Campaign Contributions – What Do They Buy and Should They be Capped?

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Quite predictably, stories surrounding scandals about money in politics keep resurfacing in the headlines of newspapers. In 2009, for example, two peers were suspended from the House of Lords for six months after being accused of offering favors for cash. A Lords committee found them guilty of being willing to change laws in exchange for cash. Another example comes from the US, where in 2005 Representative Randy "Duke" Cunningham pled guilty to bribery and resigned from office. Cunningham had sold his house to a defense contractor for USD 1.6 million, at which point the contractor immediately sold the house again for a loss of USD 700,000. The transaction was said to be payback for Cunningham, who had previously influenced the awarding of a Pentagon contract in favor of the contractor. Obviously the question arises whether these anecdotes are merely stories of a few renegade legislators who broke campaign finance laws, or whether these stories represent just the tip of the iceberg of a corrupt system in which contributors and legislators exchange money for political favors.

In the US, concern about the influence of special interests on politics, through the vehicle of campaign contributions, is amplified by the rapid rise in the campaign expenditures of candidates running for office. The rising campaign expenditures are especially noteworthy in US presidential campaigns. While President Bill Clinton and Republican challenger Senator Robert Dole spent USD 80 million altogether in 1996, just four years later, candidates George W. Bush and Albert Gore spent USD 307 million campaigning for the presidency. By 2004 the expenditures of Senator John Kerry, the opponent of incumbent Bush, amounted to more than USD 550 million and in the 2008 election, Democrat Barack Obama and Republican John McCain spent over USD 1.1 billion on their election campaigns. And it is all but certain that these record amounts will be easily surpassed in the 2012 election.

The topic of campaign contributions and campaign spending has received new scrutiny since the 2010 US Supreme Court decision *Citizens United v Federal Election Commission* (130 S.Ct. 876, 2010), which allows corporations and unions to spend unlimited sums on advocating the election – or the defeat – of a candidate. The Citizens United decision was so controversial that President Obama explicitly criticized the Supreme Court justices about this landmark decision during his 2010 State of the Union address.

Theory is useful in helping us examine under what conditions political favors are granted in return for campaign contributions (for example, Grossman and Helpman 1994, Austen-Smith 1987, Coate 2004). However, depending on the assumptions in the models, theory can also lead to conflicting predictions regarding the role of money in politics. Theoretical predictions about the effect of contributions on policy are very sensitive to assumptions about the objectives of candidates, whether their positions are immovable or not, to what extent the voters are rational, the type of electoral competition and electoral institutions, the goals of contributors, and the role of advertising in inducing voters to change their voting behavior, and to what extent voters can punish candidates for not following their platforms.

One of the perhaps oldest lines of research in the area of campaign contributions and special political favors is the examination of the effect of campaign contributions on voting behavior. Academic work started out by analyzing the influence of campaign contributions on policy decisions by correlating campaign contributions with the voting record of legislators. This research agenda faces several challenges. One is that of causation. Do contributions cause changes in voting behavior or do contributions simply reflect the policy positions held by legislators? In the latter case, a positive correlation between contributions and voting for the contributor's interest merely re-

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flects that the contributor donated money to those who have the same policy positions as the contributor.

Some studies address the causation issue using instrumental variable methods. But both studies – those that address the causality issue via instrumental variables and those that do not explicitly address this issue – have found mixed evidence for the hypothesis that contributions have a corruptive effect on voting behavior in the legislature (Ansolabehere et al. 2003). A meta analysis of a large number of studies on these issues has found, however, that contributions influence legislative voting behavior (Stratmann 2005).

Nonetheless, the mixed findings suggest that legislative voting behavior is not primarily determined by special interest contributions. Especially on issues that are visible to the public and where the public has an interest in the issue, such as abortion legislation or gun control, money has probably little influence on legislative voting behavior and especially here, the interested parties give to those politicians who they know will support their cause. When voters are aware of an issue, and thus closely monitor their representatives, contributions are unlikely to affect anything as visible as a vote in a legislature. An effect of money on voting behavior is more likely to be found with issues that are not of high salience to voters. Further, it would be advisable to look at issues where the benefits of the decision are concentrated and costs disbursed. When the costs of decisions are disbursed, voters face a weaker incentive to monitor their representatives.

One way of overcoming the nagging causation issue – that the allocation of campaign contributions may simply reflect legislators' positions – is to hold representatives' positions constant, and examine whether they alter their vote for or against special interests when they receive higher or lower contributions from these interest groups. Stratmann (2002) does so by examining votes on financial services legislation. Financial services legislation is an issue of relatively low salience, especially prior to the financial meltdown in 2008, and an issue area where voters do not necessarily closely monitor how their representative votes. Stratmann (2002) investigated the repeal of the Glass-Steagall Act, which separated commercial banking from investment banking. He identified two nearly identical bills, one from 1992 and one from 1998, to repeal this act. US House representatives had voted on the repeal of this act in those years. Banking interests favored the repeal of the Glass-Steagall Act, while investment banks and insurance companies opposed it. Between 1992 and 1998 some legislators received an increase (or decrease) in contributions from the special interests favoring or opposing the repeal of the act. The results of the study show that legislators who received an increase in banking contributions from the time the first vote was cast to the time the second vote was cast had a higher probability of favoring banking interests on the second vote than on the first. And representatives who received an increase in contributions from insurance and investment bank interests were more likely to oppose the repeal of the act in 1998 than in 1992.

But voting is only one dimension of legislative work. Voting is studied because it is easily observable, but also because it is the best measure of interest group influence. Other aspects, not as easily observable as voting, such as talking to bureaucrats, spending time advancing the agenda of special interests behind closed doors, and inserting specific language into bills, are clearly important and because they are less likely to be observed by voters, it may be in this area that money has the largest influence on politics.

Money donated to advocate the election or defeat of a candidate is different from contributing to the candidate. While the winning candidate may be grateful to the corporation that advocated defeat of his opponent, a direct quid pro quo may be less likely if the corporation gives the money directly to the politician.

Another approach for testing the importance of contributions is to link contributions to stock market performance. Scholars have started to examine the effect of corporate campaign contributions on the fortunes of the contributing firms. These works include an interesting study by Jayachandran (2006). Using the unexpected departure of Senator Jim Jeffords from the Republican Party in May 2001, which resulted in a shift in the Senate majority, Jayachandran examined the effect of this change on the market value of firms contributing soft money to the Republican and Democratic parties. It was shown that in the week after Jeffords left the Republican Party, firms lost 0.8 percent of market capitalization for every USD 250,000 contributed to Republicans. The stock price gain to firms with Democratic contributions was smaller, but not statistically different in magnitude. Cooper, Gulen and Ovtchinnikov (2010) studied stock-market returns for companies that gave contributions and

found that a firm's future stock returns increased with the number of candidates the firm supported for political office. The authors report that this effect was particularly strong when a firm supported candidates in its own home state, candidates in House races, and Democratic Party candidates.

Discussions about money in politics often center on the tension between providing information and corruption. Independent expenditures and expenditures by candidates can provide voters with the necessary information to cast an informed vote at the ballot box. On the other hand, politicians may engage in an explicit or implicit quid pro quo for contributions received or for independent expenditures that advocated their election.

According to the US Supreme Court, the main justification for capping contributions is that large contributions may result in corruption. More specifically, that the incumbent will hand out favors to the contributor. For the court, one argument that weighs against the capping of contributions is that contributions are a form of speech, and free speech is protected by the US constitution.

Before thinking from an economic perspective about whether contributions should be capped, it is necessary to consider benefits and cost of contributions, regardless of whether or not the constitution justifies the capping of contributions. Campaign contributions help candidates to finance their election campaigns and to advertise their positions. Thus campaign spending, fueled by campaign contributions, provides information to voters. With this information, voters can infer which candidate is most closely aligned with their own policy positions and subsequently cast appropriate votes. Having more information may also increase turnout, and thus participation, in the election. With adequate disclosure of who contributed to candidates, voters also receive information about who supports the candidate, and this may help voters to make inferences about candidate positions. For example, if a candidate receives large contributions from the gun control lobby, this may indicate that that the candidate favors gun control. Although there are some informational gains from campaign spending, some of these gains may be lost if voters believe that the candidate has accepted contributions for future favors. In this case turnout may be lower than it would be otherwise (Houser, Morton and Stratmann 2011).

One concern regarding the capping of contributions is that caps are an incumbent protection device. Since incumbents have an advantage over challengers because they have the power of their office, connections and receive free press coverage, challengers have to raise large sums to be competitive in a race. Because of the lack of connections, challengers may rely on only a handful of large contributors and by capping contributions, challengers cannot raise enough money to defeat an incumbent.

In particular, capping contributions too low may have adverse effects. If limits were set to zero, in a private campaign financing system, challengers could not rely on contributors for the financing of campaigns. While the same is true for incumbents, they, however, have the power of their office to advertise for themselves and receive free coverage by the media. Thus very low contribution limits could tilt the competitive advantage more towards the incumbent. In fact the US Supreme Court struck down a Vermont law which set the contribution cap at USD 200 per person because the court thought that the caps were too low, potentially leading to uncompetitive elections because challengers cannot mount a viable campaign.

However, the concern that low contribution limits lead to uncompetitive elections may not be justified. A recent study for the American states examined whether contribution limits of USD 500 and below have uncompetitive effects (Stratmann 2010). That study showed that low limits do not have uncompetitive effects, and that states with limits of USD 500 and below have more competitive elections in races to state assemblies relative to states with contribution limits of USD 1,000 or higher. Thus this study suggests that some caps can reduce the incumbency advantage. One explanation for this finding is that contribution caps primarily adversely affect the fundraising ability of incumbents, pulling them down closer to the fundraising capacity of challengers.

But the consequences of caps of more than that may limit corruption and, at least over some range, reduce the incumbency advantage. This is because voters obtain information through campaign spending, and campaign advertising allows voters to make a more informed choice. Contribution caps can lead to lower campaign spending and thus capping contributions may limit the information flow to voters, leading voters to make suboptimal choices.

Besides capping contributions, some have advocated the capping of campaign expenditures of candidates. The US Supreme Court, however, struck down such expenditure limits because they considered this an inappropriate curtailment of free speech. From an economic perspective, expenditure limits could be efficiency-enhancing if campaign spending is a zero sum game, and all that expenditures do is to offset each other. However, expenditures may serve as useful signals to the candidate's ability because high quality candidates may be able to attract more contributions. Specifically, if those candidates who propose the most efficient policies receive the most contributions, then by observing the size of the expenditures voters are informed about which of the candidates has the most efficient policies. That being said, it should be noted that although the idea that candidates with the best policies receive the most contributions is interesting, this hypothesis has not yet been tested.

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