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Transparency and special interests

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ABSTRACT

In this paper opposing lobbies influence a politician via contributions. Society may grant access to decision relevant information. Transparency maximizes welfare if the lobbies have a similar size. Secrecy is optimal if their size is comparable, but not too similar.

1. Introduction

In Germany, representatives of major firms or organizations are permitted to work in Ministries. The programme was intended to promote an institutionalized exchange of views that could be beneficial for policymaking. Employees of BP and E.on worked in the Ministry of Foreign Affairs that decides on strategic energy issues. BASF and Bayer representatives have offices in the Department of the Environment.[1] In 2007, reporters found out that some lobbyists communicated sensitive information to their employers. This raised serious public concern.

This paper inquires whether transparency could be socially beneficial in the presence of external influence. Transparency means that the lobbies have access to sensitive information. To make the point as strong as possible, this paper abstracts from potentially welfare increasing informational lobbying. Influence takes place via contributions. Transparency is enforceable by society, but not secrecy. The idea is that politicians have access to soft information that is e.g. generated by Ministries. Society may grant the lobbies access to this information. However, access may not be desired. Secrecy can only be implemented, if the politician does not have an incentive to forward information to the lobbies.[2]

This paper shows that transparency may be socially optimal in the presence of opposing groups.[3] The ranking depends on the lobbies' relative size (or their degree of polarization). A lobby's size is measured by the valuation for its preferred option. If lobbies have a similar size, then transparency is socially best. Secrecy is optimal if they are not too similar but still roughly comparable. No scheme provides protection if the lobbies are too asymmetric.

Bernheim and Whinston (1986), Dixit, Grossmann and Helpman (1997), Martimort and Semenov (2007, 2008) and others study the influence of several lobbies on a decision maker. Similar to Martimort and Semenov (2008), this paper analyses a complete information world (transparency) and a world, where the politician's information is not known to the lobbies (secrecy).[4] The current paper takes a design perspective. Society does not participate in the bargaining, but determines the level of transparency. Transparency can be enforced, but secrecy has to emerge in equilibrium. The lobbies are assumed to be small and their utility does not enter welfare.[5] Competing lobbies potentially decrease social welfare under complete information.

2. Model

Consider the following common agency model. A politician, the agent, chooses $x \in \{0, 1\}$. The socially optimal decision depends on a state $s \in \{0, 1\}$. Both states are equally likely. A decision is socially best if $x = s$. The politician observes a soft signal $s_d \in \{0, 1\}$ about s, which is

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[1] http://www.spiegel.de/politik/deutschland/0,1518,496720,00.html.

[2] If society cannot prevent bribes, then it is implausible that cheap talk can be prevented.

[3] If there is a single lobby, then secrecy is weakly best. Under transparency the lobby can replicate the behavior under secrecy, yielding more distortions.

[4] Martimort and Semenov (2007) consider a continuous state model. The first-best can be supported under ex ante contracting, given that negative transfers are feasible. Felgenhauer and Grüner (2008) analyze a model in which the lobbies have the same size.

[5] This assumption is appropriate if society is unable to organize.

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correct with probability $p \in [\frac{1}{2}, 1]$. The politician cares for welfare and contributions. His utility is

$$u = y + \sum_i t_i,$$

where t_i is lobby i′s contribution and

$$y = \begin{cases} 1 & \text{if } x = s \\ 0 & \text{otherwise} \end{cases}$$

denotes a fraction of social welfare.

There are two opposing lobbies, the principals. Group $i \in \{0, 1\}$ prefers decision $x = i$. A lobby i′s utility is

$$u_i = \theta_i z_i - t_i,$$

where $\theta_i \geq 0$ is a measure of its size and denotes i′s valuation for $x = i$ and

$$z_i = \begin{cases} 1 & \text{if } x = i \\ 0 & \text{otherwise} \end{cases}.$$

Each transfer is assumed to satisfy $t_i \in [0, \theta_i]$. A lobby therefore is not allowed to "harass" the politician with negative bribes and the contributions have to be credible in the sense that they cannot exceed i′s valuation. The restriction implies that the politician's ex post participation constraint is satisfied. The transfers can be made contingent on any observables. It will be shown that $t_i > 0$ iff $x = i$. The lobbies are small in the sense that their valuations do not enter social welfare.

The timing is as follows. First, society decides whether the lobbies are granted access to s_d. If access is denied, then the politician sends a message $m \in \{0, 1\}$ about s_d. Next, the lobbies non-cooperatively offer contributions. Finally, the politician chooses x. The solution concept is perfect Bayesian equilibrium.

2.1. The politician's decision

The game is solved backwards. A politician is indifferent to decide sincerely after observing $s_d = i$ if [6]

$$\text{prob}(s = -i | s_d = i) + t_{-i} = \text{prob}(s = i | s_d = i) + t_i$$

$$(1 - p) + t_{-i} = p + t_i$$

$$t_{-i} = (2p - 1) + t_i.$$

The politician experiences a utility loss if he decides against the option he thinks is best. He decides sincerely, if the difference between the transfers is small.

2.2. Transparency

The game corresponds to common agency under complete information. W.l.o.g. suppose $s_d = i$. The bidding behavior is as under price competition taking $(2p-1)$ into account.

Let $\theta_i \geq \theta_{-i} - (2p-1)$: The equilibrium bids are

$$t_i = \begin{cases} \theta_{-i} - (2p-1) & \text{if } x = i \\ 0 & \text{otherwise} \end{cases}, \quad t_{-i} = \begin{cases} \theta_{-i} & \text{if } x = -i \\ 0 & \text{otherwise} \end{cases}.$$

The winning group i underbids $-i$′s offer of θ_{-i} by $(2p-1)$. The politician is indifferent and chooses $x = s_d$.

Let $(2p-1) \leq \theta_i < \theta_{-i} - (2p-1)$: The equilibrium bids are

$$t_i = \begin{cases} \theta_i & \text{if } x = i \\ 0 & \text{otherwise} \end{cases}, \quad t_{-i} = \begin{cases} \theta_i + (2p-1) & \text{if } x = -i \\ 0 & \text{otherwise} \end{cases}.$$

The larger group $-i$ just overbids i sufficiently in order to obtain $x = -i$. The politician chooses against the social optimum.

Let $\theta_i < 2p - 1$ $\forall i$: The equilibrium bids are

$$t_i = 0, \; t_{-i} \in [0, \theta_{-i}] \text{ if } x = -i, \; t_{-i} = 0 \text{ otherwise}.$$

The lobbies and their contributions are too small to influence the decision.

It can easily be verified that no player has an incentive to deviate.

An equilibrium in this common agency game under complete information maximizes the sum of the lobbies' and the politician's utilities. If the groups have similar valuations, then the politician's gross utility is decisive and he chooses the social optimum $x = s_d$. Otherwise, the bigger group always obtains its preferred option. The social welfare properties under transparency directly follow.

Lemma 1. *(Transparency) The expected social optimum $x = s_d$ is implemented, iff $\theta_i \in [\theta_{-i} - (2p-1), \theta_{-i} + (2p-1)]$. Otherwise, the probability that $x = s_d$ is $\frac{1}{2}$.*

Transparency provides protection if the lobbies have a similar size.

2.3. Secrecy

The politician has private information and sends a cheap talk message m about s_d.[7] A babbling equilibrium, where m is uninformative, always exists. If the recipients think that m is uninformative, then m does not change their behavior. Hence, any message is optimal. Lemma 3 below shows that focusing on babbling equilibria is simplifying.

In a babbling equilibrium the politician receives an informational rent. The (θ_i, θ_{-i}) intervals where a lobby always, sometimes or never purchases the decision differ from transparency.

Let $\theta_i < 2(2p-1)$, $\forall i$: Suppose $t_{-i} = 0$. In order to win regardless of s_d, group i has to offer (at least) $t_i = 2p - 1$. The utility is

$$u_i = \theta_i - (2p - 1).$$

Offering $t_i < 2p - 1$ yields a fifty percent winning chance. The utility from $t_i = 0$ is

$$u_i = \frac{1}{2}\theta_i.$$

The latter is higher if $\theta_i < 2(2p-1)$. No lobby offers bribes, there are no distortions.[8]

Let $\theta_i > \theta_{-i} + 3(2p-1)$: The equilibrium transfers are

$$t_i = \begin{cases} \theta_{-i} + (2p-1) & \text{if } x = i \\ 0 & \text{otherwise} \end{cases}, \quad t_{-i} = \begin{cases} \theta_{-i} & \text{if } x = -i \\ 0 & \text{otherwise} \end{cases}.$$

Given $-i$′s behavior, these transfers are better for i than offering slightly more than $\theta_{-i} - (2p-1)$ (ensuring a fifty percent winning chance) if

$$\theta_i - (\theta_{-i} + (2p-1)) > \frac{1}{2}(\theta_i - (\theta_{-i} - (2p-1)))$$
$$\theta_i > \theta_{-i} + 3(2p-1).$$

[6] "$-i$" denotes "not i," e.g. if $s_d = i = 0$ and $s = -i$, then $s = 1$. t_{-i} are the transfers of i′s opponent.

[7] The game is of interim contracting.

[8] This resembles the "no influence" result of Martimort and Semenov (2008).