WORKING PAPER

The Political Economics of Campaign Finance: Lessons for Reform

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"I personally don't think it's a bad thing for a person who has done well in this country and believes in politics and wants to contribute something back, to be able to do that. I think it is a good thing you're doing here tonight, not a bad thing, and I'm proud of you for doing it."

— President William Clinton[1]

1. Introduction

The public debate over campaign finance reform is often framed as necessitating an unfortunate tradeoff between the liberal ideals of free speech and association on one side, and the democratic ideals of equal representation and participation on the other. However, despite frequent calls for dramatic action[2], the terms of this tradeoff are not well-understood. This is in part attributable to the fact that the study of the political economics of campaign finance is perhaps more notable for its faults and oversights than its contributions. For example, I know of no political economic analysis of the effects of campaign finance regulations on freedom of speech or association.[3] And while there is a plethora of work on how money affects either electoral or policy outcomes, the quality of these studies is sometimes wanting. However, recently there have

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[1]From the text of the President's speech at a Democratic National Committee fund-raiser on September 26, 1997 ("Remarks by the President at the DNC Dinner" at www.pub.whitehouse.gov).

[2]For example, House Minority Leader Richard Gephardt urged, "...let's amend the Constitution to honor ... the Founders ,"at the National Press Club on January 30, 1997 ("Ending the Money Chase..." at www.house.gov/democrats/speeches/reform1.html).

[3]However, legal scholars [e.g., Bevier (1997) and Johnson and Beard (1997)] and journalists [e.g., Will (1996) and Rauch (1997)] have addressed the impact of campaign regulation on the exercise of free speech and free association.

been important methodological advances in the empirical analysis of the electoral consequences of campaign spending, although there is still no strong consensus on the importance of money in elections.[4] Also, there are several admirable empirical studies of campaign contributions, but these tend to focus on the allocation of funds by political action committees to Congressional incumbents.[5] And while not unimportant, PAC contributions represent a small and declining share of total campaign contributions.[6] Further, there is also no consensus in this literature as to whether campaign contributions are the functional equivalent of bribes.[7] Finally, several relevant insights from the theory of social choice have not been applied to the question of how campaign finance affects the democratic process. In this article, I primarily address this last point; I argue that contrary to the apocalyptic rhetoric of some reformers, interested money plays a less deleterious role in American politics than is commonly held. I conclude by proposing two very simple and benign campaign finance reforms, inspired by the political economics of campaign finance: educate citizens about the realities of both campaign finance and democracy, and encourage ordinary citizens to contribute more resources to candidates of their own choosing.

[4]For example, see Grier (1989), Levitt (1994), Ansolabehere and Snyder (1996b), Erickson and Palfrey (1998), Gerber (1998) and Milyo (1998a).

[5]For example, see Snyder (1990, 1992 and 1993), Grier and Munger (1991a,b), Grier, Munger and Roberts (1994).

[6]PAC contributions accounted for only about 15% of all Federal campaign contributions in the 1995-1996 electoral cycle.

[7]See Milyo (1998b) for a discussion on the degree to which campaign contributions are interested; see Lowenstein (1996) for a detailed discussion of the legal issues regarding bribery and influence-peddling in politics.

2. The Conventional Wisdom

"The campaign system is broken."

— President William Clinton[8]

The corrupting influence of money in politics is a staple of media pundits, public-interest advocates, and even many politicians.[9] The basic claim is that interested money perverts the democratic process in three ways: 1) campaign contributions buy legislative favors, 2) campaign expenditures buy elective office and 3) popular disgust with the dominant role of money in politics causes "ordinary" citizens to withdraw from participation in the political process. Consequently, the current system of campaign finance is thought to undermine the twin democratic principles of representation and participation.

Indeed, it is not difficult to find lurid examples and descriptive statistics that are consistent with the claim that money is the driving force in American politics [e.g., Stern (1991,1992), Morris and Gamache (1994), Makinson and Goldstein (1996)]. For example, it is most often the case that in any electoral contest the candidate who spends more money wins. Further, when incumbent office-holders run for re-election, they usually spend far more than their challengers and they usually win re-election easily. It is also the case that PAC contributions flow disproportionately to incumbents and that these same incumbents often vote in ways that are

[8]This quote is from the text of one of the President's weekly radio addresses to the nation on September 13, 1997 ("Remarks by the President in Radio Address to the Nation" at www.pub.whitehouse.gov).

[9]Of course, politicians may advocate for reform as an exercise in demagoguery or even cognitive dissonance (lamentations about the corrupting influence of money are often heard from dis-empowered politicians: those recently retired or defeated, those soon to be so, and those on the losing side of some particular vote).

pleasing to the sponsors of their donor PACs. This fund-raising advantage of incumbents is compounded by the fact that the absence of serious competition permits many incumbents to build up large stockpiles of unspent campaign funds. To the extent these war chests deter future challengers, the incumbent is more securely entrenched in office. Finally, it is also true that turnout in elections has been generally decreasing and that campaign spending has been generally increasing. Nevertheless, more sophisticated and systematic evidence tends not to corroborate the conventional wisdom.

Empirical Studies of Campaign Finance

The conventional wisdom on the role of money in politics stands in disturbing contrast to the findings of most academic research on the topic (to the great frustration of those of us doing the research!). In short, most academic experts would agree that it is very difficult to find consistent and convincing evidence that interested money buys either elections or policy favors [e.g., Sorauf (1992) and Levitt (1995)].

One important implication of recent empirical research on campaign finance is that the marginal value of a campaign contribution is quite small, both to the recipient and to the donor.[10] This is because current law limits the size and source of contributions and because marginal campaign spending appears to have little effect on electoral outcomes [Levitt (1994), and Milyo (1997b and 1998a)].[11] It is therefore not surprising that there is little evidence that PAC

[10]Milyo (1998a,b) makes this argument at length.

[11]Corroborating evidence is found in studies which demonstrate that neither campaign war chests nor candidate wealth deter challengers [Ansolabehere and Snyder (1996a) and Milyo and Groseclose (1998)]. Also, consider the following quotes from President Clinton on the efficacy of campaign spending:

contributions influence the roll-call voting behavior of legislators [e.g., Bronars and Lott (1998) and Levitt (1998)].[12] These findings are consistent with the fact that aggregate contributions to Federal candidates and parties during the 1995-1996 electoral cycle were only about $2 billion (Miller, 1997). This is equivalent to about .02% of GDP, or roughly one-third of the amount of money contributed to the United Way during that time period; further, case studies of major corporations suggest that the funds spent on charitable activities by major firms are an order of magnitude larger than the total amount devoted to political activities by those firms, associated PACs and their employees, combined (Milyo, 1998b). Consequently, most political contributions should be considered relatively *uninterested* money.

Soft Money

An important distinction must be made between campaign contributions to candidates and PACs (which are limited by the Federal Election Campaign Act), and those to parties or issue-advocacy campaigns (which are not currently limited). Money raised in accordance with Federal

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> ...all of us who have run in elections know that there is a core, a threshold amount of money you have to have to make sure your voice is heard. After that, if somebody's got a little more, it's not important [from the text of a press conference on May 7, 1993 ("Statement by the President, ..." at www.pub.whitehouse.gov)].

> I was asking the students ... How many people have you voted for because you thought they had the best television ads? How many people have you voted against because you saw a negative campaign ad (?)... and they all started laughing as we rocked along, you know [from the text of comments made at a fund-raising dinner on September 26, 1997 ("Remarks by the President at the DNC Dinner," at www.pub.whitehouse.gov)].

[12]Hall and Wayman (1990) argue that interested money may influence the activities of legislators in more subtle ways (bill sponsorship, bill content, etc.), but neither Wawro (1997) nor Milyo (1998b) find much evidence for this claim.

contribution laws is known as “hard money”; such contributions may be spent on any type of political advertisement. “Soft money” is any donation to a party or other group which does not qualify (by either size or source) as hard money[13]. Soft money may be used to run generic issue-advocacy advertisements, but not for advertisements which explicitly advocate voting for or against a particular candidate. Of course, these generic issue-advocacy activities are sometimes close substitutes for campaign advertisements. Consequently, soft money contributions have been the target of numerous recent reform efforts (including the Shays-Meehan and McCain-Feingold legislation currently pending in Congress).

Soft money contributions are more likely to be effective “bribes” than are direct campaign contributions to individual legislators; this is because soft money contributions are unlimited in size and because political parties have various methods of disciplining their members and delivering of political favors. Despite this, soft money contributions to the two major national parties were less than $275 million during the 1995-1996 electoral cycle, an amount equivalent to 15% of the hard money spent during that time period (www.fec.gov).[14]

It is difficult to reconcile this relative dearth of soft money with the notion that such contributions constitute effective bribes. But it is consistent with the claim that most hard money contributions are uninterested, and that the sheer volume of these contributions drives down the marginal value of campaign contributions to the point where interested money has little incremental value to politicians. The reason so little interested money flows into politics is that it

[13]For a more detailed discussion of soft money, see Dwyre (1996).

[14]Further, 93% of the total soft money contributed by corporations was donated in amounts of less than $20,000.

does not buy much in the way of legislative action. However, an important caveat must be made here: it is simply not known how much money is spent on generic issue-advocacy campaigns, or on more subtle attempts to manipulate popular opinion (e.g., the content of popular entertainment programing). Consequently, it is difficult to assess the degree to which interested money affects American politics through this soft money "loop-hole."

Nevertheless, there is good reason to doubt the popular understanding of the role of money in politics. But even if interested money plays an important role in American politics, it does not follow that the basic principles of democracy are being ill-served. This is because interested money also has some salutary effects on majoritarian politics.

4. Lessons from the Theory of Social Choice

"... restore democracy in our country..."

— Vice President Albert Gore[15]

The most significant result of the last half century of social choice theory is the realization that there is no collective decision rule which can always satisfy a reasonably minimal set of "rationality" conditions (Arrow, 1963). Further, given a collective of heterogeneous individuals, there exist several different methods of aggregating their individual preferences into a collective preference, each of which is arguably consistent with the democratic ideals of representation and participation, but which produce different collective choices (e.g., Riker, 1982).

In this context, it is not obviously undesirable for interested money to produce deviations

[15]This quote is from the text of a statement made to reporters introducing the President's proposal to reform campaign finance on May 7, 1993 ("Statement by the President, Vice President, ..."at www.pub.whitehouse.gov).

from what would otherwise occur under simple majority rule. First of all, pure majority rule is irrational, that is a pure majority rule equilibrium almost never exists (Plott, 1967).[16] Worse yet, agenda setters are known to wield extreme influence over outcomes in majority rule settings (McKelvey, 1976). Finally in large elections, voters have little reason to vote responsibly (Brennan and Lomasky, 1993). It is therefore not a stretch to consider interested money to be a check on the power of political agenda setters or the whims of a less interested and temporary majority (Hayek, 1960).

What is Democracy?

In common parlance, democracy has come to mean simple majority rule. Institutions which hinder action by simple legislative majorities, whether they be internal to the legislature (the filibuster, the committee system, party leadership, supermajority rules, etc) or external (executive vetoes or judicial decrees) --- are often decried as "undemocratic." Under this definition, outside pressure from special interests in the form of lobbying or campaigning is "undemocratic" since it may cause the legislature to choose an outcome that it might not have otherwise. However, deviations from simple majoritarianism are widely accepted (even strongly preferred) in certain venues. For example, supermajority rules are used for altering the Constitution and for jury decisions, while plurality rule is used to decide the outcomes of most elections. This suggests that the frequent equivalence of democracy and simple majority rule in common parlance is more the product of imprecise language and intellectual laziness than it is evidence of a popular consensus

[16] The most important exception is the familiar median voter result in a one dimensional policy space. Poole and Rosenthal (1985) have argued that Congressional politics is essentially one-dimensional, which would imply that the existence of pure majority rule equilibria is more the norm than the exception. However, the interpretation of their evidence rests on very strong assumptions on individual preferences [Koford (1989) and Milyo (1998c)].

for such a narrow understanding of what is democratic.

A more sensible definition of what is democratic would include any institutions which limit the inevitable inequalities in representation and participation to some tolerable level. Of course, this more nebulous definition makes it impossible to objectively characterize institutions as democratic or undemocratic. Consequently, once we admit a more expansive understanding of democracy, it becomes more difficult to maintain the position that the presence of interested money in politics is necessarily undesirable.

Control of the Legislative Agenda

The intransitivity of pure majority rule is more than just a theoretical curiosity. The inherently chaotic tendencies of pure majority rule lead legislatures to adopt rules of procedure which constrain legislative choice and empower agenda-setters. Procedural rules typically limit the feasible set available to the legislature, dictate the order of consideration of these feasible options and restrict the mechanism of choice to a series of binary (yea, nay) votes. The ability to manipulate the content and ordering of the legislative agenda permits party leaders to wield significant influence over the outcomes of legislative choice (Cox and McCubbins, 1993). However, free and open public debate can focus the attention of the electorate and raise the cost of agenda manipulation.

For example, issues such as campaign finance reform, term limits and balanced budget restrictions are typically far less popular among legislators than the general public. Party leaders often block such issues from even coming up for debate. However, in many instances, special interest groups have successfully raised public awareness and concern over these issues and forced them onto the legislative agenda. By allowing interested persons to lobby their representatives and fellow citizens, the power of agenda-setters is reduced. At the same time, new information and arguments are added to the public debate. Of course, some misinformation and illogic will also be produced. But it is in no way self-evident that the social costs of issue advocacy and lobbying outweigh the social benefits.

Representation of Intense Interests

Even if we ignore the pervasiveness of intransitivity, pure majoritarian institutions are deeply flawed on normative grounds. Simple majority rule is the most direct implementation of the principle of "one person, one vote", and while this principle is held in great esteem, its appeal stems partly from the implicit assumption that all persons have an equal stake in the collective outcome. This is clearly not the case in what we might call "private" matters; indeed a generic right to privacy is so well accepted that few Americans would find that the existing Constitutional guarantees of their individual liberties are "undemocratic." The great flaw in majoritarian institutions is that each individual's preference is weighted equally, even though there may be tremendous heterogeneity in the intensity of individual preferences.

Supermajority requirements are one common method of accounting for the intensity of individual preferences; such rules permit the votes of an intense minority to outweigh those of the unconcerned majority. However, such rules may also permit an unconcerned minority to thwart the desire of an intensely interested but insufficiently large majority.

A second method of incorporating intensity of preferences in the collective choice process is to disproportionately weight the preferences of intense minorities. The committee system in Congress can be viewed as an attempt do this: preference outliers select onto committees with narrow policy jurisdictions, while the rules of the House and (to a lesser extent) the Senate permit committee members disproportionate influence over legislation in their jurisdiction (Weingast and Marshall, 1988).[17]

A third method of incorporating the intensity of interests is simply to permit deliberation and debate. By communicating their positions, intense interests can better inform the collective about any disproportionate effects of policy, or, in the very least, appeal to the magnanimity of the less intensely interested. Since not all interests will be well represented in a given legislature, and since effective persuasion may be quite costly, it is only to be expected that groups will form around common interests and pool their resources for the purpose of influencing the decisions of the legislature or the opinions of the citizenry at large. Consequently, special interest lobbying and issue advocacy activities serve a socially desirable function; they permit at least some minority interests to inform the collective about the intensity of their preferences.

A final method for incorporating information on the intensity of individual preferences into the collective choice process is vote-trading. Within legislatures, such exchanges are known as log-rolls. These vote-trades necessarily work to the advantage of the interests which are party to the exchange, since these trades are made voluntarily. Further, in majoritarian institutions, vote-trading necessarily involves minority interests, since otherwise the majority would simply pass its preferred legislation directly. Consequently, through log-rolling, minority interests improve their lot by "buying" legislation that is dear to them at the cost of supporting legislation which is relatively unimportant to them (but dear to some other minority interest). In this way, majoritarian institutions can be made more responsive to minority interests.

An indirect form of vote trading occurs through campaigning and elections. Intense

[17] However, see Groseclose (1994) and Krehbiel (1991).

interests provide support to candidates in exchange for political favors. However, candidates who cater only to special interests risk alienating large segments of the electorate. Consequently, candidates must expend resources to inform and persuade the electorate to their cause. Thus, candidates serve as arbiters, both between competing groups of intense special interests and between intense special interests and the unconcerned majority. If the interests of minority groups are sufficiently intense, then they will provide enough support to candidates that those candidates can then afford to ignore the interest of the majority on the issue in question. Of course, it is easy to envision contexts where such an outcome is either normatively appealing or appalling, but the same is also true of pure majoritarianism.

Voter Participation

Rational choice theories of voter participation posit that individuals weigh the benefits of voting against the costs.[18] The benefits of voting are the satisfaction of the act itself and the expected change in the outcome of the election that results from one vote. The costs of voting are the time and effort it takes to actually cast a ballot; for example, registering to vote, becoming informed about candidate positions, finding the appropriate polling place, and queuing to vote. It is well-known that in large elections the probability that a single vote will be decisive is essentially nil, so the decision to vote becomes a simple weighing of the intrinsic value of the act against its costs.

It is often claimed that public disgust with campaign finance is a reason for declining voter

[18]For an in-depth review and critique of this literature, see Green and Shapiro (1994).

participation.[19] The main evidence for this claim is the fact that campaign spending and turnout have been moving in roughly the opposite direction over the last fifteen years. This is consistent with the claim, but far from convincing evidence of a causal relationship.

So, does campaign spending cause voter apathy by lowering the intrinsic value of voting? If so, we might expect that individuals with more cynical views on campaign finance, party politics and government would be less likely to vote. A recent poll of voters and non-voters commissioned by the League of Women Voters suggests that this is not the case; non-voters hold views that are ver similar to those of voters.[20] The major difference found between voters and non-voters is that the latter have a higher opportunity cost of their time and are less likely to feel a strong duty to vote. This is consistent with the rational choice theory of voting, but offers no support for the claim that the prevalence of interested money in politics reduces voter participation.

However, it is possible that interested money depresses turnout in a more indirect fashion. Since interested money flows primarily to incumbent office holders, the dramatic increase in campaign spending may have reduced the competitiveness of elections and thereby lowered turnout. But this argument has two serious flaws.

First, Milyo (1997c) demonstrates that Congressional elections have actually become more

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[19]For example, consider this observation from the noted political commentator for MTV, Tabitha Soren, "Young people are alienated... young people think politics is rigged by money, and they're right," [from the text of an interview of President Clinton aboard the MTV Choose of Lose Bus on August 30, 1996 ("Interview of the President by Tabitha Soren of MTV,"at www.pub.whitehouse.gov)].

[20]See "Alienation not a Factor in Non-Voting," League of Women Voters (www.lwv.org/lwus/mellsumm.html).

competitive as campaign spending has jumped. Despite an increase in real incumbent spending and no change in the proportion of experienced challengers, House races have become closer, incumbents have drawn down their war chests, defeats have increased and the proportion of unopposed incumbents has dropped. The turnover rate (defeats plus retirements as a share of seats) for the House and Senate has averaged 20% since the 1990 redistricting; this is the highest average turnover rate for any three consecutive elections in the last four decades. This is not surprising; the increased competition for partisan control of Congress is surely one of the primary causes of the steep upward trend in aggregate campaign spending. Further, the failure of increased competitiveness to cause a similar increase in the voter participation trend is consistent with the prediction that the instrumental value of voting does not drive an individual's decision to vote.

The second flaw in this logic is the presumption that electoral competitiveness should cause turnout in large scale elections. It is true that empirical studies of elections repeatedly find that turnout is significantly correlated with the closeness of the electoral race. It is also true that many rational choice theorists have interpreted this as evidence consistent with the rational choice theory of voting: the idea being that an individual's vote is more likely to be decisive in a close race. However, in large elections, the probability of casting a decisive vote, even in a close election, is still negligible. Consequently, changes in the expected closeness of an election should not have a significant and direct affect on turnout.

The observed correlation between turnout and closeness is not evidence of a proximate causal relationship. Rather, greater electoral competition causes increased spending, which in turn causes increased turnout. The link from electoral competitiveness to campaign spending occurs for two reasons: the expected closeness of the election increases the propensity of donors to give to candidates (Milyo 1997a) and causes candidates to expend more effort on raising funds (Milyo, 1998e). The second link from spending to turnout is also quite intuitive. Since campaign spending is largely used to run campaign advertisements, it should be no surprise that voter interest is peaked in districts that are bombarded with numerous advertisements.[21] In fact, voter turnout is significantly related to campaign spending, even when controlling for the closeness of the race (Milyo, 1998d). Consequently, there is little support, in either theory or empirics, for the claim that the presence of interested money in American elections is a cause of the general decline in voter turnout.

4. Conclusion

The public debate over campaign finance reform has taken as given the notion that interested money corrupts democratic politics. However, recent empirical studies suggest that interested money does not play an extremely influential role in Federal elections. More importantly, the theory of social choice informs us that the net effect of interested money on the democratic ideals of representation and participation is ambiguous. This raises the burden of reformers: any cost-benefit analysis of campaign finance reform must consider not only the real costs of regulation on free speech and association, but must also demonstrate a net positive effect on democratic procedure.

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[21]Ansolabehere and Iyengar (1995) argue that negative advertising reduces turnout, but Finkel and Greer (1998) find no strong evidence for this association. Further, I have been unable to find any evidence that increased campaign spending leads to more negative advertising, despite numerous assertions of to that effect by reform advocates (e.g., Kuttner, 1998).

Of course, there is no objective way to gauge the net effect of interested money on the democratic process. However, numerous opinion polls reveal that in the subjective evaluation of most Americans, interested money does have an undesirable net effect on politics (Miller, 1997). Of course, part of this support for reform stems from ignorance.[22] After all, the insights from recent empirical and theoretical studies are not often heard on the nightly news or seen in newspaper editorials. Consequently, one avenue of reform is simply to inform citizens that interested money does not necessarily undermine democracy, either in theory, or practice.

If Americans nevertheless believe that interested money plays too great a role in their politics, there is still an important lesson for reform here. It has been argued that soft money contributions (to parties and issue-advocacy campaigns) are the more likely pathway for interested money to influence political outcomes. The failure to index hard money contribution limits for inflation means that these limits have been reduced by over 70% since their inception in 1974. To the extent this has slowed the flow of money to candidates (from what it would have been otherwise), it will have raised the marginal value of soft money and thereby increased the influence of interested money in American politics. Current reform efforts are aimed restricting these activities, but such regulations will have consequences for free speech and association and may not survive a Constitutional challenge.[23] However, a more promising approach is available.

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[22]In a recent poll sponsored by the Citizens for Responsive Politics, only 12% of respondents could correctly answer more than two out of five simple true-false questions on campaign fiance (www.crp.org/s1/s2.htm). For comparison, hamsters, pushing levers at random corresponding to “true” or “false,” could be expected to demonstrate significantly more knowledge about campaign finance based on their “answers” to similar questions.

[23]Although, consider the reflections of an expert on the subject of unintended consequences:

Since campaign contributions to candidates are relatively uninterested, it is possible to drive down the marginal value of interested money to recipients by increasing the flow of hard money to candidates. This could be accomplished through subsidies, increasing and\or indexing the current nominal hard money contribution limits, or simply through public interest advertisements (akin to the ubiquitous "get out the vote" advertisements sponsored by various groups). This type of reform has no serious consequences for freedom of speech or association because it avoids the need to define and monitor issue-advocacy, etc. Further, by encouraging more contributions, candidate spending will likely increase, which can be expected to lead to higher rates of voter participation.

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> skeptics look at ... reform measures and ask whether ... there will be unintended consequences. The truth is that ... there will be unintended consequences. But...that's what makes life interesting and keeps us all humble [from the text of a speech made to the National Press Club on March 11, 1997 ("Remarks by the President in Address to the Conference on Free TV and Political Reform," at www.pub.whitehouse.gov)].

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