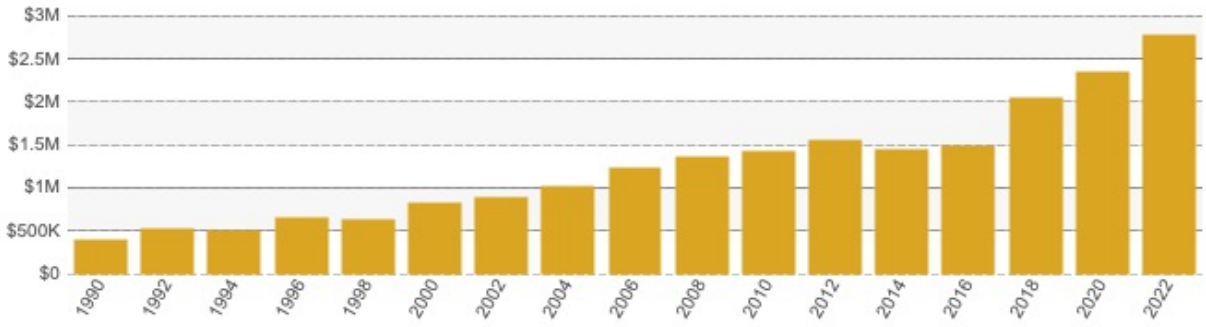
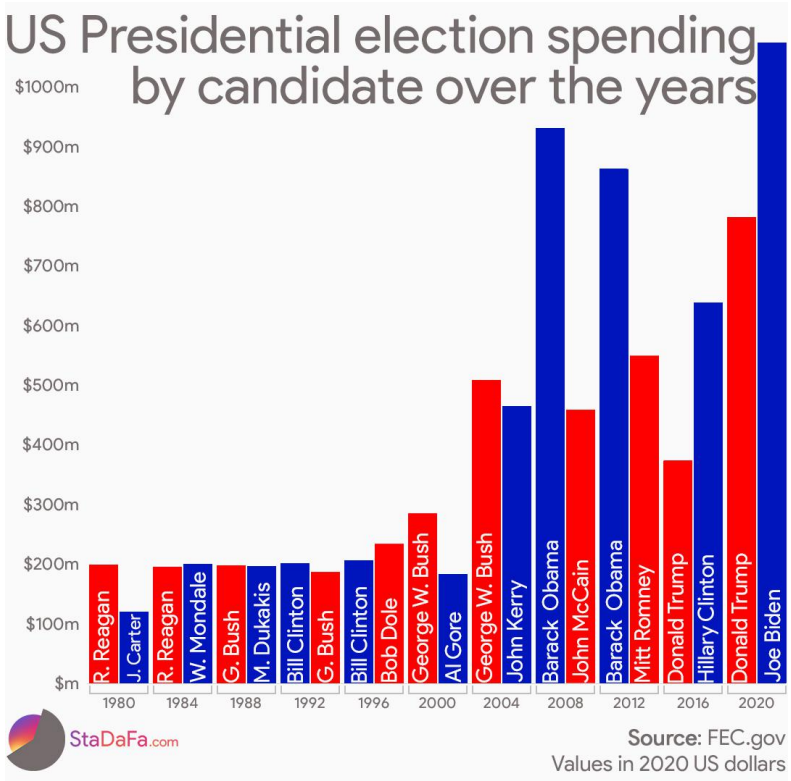
Interest Groups

- Organizing for collective action
- Rent Seeking and Lobbying
- **Campaign finance**

Campaign expenditures in US elections

Average spent by winning house candidates





Let's put this in perspective.
Guess: How much did Coca Cola spend on advertising in the United States in 2022?

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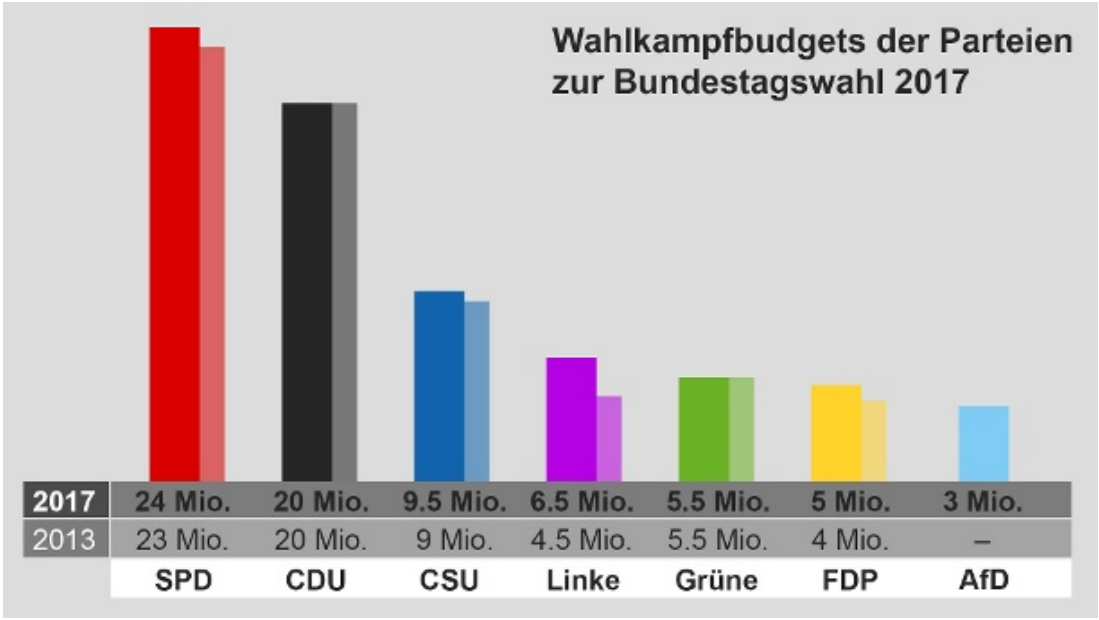
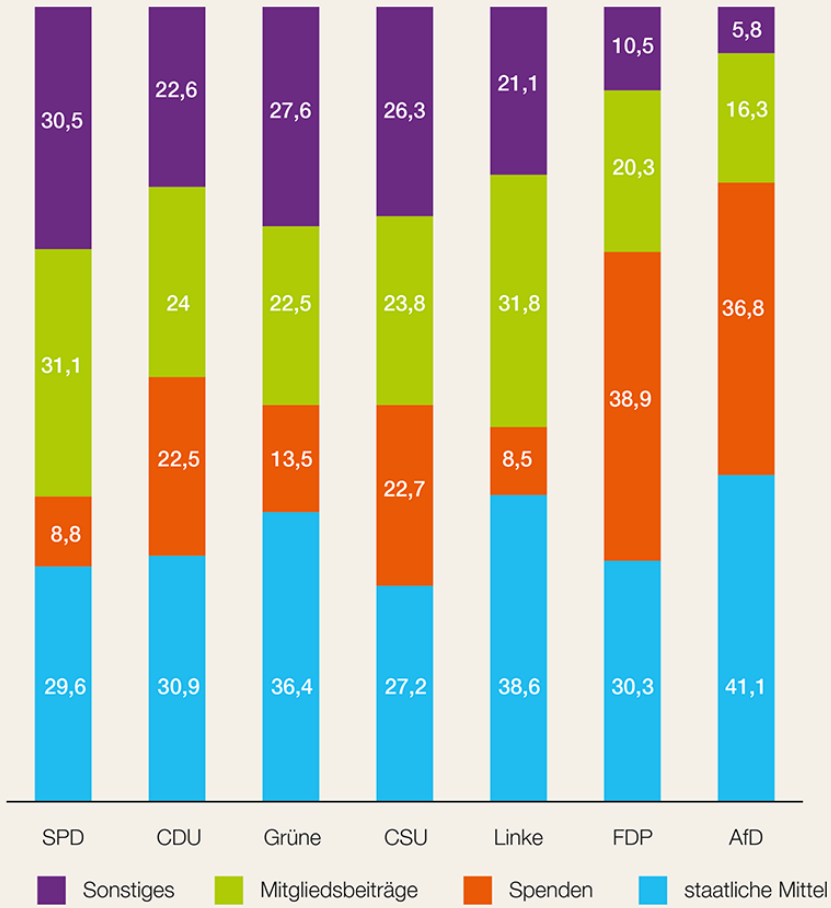
Answer: 645.4 million USD



Compare:

- Population US / Germany ≈ 3.75;
- Very roughly, 1 USD $\approx$ 1 EUR
- Total spending in Germany X 3.75 $\approx \$275$ mio.

Einnahmequellen der Parteien im Jahr 2017 (in %)



Quelle: Deutscher Bundestag; eigene Darstellung

Introduction

- Electoral campaigns involve large expenditures by parties, candidates, and interest groups.
- In the US,
  - most money comes from private donations
  - some public funding (matching private donations, tied to spending limits)
  - some self-financing (e.g. Trump spent $\$66$ Mio of his own money)
- In Germany,
  - Main sources are membership contributions and public funding.
  - Candidates themselves make significant contributions.
  - Importance of private donations has grown.

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  - *unequal influence* and
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  - Expenditure limits
  - Reporting requirements
  - Public funding of political campaigns

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- Regulations of campaign giving and spending:
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  - Reporting requirements
  - Public funding of political campaigns
- Constitutional concerns:
  - Restrictions on private contributions and spending may violate **free speech**.
  - Public funding may violate **independence of parties and state**.

Supreme Court (Buckley v. Valeo 1976)
“A restriction on the amount of money a person or group can spend on political communication during a campaign necessarily reduces the quantity of expression by restricting the number of issues discussed, the depth of their exploration, and the size of the audience reached. (...) The electorate’s increasing dependence on television, radio, and other mass media for news and information has made these expensive modes of communication indispensable instruments of effective political speech.” [424 US 1, 19]

Research questions:

- (How) does campaign spending affect electoral outcomes?
- (How) do campaign contributions affect the behavior of politicians and parties?
- What are the costs and benefits of private and public funding?

Effects of campaign spending

- Spending is highly predictive of electoral success (positive *correlation* between spending and winning).
- Empirical studies document positive impact of campaign spending on voters' knowledge
  (candidate name recognition, ability to place candidates on ideological scale, etc.)
- Causality is unclear: Maybe popular and well known candidates simply raise and spend more money?
- Direct evidence that campaigns affect individual voters' *choices* is mixed (Kalla and Broockman 2017, Sides et al 2021).

Empirical evidence from US Congressional elections

- Typically find large effects of challenger spending on vote shares, but basically no effect of incumbent spending (see Mueller Table 20.2a)
- Levitt (1994) points out simultaneity bias
  - Strong challengers will tend to raise and spend more.
  - Incumbents will spend more when faced with strong challengers.
  - Not controlling for challenger strength leads econometrician to overestimate effectiveness of challenger spending and underestimate effectiveness of incumbent spending.
- Levitt uses repeat challengers to eliminate bias and finds very small effects of campaign spending
- Effectiveness of spending differs depending on candidate quality, sources, and sizes of contributions (Dharmapala and Palda 2002, Vanberg 2008, Prat et al 2011)

Possible channels for a causal effect

- Directly informative advertising (messages containing verifiable facts)
  - about policy positions
  - about candidate characteristics (honesty, 'valence')
- Indirectly (implicitly) informative spending ('burning money').
  - ability to raise and spend money is a signal
  - voters (rationally) conclude that candidate is high quality
- Non-informational effects (emotional appeals, persuasion)

Motivation of donors

- Position induced contributions
  - Candidates independently select policy positions
  - Donors support candidates whose positions they prefer
  - Contributions influence only the outcome of the election
- Service induced contributions:
  - Donors support candidates in exchange for (promises to take) policy positions.
  - Contributions affect both policies and the electoral outcome.

Empirical evidence form US Congress

- Donors favor candidates...
  - they expect will win (Welch 1980)
  - who share their ideology (Poole and Romer 1985)
  - with agenda setting power (Fouirnaies 2018)
- Evidence of the impact on legislator behavior is mixed
  - Many studies conclude that donations do not influence legislator behavior (e.g. Chappell 1982, Ansolabehere et al 2002)
  - Others find evidence for a quid pro quo (Stratmann 1992, Fellowes and Wolf 2004)
  - Some studies find that contributions buy "access" (Kalla and Brookman 2016)

Benefits of public funding

- Reduces concerns about corruption and unequal influence.
- Reduces time & effort spent on collecting contributions.

Costs of public funding

- May reduce the informational value of campaign spending (if indirectly / implicitly informative)
- Must be paid for through taxes.
- May allow incumbent politicians to limit political competition.

Informational models of campaign finance

Ashworth (2006) - Directly informative advertising

Agents

- 2 candidates (Mr.1 - incumbent, Mr. 2 - challenger)
- one voter
- one donor

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Candidates

- Candidate 'quality' θ_i
  - Incumbent is known: $\theta_1 = 1$
  - Challenger is uncertain: θ_2 is equally likely to be 0 or 2
- Candidates obtain utility from being elected

$$u_i = 1 \cdot (\text{elected})$$

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Voter

- Voter's utility depends on money and the quality of the candidate elected:

$$u_v = m + \theta$$

Ashworth (2006) - Directly informative advertising

Communication

- At start of game, candidates learn θ_2, voter does not
- At cost $c \in (0, 1)$, candidate 2 can reveal θ_2 (*truthful* advertising)
- Candidate 1 cannot advertise (i.e. no negative advertisements)

Campaign finance

- Candidate 2 has no funds of her own
- Government may donate c (perhaps under certain conditions)
- Donor may donate c (perhaps out of different motives)

Ashworth (2006) - Public funding

Benchmark scenarios (polar cases)

(1) No campaign

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- Candidate uses funds to reveal $\theta_2 = 2$.
- Voter elects Mr. 2 if there is an advertisement, otherwise Mr. 1.
- Her ex ante expected utility is

$$\frac{1}{2} + \frac{1}{2}(2 - c) = \frac{1}{2}(3 - c) > 1$$

- Each candidate still wins with probability $\frac{1}{2}$

Ashworth (2006) - Private funding

Public funding is better than no funding

- "Optimal public funding" Pareto dominates "no campaign"
- However, voter must trust the agency to fund qualified candidates
- This arrangement is vulnerable to collusion between the incumbent and the agency.
- Can *private financing* improve upon the "no campaign" benchmark?

Modeling private funding

- Effects will depend on assumptions about donor motivation:

  Position induced contributions: Donors support candidates whose policy preferences they share.

  Service induced contributions: Donors support candidates *in exchange* for services (favors, changes in policy position)

Ashworth (2006) - Position induced contributions

CASE 1: Position induced contributions

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- Donor receives $b > 0$ if candidate 2 wins. (No matter what θ_2 is.)
- The idea is that the donor simply prefers candidate 2.
- His payoff after donating k:
  - $b - k$ if Mr. 2 wins
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Timing:

1. Candidates and donor learn θ_2
2. Donor chooses contribution $k \geq 0$
3. If $k \geq c$, candidate chooses whether to advertise (truthfully revealing θ_2)
4. Voter observes advertisements, selects the winner.

Ashworth (2006) - Position induced contributions

Proposition: If $b > c$, then there is an Equilibrium in which

- the donor contributes c if and only if $\theta_2 = 2$ and
- the voter chooses Mr.2 if and only if she sees an advertisement revealing that $\theta_2 = 2$.

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Note:

- Voter's expected utility is $\frac{3}{2}$, so he is better off than under *both* benchmark solutions. (Why?)
- Banning contributions reduces the voter's expected utility.
- Public funding reduces the voter's utility.

Ashworth (2006) - Position induced contributions

Suppose $b < c$ (campaigns are expensive)

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  - Outcome is the same as in "no campaign" benchmark.

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- If donor gives γ to Mr.2, regulator ‘matches’ with $c - \gamma$
- The matching payment is paid for by a tax on the voter

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Outcome:

- Donor will contribute γ iff $\theta_2 = 2$ and
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Welfare: Relative to the case where contributions are banned,

- Voter’s payoff changes form 1 to $1/2(3 - c + \gamma)$.
  $\rightarrow$ better off if $c - \gamma < 1$.
- Donor’s payoff decreases from $b/2$ to $(b - \gamma)/2$.
- Candidates are indifferent ex ante

Ashworth (2006) - Service induced contributions

CASE 2: Service induced contributions

- Donor does not care about who wins.
- Candidates can credibly promise favors (transfers) in case they win.
- A transfer of t is financed by a tax of $(1 + \lambda)t$, where λ represents deadweight loss of the transfer.

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Timing:

1. Candidates and donor learn θ_2
2. Candidate 2 makes a take-it-or-leave-it offer t to the donor.
3. Donor accepts (and pays c) or rejects
4. If donor accepts, the candidate decides whether or not to advertise θ_2
5. The voter sees any advertisement purchased and selects the winner.

Ashworth (2006) - Service induced contributions

Proposition: If $(1+\lambda)c < 1$, there is an equilibrium in which the donor contributes if and only if $\theta_2 = 2$, and the voter selects candidate 2 if and only if she sees and ad certifying that $\theta_2 = 2$.

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Proof:

- Candidate 2 wants to advertise if and only if $\theta_2 = 2$. Thus, he will offer a transfer to the donor only in this case.
- If the transfer offered in equilibrium is t, the voter will select candidate 2 after learning that $\theta_2 = 2$ only if
$$2 - (1+\lambda)t > 1$$
- Assuming that this is satisfied, the donor will accept the offer only if $t \geq c$.
- It follows that an equilibrium with advertising exists if
$$(1+\lambda)c \leq 1$$
- This says that the cost of the favors necessary to elicit campaign contributions cannot exceed the value of the information revealed to voters.

Ashworth (2006) - Service induced contributions

Note: There are many equilibria of this type. The candidate could promise any transfer $t \in (c, \frac{1}{1+\lambda})$.

Best case: $t = c$, tax is $(1 + \lambda)c$

- Voter's expected payoff:

$$\begin{aligned} EU &= \frac{1}{2} \cdot 1 + \frac{1}{2} \cdot (2 - (1 + \lambda)c) \\ &= \frac{1}{2}(3 - (1 + \lambda)c) \end{aligned}$$

- This is worse than "optimal public funding"

Q: Can a contribution ban increase the voter's expected utility?

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Q: Can a contribution ban increase the voter's expected utility?
A: No, as this equilibrium can arise only if $(1 + \lambda)c < 1$.

Ashworth (2006) - Directly informative advertising

Conclusions

Under the maintained assumptions,

- Public funding is vulnerable to collusion.
- Banning private contributions is never beneficial, even when favors are promised.
- Private contributions with public matching is likely to be best.

Coate (2004) - Pareto improving campaign finance policy

Directly informative advertising

- Voters are uncertain about candidate quality (desirable characteristics).
- Advertisements *truthfully* reveal quality.
- The more money a candidate spends, the more voters see her ad.
  - Spend $x \rightarrow$ fraction $\lambda(x) = \frac{x}{x+\alpha}$ see the ad.
  - Different from Ashworth (2006), where communication is binary (ad / no ad)
- Candidates offer favors in return for contributions.

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Main conclusion:

- Banning contributions can lead to a Pareto improvement
  - despite the fact that advertising is truthful

Coate (2004) - Pareto improving campaign finance policy

Intuition

- Campaign messages paid by private donations reveal two things:
  (a) Candidate is of 'high quality'
  (b) Candidate has promised favors to those paying for the message
- As long as (a) outweighs (b) in the eyes of voters, candidates want to collect and spend *more* money, implying more favors.
- In equilibrium, (a) and (b) must exactly balance out.
- Then, voters are 'rationally cynical' and advertising becomes entirely ineffective.
  - This is inefficient, because candidates are selling favors.
- Publicly funded advertisements will be more effective (in revealing *directly informative* messages).

Prat (2002) - Indirectly informative advertising

Agents

- Candidates
  - office motivated
  - policy stance (chosen)
  - qualities (fixed)
- Population of voters
  - Heterogeneous ideal policy points
  - Homogenous preferences over candidate ‘quality’
- Several interest groups
  - Utility depends on winner’s policy and own contributions

Prat (2002) - Indirectly informative advertising

Information

- Interest groups are better informed than voters.
- They receive an *'insider signal'* on candidate quality before campaign starts.
- Voters (and interest groups) receive an additional *public signal* of candidate quality during the campaign.

Campaign contributions and policy deals

- Candidates can credibly *commit* to any position.
- Lobbies offer contributions in exchange for policy positions.

Campaign spending

- Candidates seek to impress voters by 'burning money' through campaign ads.
- No credible information is transmitted

Prat (2002) - Indirectly informative advertising

Timing

1. Lobbies receive quality signals
2. Offer contributions in exchange for specific policy stance
3. Candidates choose policy stance and collect contributions
4. Voters receive public signal on quality, observe policy stances, and see television advertisements
5. Vote for preferred candidate (no abstention). Winner implements announced policy.

Prat (2002) - Indirectly informative advertising

Equilibrium conditions

- Interest groups make optimal offers given their signals and how they expect candidates and voters to behave.
- Candidates choose policy to maximize chance of winning given offers and how they expect voters to behave.
- Voters form rational beliefs about candidate quality and vote for their preferred candidate given these beliefs.

Main result

- There exists an equilibrium in which the interest groups' insider signals are fully revealed through the amount of campaign advertising candidates engage in.
- However, policy distortions due to fundraising may be large enough to offset the value of the information revealed.

Prat (2002) - Indirectly informative advertising

Logic

- Campaign contributions as investment with uncertain return
  - Move policy stance towards interest group ideal
  - Pays off only if the candidate is actually elected
  - Willing to pay more for a given policy if expect the candidate to win.
  - Good insider signal makes winning more likely (because public signal more likely to be good as well)
  - Thus: contribute more when insider signal is good.
- Television advertisements as signals of spending power
  - Voters who see lots of advertisements rationally conclude that (many) interest groups have received a 'good' insider signal.
  - Ceteris paribus, more likely to vote for candidate who advertises a lot, making that candidate more likely to win.
- Tradeoff from candidate's perspective
  - Contributions help reveal good insider signals (good for votes)
  - But require moving policy towards interest group ideal (bad for votes)
  - Tradeoff (this is taken into account by lobbies making offers)

Testable predictions

- Importance of campaign contributions is higher the larger the information asymmetry between interest groups and voters.
  - Contributions should be lower in countries with high levels of education and citizen involvement in politics.
  - Prat provides anecdotal evidence only.
- Campaign spending should be less effective if candidates are self financed (and voters know this).
  - Palda and Palda (1998) find evidence for France.

Policy implications

- The median voter may prefer a ban on contributions.
  - Cost of policy distortion may exceed benefit of information regarding candidate quality.
  - Intuition: Politician may distort policy enough to completely outweigh the value of ‘valence’ revealed.
  - Voter would prefer ‘not to listen,’ but cannot commit to ignoring advertisements if it is permitted.
- May want to prohibit split contributions (contributing to both candidates has no informational value but distorts policy)
- Public funding of campaigns may be ‘useless at best’ (No information value, may ‘garble’ the private signal.)

Vanberg (2008) - One Man, One Dollar?

Campaign contribution limits to equalize donor influence?

- Common argument for contribution limits
  - Campaign war chests (and expenditures) fail to reflect 'public support'
  - This is because a small number of large contributions can outweigh a large number of small contributions.
  - Limiting the size of individual contributions will cause aggregate campaign funds to reflect the size of a candidate's support base
- In our terminology: limiting contributions may improve the signaling value of campaign expenditures
- Assumptions underlying this 'equalization argument'
  - Advertising only implicitly informative
  - Number of (small) donors reflects 'true' public support
- Empirical implication: If this is true, reliance on large contributions should negatively affect electoral success (*ceteris paribus*).
- Evidence: The *opposite* is true (US Congressional races, 1990s)
- Indicates that 'good' candidates strongly rely on large contributors.

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