareto improvements through negotiation. Any point outside of the triangle has at least one point on or in the triangle that all three parties prefer. We assume that each of P, H and S has a veto over any proposition, so that once policy has been moved into the triangle or its border, it cannot be subsequently moved without making one of the three worse off.

Given the preferences in Panel I we can predict that the status quo has a good chance of being moved to some point in the lens that emanates from Q_0. Further, we can predict that if it is moved, it will end up in the portion of the lens that is in the triangle. Which point exactly will depend on how well each party negotiates during the process of passing a new law and also on contextual features. But once the policy has been moved into the triangle any further proposed change should be vetoed by at least one of the three players.

What McCubbins, Noll and Weingast (1989) sought to highlight was the principal-agent problem between the coalition formed by P, H and S (the principals) and the agency charged with implementing the legislation at B_0. The problem arises because once the delegation has occurred it is very difficult for the politicians, who have neither the expertise nor the time, to monitor the agency and assure that it is faithfully implementing B_0. The agency can take advantage of the information asymmetry and instead implement a different policy, say Q_1. This bureaucratic drift can go unnoticed by the coalition for a considerable

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[36] The indifference contours are circles centered at each players preferred point that show all policies that have the same utility for that player. Standard assumptions assure that the curves are well behaved and have only one global maximum at the preferred point. As with indifference curves there is an infinite number of contours but we only show those of interest in the diagram.

amount of time as policymakers' attention is a scarce resource (Jones and Baumgartner, 2005). Once the coalition does notice the deviation, however, it can be too late to set things straight. It is not simply a case of the coalition reiterating to the agency that it must implement B_0 instead of something else by threatening some form of punishment or by making the legislation more explicit. The reason for this is that any drift away from B_0 will necessarily make at least one of the three principals better off (in the example P is slightly better off and H is much better off, while S is harmed). Because each principal can veto further changes, the deviation by the agency will have broken the coalition over this issue.

The principals were obviously aware of this danger when the delegation was made. Since it is too difficult to predict in which direction the agency will deviate, the principals were, in a sense, subject to a lottery where each could win or lose from the agency's actions. Because politicians in office are usually risk averse this is a lottery they would rather not play. Therefore, they have incentives to seek ways to prevent the agency from deviating in the first place, and thus avoid putting the coalition under stress. The argument in McCubbins, Noll and Weingast (1989) is that this is done by setting the agency`s structure and process in such a way to tie the agency`s hand *ex-ante* so that it is unable to deviate in the first place. 'Process' refers to the rules and standards that constrain an agency's policy decisions and that guide judicial review. 'Structure' establishes who has the authority to make decisions in the agency and how resources are allocated. For example, legislation might prohibit an agency from considering regulatory impact analyses when making a decision. Or it might require an agency to hold hearings where stakeholders can voice their support or opposition to the proposed policy change. McCubbins and Schwartz (1984) argue that in the US, Congress does not try to closely monitor what agencies do, but rather sets up a system of formal and informal institutions that empower individual citizens and interest groups to examine and participate in administrative decisions. These institutions are akin to fire alarms that interested parties can use to warn Congress about agency deviations even before they take place. Together structure and process can have a profound impact on what the agency does and crucially determine its performance.

Given its impact on performance and outcomes one would expect that structure and process would be carefully set based on established principles of public administration and

best practices. McCubbins, Noll and Weingast (1989) argue instead that structure and process are primarily set by the enabling coalition so as to strategically reduce the risk inherent in the principal-agent problem. They build into the agency's design safeguards and constraints that impede the agency from deviating from the contracted policy. These restrictions might reduce the agency's performance, making it less nimble and less able to respond to the exigencies of the moment, but this cost purchases the assurance that the agency will not be able to take advantage of its informational cover to surprise the coalition with a *fait accompli* which they would be unable to revert. Thus, when confronted with a governmental service that seems woefully slow and ineffective, consider that this may not be due primarily to incompetence and laziness, but rather a case of inefficiency by design, that helps mitigate a principal-agent situation.

This framework can now be used to analyze the variety of ways through which interest groups have been found to participate in policy making processes populated by multiple other players. In the other three panels of Figure 1 we add additional players to the model. In each case it is necessary to discuss what determines the new players' preferences, what powers they have and what is their impact on the outcome. Interest groups are brought in only in the end once all other players have been introduced. We are then in a position to highlight the multiple options faced by interest groups to seek to influence policy. Each of these options is linked to a specific strand of the interest group competition literature, which we can then reference through examples and citations.

In Panel I of Figure 1 it was not made explicit why the agency shifted the policy from B_0 to Q_1. In Panel II we consider one possibility that could have led to this outcome; bureaucratic discretion. In this scenario the agency in charge of implementing B_0, the policy accorded with the coalition of P, H, and S, has preferences centered at point A.[37] What determines the agency's preferred point? It is often assumed that the bureaucracy's preferences are ideological, with bureaucrats self-selecting into jobs where they can pursue their worldviews (Rourke, 1984; Wilson, 1989; Predergast, 2007). Alternatively, bureaucrats are often modeled as maximizing their own utility by maximizing the agency's budget, as this translates into wages, perks and prestige (Niskanen, 1975). The story in

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[37] Contours are not drawn for all actors simultaneously in order not to clutter the figure, but they can be easily inferred.

Panel II is that the agency is able to take advantage of the information asymmetries that makes its actions opaque to its political principals to deviate from the principal-agent contract by pulling the policy closer to its own preferences. As long as the new policy remains in the triangle the coalition would not be able to send it back to from B_0 even when they realize what is happening as S would veto such a reversal. In this scenario the agency is largely insulated from it political principals and it is thus the agency's preferences and actions that are the key determinant of what policy effectively gets implemented. Note that this analysis assumes the agency as a single actor and abstracts from what may have been the method of aggregating individual preferences within the agency. Wilson (1989), one of the seminal defenses of the Bureaucratic Discretion view, gives armies, prisons, schools and regulatory agencies as examples of organizations that are often insulated from their political principals.

In Panel III we assume that the agency actually has preferences very close to the legislated policy at B_0, but is forced to implement policy at Q_1 by the its oversight committee in Congress. This is the scenario known as Congressional Dominance that posits that Congress (and in particular committees and subcommittees) often has a series of very effective and subtle mechanisms related to the budgetary process, appointments and reappointments, and subtle fire alarm oversight, among others, that allow close control of agency behavior even without constant direct oversight and monitoring. Weingast and Moran's (1983) case study of the FTC shows that the agency's sharp turn from highly interventionist in the 1970s to much more hands-off regulation in the 1980s cannot be traced to a preference shift of the bureaucrats, but rather to the electoral shakeup of the member of their direct oversight committees in the House and Senate, as the interventionists were replaced by more laissez-faire proponents.[38]

The Congressional Dominance story in Panel III is portrayed by explicitly considering the process through which preferences were aggregated in the House to reach preference H. This is done by assuming a three member legislature composed of H_1, H_2, and a committee C which has agenda-setting power, ex-post veto, and other prerogatives that allow it to disproportionately determine outcomes in the House (Shepsle and Weingast, 1987). In order to reach the aggregate preference of the House at H a prior process of

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[38] For a critique of the Congressional Dominance view and of the FTC case study see Moe (1987).

deliberation and voting had taken place in the House where the committee was able to pull the policy close to its preferred point C.[39] The outcome at Q_0 in Panel III is thus achieved by the House and particularly by the relevant committee through use its instruments of political control over the agency.[40]

For an interest group intent on affecting the policy it makes a lot of difference when deciding on a strategy whether it is in the Bureaucratic Discretion or the Congressional Dominance scenario. In the first case it would do best to focus its effort to establish a direct relationship with the agency, for example, providing it with information (possibly biased or distorted) and offering post-agency revolving door employment to the commissioners. In the second scenario a completely different strategy focused on committee members would be warranted, perhaps also involving information as well as campaign contributions. What determines which scenario applies are the political institution of the given context. They determine whether it is committees that matter or some other actor. It is the formal and informal institutions that decide who has voice, who can veto, who must be heard, and the sequence and locus of each step in the policy choice process. Thus the importance of an institutionally rich approach to understanding interest group competition.

And while it is not always easy to distinguish which of the two scenarios actually prevails in any given case (Weingast and Moran, 1983), there are actually many additional possibilities. In Panel IV we add three additional players to the picture: a court (J), the median voter (V), and the media (M). Each is arbitrarily given a policy preference which we do not try to justify. Additionally, each is treated as a singleton actor. This is a very strong simplification for the purpose of exposition. It is technically incorrect for example to invoke the median voter theorem for a two-dimensional case such as this. Any actual analysis would have to consider how the whole set of voter's is distributed and how well informed and mobilized each sub-set actually is. The contextual details of the case would indicate whether the Supreme Court or/and other courts are the relevant actor. Even within a court there may be a preference aggregation rule that might be relevant, placing more

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[39] The final outcome of this process at H was determined by a previous status quo, a reversion point, and a series of regimental rules which are not discussed here, as they are not directly related to the argument. See McCubbins, Noll and Weingast (1989: 435-437) and Shepsle and Weingast (1987) for spatial models of the predominance of committees in the US legislative process.

[40] In this example there is an assumption that it is the House and not the Senate or the Executive that exert predominant agency oversight.

influence on some members over others, i.e. the chief justice or the median justice. Similarly, with the media there is often great competition to influence public opinion and voters. Also it is relevant whether the media primarily portrays the facts or whether it has its own agenda or whether sells to the highest bidder.

As drawn in Panel IV the court (J) prefers policy to be at the old status quo at Q_0, indicating a possibility of judicial review of the legislation which moved it to B_0. The median voter or public opinion, has preferences close to the President, perhaps explaining why that President was elected. The media is close to the median voter (perhaps it influenced the presidential election) but lower on the vertical dimension. Note also that the legislative process within the Senate has been made more explicit. There too a committee is able to dominate the policy choice.

Faced with the specific context portrayed in Panel IV what is an interest group to do? An interest group G_1 is shown in the figure, as are two competing group, G_2 and G_3. G_1 was not particularly pleased with the legislation that moved the policy from Q_0 to B_0, and was positively displeased with the bureaucratic drift to Q_1. Is it more effective for the interest group to try to lobby the agency, the President, the House committee, the Senate Committee, or the Judiciary? Should it focus its pressure on one actor or adopt a multi-pronged approach? Would it be more productive instead to try to coopt voters to embrace a cause that would favor the interest groups position, possibly using the media to sway public opinion? Given that the other interest group also lies in the same general position on the horizontal axis relative to the current status quo, would it make sense to join forces on this issue?

The point of this chapter is that to answer these questions and chose a strategy to influence policy an interest group would need four important sets of information. Not by coincidence this is also the information that a researcher analyzing interest group behavior and impact would need to have. The first and easiest is a list of all the actors directly and indirectly involved. Panel IV gives an idea of variety of different players that might have a stake or an influence over the policy and more could be added, for example competing agencies and other bureaucratic instances, district attorneys, advocacy groups, and even foreign governments. The whole federal and state divide has also been left out of the figure, abstracting from many possible subnational and local issues.

The second type of information that the interest group must have to decide on a mode of action is the preference of each of the players. This involves not only the location on the policy space but also the intensity of the preferences. Also, the trade-offs between dimensions can be important. How much is a given actor willing to give up on one dimension to gain along another? By assuming circular indifference contours we are implicitly assuming equally weighted dimensions, but in practice the contours could very well be elliptical. To complicate further, in Figure 1 the policy was subsumed into two dimensions, but actual policies may involve many additional dimensions. Identifying the preferences of some actors may be easy, but for others it will be much harder. A further complication lies in the fact that most of the actors are actually collectives composed of more than one individual so there is often an underlying instance of preference aggregation as well as a need to solve collective action problems (Olson, 1965).

The third set of information that the interest group will need to know is what each actor can do, that is, their relative powers. This requires understanding the how the *de jure* and *de facto* rules work. The rules are determined by the political institutions and they specify who participates at each point of the process, what prerogatives they have, what constraints they face, which instruments they can use and in which arenas these interactions take place. Whereas the graphs in Figure 1 provide data about the first two sets of information – actors and preferences - they say little about the rules of the game. This information has to be filled in when explaining the game represented by the figure. Knowledge of the actual working of the formal and informal institutions is thus a critical input for an interest group's success in influencing policy.

The fourth type of information that an interest group needs is knowledge of how much information each of the other players has about the first three types of information, that is, players, preferences and powers. Knowing what and how much each other player knows turns out to be critical given the strategic nature of the interactions, including the knowledge of how much other players know about what the interest group knows, and so on in game theoretic fashion.

These four categories present different options for an interest group seeking to influence the outcomes of the policy making process. A useful way to categorize some of the most important strategies used by interest groups, and consequently some of the most

important strands of the interest group literature, is to consider through which of the four areas interest group strategies are primarily channeled; parties involved, preferences, power, or information. Clearly any real world case typically involves all three categories, but often most of the action is focused on one of the four areas, making it useful to think of the cases in these terms. In what follows we give some examples of interest group research in each of the categories.

Influencing Policy by Affecting which Players are Involved

Normally the set of players which take part in the policymaking process of any given issue is not under the control of an interest group and must be taken as given. In some cases, however, the interest group can try to influence the venue where the issue is considered thus bringing some players that might not otherwise participate into the process. One example is when an interest group initiates a lawsuit against an agency's implementation of a policy, thus bringing the courts into the policymaking process (Shipan, 1997). In Panel IV, for example, interest group G_3 was made worse off when P, S and H moved the policy from Q_0 to B_0, and even worse off after the bureaucratic drift to Q_1. It would probably be expensive and ineffective to try to lobby the coalition of P, S and H to bring the policy back closer to where it originally had been. However, G_3 can take advantage of the fact that the court's (J) preferences are centered on the old status quo Q_0 to bring the court into the game by litigating B_0. In the US the court can be overturned by Congress, so it may not be willing to take the risk of reverting B_0 all the way back to Q_0. It can be shown that, under assumptions of rational choice behavior, if the President has veto power then the final equilibrium would be on the *P-S* contract curve.[41] This would be an improvement for G_3, especially over the *de facto* status quo at Q_1. Furthermore, in real world situations transaction costs and uncertainty might obstruct Congress's ability to revert the court making litigation an attractive strategy.

Another way through which an interest group can bring additional players into the game is by publicizing and giving salience to an issue so as to turn voters, who otherwise

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[41] If the court reviews agency implementation of B_0, the House and Senate can revert the court's decision and effectively chose a new status quo. If the president does not have veto power over the decisions in Congress, this new status quo would likely be on the H and S contract curve. Aware of this, the court would not intervene in the first place, as this would be worse for it than leaving the policy at B_0. If the President does have veto power the court could put the new status quo on the *P-S* contract curve. The Senate would not collude with the House to revert the court (as that could lead to a veto). See Gely and Spiller (1990) for this and other models of the strategic interaction between the President, Congress and the Supreme Court.

might be quite aloof, into active participants in the policymaking process. Of course this will only be a good strategy if the preferences of the voters are such that they will help to promote an outcome preferred by the interest group. Many successful advocacy groups, such as Greenpeace and other environmental groups, put a lot of effort to make voters aware of the issues they defend. This indirect way of lobbying by spurring voters to pressure policymakers is often more effective than direct pressure. If voters would otherwise simply not participate in the game, this approach of strategically getting them involved is different than that of changing other players' preferences, which we discuss next.

Changing other Players Preferences

Advocacy for a given cause and proselytizing to change other people's minds can work for some more ideological issues, but where the policy has direct impacts on peoples' pocketbooks or on politicians' political survival, their preferences tend to be set and cannot be easily changed. The standard approach in mainstream political science as well as in political economy is the Downsian assumption that political actors are self-interested and their preferences are motivated by political survival (Down, 1957). If voters are absolutely well informed and engaged, this means that the politicians' preference would reflect that of their relevant constituency (which is different for *P, S* and *H*). If voters are rationally ignorant the preference would reflect the preference of interest groups, although there may also be space for politicians to pursue their own views of the world, that is, ideological consumption (see Kalt and Zupan, 1984 and 1990).

This means that interest groups can influence other players by paying them to act in favor of a project or policy that they would not otherwise support. This is the most direct way for interest groups to get what they want; simply buy the support you need to make it happen. When interest groups buy votes from legislators, bribe judges, give campaign contributions to the President, offer post-employment jobs to bureaucrats, purchase coverage in the media, or use any of a plethora of other legal and illegal means to change the actions of other players in the policymaking game, they are not really changing these players preferences, but are getting them to act as if their preference coincided with the interest group. In Panel IV, for example the implementing agency *A* has very different preferences from that of interest group G_2, so persuasion and advocacy would probably be

ineffective. But if the policy is sufficiently important to G_2, it could try to get A to implement the policy closer to point G_2 by offering bribes or revolving door employment that covered the agency's opportunity costs.

This purchase of support, however, is not as straightforward as it may seem on the surface. The complications arise because there are typically several players interested in any given policy so that attempts by an interest group to get another player to move a policy in one direction can be met with reactions from other players who would lose, exhorting the policymaker in another direction. There are typically multiple principals pressuring for multiple tasks, so that the final policy position will be the net result of several groups with different strengths pulling in different directions. The multiple tasks refer to the fact that each interest group would like to have the agent pursue different, often conflicting, outcomes. With multiple principals and multiple tasks the optimal incentives provided by the principals and the optimal amount of effort incurred by the agent turn out to be even more low-powered than in the simple principal-agent case. The agent's incentives are now not only dampened by the non-observability of effort leading to a second-best level of effort, but in addition the incentives by one principal can largely cancel out with the opposite incentives by other principals leading a third-best outcome which is even further from the optimal first-best situation. In addition there is a bias where the agent focuses on the tasks that are more easily observable to the detriment of those that are harder to perceive and quantify (Holmstrom and Milgrom, 1991; Bernheim and Whinston, 1986). The upshot is that what emerges from interest group competition under common agency and asymmetric information turns out to be much different than what would be expected from the Chicago School models where outcomes closely reflected relative interest group wealth and cohesion, and where there were forces that worked to minimize the inefficiencies needed to effect the redistribution. Once the full transaction costs inherent in these relationships are added to the analysis what emerges is a much messier picture of low powered incentives brought on by seemingly inefficient rules and institutions. For example, Spiller (1990) shows that under some circumstances legislators that are competing with an interest group to influence a regulatory agency might find it in their interest to simply allow the agency to be captured by the private interest as they can then extract the rents from the agency through their powers of appointment and budgetary control.

An important implication is that, even unorganized interest, which do not mobilize and consciously try to influence the policymaker's choices, end up being represented in the process. Voters are typically too dispersed and heterogeneous to overcome the costs of collective action, but because they vote legislators will take into consideration how they would perceive any support given to an organized interest group. Denzau and Munger (1986) provides a model of the interaction of organized interest and legislators under the shadow of voters. They derive a 'supply price' for public policy demanded by the interest group from the legislator. This price, which is paid in campaign contributions and other forms of political support, depends on both the legislator's productivity of effort – how well he is placed to affect the outcome, e.g. committee membership – and also by the legislator's constituency's preferences over that issue. If the interest group is seeking a policy that is egregious to the legislator's constituency, he may still be willing to supply effort towards that outcome, but it will be more costly for the interest group. Thus interest groups have an incentive to shop carefully for support, seeking out those legislators that are better able to affect the policy and whose constituency is less unsympathetic to the issue or less informed of what the legislator does because of rational ignorance. The upshot is a more nuanced view of the policymaking process than the simple vote-buying story:

> … interest groups do not control this process, but neither are special interests powerless. Contributions can have some influence on policies about which voters are divided, ignorant, or indifferent. The geographic constituency is not represented to the exclusion of all other groups, but departures by legislators from their voters' interests are constrained by the strong preferences voters have on some issues, and by the threat of informing and mobilizing public opinion that the news media and potential competitors always represent. (Denazau and Munger, 1986: 103)

Changing other Player's Powers

A third avenue of influence for an interest group facing a situation such as that portrayed in Panel IV of Figure 1 is to try to change the rules that determine the powers of each player in the policymaking process. These powers are determined by political institutions that specify the structure and process for how society makes choices. They determine who participates in each type of social choice and how they participate. In most situations it makes sense for interest groups to take the rules of the game as fixed and to try to do the best they can under those circumstances. But given that interest groups are in the business of affecting policy outcomes, there is no reason why they would not also try to

influence the outcome when what is being considered is not a simple policy but rather a rule of the game. This distinction between rules as exogenous and rules subject to manipulation mirror the distinction we have alluded to in Chapter 2 between institutions-as-rules and institutions-as-equilibrium. Similarly in political science this distinction has led to what has become known as the Riker Objection, having been originally formulated by William Riker. The issue is whether the choice of a choice rule should be treated as a special type of decision, or just as one more instance of many issues that a society has to face (Barbera and Jackson, 2004: 2)? Shepsle (2008: 1041) explains the Riker Objection as follows:

> The rules of the game are not fixed and inflexible. The constraints are not etched in stone. Even if no unforeseen contingencies are experienced, even if there are no *ex ante* uncertainties that come to be realized *ex post* in unexpected ways, there still is a role for amendment procedures to play. The *positivist* fact of the matter is that they provide strategic opportunities, quite apart from any welfare-enhancing justification for their utility in a constitution. The Riker Objection is both a recognition of the endogeneity of rules and procedures—they cannot be taken as preset and unvarying—and an acknowledgement of their strategic potential.

According to Ginsburg (2008: 5) nearly all the literature on constitutions assumes that there is a fundamental difference between constitutional politics and ordinary politics that makes choices about the rules more insulated than choices within the rules. Choices made in these 'constitutional moments' are supposedly more stable, enduring and consequential than regular policy choices. But he goes on to note that:

> Even if one believes in theory that veil of ignorance rules can solve the problem of self-interest at the constitutional level, true veils of ignorance are unlikely in the formation of real world constitutions. Political actors in the real world are embedded into constitutional orders to which they sometimes invest strategic energy. And they seem willing and able to move across levels when need be. (Ginsburg, 2008: 9)

The Brazilian Constitution of 1988, for example, was drafted by the elected Congress and was thus as far as possible from the conditions of a veil of ignorance. This, and other similar cases, affords a good opportunity to test for the efforts of pressure groups to entrench their interest into the Constitution by ascertaining rules for how policy will be determined that they see as favoring their positions in future contests. Mueller (1988) uses roll-call votes to shows how legislators representing the interest of large landowners in the Constitution-drafting process managed to secure rules for land reform that drastically reduced their risk of land expropriation. Similarly, Libecap (1992) shows how legislators in

the US passed the Sherman Act of 1890, that would become a landmark statute in US antitrust, partly at the behest of small slaughterhouses and farmers that were being harmed by large Chicago meat-packers using new refrigeration technology.

Affecting Policy through other Player's Information

Although direct pressure, such as vote buying, is the most obvious means for an interest group to pursue its interest, indirect strategies to change what other players do by changing how much and what information they have is at least as common. This chapter has argued that the policymaking process takes place in a network of principal-agent relations which are fundamentally defined by information asymmetries. A major implication from this is that distribution of information is a crucial determinant of the structures and arrangements that emerge as well as the players actions. It is thus natural that an interest group seeking to change outcomes might try to strategically manipulate the distribution of information so as to change those arrangements and actions. Interest groups, by their very nature, often know more about their issue area than politicians, bureaucrats and voters. When legislators produce, bureaucrats implement and courts review legislation they often need as input information on how the world really works related to the issues involved. Many times interest groups have a comparative advantage in providing that information. Although the interest groups clearly have incentives to misrepresent the information, it can be preferable for policymakers to have the biased information than nothing at all, as they can always try to discount the bias.

More interesting than the use by interest groups of the information about the parameters and working of the issue area is the strategic use of information related to the three items discussed above; players, preference and powers. In terms of Figure I Panel IV it is as if each player has his/her own figure, each with different levels and accuracy of information about who are the players, what are their preferences and what they can do. Because each of the players makes their choices in the policymaking game using their own set of information, those choices can be affected by changing the information they have. Much of the literature on interest groups focuses on these kinds of strategies (see cite some important examples).

Alston, Libecap and Mueller (2010) provide an example of an interest group that strategically targets the information of voters in order to subtlely affect the level of pressure

that voters put on policymakers. With one of the most concentrated landownership structures in the world Brazil has tried to carry out a land reform at least since 1946. But although much legislation has been passed and many programs and other initiatives have been formally implemented over time, very little redistribution actually took place until the mid-1990s when the Landless Peasant Movement (known as *MST* for *Movimento Sem-Terra*) devised a strategy of invading unproductive land as a means to attract the government authorities to expropriate the land in their favor. The strategy worked remarkably well and massive areas have since been redistributed to landless peasant, equivalent to the area of France, Austria, Ireland and Portugal combined. At first sight this is a very crude interest group strategy, based simply on violence and physically taking what you want. Why did it work for the *MST* when it hasn't worked for other interest groups, such as the urban homeless and the people displaced by dam constructions, both of which have similar organizations and have tried similar strategies?

Alston, Libecap and Mueller (2010) argue that when the *MST* invades a property its intention is not a straightforward land grab. Instead they are trying to change the nature of the multiple-principal multiple-task relation between landowners and voters – the principals – and the federal government who is charged with land reform – the agent. The crucial factor to understand is that in Brazil land reform has extremely high salience and valance as a political issue. Over time land reform has come to be a symbol and banner of the disgust with historically derived inequality and oppression. After the end of military rule in 1985 land reform was one of the first programs announced by the new democratic government and has since been a major part of the political debate. Thus, even urban voters (Brazil is 85% urban) who are not directly affected by land reform have been highly in favor of far-reaching land redistribution to correct the injustices of the past. The argument by Alston, Libecap and Mueller (2010) is that what the *MST* does when it invades properties is to get the voters' attention on land reform. This has the effect of informing voters that the government's claims that it is doing the best it can to fulfill its electoral land reform promises, should be questioned. That is, the strategy is to reduce the information asymmetry between voters and the government, so that voters apply more pressure and more land gets redistributed. It is an indirect but highly effective strategy. It is not

reproducible by other groups in Brasil because they lack the same level of voter sympathy to their cause.[42]

5. Conclusion

Inherent in interest group competition is the notion of winners and losers. In all of the models and examples given in this chapter there was always a set of players that benefited from the policy outcomes and another set that was harmed. But why don't the losers get together and propose another policy that makes themselves and a subset of the winners better off than the current status quo? It can be shown that, in general, such an alternative policy always exists. And if this could be pulled-off by the current losers, it could also be pulled-off by the subsequent losers of the new status quo. A major result from Social Choice Theory is that when societies make choices, there is no method of aggregating the preferences of many individuals that always leads to a 'good' choice, given some very reasonable desiderata for socially acceptable outcomes (Arrow, 1963; McKelvey, 1976). Simple majority rule, the most common method for making social choices across time and space, for example, does not guarantee that outcomes will be stable or optimal in any sense. According to the theory social choice is inherently unstable and subject to endless cycles, where what is decided today gets changed tomorrow as the losing parties introduce new propositions that break the current winning coalition by offering some of the winners more than they currently get.

Interest group competition is a means of making social choices about the allocation and distribution of resources. As such it should be subject to the problem of cycles, instability and chaos. Yet, even though interest group politics might seem at first glance as being inherently chaotic, on closer inspection it is evident that most outcomes are quite stable and predictable. Once something has been decided through legislation, implementation or rulings, those results tend to persist for long periods of time. It is not common for those harmed by a decision to quickly bring in a new proposal that breaks the winning coalition and upsets the status quo. Instead, decisions are usually persistent and foreseeable.

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[42] For other examples of indirect pressure by interest groups through lobbying the voter, see Sobbrio (2011) and Yu (2005). For more on landless peasants and land reform in Brazil see Alston, Libecap and Mueller (1999a, 1999b and 2000). For studies that focus on the role of the media in interest group competition see Baron (1989, 1994, 2005), Besley, Burgess and Prat (2002), Besley and Burgess (2001), and Stromberg (2004).

So why is interest group politics apparently not subject to the stark results of Social Choice Theory? Both the Chicago School models revised in section 2 and the more institutionally rich models reviewed in sections 3 and 4 tended to reach stable unique equilibria and absence of cycling. But each of these did so in very different ways. The Chicago School models essentially assumed the social choice paradox away by positing an interest group influence function measured in dollars that essentially collapses the policy choice onto a single dimension in which a standard median voter equilibrium always exists (Noll, 1989a: 54). The cost to this approach is the loss in realism given the extreme simplification of a complex policy area into an easily manageable one-dimensional choice.

The institutional models, on the other hand, took a different path – one that has the opposite effect of increasing the realism of the analysis. The fact is that in real world situations social choice is not made in an unconstrained way in which anybody unsatisfied with the status quo can simply introduce a new proposal at any time. Rather, social choice takes place under very specific rules that specify who can do what, when. These rules are the political institutions of that specific context. They vary tremendously from one country or context to another. By determining which proposals can be brought to consideration and the process which the choice must follow to be approved, the institutions strongly reduce the set of viable policies that can beat the status quo. For example, if the rules establish that that Congress can revert a decision by the Supreme Court, then any ruling by the Court that makes Congress worse off than the status quo will not be an equilibrium (Gely and Spiller, 1990). As another example, if specific committees in the House and Senate are allowed to change the proposal approved on the floor of each Chamber, these committees in effect hold an ex-post veto and the floor will tend to defer to the preference of the committees, thus removing from the set of possible equilibria proposals not preferred by the committees to the status quo (Shepsle and Weingast, 1987). In this way the entire set of rules in any given context drastically reduces the set of policies that can overturn the status quo, thus greatly increasing the chances of a predictable and stable outcome. The outcome is in a sense induced by the institutions, and is thus known as a Structure Induced Equilibrium (Shepsle and Weingast, 1981). It does not mean that that outcome cannot be beat by several other proposals where losers and some winners form a new coalition. Rather it means that those proposals where this is possible are ruled out by the extant institutions and cannot

thus upset the current outcome. Because the political institutions reflect the distribution of power in society they are in essence means through which the dominant groups seek to assure the outcomes they prefer, even if this often comes, as we have seen, at a high price in terms of distortions and inefficiencies.[43]

To say that political institutions are crucial determinants of the outcome of interest group competition does not mean that everything is preordained and perfectly foreseeable. A major theme of this book has been the dual perspective of play under a given set of institutions and play to determine the institutions. As this chapter has shown, much interest group competition plays out with all parties taking the rules of the game as given, but in other instances the competition is instead to change the rules themselves. This means that especially over longer periods of time there is a dynamic process of change that can alter institutions and consequently the outcomes of interest group competition. This process of dynamic change is both endogenous and due to exogenous shocks, and can happen incrementally or in punctuated shifts. The changes are linked to beliefs and often there is a role for leadership to induce and shepherd the process. These are themes we take on in greater detail in Part III.

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[43] Several authors have stressed the intimate relationship between institutions and form taken by interest group competition. See Cox and McCubbins (2000), Levy and Spiller (1996), Lijphart (1977), North, Weingast and Wallis (2009), and Spiller and Liao (2008).

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Table 1 – Top 20 Interest Groups Giving to Members of the US Congress – 2016 cycle

Rank 2016 (2000)	Interest Group	Total	Democrats %	Republicans %
1 (2)	Retired	$ 21,672,190	30%	70%
2 (1)	Lawyers / Law Firms	$ 15,651,757	55%	45%
3 (5)	Securities / Invest	$ 15,094,273	34%	64%
4 (4)	Real Estate	$ 12,351,051	38%	62%
5 (3)	Health Professionals	$ 11,113,548	34%	66%
6 (6)	Insurance	$ 11,017,939	31%	69%
7 (12)	Leadership PACs	$ 9,805,546	31%	69%
8 (10)	Oil and Gas	$ 7,023,845	9%	91%
9 (8)	Lobbyists	$ 6,611,021	38%	62%
10 (20)	Pharma / Health Products	$ 6,603,900	34%	64%
11 (7)	Commercial Banks	$ 5,588,606	25%	75%
12 (14)	Electric Utilities	$ 4,961,890	28%	72%
13 (24)	Misc. Finance	$ 4,779,340	32%	68%
14 (13)	Misc. Manufact. & Distribution	$ 4,435,029	26%	74%
15 (15)	Business Services	$ 4,125,653	44%	56%
16 (29)	Retail Sales	$ 4,085,087	26%	74%
17 (37)	Defense Aerospace	$ 3,966,653	36%	63%
18 (27)	Crop Production	$ 3,307,940	29%	71%
19 (21)	Accountants	$ 3,600,076	37%	63%
20 (23)	Electronic Manuf. / Equip.	$ 3,425,250	46%	54%

Source: Center for Responsive Politics http://www.opensecrets.org/ . For the methodology of how the data was classified see http://www.opensecrets.org/industries/methodology.php .

Figure 1 – Interest groups in a web of principal-agent relations
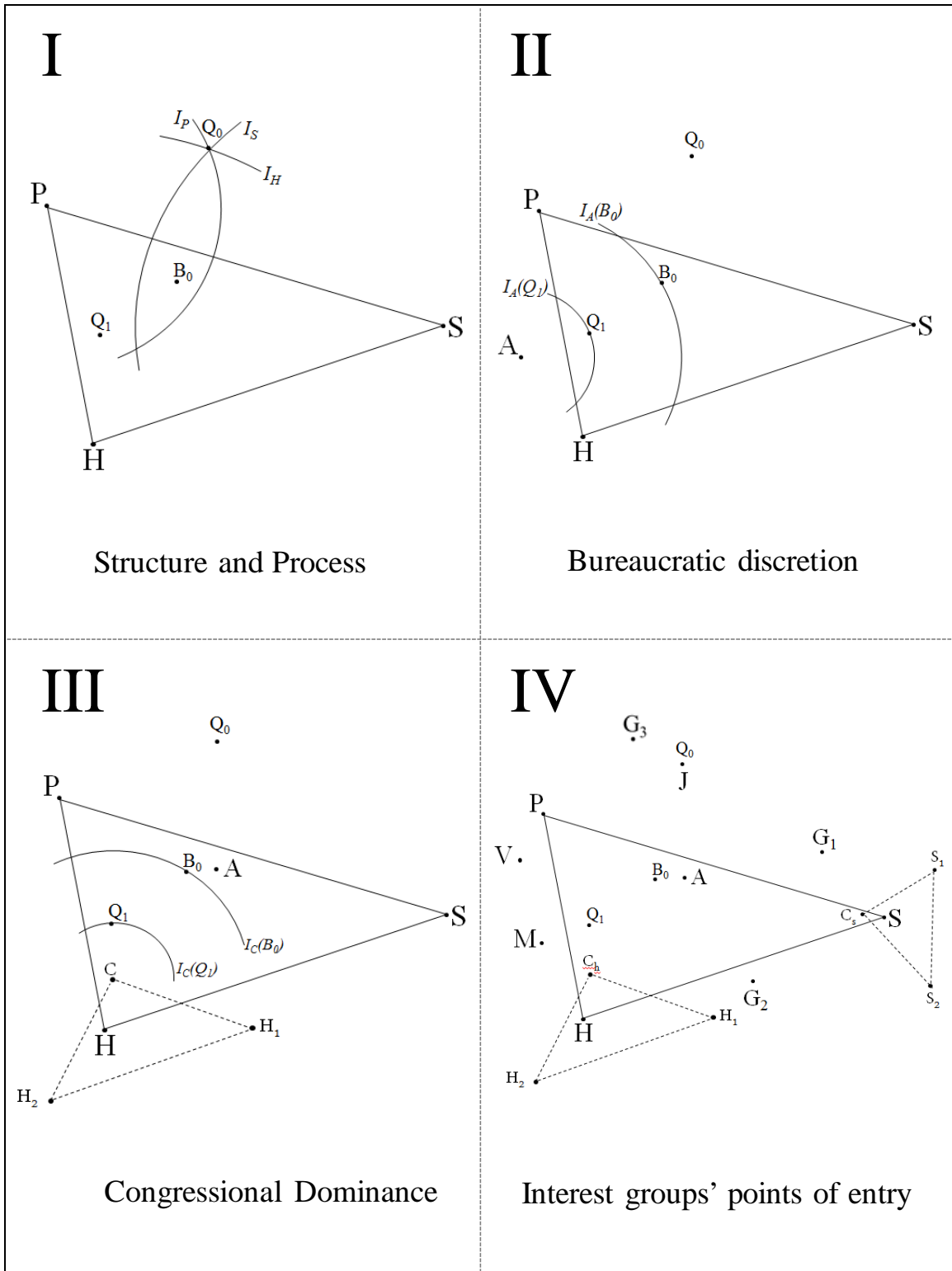
Panel I adapted from McCubbins, Noll and Weingast (1989: 438).