Who Can Organize Resources: Concentrated vs Diffuse Interests
Organizing Resources for Power

One way to wield power is to organize resources

- Lobbying
- Donations
- Get out the vote
- Protest

Societal groups that can better organize resources for politics will have more power

Policy will be distorted to over-represent such interests
Concentrated and Diffuse Interests

**Concentrated Interest:** Small group of people each of whom cares a lot about an issue

**Diffuse interests:** Large group each of whom cares a little about an issue
Groups organizing for power have an externalities problem

Less severe for concentrated interests than for diffuse interests

Concentrated interests wield power disproportionate to their interests

We will explore this idea in a simple model of lobbying
Outline

A Model of Lobbying

Politics and Climate Change

Housing Policy
A Model of Concentrated vs Diffuse Interests

1 wealthy home owner and 2 poor citizens each decide whether to hire a lobbyist

Each person can hire at most one lobbyist at a cost $c$

If poor citizens hire $P \in \{0, 1, 2\}$ lobbyists and the wealthy citizen $W \in \{0, 1\}$, policymaker build affordable housing with probability

$$\frac{P}{P + W}$$

If no one lobbies, affordable housing built with probability $\frac{1}{2}$
Policy Payoffs

For each poor citizen, the benefit of affordable housing is $B_P > 0$

For the wealthy citizen, the benefit of no affordable housing being built is $B_W > 0$

Wealthy citizen cares substantially more about housing than an individual poor citizen, but not more than both

$$\frac{3}{2} \cdot B_P < B_W < 2 \cdot B_P$$
Utilitarian Optimum

If affordable housing, net benefit is $2 \cdot B_P$

If no affordable housing, net benefit is $B_W$

Utilitarian optimum is to build affordable housing

- Poor Citizens care more, in aggregate, than the wealthy citizen
Poor citizen’s Best Responses

If wealthy and other poor lobby, lobby if:

\[ \frac{2}{3} \cdot B_P - c \geq \frac{1}{2} \times B_P \iff \frac{1}{6} \cdot B_P \geq c \]
Poor citizen’s Best Responses

If wealthy and other poor lobby, lobby if:

\[
\frac{2}{3} \cdot B_P - c \geq \frac{1}{2} \times B_P \iff \frac{1}{6} \cdot B_P \geq c
\]

If wealthy lobbies and other poor doesn’t, lobby if:

\[
\frac{1}{2} \times B_P - c \geq 0 \iff \frac{1}{2} \cdot B_P \geq c
\]
Poor citizen’s Best Responses

If wealthy and other poor lobby, lobby if:

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\frac{2}{3} B_P - c \geq \frac{1}{2} \times B_P \iff \frac{1}{6} B_P \geq c
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If wealthy doesn’t lobby and other poor does, don’t lobby
Poor citizen’s Best Responses

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\[
\frac{1}{2} \times B_P - c \geq 0 \iff \frac{1}{2} \cdot B_P \geq c
\]

If wealthy doesn’t lobby and other poor does, don’t lobby

If no one else lobbies, lobby if:

\[
B_P - c \geq \frac{1}{2} \cdot B_P \iff \frac{1}{2} \cdot B_P \geq c
\]
Poor Citizen’s Best Responses

- **lobby unless just other poor lobbies**: $\frac{B_p}{6}$
- **lobby only if the other poor doesn’t**: $\frac{B_p}{2}$ $\frac{B_W}{3}$
- **don’t lobby**: $\frac{B_W}{2}$
Wealthy Citizen’s Best Response

If both poor lobby, lobby if:

\[
\frac{1}{3} \cdot B_W - c \geq 0 \iff \frac{1}{3} \cdot B_W \geq c
\]
Wealthy Citizen’s Best Response

If both poor lobby, lobby if:

$$\frac{1}{3} \cdot B_W - c \geq 0 \iff \frac{1}{3} \cdot B_W \geq c$$

If one poor lobbies, lobby if:

$$\frac{1}{2} \cdot B_W - c \geq 0 \iff \frac{1}{2} \cdot B_W \geq c$$
Wealthy Citizen’s Best Response

If both poor lobby, lobby if:

\[
\frac{1}{3} \cdot B_W - c \geq 0 \iff \frac{1}{3} \cdot B_W \geq c
\]

If one poor lobbies, lobby if:

\[
\frac{1}{2} \cdot B_W - c \geq 0 \iff \frac{1}{2} \cdot B_W \geq c
\]

If no poor lobby, lobby if:

\[
B_W - c \geq \frac{1}{2} \cdot B_W \iff \frac{1}{2} \cdot B_W \geq c
\]
Wealthy Citizen’s Best Responses

- Lobby no matter what: $B_p / 6$
- Lobby if 0 or 1 poor lobby: $B_p / 2 + B_w / 3$
- Don’t lobby: $B_w / 2$

Lobby unless just other poor lobbies
Lobby only if the other poor doesn’t
Don’t lobby
EQUILIBRIUM

- **All Lobby**: 
  - **Lobby no matter what**: \( B_P \)

- **Wealthy & 1 Poor Lobby**: 
  - **Lobby only if the other poor doesn’t**: \( B_P \)

- **Just Wealthy Lobbies**: 
  - **Lobby if 0 or 1 poor lobby**: \( B_W \)

- **No Lobby**: 
  - **Don’t lobby**: \( B_W \)
**Equilibrium and Efficiency**

Likelihood of utilitarian optimum winning is decreasing in $c$ (until no one lobbies)

- Low cost: $\frac{2}{3}$
- Medium Cost: $\frac{1}{2}$
- High Cost: 0

Wealthy citizen is better able to organize to wield political power, even though poor citizens care more in aggregate
Why do we have inefficient outcomes?

Suppose cost is high enough that only wealthy lobbies

$$\frac{B_P}{2} < c < \frac{B_W}{2}$$

If poor citizens both lobbied, they’d each make

$$\frac{2}{3} \cdot B_P - c$$

For $$\frac{B_P}{2} < c < \frac{2}{3} \cdot B_P$$, poor citizens would be better off if they lobbied

Poor citizens don’t lobby because they only think about private costs and benefits, not shared benefits
Concentrated vs. Diffuse Interests

Small group each of whom cares a lot about an issue (Concentrated Interest) more powerful than large group each of whom cares a little (Diffuse interests)

Diffuse interest is hampered by greater externalities problems

This makes it hard to organize in support of even very important issues
Canonical Second Best Analysis

People don’t internalize externalities from carbon use

We each use too much carbon

To mitigate climate change, need to increase price of carbon to reflect social cost

Two ideas for how to do carbon pricing
  ► Carbon tax
  ► Cap and trade
“A well-designed carbon price is an indispensable part of a strategy for reducing emissions in an effective and cost-efficient way”

“Carbon prices encourage producers to decrease the carbon intensity of the energy sector and manufactured products, and consumers to choose less carbon-intensive goods”

“Carbon pricing promotes innovation and incentivizes the generation of new ideas”

Stiglitz et al. (2017)
An inflexible cap-and-trade program... would require too many reductions when the cost of achieving them was high and would mandate too few reductions when the cost was low.

Greg Mankiw
There is no federal carbon tax or cap & trade

A few states have implemented cap & trade systems

But carbon pricing has not been a major part of climate change policy because the politics are terrible
Percent of Greenhouse Gasses Covered by Pigouvian Tax

Social cost of carbon in 2020 at 3% discount rate: $97 per ton CO$_2$
Social cost of carbon in 2020 at 4% discount rate: $46 per ton CO$_2$
Social cost of carbon in 2020 at 5% discount rate: $26 per ton CO$_2$
Concentrated Interests and Carbon Pricing

Benefits are diffuse, costs are concentrated

Fossil fuel firms and labor oppose carbon pricing
  ▶ But cap & trade can allocate permits to big polluters

Fossil fuel consuming firms oppose carbon pricing
  ▶ Those that can reduce emissions might benefit from cap & trade

Financial services industry benefits from cap & trade

Cap & Trade is economically inferior, but politically more feasible
Inflation Reduction Act

Spending and Tax Cuts
Figures in billions over 10 years from 2022-2031

- Health Care $98
- Clean Fuels and Vehicles $39
- Manufacturing $43
- Individual Clean Energy Incentives $37
- Conservation, Rural Development and Forestry $35
- Climate $35
- Air Pollution $35
- Transportation and Infrastructure $7
- Clean Energy $177
What the IRA does

Consumer incentives
- low emissions vehicles
- reduced household emissions

Business incentives
- Carbon capture
- Emissions free energy
- Energy infrastructure
- Clean manufacturing

Industrial policy
- Domestic production requirements
- Prevailing wage requirements
The IRA’s Basic Trade-Off

Rather than make carbon more expensive, subsidize clean energy and emissions reductions

Shifting cost of reducing emissions from households and businesses to diffuse tax base

Less economically efficient
  - Choosing winners and losers among technologies
    - What if it chooses “wrong” technology?

More politically feasible
Politics of Subsidies

Carrots more attractive than sticks

Subsidizing concentrated interests
  ➤ Domestic industry
  ➤ Labor unions

Using tax code rather than grants to state and local government to avoid partisan conflict
  ➤ Compare to Medicaid expansion
Politics of Industrial Policy

Long-run sustainability by creating local concentrated interests

- Domestic manufacturing and union/high-paid workers
- In red states
- Analog to placement of military bases

This also helps break apart concentrated opposition

- Decouples unions and some manufacturing from fossil fuel industry
OUTLINE

A MODEL OF LOBBYING

POLITICS AND CLIMATE CHANGE

HOUSING POLICY
expensive homes, they do not represent the norm for America. However, both poor and non-poor people suffer from higher housing costs in such areas.

ZONING AND THE DEMAND FOR LAND

Why are home prices in those areas so high? The traditional answer is that land in those areas is intrinsically expensive. According to that view, there is a great deal of demand and land, by its very nature, is limited in supply. As such, the price of housing must rise.

There is another alternative, namely that homes are expensive in high-cost areas primarily because of government regulation in the form of zoning and other restrictions on building. According to this view, housing is expensive because of artificial limits on construction created by the regulation of new housing.

There is no doubt that property values are relatively high in the coastal parts of the country, at least partially because of strong demand to live in those high-amenity areas. However, our examination of the data suggests that there is plenty of land in high-cost areas, and new construction might be able to push the cost of houses down to near the cost of construction. However, the barriers to building create a potentially massive wedge between housing prices and building costs.

The gap between total housing costs and the price of structure is a combination of land costs and what we call the "zoning tax." The zoning tax is meant to include all of the impact of government regulation on the cost of construction. In principle, the gap between structure costs and total housing costs measures the combination of the zoning tax and the land costs. However, we can use several measures to determine the significance of the zoning tax.

Land-value testing

If the driving force for the wedge between construction costs and housing costs is intense demand for land in high-cost areas, then houses with bigger lots should be much more expensive than similar houses on smaller lots. If you double the lot size, you should double the gap between the structure cost and the housing price. But, if zoning also is driving the wedge, then the gap should be wider (and more constant for homes on various-size lots). That is, the lot's ability to accommodate a house in accordance with land-use regulations produces the lot's value. That implication is the best test of the importance of the zoning tax.

Empirically, we can test that implication by

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<tr>
<th>City</th>
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<tr>
<td></td>
<td>Units valued less than 90% of construction costs</td>
<td>Units valued greater than 140% of construction costs</td>
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<tr>
<td></td>
<td>Units valued less than 90% of construction costs</td>
<td>Units valued greater than 140% of construction costs</td>
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<td>Raleigh, N.C.</td>
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<td>San Antonio, Tex.</td>
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<td>Tulsa, Okla.</td>
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<td>Wichita, Kans.</td>
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Source: Authors' calculations, derived from central city data contained in the American Housing Survey and construction costs from the R.S. Means Company.
The Housing Affordability Problem

Country can be divided into three groups

Housing priced below cost of new construction
  - central cities in the northeast and midwest

Housing priced near new construction costs
  - much of the country

Housing priced way above new construction costs
  - New York, CA, some western and southern states
New Supply of Traditionally Affordable Housing Segments Are Shrinking
Why Not Build?

Regulatory hurdles
- Environmental impact to block building
- Zoning requirements to prevent multi-unit housing

Legacy homeowners block regulator change
- Concentrated interest
- Empowered by institutions
- Significant influence over local politicians
What might be some elements of an effective policy strategy to address the housing crisis that takes seriously these political constraints?
Concentrated interests are better able to organize resources and wield political power than diffuse interests.

This is because of an internal externalities problem.

This distorts policy towards those favored by concentrated interests.

Policy entrepreneurs seeking to solve problems need to find ways to work around or coopt concentrated interests.