Were you naughty or nice?

An Impartial Theory of the Effects of Lobbyism

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Abstract

Lobbyism is often judged prematurely. Both, those in favor of and those against lobbyism, tend to implicitly judge lobbyism ex ante. We hypothesize that these polarized viewpoints can also be found in the academic literature. Specifically, we hypothesize that existing economic theories of methods of lobbying come with a connotation of the welfare effects of lobbyism because of the assumptions made. We argue that there is a lack of theory describing the effects of lobbyism without implicitly pointing in one direction of the resulting welfare effect. That becomes problematic when analyzing specific cases of lobbyism. It remains unclear if the lobbying effort itself leads to certain welfare effects or if these are identified because of the assumptions made by the theory used. We solve this problem by developing a theoretical framework that describes lobbyism as a process of shaping transaction costs. It is not clear per se, if changes of transaction costs lead to positive or negative welfare effects. We exemplify our theory with two channels of lobbyism; information and contribution. Thereby, we contradict the intuition that society profits from lobbies providing information to politicians and suffers from lobbies providing contributions to politicians. Further, we sketch out how problematic lobbyism can be identified and regulated based on our theory.

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1. Introduction

Lobbyism is often judged prematurely. Both, those in favor and those against lobbyism, tend to implicitly judge lobbyism ex ante. Some perceive it as bad for society, arguing it undermines the democratic ideal of "one person on vote". Others see in it an inevitable way for groups to express their interest. We agree that lobbyism is a cornerstone of a democratic society. Individuals form groups to express their interest. That indeed is inevitable. Obviously, that does not imply that lobbyism is per se a good or bad thing. If a lobby is "naughty" or "nice", should be judged independently of the actor (who?) or the motive (why?). In a democracy everyone is free to choose what is in his or her interest.[1] In general, the reasons to regulate lobbyism can be found in the means of lobbyism, in the process (how?) of lobbyism and its effects. Besides its interest in ensuring a democratic process of lobbyism, society might have an interest in regulating lobbyism because of its economic effects. We – as economists – focus on the latter perspective.

We hypothesize that the polarized viewpoints sketched out above can also be found in the economic literature. Precisely, we hypothesize that existing economic theories of methods (how?) of lobbying come with a connotation of the welfare effects of lobbyism. We argue that there is a lack of theory describing the effects of lobbyism without implicitly pointing in one direction of the resulting welfare effect. That is problematic when analyzing specific cases of lobbyism. It remains unclear if the lobbying efforts lead to certain welfare effects or if these are identified because of the assumptions made by the theory used. This lack of theory impartially describing the effects of lobbyism also makes it harder for policy makers to think of alternative regulations of lobbyism other than transparency regulations.

Even though lobbyism received increased attention from policymakers over the course of the last decades, nothing more than transparency regulations has been developed to make the process of lobbyism more democratic. Transparency regulations like the Lobbying Disclosure Act (1995) or the the Honest Leadership and Open Government Act (2007) in the United States, the transparency register of the EU (2011, updated in 2014 and 2021) or the just recently established "Lobbyregister" in Germany (2022), can help to give society a better picture of the process of lobbyism (if they are well executed). But, for example, the German "Lobbyregister" lacks a legislative footprint which would provide the public with relevant information to understand the process of lobbyism and its effects on legislation. Transparency regulations are often focused on the disclosure of actors and motives and not so much on the process and its effects. But at least they are weak because they rely on behavioral changes because of increased visibility of the action (ex post). Researchers need to provide a theory helping to understand the process of lobbyism and its effects, otherwise no alternative (ex ante) regulations can be developed.

[1] There are exceptions, for example if groups gather to plan unconstitutional activities

A comprehensive theory of lobbying should at least address three fundamental questions: *Who* lobbies? *Why* do they lobby? And *how* do they lobby? In section two, we evaluate the state of economic theory of lobbyism along this guideline. The first two questions have been discussed extensively by scholars of political economy. Tullock (1967) and Krueger (1974) are most notable for their discussion of the economics of rent-seeking, where economic actors form groups to lobby for their collective interests and secure rents (*why?*). Olson's (1965) group theory meanwhile uncovers the various degrees to which groups can organize (*who?*). There is a substantial body of literature addressing the third question (*how?*). It analysis two channels of lobbying, namely (monetary) contributions and the provision of information, yet these approaches only analyze single channels of lobbying (Bernheim and Whinston 1986a, b; Austen-Smith and Wright 1992; Grossman and Helpman 2001). Our goal is to widen the perspective on the process of lobbying and discuss general rather than specific theoretical dynamics. Further, we focus on the effects of the process of lobbying and not so much on the means. We also argue that both approaches come with a connotation of the welfare effects caused by lobbyism. While the provision of information to societal groups is generally "nice" because it helps rational actors to make better decisions, the provision of contributions realigns the interest of an agent from one principal (the voters) to another (the lobby) and is therefore "naughty" in the eyes of the first principal (the voters).

In section three, we argue that lobbies aim to change the transaction cost structure of the market for goods and services in which their members primarily act (primary markets). In contrast to the raising rivals' costs approach (Salop and Scheffman 1983), lobbies do not change the costs of their competitors directly, such as by vertical integration, but rather indirectly through a secondary market. Lobbies are a vehicle for economic actors in the market for political services. The emergence of a lobby leads to an interdependency between the primary market and the market for political services. Lobbies can change transaction costs for other actors, such as politicians or voters, in the market for political services, for example, by providing information and making monetary contributions. In exchange, actors on the other side can change the transaction costs within primary markets through politics (labels, subsidies, taxes, tariffs, minimum wage). Politicians and voters can provide the lobby's members with what they wanted in the first place: namely, rents in a primary market for goods and services. We argue that it is unclear whether lobbyism is generally "naughty" or "nice". This judgment depends on the welfare effects caused by the change in transaction costs structures in the markets involved.

In section four we tackle the usual connotation of lobbying via information being welfare increasing ("nice") and lobbying via contributions being welfare decreasing ("naughty") based on our theory developed before. From an economic perspective it is more important to analyze how the process of lobbyism shapes markets – independent from the means used to lobby – and thereby influences societal welfare. We contend that lobbyism can become problematic from an economic perspective if the members of a lobby, as well as the lobby itself, simultaneously become gatekeepers of the primary market *and* the market for political services. Market power over two interdependent markets is considered highly problematic because rent-seekers can shape their policies and secure their rents in the long run. We discuss basic elements of an ex ante lobbying policy.

2. Lobbies are naughty or nice

In principle, we do not distinguish between the voter who wants a community project for more bike lanes or a firm that wants to ensure some degree of trade protection against foreign competitors. Both are actors who choose to express their interests to enhance their well-being. In the specific case of this article our argumentation is limited to market-based groups; we make an economic argument. The analysis is grounded on a rational-choice group theory and rent-seeking behavior in markets. As soon as a group can be described on this micro-economic foundation our argument applies to this group. We suppose that a comprehensive theory of lobbyism should answer at least three questions: *Who* lobbies? *Why* do they lobby? And *how* do they lobby? The economic theory of lobbying provides an extensive body of literature discussing the actors (*who*), motives (*why*), and methods (*how*) of lobbying. From an economic perspective, the motive to lobby is to realize or secure possible rents (Tullock 1967; Krueger 1974). Because of this motive, lobbying is often regarded as an unproductive economic activity (Alchian and Demsetz 1972; Baumol 1990).[2] We conceptualize lobbying as a group phenomenon in general, and a contractual relation involving both informal and formal elements among different economic actors in particular. Whether the action performed by a lobby is harmful to society or not, depends crucially on the *process of lobbying* and its effects. We show that the process, and especially the methods, of lobbying are analyzed extensively, while the economic effects of the process of lobbying are not investigated independently of the actor, motive or method of lobbying.

Olson (1965; 1982) argued that some kinds of groups might be more privileged than others. In *The Logic of Collective Action: Public Goods and the Theory of Groups* (herafter: LCA), Olson (1965) developed a group taxonomy completely on rational grounds (Olson 1965, p. 16 ff.).[3] The exploitation hypothesis is one of the best-known insights of LCA: the small can exploit the large. Olson and Zeckhauser (1966) tested this hypothesis. They analyzed whether members of NATO contribute to the

[2] Congleton (1988) asked whether the welfare gains of lobbyists count as positive welfare effects for society. This is not the case because these rents are unproductive and show high opportunity costs. Further, he showed that the losses anticipated by Tullock even underestimate the welfare loses for society.

[3] In contrast to Pluralistic approaches (Bentley 1965 [1908] and Truman 1981 [1951]) Olson showed that the competition between pressure groups might not be balanced by markets because of the different levels of sovereignty of the groups. They cannot be assumed to be equal, like it is mostly done in microeconomics when analyzing individual behavior. Every theory assuming individual actors to lobby for a special purpose ignores the process of forming a group which changes the nature and capabilities of these collective actors (independent of the incentive to lobby, i. e. the rents). It assumes all of them to be equal and therefore reproducing the Pluralists pitfall Olson invalidated in LCA. Groups which can assert coercion, provide selective incentives, or are privileged will provide a higher level of the common good than other groups. These other groups might even fail to provide any common good, i. e. lobbyism, at all.

collective good of military defense proportionally to their GDP and found that small nations, in terms of GDP, contribute a smaller share than larger nations. In *Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (1982), Olson argues that more settled societies, in terms of institutional stability, tend to develop institutional sclerosis, because more groups try to redistribute wealth from non-members to members. These distributional coalitions can attract members more easily than pro-growth groups, because of the exclusive nature of the collective good. The losses in economic growth are the costs of institutional sclerosis, i. e. the lobbying activities of distributional coalitions. Notice that it is not clear *how* distributional coalitions can enlarge their slice of the pie and *how* pro-growth groups enhance growth for society. The general mechanism of the process of lobbyism remains unclear. Institutional sclerosis emerges because of *who* lobbies but not *how*.

Becker (1983; 1985) is less pessimistic than Olson[4]. Becker conceptualizes the interaction of pressure groups as a market interaction that helps to discover inefficient rent-seeking behavior. Privileged groups cannot lobby in unchallenged fashion; they face reactions from other groups that want to stop the rent-seeking behavior or wish to seek rents themselves. For Becker, competition among pressure groups is a way to discover inefficiencies in the economy. However, this procedure is quite expensive for society. Competition among pressure groups is not productive, and therefore it is also in the interest of society not to spend too many resources on this type of competition, even though it might help in discovering inefficiencies (Alchian and Demsetz 1972; Baumol 1990). It remains unclear when the costs of lobbying are outweighed by the benefits, i.e. the identified inefficiencies.

Rents are the primary goal of lobbies (*why?*). The costs of rent-seeking in general and the costs of lobbying in particular can be significant for society (Tullock, 1967, p. 232): "The cost of a football pool is not measured by the cost of the winner's ticket, but by the cost of all tickets." This especially applies to the pool of lobbying (Congleton 1988). It is not only the group which realizes or secures rents which will invest in lobbying, but also other economic actors who wish to secure these rents partially by themselves. As alluded to by Tullock, it is not only the monopolist who will devote resources to secure his power, but competitors might also invest in lobbying to undermine the position of the monopolist. That is the case, even if these actions turn out not be fruitful and the invested resources are wasted. The costs of rent-seeking for the society are also determined by the efficiency resources are used to seek rents. Society has an interest in a supportive constitutional framework for the expression of interest, because otherwise a lot of resources might be wasted because of inefficient ways of expression of interest.[5]

[4] He agrees with Olson that some groups are more privileged than others and are more likely to provide a collective good. But he does not think that this must automatically lead to institutional sclerosis. Just because some groups are more latent does not mean that they cannot exert pressure.

[5] If the interaction of pressure groups is analyzed as a market interaction, as done by Becker, society is interested in an efficient market interaction. The costs of lobbying are then more likely to be outweighed by the benefits, i. e. the discovered inefficiencies.

Salop and Scheffman (1983) pointed out that a rent seeker who aims to achieve higher prices or a greater market share may choose to increase the costs of their rivals. They argued that this strategy could be more cost-effective than engaging in predatory pricing, which would require greater resources in the short run (Salop and Scheffman 1983, p. 267):

> "A higher-cost rival quickly reduces output, allowing the predator to immediately raise price or market share. Third, unlike classical predatory pricing, cost-increasing strategies do not require a "deeper pocket" or a superior access to financial resources. In contrast to pricing conduct, where the large predator loses money in the short run faster than its smaller 'victim', it may be relatively inexpensive for a dominant firm to raise rivals' costs substantially. For example, a mandatory product standard may exclude rivals while being virtually costless to the predator."

Meeting regulatory standards can be quite expensive for small-scale businesses. Some of them even forgo attaining a certain certificate because of its price, even though the product meets the regulatory standards. This is costly for society because now consumers cannot completely rely on the certificate. In some cases, they need to identify if products meet certain criteria by themselves, even though a certificate exists in the market to signal this. Consider a small third-wave coffee roaster who does not get an ecological certificate because of the associated costs. Many third-wave roasters trade coffee directly from highly ecological farms, exceeding the standards of the respective certificates, but they cannot afford to signal this behavior. Customers might face a situation where the direct-trade coffee is not certified at all and is more expensive than industrially-produced coffee, which is marketed with an expensive and well-known certificate. The costs for society result from unrealized transactions because of incomplete information about the product and misguided customers who want to buy the better product but are misled by the asymmetric signaling of the real quality. Salop and Scheffman identify an important mechanism of rent-seeking and lobbying, but they are not very precise about the kind of costs raised by competitors.

Two very common methods (*how?*) of lobbying are making monetary contributions or providing information on an issue (Bernheim and Whinston 1986 a, b; Austen-Smith and Wright, 1992). Lobbyism via monetary contributions is analyzed within an agency framework (Holmstrom 1982 and Bernheim and Whinston 1986 a, b). In contrast to the basic principal agent model developed by Holmstrom (1982), Bernheim and Whinston (1986 a, b) discuss lobbyism from a common-agency perspective. They assume that one agent is obligated to more than one principal. Politicians are agents of different principals, e. g. voters, and private interest groups. Politicians maximize a personal welfare function which is determined by personal utility and society's welfare (Peltzman 1976). Personal utility increases because of received payments, invitations, party contributions, etc. Society's welfare increases because of policy decisions in favor of the voters. These two inputs to the politician's individual welfare function can take different directions, especially if lobbyism takes place. The private interest group might offer payments, or party contributions if the politician in turn enforces a policy which is in favor of the group's interest. This policy might regard e. g. trade protection from foreign competitors (Grossman and Helpman, 1994) and has negative effects on society's welfare. Depending on the intensity politicians assign to individual interests and collective interests the negative effects on societies welfare differ.[6] Since society takes a passive role in common-agency modelling they always suffer from activities like these. Because of that it is not surprising that lobbyism is negatively connoted within this framework. In the best scenario, all efforts by interest-groups cancel each other out. In this scenario the resources invested in lobbying are wasted from society's perspective, leading even the "best" scenario of the model to predict a negative effect of lobbyism for society.

The theoretical framework of Bernheim and Whinston applies better to systems which are characterized by a concentration of power. Common agency models fit the politics in United States better than e. g. the German political system.[7] The theory was applied and developed many times after its publication (Grossman and Helpman 1994 and 2001). Mallard (2014) provides an overview of the common-agency literature while Grossman and Helpman (2001) rather discuss the wide variety of the lobbyism analysis in general. Grossman and Helpman (1994) discuss common agency in the context of trade regulation and show that from a common-agency perspective tariffs, taxes, or "protection" generally are "for sale". Interest groups can buy their preferred policy in the market for political services. This is related to the literature regarding entry barriers of markets and the lobbying for protection (Michaelis 1994; Oster 1982; Stigler 1971; Young and Magee 1986). They focus on entry barriers in the market where a firm produces goods and discuss this problem from a competition rather than a lobbyism policy perspective.

Informational lobbyism tends to focus on asymmetric information, signaling and the resulting incentive structure, and only to a lesser degree on agency. It assumes from its outset the prevalence of asymmetric information. The literature assumes politicians to be generalists who know few things in-depth about a wide range of topics (Austen-Smith and Wright, 1992; Potters and van Winden, 1990; Ainsworth, 1993; Sloof 1998). When politicians are interested in regulating an industry, for example, they require specialized information about the industry. Interest groups are assumed to possess this specialized knowledge about specific industries. They are specialists who provide politicians with information which they need to create good policies but cannot attain without the help of interest groups. Interestingly, politicians use information only to further society's welfare. They do not have a conflict of interest between their own and the principal's interest. The individual welfare of the politician is only determined by society's welfare. It is not surprising that lobbyism comes with a

[6] It remains unclear how a politician decides how to weight the different inputs.

[7] Most Common-Agency literature takes the group formation as exogenous. Mitra (1999) is an exception to this fundamental criticism (Mallard 2014). As a consequence of exogenous group formation, the different capabilities of groups to foster their interest are ignored. Groups become rational individual actors which are all capable of the same set of actions. Especially in the analysis of lobbies this is a problematic backside since a lobby is always some kind of group. Most of the Common-Agency literature ignores this fact.

positive connotation within this framework. A larger information set is assumed to lead to better decision, if the signaling game is solved. That is the case if there is perfect competition between the interest groups.

Since interest groups only further their own interest and do not profit per se from increased societal welfare, they will only share information which leads to policies congruent with their own interests. Therefore, politicians need to decide whether they can trust the information provided by the interest groups; a signaling game arises. The literature identifies mostly positive effects on society's welfare, because the politicians can make better decisions because a wider set of information is available. Though, the equilibria crucially depend on the parameters assumed. If the special interest group needs to gather information *before* they can be transmitted to a politician, externalities occur. The interest group might have an incentive only to acquire information which is in its own interest. As a result, politicians can also learn something from withholding information. The provision of information by special interest groups can cause external effects to other interest groups. This externality declines as competition between interest groups emerges. The positive welfare effects of this kind of lobbyism are more prevalent if there is intense competition between the interest groups. Otherwise, the special interest group might have a monopolistic position in informing politics and can exploit this position in its own favor. Anyhow, more information is generally better for a rational actor. Therefore, lobbyism via information is regarded as rather "nice" for society. Further, this is the case because politicians are not assumed to have a conflict of interest between different principals and their own interest. They are assumed to behave accordingly to the interest of the voters.

Contrary to our implication over the previous paragraphs, the two discussed channels of lobbyism, monetary contributions and providing information, are not always discussed as separate (Austen-Smith 1995; Bennedsen and Feldman 2006; Dahm and Porteiro 2008; Cotton 2009; 2012; Schnakenberg and Turner 2019). They can be complements and substitutes, and they are interdependent. Contributions can help the lobby to get access to politicians and promote informational lobbyism, and they can work as a signal about the informational content as well (Austen-Smith 1995). If party contributions are capped and only possible up to a certain sum, it can have positive and negative effects on informational lobbying (Cotton 2009; 2012).[8] The literature so far is rather narrow in merely assuming these two channels of lobbyism. They are indeed mostly limited to the analysis of equilibria outcomes and therefore miss the bigger picture of the process of lobbyism. Further, both bodies of literature come with a connotation of the welfare effects caused by lobbyism. We argue that these depend on the context and a theory describing the phenomenon should be neutral regarding these effects ex ante.

[8] Cotton (2009; 2012) discussed how taxation of or a cap for party contributions influences the informational signal. A cap for party contributions makes lobbying via information more attractive. Hence, it can reduce the informational content as well as it might distort the signal.

To the best of our knowledge, there is no theory that describes the welfare effects of lobbying on a general level like the rent-seeking literature provides an explanation for the motive, and group theory provides an explanation for the actors of lobbying. The existing theories of the effects of the process of lobbying focus on one concrete method and imply positive or negative effects of the methods because of the assumptions of the theory. Lobbyism seems to be either naughty or nice depending on the method used. We argue that a theory analyzing the effects of lobbying should be impartial ex ante. It is not clear why the provision of information or contribution should be good or bad from its outset. A theory analyzing the effects of different methods of lobbying should acknowledge that point. Salop and Scheffman discuss an interesting focal point of rent-seeking efforts, namely: the cost structure of competitors. We also believe that the cost structure of competitors is of interest to rent seekers and can be influenced more easily than one might think. But what kind of costs can a lobby influence?

3. But what is it they do?

We conceptualize political action as a market interaction (Kau, Keenan and Rubin 1982; Denzau and Munger 1983; Mueller 2012; Paola and Scoppa 2011; Balles et al. 2018; Ramos Pastrana 2021). Politicians are suppliers of political services, citizens and interest groups act as those making up its demand. They are, however, by far not the only ones. Firms, consumers, and workers, as well as every other group, also demand political services.

Once a lobby is formed a new actor in the market for political services exists. We conceptualize the lobby as a vehicle for firms to act as one group in the market for political services; an interest group. The lobby aims to further the interest of its members in their pursuit of profit, sovereignty, or contestability; their rent-seeking behavior (*why*). It should not be conceptualized as an individual actor because this would camouflage the different degrees in the ability of the provision of a collective good within these groups (*who*). The collective good a lobby provides is the action pursued on the market for political services[9], i. e. lobbing activities. The collective good can take different forms, e. g. providing information or contribution to politicians (*how*). Through the lobby's behavior in the market for political services the members seek to impact the structure of the markets they primarily act in. We call these the *primary markets* of a lobby. The activities of the members in this market generate resources as well as the incentive structure to act in the market of political services; i. e. form a lobby. The market for political services determines the structure of primary markets. In turn, the actors in primary markets can lobby in the market for political services; they can change the structure of

[9] A lobby can act in other markets than the one for political services. For the simplicity of our argumentation, we will abstract from these cases and only discuss the process of lobbying in the market for political services.

transaction costs in the market for political services.[10] An interdependence between the market for political services and the primary market emerges (Figure 1).

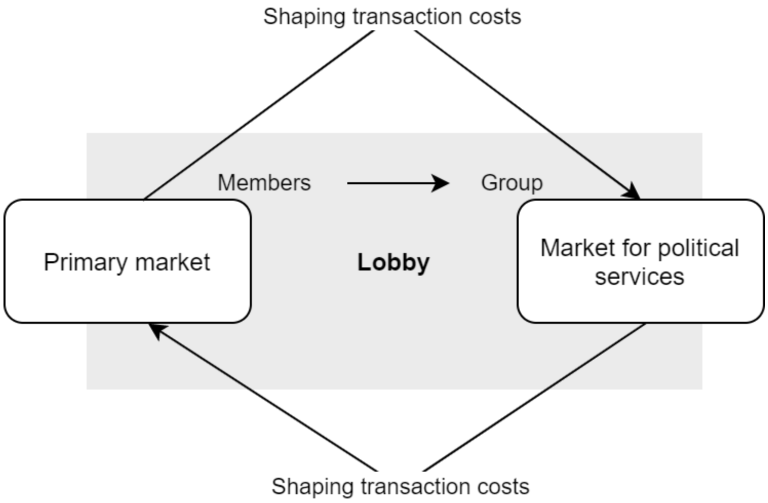

Figure 1 Interdependent markets of lobbyism

As with every other market, the use of the market for political services induced transaction costs (Coase 1937; Alchian and Demsetz 1972; Williamson 1993; 2010). These are search, informational, and bargaining costs. A politician developing policy needs information about the issue at hand, resources to research pertinent information on the topic, the political position to address these issues, and so on. The success of the politician depends, inter alia, on the structure of transaction costs in the market for political services. Institutions can be built up to reduce the transaction costs for individual politicians, e. g. parties, in a similar way a firm reduces transaction costs in other markets. Hence, we want to discuss a different way for politicians to reduce transaction costs and be more competitive in the market for political services: they can collude with a lobby. Since lobbies possess specific information about their members' activities and markets they act in, they are capable of a valuable resource for politicians. They can devote resources to the politicians' organization, e. g. party contributions, and enable the politicians' organization to supply more or better political services or resecure their power, e. g. election support. We argue that these two well-analyzed channels of lobbyism share a common focus, the transaction costs of politicians. Politicians are better informed, may have a wider network, or are part of well-equipped institutions and are therefore more competitive in the market for political services. Depending on a politician's utility function he will use this position to further the interest of the voters, of society, or/and himself. The main reason for

[10] This interdependence is comparable to the spiral effect described by Buchanan and Tullock (1967, p. 287): "The organized pressure group thus arises because differential advantages are expected to be secured through the political process, and, in turn, differential advantages for particular groups are produced because of the existence of organized activity. A spiral effect comes into play here, the results of which may be observed in the federal income-tax structure, federal tariff legislation, federal resource-legislation in particular. This spiral effect has an important bearing on the individual constitutional calculus […]."

politicians to interact with lobbies is grounded in *their power to influence transaction costs* the politician is confronted with in the market for political services.

The lobby itself has an interest in this interaction because of the politician's power to change the market structure of the markets the lobby's members act in – their primary markets. Policies determine the structure of a market and can lead to monopolies (patent, closed-shop) or other sources of rents (labels, subsidies, taxes, tariffs, minimum wage) (Michaelis 2014; Salop and Scheffman 1983). The pursuit of profit in a market depends on the transaction costs of a market, they are like boarders to innovative, productive entrepreneurship (Baumol 1990; Coase 1937). High market entry costs because of transaction costs keep potential rivals out of the market, while low transaction costs lead to easier market entry for new entrepreneurs. Depending on the position of an economic actor, inside or outside of the market, he is interested in increasing or decreasing transaction costs.[11] In other words, in encouraging or discouraging contestability. The main reason for lobbies to interact with politicians is *their power to influence the transaction costs* the lobby's members are confronted with in the market they primarily act in.

The relation between lobbies and politicians is not the only one of interest for a lobby in the market for political services. They also interact with voters. Voters can influence the power of politicians. They can discharge or elect politicians, and influence their opinions through demonstrations or other political activities.[12] Because of the lobby's interest in "like-minded" politicians, they want to mobilize "like-minded" voters. This improves the chance of finding more powerful politicians in the market for political services, which have an aligned interest with the lobby. As a result, lobbyism can become more effective. The main reason for lobbies to interact with voters is *their power to indirectly influence the transaction costs* the lobbies members are confronted with in the good market they primarily act on.[13]

Voters are interested in interaction with lobbies for the same reason politicians are. Lobbies can change the transaction costs of voters in the market for political services. They can provide information which lead to more informed voting behavior and enables the voters to express their interests more efficiently. Further, the members of a lobby can provide political services by themselves or contribute to their provision (Public-Private-Partnerships). The main reason for voters to interact with lobbies is *their power to influence the transaction costs* the voters are confronted with on the market for political services.

[11] We hypothesize that high transaction costs on any primary market and on the market for political services may indicate strong lobbies. This hypothesis remains subject to further empirical research.

[12] For a discussion of the signaling game arising because of mass political action see Lohmann (1993).

[13] We want to express, there are different reasons for lobbies to interact with voters. The group of voters and the group of workers overlap. Interaction with voters, citizens, or workers change also the cultural context of economic action. These activities can also be classified as lobbyism but are of smaller interest from our economic perspective. We focus on lobbying activities in the market for political services and therefore abstract from cultural effects and narratives in general. Note, however, that cultural effects can also change the transaction costs of markets.

How lobbies change transaction costs depends on the method, i. e. the channel, they use to lobby. We argue that a theory describing the dynamics of lobbyism should not come with a connotation for the welfare effects of lobbyism; positive (signaling) or negative (common-agency). Lobbyism might enhance or reduce the wealth of a society, the direction of the welfare effects depends on its context and cannot be stated per se. In our opinion this perspective is an advancement for the economics of lobbyism provided by our theory. Anyhow, the question remains how problematic, welfare-diminishing and undemocratic lobbyism can be identified, and then regulated, within our transaction costs framework.

4. Welfare Effects of Lobbyism and Gatekeepers

Economic analysis, and especially those from a Public-Choice perspective, weigh cost and benefits. This needs to be done as well if single processes of lobbyism ought to be judged economically. An analysis stating that an increased set of information is good for politician only focuses on the benefits while an analysis stating that contributions can lead to "politics for sale" only looks at the costs. It is not clear why the provision of information should automatically have net positive effects and the provision of contributions should have net negative effects. It depends on what politicians or other societal groups do with that information and resources. We argued that the process of lobbyism – no matter if done via information, contribution, or any other method – leads to a change of transaction costs in the markets involved. If one wants to judge the effects of lobbyism from an economic perspective one should not ignore the effects on transaction cost structures. They crucially determine the efficiency of markets and therefore the welfare of society.

Our framework enables one to analyze the welfare effects of lobbying. The reduction of transaction costs for politicians because of more information, leads to positive welfare effects in the market for political services. But if raising transaction costs in the primary market emerge because of that enriched set of information there are costs to this kind of lobbying because of the reduced efficiency in the primary market. Take again our example of a third wave coffee producer and the industrial producer. If the industrial producer provides information to politicians about the working conditions of coffee farmers around the world and argues in favor of a label indicating that producers comply with human rights and certain standards, then one might think, that this is automatically better for society. But that does not need to be the case. There is a benefit for society because of a more efficient market of political services, because of the reduced transaction costs for regulators. But if they do not notice the raise of transaction costs in the primary market (market for fair coffee) caused by a certificate, the industrial producer might be able to seek rents because less third wave coffee producers can compete against him in the primary market. The small third wave producer might not be able to afford the certificate and cannot signal that they comply with the standards. They cannot enter the market for certificated coffee even though they trade (very) fair coffee. That leads to rising rents for the industrial coffee producer and has negative welfare effects for society because of an inefficient allocation of resources. To judge whether this process of lobbying is “nice” or “naughty” from an economical perspective one needs to weigh the benefits (positive welfare effects because of reduced transaction costs in the market for political services) against the costs (negative welfare effects because of higher transaction in the primary market).

The same logic applies to lobbying via contribution. It does not need to be automatically bad for society if a lobby provides party contributions. Suppose once again our example of the coffee industry. If the third wave coffee producers somehow overcome collective action problems and form a group to lobby in the market for political services, they can use party contributions to align politicians’ interest with their own. They might use these to “buy politics” which reduce the transaction costs in the market for fair trade coffee so they are able to enter it. For example, they could try to obtain a costless certificate subsided by the government, so there would be no budget restriction to signal compliance with ethical standards once they are achieved by a firm. The contribution to the politician’s party would reduce the transaction costs exclusively for this party in the market for political services and therefore rises the relative transactions costs for competing parties (negative welfare effect for society because of rent-seeking by politician). The subsidies would reduce the transaction costs on the primary market (the market for fairtrade coffee) for everyone. Even though the politician behaved like this to further his own interest, which was getting the party contribution, the lobbying process might have led to a situation desirable from societies perspective. The reduction of transaction costs in the market for political services is exclusive, it is only for the politician’s party. That increases the chance of rent seeking behavior of the politician in this market which would be a cost for society. The reduction of transaction costs in the primary market, leads to a higher degree of contestability, a more competitive and therefore more efficient market. The lobbying process enfolds positive welfare effects in the primary market. If these outweigh the costs of potential rent-seeking in the market for political services, it is not clear per se why society should not regard this outcome as desirable.

We have shown that lobbyism creates an interdependence between two markets. The positions of members in these markets are worth considering. Regulations need to address the transaction cost structure of *both* markets, otherwise the market position in one market can undermine regulation efforts in the other. Consider competition policy which reduces market power of a firm in any given primary market. If the firm is a member of a lobby which has a central position in the market for political services, it can influence the transaction cost structure of the primary market. It can thereby undermine competition policy in the market, for example by weakening its implementation. Vice Versa, if market power in the market for political services is regulated the market position as a rent seeker in the primary market can enable the lobby to regain influence in the market for political services. If members of a lobby have some market power in any primary market *and* face a reduction of market power in the market for political services, e. g. because of restricted access to politicians, they can compensate this reduction of influence in the market for political services. The lobby can use the rents to compensate restricted access to politician with increased party contribution to secure the influence in the market for political services. When a lobby has a monopolistic position in both markets, the process of lobbyism can be regarded as having adverse effects and of calling into question basic elements of democratic governance. The most problematic lobbies are those which can dictate policies for their members' primary market.

Lobbies of this kind can reduce the contestability of their primary market and the corresponding market for political services. They achieve a gatekeeper position. These actors can control the transaction cost structure and can restrict entry to markets. The market position of the gatekeeper enables him to determine the extent of entry barriers to the marketplace. The concept of gatekeeping is a quite recent one. It is related to the Baumol's (1982) idea of contestable markets but focuses more on the actors than on the market structure. A gatekeeper can influence the contestability of a market. This is a promising idea for the regulation of lobbyism. Recall section two (Fig. 1). The group, which can, at least partially, control transaction costs in the market for political services can become a (partial) gatekeeper for political decision making. Vice versa, the one capable of influencing the transaction cost structure of primary markets can also be regarded as a gatekeeper. To be able to do so a market position as a (partial) price maker in the market for political services is necessary. We argue that a successful lobby will be a gatekeeper in *both* markets.

"One-sided" gatekeepers are not as problematic from a lobbying perspective. Politicians are, by definition, gatekeepers in the market for political services. Of course, they can be regarded as a lobby of voters, but this will not further the understanding of how to identify and regulate "problematic" lobbyism.[14] Vice versa, gatekeepers of primary markets are of concern for competition policy but not automatically for lobbying policies. Patent holders are gatekeepers in primary markets but are not per se of interest for lobbying-related regulations. This is only the case if patents emerge because of a gatekeeper's position in the market for political services. Then the interdependence between the primary market and the market for political services exists. If politicians decide to grant a patent to a firm inventing a new vaccine, this is not per se regarded as problematic lobbyism which should be regulated; it might be part of a democratic process. It is not one group which is the gatekeeper of both markets. We regard those lobbies as highly problematic which are (partial) gatekeepers in the primary market *and* the market for political services. They are most susceptible of determining themselves the rules by which they must abide and therefore undermining democratic ideals.

[14] Imagine a politician would own a company on any primary market which is a rent seeker on this market. If the politician would now be trusted with regulating this market a conflict of interest would emerge. In terms of the theory presented above on could say, the politician would then be in the position of a "double"-gatekeeper. The constellation where a politician, even if democratically legitimated, ought to regulate markets where he or she has a personal interest in, is indeed highly suspicious of being problematic from a lobby perspective.

Once a lobby is formed and has built up a double-gatekeeper position, it becomes unequally harder to regulate it. We argue that an ex-ante approach should be chosen to regulate lobbyism. In one line with the theory of the effects of lobbying proposed above and the resulting interdependence of markets, we want to outline some basic ideas for a regulative framework of lobbyism. The main characteristics of this policy are (i) the focus on the transaction cost structure of (ii) two markets. Different from competition policy lobbying policy needs to be built on the premise that lobbyism becomes particularly problematic if one group is in control of the interdependence of the market for political services *and* the primary market. Policies regulating lobbyism should therefore address the transaction cost structure of the primary market as well as the market for political services. (iii) Lobbies which achieve a (partial) gatekeeper position in both markets are seen as the most problematic lobbies, because of the danger they present in making their own rules about how political decisions will be made. The characteristics of the gatekeeper position need to be defined.

5. Concluding Remarks

In this article we developed a theoretical framework to resolve the polarized discussion about lobbyism. We argued that lobbyism is mostly regarded as “nice” or “naughty” even though it is obvious that this judgment depends on the context. We hypothesized that not only in non-academic discussions lobbyism is often judged prematurely. Even seemingly “neutral” theories of rational- and public-choice implicitly judge the phenomenon ex ante. That does not mean that any researchers necessarily conduct a normative analysis, but that the assumptions underlying the theories imply a direction of the welfare effects of lobbyism. The provision of information is generally “nice” for a rational actor, because his decision becomes more informed and therefore “better”. The provision of contributions is generally “naughty” for a rational actor because his decision becomes corruptible. That leads to situation comparable to bribery or “politics for sale” and is therefore “worse” for society.

We developed a theoretical framework which is ex ante neutral regarding the actor (*who?*), the motive (*why?*), and – especially – the channel (*how?*) used to lobby. Whether lobbying efforts are “naughty” or “nice” for society depends on the effects of this process, not solely on the methods used. We have identified three important theoretical characteristics of the process of lobbyism. First, lobbies aim at changing the transaction cost structure of markets. Thereby they raise their rivals’ costs or reduce their own. More generally spoken, they shape markets and their level of contestability. Second, they do so in *two* markets – the primary market and e. g. the market for political services. These markets become interdependent because of the lobby. Third, if a lobby achieves a gatekeeper position in both markets, they can regulate their own business and become problematic from an economic and societal perspective. We propose that an ex ante policy regime regulating lobbyism should (i) aim at the transaction cost structure of (ii) both markets involved to ensure that (iii) no lobby can achieve a gatekeeper position in both markets. Further policy implications need to be grounded within a broader understanding of the transaction cost economics of lobbyism.

Deeper analysis of the question of the optimal form of organization for lobbies needs to be conducted to foster the understanding of the process of lobbyism. As Alchian (1984, p. 39) has pointed out, transaction cost economics does not apply solely to the firm. It is rather an institutional, contractual perspective which can be applied to other actors, e. g. lobbies. In addition to our conception of *lobbying transaction costs*, lobbies face transaction costs in their group building process at a micro-level.[15] It would be interesting to elaborate how forms of organization - hierarchical, decentralized, or hybrid - influence the choice of the optimal organization of a lobby, depending on the kind of group (Olson 1965; Williamson 1991). Privileged groups might optimally choose a different form of organization from the one preferred by latent groups. An expansion of the microeconomic foundation might bolster our macroeconomic argument. Groups which are well-organized – privileged or latent – could be defined. These groups have more pronounced potential to achieve gatekeeper positions in both relevant markets.

By describing the effects of the process of lobbyism at a general level we have erected a theoretical umbrella which unites the dominant existing theoretical pillars of the analysis of lobbying channels. Further, we complement the existing theories of public choice which describe the actors and motives of lobbyism. Case studies are needed which examine the multitude of ways in which lobbying transaction costs can occur, and how the analysis of our theory applies in specific contexts. Further, the process of lobbyism itself needs a broader analysis. The existing theories focus on two channels of lobbyism, but there are more. Especially if one leaves the framework of rational-choice aside. Lobbyists do not always "buy political favors" by providing information or contributions. Sometimes they persuade with the means of rhetoric and the use of media to shape the minds of societal groups. These kinds of lobbyism are not covered by standard economic approaches but might also lead to changes in the structure of transaction costs in the markets involved.

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[15] A first approach to this question is The Logic of Collective Action, Olson (1965).

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