How do politicians determine public policies? Do they respond more to electoral constraints or to the lobbying and rent-seeking activities of interest groups? For true believers in policy decisions being taken through strategic policy contests, Gil S. Epstein and Shmuel Nitzan wrote a clear, comprehensive, detailed, almost divine book. More agnostic readers will find the book equally likeable and interesting. Most likely, however, they will not be convinced by the authors that two-stage policy contests populated by bureaucrats, (two) interest groups, and a "randomizing" politician constitute a general--that is, independent of the specific political structure--reasonable way of representing the process of policy decision making.

The authors are very effective in providing a clear and accessible introduction to the basic policy contest and to its main character--the contest success function. After
chapter 2, the reader is, in fact, advised that the outcome of a contest between two groups, as decided by the politician, is indeed random. It depends on a contest success function—for example, a lottery or an action function—that takes into account the activities (such as contributions or effort) undertaken by the two interest groups. Chapter 3 is instead entirely dedicated to convince the agnostic reader of the usefulness of this way of modeling the process of policy decision making. The main argument is simple and convincing. Politicians may prefer the randomness of the contest success function, which will likely induce contributions in their favor by the interest groups, to a certain, but ex ante (that is, not affected by the interest groups’ actions) policy decision. However, this rationale is only partial. For instance, what if politicians could determine the policy with certainty after the interest groups have exerted their lobbying effort—as in a typical lobbying model? Unfortunately, this comparison is not discussed.

The work-horse model of this book is the two-stage policy contest developed in Epstein and Nitzan (2002). The presentation of the basic contest game (in chapter 4) correctly emphasizes the sequence of the game as one of its characteristic features. In the first stage, politicians—or alternatively bureaucrats working for the politicians (and/or sharing their preferences)—select a policy, which will be compared to the status quo. In the second stage, two interest groups—each one supporting a policy—choose how much effort to exert, or how many resources to devote, in order to promote their most preferred policy. The final decision on the policy to be implemented is then left to the politician or—better said—to a contest success function. Which real-world situations may this contest describe? The authors provide several applications throughout the book and, in particular, in the last five chapters. For instance, this policy contest may emerge in the case of decisions on public good provision, such as the creation of a public park, in which two interest groups may support opposite policies—the status quo (no park) and the new policy (building the park). A detailed discussion of all the properties of different families of these two-stage policy contests is provided at chapters 5 to 9. Some interesting results emerge. For instance, while in most political economy models an increase in politicization is harmful for social welfare, this may not occur in a two-stage policy contest. Here, an increase in the weight given by the politicians to the contribution received by interest groups (and a corresponding reduction in the social welfare weight) may induce the first-stage movers (the bureaucrats or politicians) to modify the proposed policy in the direction of increasing social welfare. Analogously, while in the typical lobbying models summarized in Gene M. Grossman and Elhanan Helpman (2001) the equilibrium policy is moderate since it represents a combination of the most preferred policies by the two interest groups, this result may not hold here. A more extreme policy may in fact emerge in this two-stage environment since, in the first stage, bureaucrats (or politicians) may find it convenient to propose an extreme policy in order to extract more contributions. Another interesting property of these games (discussed at chapter 8) shows that interest groups’ behavior is affected by the relative payoffs of the two policies, namely the distribution of the prices associated with the two policies—the one chosen by the bureaucrats and the status quo, more than by their absolute size. Finally, chapter 9 proves that, when side payments (or transfers) are available, a Coase like theorem holds.

The fourth part of the book, consisting of chapters 10 and 11, discusses a different two-stage policy contest. In the first stage, the interest groups replace the bureaucrats (or the politicians) in selecting the two policies that enter the contest. As in the previous version of the contest game, in the second stage, interest groups continue to provide some action to influence the politicians’ decision, which is again taken according to a contest success function. How relevant is this new game with respect to the contests analyzed in the previous chapters? The authors use the example of the monopoly-consumer contest, which is indeed recurrent in the book, to underlying its real-world underpinning. Interestingly, they show that the "defender" interest group (i.e., the consumers) will set a price, which is indeed higher than the status quo perfect-competition price; while the "challenger" interest group (i.e., the monopolist) will strategically restrain the price below the (static) monopolist price. This moderation result stems from the incentives that the interest groups have not to battle too hard in the second stage. Full convergence is however not achieved.

The last part of the book (chapters 12 to 16) presents five applications of the two-stage policy contests respectively to monopoly-price discrimination, privatization, migration policy, minimum wage, and tournaments. These examples lead to some surprising results. In a monopoly-price discrimination situation, regulators interested in
contributions may set an even higher price than the one charged by the monopolist. In the case of privatization, with politicians setting the price of the state-owned-enterprises, privatizations are more likely to occur if politicians care more about the transfers (from the interest groups). But perhaps the most appealing application is to tournaments. Here, the principal (a manager) sets a tournament to exert a promotion effort from two agents (the workers). This promotion effort represents a private rent for the manager that does not accrue to the firm's benefit. While its application to the private sector may be questionable--what is the cost for the manager to promote bad workers?--this situation may indeed describe quite accurately the process of promotions in the public section whenever the managers pay little or no penalty to select bad workers.

For the true believers in strategic policy contests, the book, thus, provides a full range of theory and applications. Yet, is this enough to convince the agnostic reader of the empirical relevance of this modeling tool? Despite the precious effort, some concerns about these strategic policy contests indeed remain. Modeling the politician's choice with a contest success function lacks micro-foundations. Even within a two-stage strategic contest, wouldn't the politician be better off by directly determining the public policy rather than relying on this contest success function? The authors acknowledge (in chapter 3) that other models of policy decision are instead micro-founded: but they criticize the underlying assumptions on individuals' preferences, political institutions, and policy space. In their view, a more general, albeit reduced form model, such as these strategic policy contests, has more potential to explain public policy decision making. Yet, the recent political economy literature seems to have taken a different root (see Torsten Persson and Guido Tabellini 2000 and Daron Acemoglu and James A. Robinson 2006). Several scholars have also analyzed the framework conditions of the policy-making process, such as political institutions, historical and legal background, and even cultural traits. In their book, Epstein and Nitzan often refer to political culture, and derive some interesting results that rely on this crucial concept. Unfortunately, however, political culture represents only a parameter in their politicians' objective function, and it is unclear how much we can learn from it.

A final note on the style. The diligent reader who begins at page 1 and finishes at page 202 will have to go through some repetitions of formulas (typically, first order conditions) and examples, which may make his task less pleasant. This is, however, a small price to pay to favor end users of strategic policy contests, who will find this book an excellent compendium where to look for clues, inspiration and solutions on two-stage policy contests.

References

