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Who wants to regulate Lobbying ?

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In this paper, I consider a two-tiers hierarchical structure, composed of a decision-maker and a regulator, where the regulated firm can have access to one of the two levels. The decision-maker is the one in charge of the decision, while the regulator possesses the relevant information. When the firm can lobby the decision-maker, she will be able to influence the use he makes of information, while by lobbying the regulator the firm can induce him to manipulate the information he gives to the decision-maker. I show that the firm's ability to influence the regulator not only hurts the decision-maker, but also the firm herself because it leads the decision-maker to reduce the discretion he gives to the regulator, and hence leads to less informed and more inaccurate policies. This indirect informational effect is such that in a very large range of situations, **both the firm and the decision-maker would be better off if the firm could commit not to influence the regulator**. This also explains why, when having potential access to both, the firm prefers to lobby the decision-maker than the regulator

REGULATORY CAPTURE AND TRANSPARENCY

It is a frequent and well documented situation that the power to take the decision belongs to one entity, while another entity is better informed about the real consequences of a given policy. Much has been written over the relationship between decision-makers and bureaucrats, but much less about **how firms interested in the decision can interfere with this relationship**. This feature is yet a first order one, as recalls the Mediator case in the French actuality: experts that have to give advice about a policy decision are not free of influence by the firm concerned by this decision. Among the key questions that arise in such a context, a crucial one is **the regulation of lobbying and access**. Which rules are desirable from the decision-maker's or the firm's view point, and how enforceable are they?

When deciding to influence a regulator or an expert, a firm faces two conflicting consequences. The most obvious one is that once the relationship between the decision-maker and the regulator has been determined, the firm always benefits from being able to induce the regulator to recommend more favorable policies.

But there is a second effect: anticipating this influence by the firm, the decision-maker adapts the discretion he gives to the regulator, and tends to be more directive. **This reduces the ability of the regulator to use his information**, which proves harmful for the firm. Comparing these two effects provides insights about the consequences of transparency and putting up "Chinese walls" between firms and regulators - this not only from the welfare perspective, as usually considered, but also from the firm's viewpoint.

THE APPROACH

I adopt a mechanism design approach, where the decision-makers acts as a principal, but cannot verify the information transmitted by the regulator. This last feature captures the idea that the decision-maker lacks necessary expertise, and has to rely on the regulator's knowledge even when he knows that this regulator may not perfectly share his objective. The relationship between the decision-maker and the firm rules out the use of monetary transfers in order to provide incentives to the regulator. In practice, such transfers are indeed either banned by the law, or difficult to implement in a transparent way[1].

1. Cf. Hiriart and Martimort, "How much discretion for risk regulators", Rand Journal of Economics, 2012

In this context, the contract between the decision-maker and the regulator takes the form of a "rule versus discretion" tradeoff : the principal grants the regulator with discretion over to the decision, but restricts the set of implementable decisions. **The standard "ally principle" applies, that stipulates that the level of discretion shrinks as the conflict of interest between the decision-maker and the regulator becomes more stringent**. This framework therefore allows to consider intermediate levels of discretion, and extends the two extreme cases that are generally studied in political science: full control by the principal, and delegation of the whole decision to the regulator. This also provides a tractable way to measure the increase in rigidity that arises from the firm's ability to influence the regulator. By inducing the regulator to be closer to her interests, the firm gets better decision in the discretion set granted by the decision-maker; but in return the decision-maker, anticipating this, reduces the extent of discretion, which leads to more rigid and inefficient policies.

THE FIRM AND THE DECISION-MAKER HAVE EX ANTE CONVERGING INTERESTS CONCERNING THE REGULATION OF ACCESS

This model allows giving a certain number of answers to the question of the optimal regulation **from the firm's perspective**. First, it shows that the firm never wants the regulator to be too close to her own interests. The firm indeed gains from the relationship between the decision-maker and the regulator being trustful, because it allows for more flexible policies. Second, the incentives for the firm to commit not to influence the regulator depend on the informational asymmetry between them: has the regulator an informational advantage with respect to the firm or not? Incentives for the firm to have access to the regulator decrease with this informational advantage. Third, whatever this information asymmetry, it remains that the cost entailed by an increased rigidity, generally speaking, overcomes the gains from more advantageous decisions.

As soon as the regulator is slightly more prone than the decision-maker to take decisions favorable to the firm (the well documented "regulatory bias"), **the firm would prefer to commit ex ante not to have access to the regulator**. Such a commitment is obviously also in line with the decision-maker's objective. However, in the absence of credible commitment the firm cannot resist the incentives to influence the regulator.

POLICY APPLICATIONS: GAINS FROM TRANSPARENCY AND COMPLIANCE PROGRAMS

To conclude this study suggests that the difficulty to devise and agree on a regulation of access is not due to conflicting interests between decision-makers and interest groups. Instead, we conjecture that **enforcement problems play a crucial role in undermining the credibility of such regulation**. Our results also provide an argument in favor of compliance programs aimed at tightening the firm's internal control over its bribing and lobbying activity. If correctly designed and enforced, such programs can contribute to solving the credibility issue which we find is beneficial to the firm individually and to society at large.

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