Referee Report on
Corruption and Political Competition

The authors analyse the impact of electoral competition on corruption and lobbyism. Defining corruption as using campaign funds of parties for the politicians' private purposes, they argue that corruption increases with the intensity of the electoral competition. On the other hand, electoral competition reduces the distortionary influence of lobby groups on policy decisions. In this sense, competition is a double-edged sword.

The authors apply a model with two parties, one lobby group and both informed and uninformed voters. In this model, political parties first choose the degree of embezzlement; that is, the share of their funds devoted to private purposes instead of campaigning. The lobby group then determines the contribution schedule to the parties. Finally, the parties decide on their policy platforms. The formal analysis is based on Grossman and Helpman's model [G.M. Grossman and E. Helpman (1996), "Electoral Competition and Special Interest Politics", Review of Economic Studies, 63, 265-286]. The authors substantially simplify the Grossman-Helpman model in order to incorporate their new element, namely corruption and its interaction with lobbyism.

The authors address a very interesting and important topic. I like their basic approach and their intuitive explanations. But I have some troubles with the formal analysis, its relation to the economic explanations, and some conceptual issues, as I explore below. In particular, I am not convinced that all conclusions are correct.

Comments

1. How do I know that the RHS of eq. (11) is negative? The assumptions are $R > L$, $0 \leq \alpha \leq 1$, $0 \leq \theta \leq 1$, and $h > 0$. So the denominator is unambiguously positive, but the numerator can be positive or negative, depending on the effectiveness of the campaign h. So the result seems to be ambiguous. Assume that campaigning is very ineffective, i.e. h is very small. Then, the more resources are used for (ineffective) campaigning, and thus the less are used for personal purposes, the more the lobby group's contribution increases. This conclusion is in contrast to the result of the authors, but it could make sense. Note that Lemma 3.1 and therefore the two propositions 3.4 and 3.5 also depend on the sign of eq. (11). So the authors should carefully check their calculations and all underlying assumptions of their results.

2. I am not sure whether I completely understand what the authors intend to show in proposition 3.4. They suggest that they analyse the impact of competition, as measured by the parameter b, on corruption in equilibrium. The equilibrium is indirectly determined by the first-order condition (22) and its counterpart for party B. These two conditions are interdependent. So any comparative statics regarding equilibrium outcomes has to take into account both conditions. But in the proof of proposition 3.4, only one first-order condition is considered. So I think the authors analyse the hypothetical impact of competition on the embezzlement of party A, assuming that this condition leaves the embezzlement of party B unaffected. In other words, the authors analyse how party A's reaction curve shifts in response to intensified competition. They do not analyse the change of equilibrium corruption itself, which is the more interesting point.

This qualification is particularly important, since the 'competition' parameter b measures the voters' bias towards party A. A lower b is good news for party B, but bad news for party A. Given this asymmetry, the impact of changes in b on party A and party B might be somewhat different. It, therefore, is difficult to draw any conclusions regarding overall corruption from the results regarding just one reaction curve (although we learn in proposition 3.5 that the party's degrees of embezzlement are strategic substitutes).

3. The authors use a very specific interpretation of competition (see also my last comment) and corruption. They might discuss this approach more intensively. The authors also speak about "efficient" decisions several times. I am not sure what they exactly mean by "efficiency" in the context of their paper. Also, as an informed voter, I might be quite happy when a party that is influenced by a lobby group uses its funds for personal purposes rather than for campaigning, as the lesser of two evils. It, thus, is not clear to me whether corruption, as defined in this paper, is something the informed median voter should be worried about.

4. The authors state that the participation constraint (10), which denotes the contribution to party A necessary to induce them to choose policy platform PA, has to be binding. They argue this results from the fact that the contributions have a direct, negative impact on the group's utility. But I think this argument is in itself not sufficient. As Grossman and Helpman (1996) explore, there might be an electoral motive to contribute more than the minimum amount necessary to induce a party to adopt platform PA. Why is this not the case in the current model? Are there any further underlying assumptions?

5. I would like to see more motivation for some of the model's assumptions. Why do the parties decide on the allocation of funds between campaigning and private purposes before they actually receive the donations? How can this "first-mover advantage" (p. 3) be justified? Related to this issue, the lobby group can offer contributions contingent upon policy platforms. But it cannot offer contributions contingent upon embezzlement (although the lobby group can observe the embezzlement and take it fully into account when deciding on its contributions to the parties). From my perspective, the authors' arguments (p. 2) do not sufficiently explain this asymmetric treatment. Why is there some tacit reciprocity between the lobby group and a party regarding the policy platform, but not regarding embezzlement?

Overall, this paper covers a very interesting and important topic. It would be worthwhile to improve the analysis and the presentation of the paper.