The Power of K Street: New Research on the Economics of Lobbying

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Introduction

Political lobbying is as old as government. Indeed, in the United States, lobbying is protected under the right of petition in the First Amendment of the Constitution. While the term originated in Britain – where it was used to describe the cajoling of MPs in the lobbies of the House of Commons – nowhere have lobbyists reached a more evolved state than on "K Street" in Washington, DC.

In this article we review new research on the economics of lobbying in the US, focusing on activity at the Federal level. Significant improvements in data availability are promising to make this topic a new focus for empirical political economy research in the next decade. This promise is also enhanced by Washington's dynamic political environment, which offers many opportunities for defining novel research designs.

The comprehensive reporting of lobbying expenditure first began with the passing of the 1995 Lobbying Disclosure Act (LDA). Since this time the US federal lobbying industry has experienced startling growth. Between 1998 and 2009, lobbying expenditures approximately doubled, reaching USD 4 billion a year. Most recently, the Obama administration's attempts to reform the health care and financial services industries have stimulated lobbying spending in those sectors. In turn, these recent debates on health care and financial reform have been marked by sharp criticisms of the role of staffers-turned-lobbyists in watering down the bills.

A secondary outcome of the LDA has been that it has made new data available on both the organisations that spend on lobbying and on the professional profiles of lobbyists themselves. Independent non-partisan organisations such as the Center for Responsive Politics (CRP), the Sunlight Foundation and Legistorm have played an important role in consolidating the raw data released under the LDA and promoting its availability. So far, we can classify research using this LDA-derived data into two areas: work on the economics of legislative reform and research on the professional careers of lobbyists. We consider each of these areas in turn.

The economics of legislative reform

The 2008 financial crisis provides a good setting for studying the links between lobbying spending and legislative change. The IMF study by Igan, Mishra and Tressel (2009) provides a significant contribution here. They study the relationship between lobbying by financial institutions and trends in mortgage lending in the period leading up to the 2008 crisis. Their analysis has two main strands. Firstly, Igan et al. (2009) examine whether mortgage lenders who engaged heavily in lobbying also had an ex ante association with risk-taking. The propensity for risk-taking is measured in terms of loan-to-income ratios, proportion of loans sold and mortgage loan growth rates (i.e., credit expansion). They find that lobbying is associated with each of these measures. In the second strand of the analysis the authors look at lobbying and the ex post performance of mortgage lenders. Here they study area-level delinquency rates and abnormal stock returns during four financial crisis events between 2007–08. In both cases they find associations between lobbying lenders and the given outcome variables.

Overall, the findings of Igan et al. (2009) are consistent with a moral hazard story, that is, lenders pursuing a strategy of rent-seeking lobbying combined with subsequent risky lending. This could be sup-

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ported either by mechanisms such as (i) the expectation of preferential treatment by lenders in case of a crisis (i.e., higher bailout probabilities); or a strategy of "short-termism". In the latter strategy lenders lobby to create weak regulatory environments that open up opportunities for short-term gains based on risky lending structures. While alternative explanations to the moral hazard approach can be advanced (for example, that lobbying lenders were also specialised in riskier areas of the market) additional evidence by Igan et al. (2009) suggests these alternatives are less plausible. In summary then, Igan et al. (2009) provides an in-depth empirical illustration of lobbying as a rent-seeking activity.

Other recent research in this area has focused on campaign contributions as a measure of special interest activity. The work by Mian, Sufi and Trebbi (2010) tracks how mortgage industry campaign contributions were associated with congressional voting behaviour on financial bills. This pattern of contributions occurred in tandem with the district-level distribution of sub-prime borrowers – the mortgage industry targeted those legislators whose constituent interests lined up with their own policy preferences. The paper by Maheshri (2010) takes a more general look at the legislative process, again using campaign contributions as a measure of special interests but also focusing on agenda setting. He argues that the obstruction of bills in Congressional committees is a major engine of legislative influence by special interests.

Professional careers and the "revolving door"

The movement of political staffers from roles in the government to lucrative jobs in the lobbying industry is often described as a "revolving door". This flow of money and staffers towards Washington's lobbying firms has led to concerns that corporations and other organisations are able to buy influence and acquire privileged access to serving politicians.

The existence of the revolving door raises several concerns. Firstly, career concerns in the lobbying industry can potentially affect the actions taken by serving government officials (Leaver 2009). Secondly, the prospect of post-government monetary windfalls can change the type of people that are attracted to public service (Casselli and Morelli 2004; Besley 2005; Keane and Merlo 2007; Matozzi and Merlo 2008; Kaiser 2009). Thirdly, the disparity of access and influence over elected representatives creates ethical issues and perpetuates the impression that political decision-making is controlled by a tightly knit elite, thus undermining popular support for democratic institutions.

The most common criticism of former staffers is that they are simply trading on their political connections. But lobbyists often dispute this notion. They claim instead that their earnings reflect expertise on policy issues and the inner workings of government in general. In other words, they argue, it is "what you know" not "who you know" that matters. Salisbury et al. (1989) use a survey to argue that policy and process knowledge are regarded by lobbyists as more important than personal connections.

Empirically, the issue of separating the "what you know" from the "who you know" is a challenge for researchers. A plausible argument can be made that former staffers would be high earners even if political connections did not matter. The specific problem here is separating the effects of ability and expertise on earnings from those of acquired political connections. Generally, earnings or revenue data only allow us to observe the effects of both factors together.

In a recent paper, Eggers (2010) provides some evidence that connections to the ruling political party are particularly valuable. In particular, he finds that the share of total lobbying revenue pocketed by lobbyists with political connections to the Democratic party is higher when the Democratic party controls Congress and the White House. For ex-staffers, this is particularly the case in non-ideological issue areas, whereas for ex-congressmen, the correlation between control of government and the partisan composition of lobbying occurs across all issue areas.

One alternative way to identify the effect of revolving door connections is to look at the impact of a serving politician's exit on the lobbying revenues of his or her former staffers. The point at which a politician leaves office provides a window for examining the specific role of political connections. If a politician is no longer serving in Congress, then the political connection held by their former staffers should be in effect obsolete.

This is because the politician in question no longer has direct influence over legislative outcomes or the content of congressional debates. In turn, this means that in cases where gaining access is a goal of special interest groups, lobbying spending will move away from lobbyists affiliated with exiting politicians and towards those with still current connections.

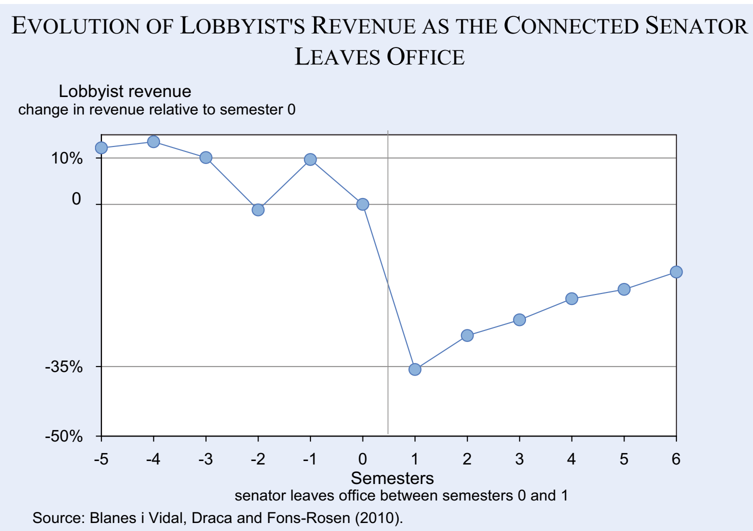
Blanes i Vidal, Draca and Fons-Rosen (2010) use this "identification strategy" to estimate the value of political connections. They find that lobbyists suffer an average revenue loss of over 20 percent when their former political employer leaves Congress. In dollar terms, this translates into USD 177,000 per year for the typical lobbyist's practice. Furthermore, this effect is persistent for at least three years – it seems that it is difficult for lobbyists to offset the impact of a lost political connection.

This impact is demonstrated in the Figure which shows the semester-by-semester change in lobbyist revenues for the periods before and after a senator leaves office. The Figure shows that there is a sharp drop in revenues in the period immediately after the senator's exit (more than 25 percent). Furthermore, there is only a limited "mean reversion" over the next five semesters.

A key concern of this approach is that their may be "shared trends" between politicians and their former staffers-turned-lobbyists. For example, low ability staffers could sort towards employment with low ability politicians whose political fortunes may be in decline. In turn, the revenue shock observed may be the result of an ongoing downward trend associated with a particular politician. However, the clear discontinuity observed at the point of exit rules out the presence of such trends.

Further results indicate that that proximity to power matters for lobbyists. Specifically, the size of the revenue effects increases with the importance of a politician. For instance, senators are more valuable than representatives and, even within the two chambers of Congress, more senior politicians – defined in terms of either tenure or committee status – are more valuable than their junior counterparts. Unsurprisingly, ex-staffers turned lobbyists are more likely to exit the lobbying industry when their previous employer has left Congress.

Figure



Conclusions and future research

In the US, new data released under public disclosure laws – in particular Lobbying Disclosure Act (LDA) of 1995 – has facilitated the development of empirical research on lobbying and special interest politics. Notably, non-partisan organisations like the Center for Responsive Politics (CRP), Sunlight Foundation and LegiStorm have done further important work improving access and promoting usage of the data. This data can potentially be used to provide a check on the use of power by government officials.

Researchers now have the possibility of combining datasets across a number of sources to search for statistical patterns such as those we find for politically connected lobbyists. As a result, this takes public scrutiny to a new level. We can try to find important information and behaviours "hidden" in the data. Hence, one major consequence of laws such as the 1995 Disclosure Act is that they make independent research and evaluation of political questions possible.

Though its focus is on Washington, the emerging research agenda on lobbying and special interests is relevant to policy-makers and regulators in other countries. However, this is impeded by a lack of data. For example, the type of research surveyed in this article would not be possible in the UK since the government simply does not demand the registration and reporting of lobbying activity at the same level as in the US. This has allowed lobbying in the UK to take place as a sort of shadow economy, as the recent "cab-for-hire" scandal – where Ministers were secretly recorded selling their service – showed. While their have been efforts to improve disclosure in the UK, Australia and Canada the relatively long history of disclosure in the US means it will remain the main focus of research.

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