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How Campaign Contributions and Lobbying Can Lead to Inefficient Economic Policy

By John Craig and David Madland May 2, 2014

The U.S. Supreme Court struck down two campaign finance provisions in the past few years that limited independent political expenditures by corporations and other organizations and placed aggregate limits on individual donations.[1] The Court found that the provisions infringe on the right of free speech and that the aggregate limits do not prevent a narrowly defined version of corruption.[2] Since then, federal courts have begun overturning state lobbying regulations under the logic used by the Supreme Court.[3] While there is considerable disagreement about whether the Court was correct in finding that those campaign finance rules failed to prevent corruption,[4] imposing limits on campaign financing and lobbying may be justified for another reason—promoting productive economic activity.[5]

The primary way that campaign contributions and lobbying may dampen economic growth is via a practice known as rent-seeking—the process of seeking income through special government favors rather than through productive economic activity. When firms and individuals engage in rent-seeking behavior, it has several negative effects on economic growth. Not only do people spend more time and money trying to get a bigger piece of the economic pie for themselves rather than trying to enlarge the pie, but the policies they seek are often wasteful, inefficient, or even harmful. If rent-seeking is a successful strategy for businesses or individuals, it can impose great harm on society by slowing or even stopping economic growth. As Nobel Prize-winning economist Joseph Stiglitz explains, rent-seeking not only wastes tax dollars on unnecessary or inefficient projects—redistributing money from one part of society to the rent-seekers—but it is a "centripetal force" that hollows out the economy because "the rewards of rent seeking become so outsize that more and more energy is directed toward it, at the expense of everything else."[6]

While it is impossible to quantify the economic harm done by rent-seeking to the American economy, this issue brief reviews the literature and finds that the harm is likely quite significant.

Certainly, not all money in politics is spent for the purpose of capturing private favors, but there is evidence that at least a significant percentage of it is. Most Americans do not make campaign contributions or lobby politicians.[7] Rather, the vast majority of money spent on these activities comes from wealthy citizens and business interest groups.[8] Moreover, studies find that businesses with the most to gain from favorable public policy engage in the most political activity.[9]

Even worse, research indicates that campaign contributions and lobbying often help shape policy outcomes, which suggests that rent-seeking efforts are often successful. While disagreement exists about how much influence campaign contributions and lobbying have,[10] money in politics seems to be most effective in shaping the outcomes of issues that are less visible and less ideological,[11] exactly the type of special favors one would expect rent-seeking to target. Furthermore, there have been several findings that show a clear relationship between specific instances of lobbying or campaign contributions and government favors. To take just a few examples:

- One study found that increasing lobbying reduces a corporation's effective tax rate, with an increase of 1 percent in lobbying expenditures expected to reduce a corporation's next-year tax rate between 0.5 percentage points and 1.6 percentage points.[12]

- Another study based on data from 48 different states found that a $1 corporate campaign contribution is worth $6.65 in lower state corporate taxes.[13]

- Finally, federal contracts were more likely to be awarded to firms that have given federal campaigns higher contributions, even after controlling for previous contract awards.[14]

These findings are deeply troubling for our democracy and our economy. And, unless actions are taken, the damage is likely to grow worse in the future. With recent court rulings knocking down important restrictions on money in politics, rent-seekers will have even greater opportunity to seek special favors, doing further harm to the economy.

Rent-seeking

Most economists agree that rent-seeking causes a net societal loss that harms the economy.[15] Rent-seeking involves spending resources to influence a division of profits, instead of creating a good or service that other businesses or individuals are willing to pay an amount that exceeds the cost of producing said good or service.[16] While rent-seeking exists in both private and public forms,[17] the scope of this paper is the discussion public rent-seeking and specifically two public rent-seeking activities—lobbying and campaign funding.

When engaging in rent-seeking from public institutions, businesses and individuals may seek favors from the government through both legal activities—lobbying and contributing to political campaigns—and illegal strategies—bribery and corruption.[18] What identifies rent-seeking behavior is that resources are spent in an attempt to influence policy in order to obtain a greater share of benefits. The benefits targeted by rent-seeking vary but include: profits from state-created monopolies, favorable government contracts, beneficial regulations, tariffs that dampen foreign competition, and tax preferences and subsidies.

The major economic concerns of rent-seeking can be categorized into three types of inefficiencies:

1. Resources are wasted engaging in rent-seeking.
2. Policies sought by rent-seeking result in an inefficient use of resources.
3. Rent-seeking policies may prove so destructive that they cause resources to sit idle.

The first inefficiency created by rent-seeking is that private resources are intentionally wasted on pursuing and competing for rents rather than producing economic gain. An important caveat of this waste is that it is irrelevant whether or not the rent-seeker achieves the sought-after policy goal. What triggers this waste is the fact that time, effort, and resources were diverted away from producing goods or rendering services that others are willing to pay for and instead used to influence policy for private gain.

The second economic concern of rent-seeking behavior is that the policy positions sought and protected create a misallocation of government or private resources. In the case of government resources, it may be that scarce government revenue is used to create a special interest tax subsidy instead of investing in research or infrastructure that would be more beneficial to society as a whole. Private resources may also be misallocated. Without proper regulations, for example, banks may overleverage themselves if they believe that the federal government will bail them out.

Finally, rent-seeking could prove so harmful to the economy that not only are resources not used in the most efficient manner possible, but they are actually idle. During a recession or its aftermath, for instance, workers are unemployed and significant capital remains on the sidelines. Indeed, some argue that the 2008 financial crisis—the effects of which we are still suffering from—was fueled by rent-seeking behavior.[19]

A paper on tariffs and monopolies by Gordon Tullock of George Mason University emphasized this idea—that both the ends and means of rent-seeking can waste resources—nearly 50 years ago.[20] Originally, only the increased cost on consumers was recognized as a domestic economic effect of tariffs and monopolies, as they allowed domestic firms to charge a higher price than they could with unrestrained competition.

This zero-sum transfer, however, looks worse when other factors are introduced.[21] First, the government must incur administrative costs to assure compliance. In the case of tariffs, customs agents need to be hired to administer the tariff and the U.S. Coast Guard must protect against smuggling. Furthermore, tariffs do not come about without significant pressure from U.S. businesses, and they must also account for the expenditures that they make to bring about policy change. In the end, a zero-sum transfer from consumers to businesses becomes a negative-sum transfer after both the government and U.S. business spend a considerable amount of resources advocating for and imposing the policy.

A modern example: Tesla Motors

One clear case of modern rent-seeking is car dealers' attempts to prevent Tesla, the maker of premium electric vehicles, from entering local markets. This has occurred through car dealers and their lobbyists seeking to enact or strengthen state laws that require cars to be sold through dealerships rather than directly from manufacturers.[22]

Car dealers claim that these regulations allow for easier comparison shopping and protect consumers in ways that a car manufacturer would not.[23] Car dealers in New Jersey partnered this argument with nearly $700,000 in campaign contributions to New Jersey lawmakers from 2003 to 2009,[24] with another $155,000 spent on lobbying in 2013 alone.[25] Unfortunately for Tesla, their business model does not currently include independent car dealers. Instead, Tesla sells cars directly to customers, cutting out an intermediary that the company believes will not sell their cars as effectively.[26]

Incumbent car dealers, through their lobbying efforts, are both protecting their place in the car market and raising the costs of a new competitor. For a new firm such as Tesla to enter a market, it would either have to go through an incumbent dealership that it does not trust to sell its cars—considering the profits dealerships make offering service of gas vehicles[27]—or it would have to support new franchises, which would involve a significant cost for Tesla.[28] Commentators have argued that the behavior of incumbent car dealers constitutes rent-seeking that hurts consumers and solidifies inefficiencies in the car market.[29]

A well-functioning economy counts on new firms to enter a market and, through innovation, either offer a better product or a lower price, forcing older firms to compete to match them on one of those fronts. No matter who wins the competition, consumers come away with a better outcome than they had prior to the new entrant. By engaging in rent-seeking and raising costs for potential rivals, however, firms are able to capture a larger share of the market—not by offering a better or cheaper product, but by preventing the entrant from doing so.

The best case scenario for incumbent firms, such as the car dealers lobbying for dealership requirements, would be to raise potential rivals' costs enough that they forego the market entirely, opting instead to focus on another geographic area. With fewer competing firms, car dealers are able to protect a larger share of their profit—not through innovation, but by denying consumers a better alternative, which hurts the economy.

Campaign finance, lobbying, and influence

Given the negative effect that rent-seeking can have on economic growth, examining the relationship between some of the primary vehicles of rent-seeking—campaign contributions and lobbying—and legislative outcomes offers a glimpse into the success of rent-seeking business strategies.

The mere presence of money spent seeking rents—rather than trying to productively increase profits—has a significant economic cost in its own right. The total cost of federal campaigns in 2012 totaled $6.3 billion.[30] This huge sum was raised from a very small percentage of U.S. residents, with 0.12 percent of the population giving $200 or more to candidates, political parties, or political action committees and 0.02 percent giving $2,600 or more.[31] Unsurprisingly, most of these contributions come from Americans who can most afford them.[32] The total spent on federal lobbying in 2013 stood at slightly more than $3.2 billion,[33] with large businesses and business associations comprising the largest lobbying spenders.[34] And these figures underestimate the total amount of money in politics, as some types of spending are not required to be disclosed[35] and a considerable amount is spent on campaigns and lobbying at the state and local levels.[36]

While not all money in politics constitutes rent-seeking, lobbying by business groups and trade associations dominates the field and gives rise to the suspicion surrounding rent-seeking. According to Kay Lehman Schlozman, professor of political science at Boston College, Sidney Verba, professor emeritus and research professor of government at Harvard University, and Henry E. Brady, dean of the Goldman School of Public Policy at the University of California, Berkeley, business-related lobbying makes up 72 percent of lobbying expenditures, while public interest groups make up only 16 percent.[37]

Furthermore, several studies indicate that the businesses that are most likely to make contributions or lobby are also those with the highest payoffs from favorable policy decisions,[38] providing credence for the position that business political activity is to a significant degree about rent-seeking. Businesses in regulated industries, for example, are the most likely to make campaign contributions,[39] while firms that lobby are more affected by policy outcomes[40] or more profitable[41] than their less political counterparts. On top of the concern that businesses may exert an outsized influence on policymakers, the dominance of business groups in lobbying highlights the risk of the emergence of what Marvin Ammori, a fellow at the New America Foundation, calls a "corruption economy," in which firms compete over political influence rather than product innovation.[42]

There is not only evidence that lobbying and campaign contributions are part of an effort to seek rents but also that policy changes in response to money in politics. Political scientists are divided about exactly how much influence campaign contributions and lobbying have. Some find fairly direct consequences while others do not, but most understand that these expenditures have some degree of influence.[43] Research shows that campaign contributions and lobbying can each have an independent effect on policy but are particularly effective when used in combination. Contributions often help open the doors that can make lobbying so successful.[44]

That rent-seeking is successful is a particularly serious economic concern because it both indicates that government and private resources being inefficiently used and raises the specter that a viscous cycle could take hold—one where successful rent-seeking provides additional incentives to engage in further rent-seeking.

Campaign contributions lead to policy outcomes

Several researchers have found that campaign contributions can directly affect policy outcomes. In addition to the previously mentioned finding that campaign donations play a role in winning government contracts and lowering tax rates,[45] scholars have found that campaign contributions influenced votes on trade policy[46] and banking regulations[47] and that contributions from the banking sector were associated with a greater likelihood to vote for the Emergency Economic Stabilization Act of 2008, which bailed out the largest U.S. banks.[48]

Recent and particularly relevant research by Timothy Werner—assistant professor of business, government, and society at the University of Texas—and John J. Coleman—the chair of the department of political science at the University of Wisconsin—found that when stronger campaign finance laws are enacted on the state level, new pro-management, anti-takeover laws are less likely to be enacted.[49] Anti-takeover laws are management-friendly rules that make it harder for shareholders to change the management of a corporation. Not surprisingly, existing managers should have close to a consensus view on anti-takeover laws, since such laws keep their jobs safe. The fact that allowing more money into state elections is connected with a near-universal management preference is consistent with the idea that businesses will take advantage of weak campaign finance rules and use corporate resources to pursue policy objectives that provide narrow benefits to them but not to the economy.

The research by Werner and Coleman also helps illustrate the kind of policy outcomes that campaign contributions are most likely to influence. The authors noted that in contrast to obscure policies such as anti-takeover rules, legislators' voting behavior is unlikely to be swayed by campaign contributions for highly salient and widely understood issues.[50] Earlier studies support the position that campaign contributions are less likely to change voting patterns for visible and ideological issues.[51] But this finding does relatively little to assuage concerns about rent-seeking. The special interest tax breaks and agency regulations that are the targets of rent-seeking behavior are not always of the visible and ideological variety.

In addition to being less likely to affect publicly salient issues, Werner and Coleman find that campaign finance laws do not exert much direct influence on the partisan outcomes of elections.[52] Similarly, other researchers have noted the difficulty of determining whether money causes electoral victories or the likelihood of winning induces campaign contributions by donors who want to support the winner.[53] Still, contributions have a significant effect on elections—particularly in shaping who will run in the first place. "The most powerful effect of money on elections is on the selection and competitiveness of challengers," according to the report for the Task Force on Inequality and American Democracy of the American Political Science Association.[54] The fact that contributions have a greater effect on the types of candidates who run for office than on the partisan outcome of the election is consistent with the idea that donations are most useful on issues that are less noticed by the average voter.

Despite significant evidence indicating the influence of campaign contributions, the literature on the topic does not unanimously hold the idea that campaign contributions are made to buy policy outcomes. Stephen Ansolabehere, professor of government at Harvard University, John M. de Figueiredo, professor of law at the Duke Law School, and James M. Snyder Jr., professor of government at Harvard University, argue that under a competitive market for government favors, more money should be expected considering the size of government budgets and the supposed return on political investment.[55] The authors similarly review the lack of strong evidence in the literature that campaign contributions affect roll-call votes.[56] Since relatively little money is spent on candidates compared to the size of government budgets and campaign contributions do not frequently change roll-call votes, they argue that political campaign contributions are better understood as consumption spending by wealthy individuals, often through businesses they control, rather than an attempt to buy favors.[57]

There are several critiques of this view—including some made by the authors themselves—that explain how donations to candidates lead to policy favors even if a competitive market for those favors has not emerged. First, the authors focus their analysis on roll-call votes, which are often highly visible public affairs in which contributions are thought to have less impact, rather than on less visible acts such as committee votes, letter writing, or the amount of effort or time put into pursuing a legislative outcome.[58]

Second, campaign contributions can skew policy proposals toward the preferences of the affluent. Rather than buying a legislative outcome, contributions work as a weighting mechanism that gives donors' preferences greater importance.[59] Evidence for this view has been found in subsequent research, showing that the policy preferences of wealthy individuals and business-oriented interest groups exert a large influence over U.S. public policy.[60]

Finally, contributions are especially helpful in buying access.[61] Rather than paying for a certain outcome, contributors are paying for the right to get their policy arguments heard.[62] As the American Political Science Association's task force put it: "Money does 'buy' something—privileged access for contributors and the special attention of members who reward them with vigorous help in minding their business in the committee process."[63] Access means that lobbyists can visit politicians to explain their preferences for governmental policy, indicating that campaign contributions help make lobbying efforts more successful. And researchers have found that donating to political campaigns can grant access to legislators that would not otherwise be given.[64] Furthermore, if contributions can buy access to lobby, then lobbying victories would necessarily increase the incentive to engage in campaign funding.

Lobbying leads to policy outcomes

While not always successful, lobbying efforts have been found to affect legislative outcomes, especially in cases of preventing policy change.[65] A recent study of Wisconsin lawmakers found that lobbying has a significant effect on legislative outcomes, according to Daniel C. Lewis, an assistant professor of political science at Siena College.[66] Wisconsin provides an excellent example for studying the effect of lobbying because state regulations there require lobbyists and interest groups to disclose which bill they are seeking to influence and their position on the bill.[67] By tracking the level of lobbying that occurs for and against a given bill and comparing it to the eventual outcome, the study found that lobbying efforts significantly affected legislative outcomes.

One reason that lobbying cannot succeed in all instances is that lobbyists often are working against one another. In those cases, the advantage goes to the lobbyist who is defending the status quo position, and stopping policy change from occurring is one area in which lobbying has proven especially effective.[68] Maintaining the status quo is substantially advantaged, according to Amy McKay, a professor of political science at Georgia State University.[69] According to McKay's research, roughly 3.5 lobbyists must advocate for changing a policy to overcome one lobbyist advocating against a policy change. In other words, a lobbyist seeking to maintain the status quo is more than three times as influential as one seeking change. One explanation for the difficulty of enacting change comes from Stiglitz, who has noted that uncertainty and complexity play a large role in preventing policy changes that are good for all involved.[70]

One view of lobbying that is more generous than moneyed interests trying to persuade legislators to change their vote is the idea that lobbyists provide a legislative subsidy for their allies.[71] Under this view, lobbyists target legislators who already support their preference and provide them with the expertise and arguments they need to carry their causes through committees and convince fellow legislators of the preferred policy position's benefits. Whether convincing legislators directly or through their colleagues, however, the money spent on advancing policy preferences is still rent-seeking if the goal is special-interest favors.

With billions spent on lobbying the federal government in 2013,[72] it is unlikely that businesses and other organizations are spending this amount of money without realizing some benefit. Indeed, one commentator has noted that if lobbying was not profitable, it is likely that more shareholder lawsuits would have emerged attacking the practice.[73] Instead, lobbying is conducted by firms looking to affect government policy and can be quite successful.[74] Similar to other political activities,[75] firms that have a greater stake in policy outcomes most commonly engage in lobbying.[76] The effectiveness of lobbying shows up through the channels described above. It is associated with moving bills through committees,[77] stopping policies from passing,[78] and achieving ultimate legislative outcomes.[79]

Conclusion

Economic growth depends upon an efficient use of resources. As this brief has outlined, however, rent-seeking is inherently inefficient because it diverts resources from potentially more-productive activities and thus imposes significant economic costs.

Sadly, the evidence suggests that there is significant rent-seeking in the U.S. economy. Not only are large sums of money spent on campaign contributions and lobbying, the research indicates that these efforts can and do shape policy outcomes. To be sure, not all effort to influence policy is clearly rent-seeking and harmful to the economy, but at least some of the policy changes brought about by money in politics have been wasteful, inefficient, or directly harmful. Additional research is needed to help clarify the scope of the harm that rent-seeking does to the U.S. economy. But as this brief's review of the literature suggests, the harm is likely quite significant.

Even worse, the economic costs of rent-seeking are likely to grow in the future. With the barriers that limit money in politics falling in the courts, it should be expected that even more money will be directed toward rent-seeking activities in the future.

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Endnotes

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