MARKET STRUCTURE, OPPORTUNITY COSTS, AND TAX AVOIDANCE
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ABSTRACT

There have been several studies examining the relationship between an industry's market structure and its ability to affect political outcomes. These studies have assumed that political outcomes are likely to be influenced by a variety of traditional market structure characteristics, but these studies have ignored the impact of differences in the opportunity cost of lobbying that undoubtedly exist across industries. A model is developed that directly incorporates the opportunity cost of lobbying for tax breaks. Using data on tax avoidance rates in 1963, it is then suggested that in industries with high opportunity costs of lobbying, fewer tax benefits were received.

1. Introduction

In recent years there have been several studies examining the relationship between an industry's market structure and its ability to affect political outcomes (McPherson, 1972; Pincus, 1975; Rose, 1976; Caves, 1976; Salamon and Siegfried, 1977; Coolidge and Tullock, 1980; Esty and Caves, 1983; Noam, 1984; and Masters and Keim, 1985). These studies were based on political and economic theories which suggest that the ability and incentive for firms to affect political outcomes are likely to be influenced by a variety of market structure characteristics such as market concentration, firm size and industry profits.

While these studies have added to our understanding of the relationship between market structure and political influence, they have neglected one factor that should have a significant impact on lobbying effort: the opportunity cost of lobbying. No previous study has incorporated directly a measure of the differences in the opportunity cost of political lobbying that undoubtedly exist across industries. It will be suggested in this

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paper that opportunity costs must be considered when analyzing
the relationship between economic power and political influence.

The relationship between opportunity costs and investment
is one of the most fundamental of economic theory. When
economists discuss investment it is always in terms of opportunity
costs. Firms are unlikely to invest in the United States shoe
industry because the opportunity costs are too high. Many
politicians and voters are hesitant to invest in SDI (Strategic
Defense Initiative, Star Wars) because the opportunity costs are
too high. And in a completely analogous manner, firms will not
invest in lobbying if the opportunity costs are too high.

Despite the fundamental importance of opportunity costs
for investment decisions, the theoretical and empirical work in
this area has ignored opportunity costs. Probably the most
important theoretical work was Mancur Olson's *The Logic of
Collective Action* (1965). Olson expanded the economic concept
of public goods to include the public goods nature of political
influence. Olson hypothesized that small groups of large actors
are more likely to engage in successful political influencing
activity than large groups of small actors. According to Olson's
"free rider" hypothesis both the ability and incentive for firms to
engage in influencing activity should increase as market
concentration increases.

Olson's hypothesis of a consistent positive relationship
between concentration and political influence has not gone
unchallenged. Michael T. Hayes (1981) surveyed the economic
and political science literature in this area and concluded that:

> Sheer size by itself is a mixed blessing for
> any group. The larger and more diffuse the
> group, the more constituencies in which it can lay
> claim to political support . . . . [I]t is extremely
> important for groups to be dispersed, with
> members in a large number of congressional
districts. . . .
>
> Thus privileged groups [who gain
> influence] can be seen to have the best of both
> worlds: a core of a few large members with a
> substantial stake in obtaining the collective
> benefits and therefore willing to bear the costs of
> lobbying, and a larger group of peripheral firms
> widely distributed to maximize political
> appeal. . . . (Hayes, 1981, pp. 49-51)

Hayes is skeptical of the theoretical basis for a consistently
positive relationship between concentration and political
influence.