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Protection, lobbying, and market structure

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Abstract

We look at a model of lobbying by oligopolistic industry where firms allocate resources between lobbying and internal cost-reducing activities. We ask the following questions: (i) if firms differ with respect to comparative advantage in lobbying, what is the equilibrium allocation of resources between lobbying and cost-reducing activities? (ii) Can lobbying opportunities reverse the profitability ranking among firms? (iii) Under what condition is the conventional wisdom that highly concentrated industries tend to obtain more protection valid? The answers depend on various measures of comparative advantage in lobbying and on the demand curve. © 2001 Elsevier Science B.V. All rights reserved.

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1. Introduction

There is a presumption, dating at least to Olson's (1965) classic analysis of collective action, that small group size is advantageous in influencing endogenous policy. The argument is that, under institutions of representative democracy, governments and candidates for political office have political-support needs that

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can be better satisfied by 'cohesive' coalitions, as these are less prone to defection and free-riding than more 'diffuse' coalitions. Hence, under representative democracy, 'the small exploits the large'. In contrast, under direct democracy where voters determine outcomes, larger group size is more advantageous.[1] An implication of the advantage of small group size for collective action is that more concentrated industries should (all else equal) be more successful in securing protection and/or in resisting trade liberalization. Empirical studies have however failed to find an unambiguous relation between industry concentration and policy effectiveness of an industry (see the surveys by Baldwin (1984), Hillman (1989), Potters and Sloof (1996), and also Goldberg and Maggi (1999)). Potters and Sloof (1996, pp. 417–418) summarize the diversity of the extensive empirical evidence as follows:

> Most scholars indeed find an increased scope for political influence with higher degrees of concentration, but there are many that find no effect or even a negative effect. Equally ambiguous are the results of the use of numbers for the free rider effect. A large number of participants to collective action is usually hypothesized to increase the free riding problem. Sometimes indeed a negative effect of numbers on influence is reported. More often, however, a positive effect is found. Hence there appears to be relatively little direct empirical support for the Olson (1965) influential theoretical study on collective action.

One may therefore well wonder what is going on. In this paper we consider theoretical foundations for the source of the empirical ambiguities. There are different possible points of departure. One beginning is Stigler's (1964) proposal that a theory of oligopoly should start by assuming collectively rational behavior, and then should proceed to investigate the costs of defection from the cooperative equilibrium. Stigler's perspective on oligopoly provides a reasonable basis for Olson's collective-action proposition. Smaller group size increases the probability of detection of free-riding behavior and decreases the transactions costs of organizing and monitoring contributions to collective action. More concentrated industries are expected to be more effective in influencing endogenous policy decisions. This is not however the unambivalent picture provided by the empirical evidence. The alternative non-cooperative Cournot–Nash approach adopts as a point of departure individually rational behavior. Policy influence then becomes a case of non-cooperative private provision of a public good.

In the latter approach, we have well-established results for the case where consumers choose public good provision (see Cornes and Sandler (1996)). If the public good is a normal good, there are countervailing substitution and income

[1]For an overview of theories of collective action, see Sandler (1992).

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