

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF COLUMBIA

CONGRESSMAN RON PAUL, et al.,	)	CIVIL ACTION NO. 02-CV-781
Plaintiffs,	)	(CKK, KLH, RJL)
	)	
v.	)	Consolidated with
	)	CIVIL ACTION NOS.
FEDERAL ELECTION COMMISSION, et al.,	)	02-CV-582 (CKK, KLH, RJL) (Lead)
Defendants	)	02-CV-581 (CKK, KLH, RJL)
	)	02-CV-633 (CKK, KLH, RJL)
	)	02-CV-751 (CKK, KLH, RJL)
	)	02-CV-753 (CKK, KLH, RJL)
	)	02-CV-754 (CKK, KLH, RJL)
	)	02-CV-874 (CKK, KLH, RJL)
	)	02-CV-875 (CKK, KLH, RJL)
	)	02-CV-877 (CKK, KLH, RJL)
	)	02-CV-881 (CKK, KLH, RJL)

**REPORT OF JAMES C. MILLER, III**

Introduction

My name is James C. Miller III, and I am Chairman of CapAnalysis, an economic, financial, and regulatory consulting firm associated with the law firm Howrey Simon Arnold & White, with offices in Washington, DC, California (various locations), Houston, Chicago, London, and Brussels. I hold a Ph.D. in Economics from the University of Virginia (1969), a B.B.A. in Economics from the University of Georgia (1964), and am the author or co-author of over 100 articles in professional journals and nine books, the most recent of which is *Monopoly Politics*, published in 1999 by the Hoover Institution Press at Stanford University. (A copy of this book appears as Attachment A.) Before joining CapAnalysis, I held various academic and research posts and served in government, most recently as Director of the U.S. Office of Management and Budget and Member of President Reagan's Cabinet (1985-1988). Before that, I served as Chairman of the U.S. Federal Trade Commission (1981-1985), an agency which has a responsibility to enhance competition -- a matter of particular relevance here. In 1994

and again in 1996, I ran (unsuccessfully) for the U.S. Senate from Virginia. In 1998, I served as Treasurer of my wife's (Demaris H. Miller's) unsuccessful campaign for the U.S. House of Representatives to represent the 8<sup>th</sup> District of Virginia, and then again in 2000, I was involved in my wife's (unsuccessful) campaign for that same office.

A copy of my curriculum vitae appears as Attachment B. In the past four years, I have testified (in court) in only one case as an expert witness: *Maritrans v. United States*, #96-483C, U.S. Court of Federal Claims.

### Summary of Analysis and Conclusions

In this report, I address, first, the applicability of economic principles to the political marketplace. As I outline in *Monopoly Politics*, campaigns are a manifestation of the market for political representation. Just as in commercial markets, where sellers compete for consumers, in political markets, candidates compete for voters. The propensity of commercial enterprises to limit the ability of new entrants has its counterpart in political markets, where incumbents have a propensity to limit the ability of challengers to mount successful campaigns.

Second, I describe the benefits of incumbency – and the obverse, the obstacles faced by challengers. I describe not only the *natural* advantages such as having invested in advertising and other messages to become well known, but also, and more importantly, the *contrived* advantages of incumbency (and the obstacles imposed on challengers). These include the taxpayer-financed advantages of subsidized communications for incumbents (TV and radio studios, franked mail, *et cetera*) and the ways the office is abused to increase the chances of reelection, but, more importantly, the ways campaign rules are “rigged” to benefit incumbents and penalize challengers.

Third, I describe in more detail the steps a candidate has to undertake just to run for Federal office. I show that complying with current Federal election laws and the

rules promulgated by the Federal Election Commission (FEC) impose a differentially heavy burden on challengers. I also show that the new Bipartisan Campaign Reform Act (BCRA) of 2002 further increases the advantage enjoyed by incumbents and heightens the discrimination faced by challengers. Finally, I show that the requirements are so burdensome that, in effect, they amount to a candidate's having to secure a "license" from the government in order to compete for political representation. Such requirements not only increase costs, especially for challengers, but limit candidates' and their supporters' freedom to control how they run their own campaigns.

Fourth, I describe how political markets would perform without the anti-competitive constraints presently incorporated in Federal campaign laws and regulations. I conclude that with their removal the market for political representation would be much more competitive and that voters would be better served, just as consumers are better served by competition in commercial markets.

### I. Campaigns and the Market for Political Representation

Although most Americans spend little time considering the government's impact on their daily lives, the importance of decisions made in political markets rivals that of decisions made in the commercial sector. A quick look at the size of the Federal and state governments clearly indicates the magnitude of political decision-making. For fiscal year 2001, Federal expenditures topped \$1,936 billion, while the 50 states spent nearly \$1,293 billion. Combined, these two levels of government accounted for 32 percent of the nation's GDP (\$10,082 billion).

Just how governments go about deciding what to spend and how to finance those expenditures has been the subject of intensive study.<sup>1</sup> One key outcome of the

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<sup>1</sup> Much of this research comes out of the sub-discipline of economics and political science known as "public choice." For his contributions to the development of public choice, James M. Buchanan of George Mason University received the Nobel Prize for Economic Science in 1986.

research is a recognition that elected officials respond to incentives just as producers and sellers in commercial markets. Elected officials compete for voters in elections, just as producers and sellers compete for consumers in the commercial marketplace. Accordingly, the type of analysis economists have applied routinely to assess the efficiency and effectiveness of commercial markets can also be used to assess efficiency and effectiveness of political markets. That this is possible becomes clearer when we recognize that in most relevant ways commercial and political markets are very much alike.

In commercial markets, providers compete for consumers' dollars. In political markets, candidates compete for citizens' votes. In commercial markets, the ability of providers to step up to the plate, make offerings to the public, and *communicate* what they have to offer is of vital importance in assuring consumers of the most value for their money. In broad terms, markets are said to be efficient (and effective in serving consumers' wants) when competition is vigorous and sellers have ample opportunities to communicate their offerings.

In a similar manner, political candidates compete for the attention of citizens, soliciting their votes at the ballot box. Just as with commercial markets, political markets are efficient (and effective in responding to citizens' preferences) when candidates are able to step up to the plate, make offerings to the public, and *communicate* what they have to offer to prospective voters.<sup>2</sup>

There are differences between commercial markets and political markets, but they are not particularly material for the analysis at hand. In the latter, the voters choose a single person to represent their interests. But choosing a representative in a political

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<sup>2</sup> For more on the similarities and differences between commercial markets and political markets, see *Monopoly Politics*, Chapters Two through Four.

market is very much like choosing a retailer in a commercial market.<sup>3</sup> The retailer serves as the consumer's "agent" in picking a line of products or services from which to choose. Consumers typically do not survey all the goods or services offered for sale, but instead rely on stores such as Wal-Mart, Winn-Dixie, and their local insurance broker to search through the available product and service offerings and carry a select few. This makes the consumer's effort to find a good buy much simpler, but in doing so he or she puts a certain amount of trust in the judgment of the retailer chosen. If, however, the consumer finds over time that the retailer selects poor product or service lines, he or she will pick a better "agent."

In political markets, voters choose an agent to represent them in collective decision-making. Rather than survey all of the political issues facing Congress, inquire into the pros and cons of each, form an opinion, and then take part in a massive referendum on each and every one, voters choose representatives whose job it is to review all of these issues and make informed judgments. Just as in commercial markets, if citizens find that their agent does not serve them well, they will choose someone else -- that is, unless obstacles prevent or otherwise impede their ability to select the best person.

Political markets have equivalents to franchises in commercial markets. They are interest groups and, especially, political parties. In commercial markets consumers normally frequent those establishments that have earned their trust as agents. They gravitate towards these places because they have learned that a particular establishment consistently gives good advice, offers low prices, has outstanding service, or any number of other factors of importance. The reputation earned by

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<sup>3</sup> The following discussion replicates points made in Donald Wittman, "Why Democracies Produce Efficient Results," *Journal of Political Economy*, 1989, pp. 1395-424.

establishments from meeting customers' expectations consistently can be leveraged through franchising. A consumer traveling far from home knows that the McDonald's on the road will serve the same menu, with the same quality, to which they are accustomed. This reliance on a firm's reputation to deliver value is the principal reason for franchises.

In political markets the equivalent to a commercial franchise is a political party, or to a lesser extent interest groups. Individuals faced with limited time and resources may choose to rely upon the label, Democrat or Republican. Or perhaps the citizen may take note of the opinions offered by the many interest groups such as the National Rifle Association, Greenpeace, labor unions, or the countless other organizations that take positions on political philosophy and/or policy issues. These groups do more than just inform voters: they also pressure the candidates to remain true to the principles they espouse. If a candidate (or elected official) diverges too far, the group may withdraw its support, just as Burger King might pull its franchise from stores that fail to perform.<sup>4</sup>

Incentives to innovate exist in both markets. Business firms spend considerable resources to develop new products and services -- to gain advantage over their competitors. In a similar manner, candidates (and their parties) put a great deal of effort and expense into making them more appealing to voters and gaining an advantage over their opponents. This can take the form of researching an issue, developing a unique solution, and communicating it to prospective voters. It can also take the form of polling in an effort to probe and assess the opinions and wishes of the public. For both politicians and businesses, the most important development is irrelevant if nobody knows about it. The popular saying, "Build a better mousetrap and the world will beat a

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<sup>4</sup> Political parties withdraw their support of candidates – especially incumbents – very rarely.

path to your door,” is not quite accurate, as the world needs to be informed and sold on the new idea.

Would-be agents in both commercial and political markets solicit our support. In commercial markets, it is called advertising; in political markets, it is called campaigning. With respect to purpose there is really no difference between the two. In commercial markets producers promote their prices, qualities, and services, and sometimes even point out the inferior features of their competitors’ offerings, while in political markets, candidates promote their agendas, their character, their histories on the issues, and on occasion suggest flaws in their opponents’ character or the positions they take. In both cases the purpose is to inform about attributes that are expected to be decisive to the intended recipient.

As mentioned earlier, for commercial markets to be efficient and effective, they must be competitive. That is, providers must be free to make offerings and “compete” for business. That simple notion is what underlies the antitrust laws and their enforcement. The reason is that, as Adam Smith observed over two centuries ago,

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.<sup>5</sup>

Just as the ability to collude and exclude rivals in commercial markets leads to higher profits, higher prices, lower quality, and less innovation, collusive/exclusionary behavior in political markets makes life better for elected officials to the detriment of voters. Elected officials who are able to exclude, or even disadvantage, rivals have more power and influence, can more easily ignore their constituents, and can enjoy an easier lifestyle, facing less pressure to innovate, campaign, and engage in fundraising.

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<sup>5</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Modern Library, 1937), p. 128.

The effects on citizens and voters, however, are like the effects of monopoly on consumers. The range of options is limited, the overall quality of service is diminished, accountability suffers, officials more frequently respond to vested interests rather than the electorate at large, deliberations are less transparent, and citizens have less information about the candidates, their qualifications, and their positions. In the same way that a monopolistic commercial market is inefficient and ineffective in serving consumers, a monopolistic political market is inefficient and ineffective in serving the interests of citizens.

The methods elected officials use to advantage themselves and to erect obstacles to challengers is covered in the next section. But it is important to focus on the fact that political agents have the same incentives to restrict competition as do business enterprises. Their legal liability, however, is far different. To limit anticompetitive practices in commercial markets, there are Federal and state antitrust laws, enforced by two Federal agencies, the Department of Justice and the Federal Trade Commission, numerous state Attorneys General, and the private antitrust bar. There is no corollary in political markets. Elected officials face no sanctions for anticompetitive activity. To be sure, there are Federal election laws, and the FEC, among other things, is responsible for monitoring campaign contributions and how they are spent. But as we shall see, these laws and the FEC impose far greater harm by protecting incumbents and disadvantaging challengers, than any good they do in assuring the integrity of the electoral process.

## II. Benefits Enjoyed by Incumbents and Obstacles Faced by Challengers

For competition in political markets to be vigorous there must be a reasonably level playing field -- one free of artificial advantages for one or more candidates versus others. This is not to suggest a need for rules to restrict natural advantages. Indeed, in

an ideal system the natural advantages of the candidates would shine through, whether these are a more popular platform, superior organizational or communication skills, or even name recognition from previous accomplishments.<sup>6</sup> What does need to be restricted, and what hampers the efficiency and effectiveness of political markets, are contrived advantages for certain candidates. Without exception, contrived advantages are on the side of, and are orchestrated by, incumbents.

Aside from legitimate, natural advantages, there are two types of contrived advantages associated with incumbency. The first type is associated with abuse of the office for political gain – increasing the probability of reelection. The second is more pernicious – rigging the campaign rules to advantage incumbents and to place obstacles in the path of challengers. The first is explained in this section; the second is explained in the section that follows.

Members of Congress provide themselves with a full range of free services that are not available to their more cash-starved challengers. Members of Congress have free mail privileges (referred to as the frank),<sup>7</sup> telephone and Internet access,<sup>8</sup> and well-designed web pages.<sup>9</sup> Some people may be surprised at the magnitude of these free services. For example, in a recent election cycle, of the 20 largest spenders on the frank, 11 Members spent more on this privilege than their challengers spent on their

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<sup>6</sup> The analogy in commercial markets should be evident: more desirable location and establishments, superior product/service line, more effective advertising, and better reputation.

<sup>7</sup> There are modest restrictions on use of the frank. See *Monopoly Politics*, pp. 77-78.

<sup>8</sup> There are also modest restrictions on the use of these instruments for political purposes. See *Monopoly Politics*, p. 76.

<sup>9</sup> When governments join the “digital revolution,” elected officials typically commandeer for themselves the up-front cost (web pages, e-mail, *et cetera*). See Cindy Crandall and Jeff Eisenach, *The Digital State*, 1998 (Washington: Progress & Freedom Foundation, 1998).

entire campaigns.<sup>10</sup> And benefits such as frank do help. Albert Cover and Bruce Brumberg found that a control group receiving franked mail had a higher opinion of the incumbent than those who did not.<sup>11</sup>

Members of Congress also derive a significant advantage through casework out of their district or state home offices. The increasing flow of indecipherable and ambiguous new laws (and ensuing regulations) increase the demand for casework services – which, of course, only incumbents can provide. Evidence of this can be found in the growth of House and Senate staff assigned to Members' district and state offices. From 1980 to 1997, the number of House staffers assigned to offices in the districts increased from 2,534 to 3,209, and for the Senate offices in the states, the number increased from 953 to 1,366. (The *proportion* of local-office staff vs. total staff increased as well: from 34 percent to 44 percent for the House and from 25 percent to 31 percent for the Senate.<sup>12</sup>) Academic research shows how beneficial constituent services are in garnering support and creating a positive image of the incumbent.<sup>13</sup> And

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<sup>10</sup> National Taxpayers Union and Federal Election Commission. The point made about the incumbent's spending on franked mail versus challengers' campaign spending was noted in Steve Symms, "Campaign Finance Reform Gainers," *Washington Times*, August 13, 1997, p. A14.

<sup>11</sup> Albert D. Cover and Bruce s. Brumberg, "Baby Books and Ballots: The Impact of Congressional Mail on Constituent Opinion," *American Political Science Review*, 1982, pp. 347-59.

<sup>12</sup> Norman S. Ornstein, Thomas E. Mann, and Michael J. Malbin, *Vital Statistics on Congress, 1997-1998* (Washington, D.C.: Congressional Quarterly, 1998).

<sup>13</sup> Yiannakis found that constituent service is especially effective in attracting supporters of the incumbent's challenger. See Diana Evans Yiannakis, "The Grateful Electorate: Casework and Congressional Elections," *American Journal of Political Science*, 1981, pp. 568-80.

Serra and Cover found that constituent service creates a positive evaluation of the incumbent and has the most impact on constituents where only a small portion of them identify with the incumbent's party. See George Serra and Albert D. Cover, "The Electoral Consequences of Perquisite Use: The Casework Case," *Legislative Studies Quarterly*, 1992, pp. 233-46.

Serra and Moon found that voters respond to constituent service and implied that constituent service might be able to offset policy differences between the incumbent and his or her constituents. See George Serra and David Moon, "Casework, Issue Position, and Voting in Congressional Elections: A District Analysis," *Journal of Politics*, 1994, pp. 200-13.

it is apparent that this has not gone unnoticed by the incumbents themselves. For example, Morris Fiorina found that incumbents respond to close elections by increasing allocations to casework.<sup>14</sup>

Some might argue there is nothing wrong with such a response by the incumbent. They might suggest that the incumbent is only seeking to connect more closely with the voters, and that such a response is a sign of competition. To some extent this is true. Members of Congress have legitimate reasons to communicate with constituents and to help them on occasion. There are two problems, however. First, the evidence is stark that the system is abused for political gain. Second, this activity is funded by taxpayers, a source not available to challengers. In any event, the widespread abuse of these free services constitutes a contrived advantage that makes the playing field less even, the political market less competitive, and citizens less well served.

Incumbents also have at their disposal the ability to send district- or state-specific spending back to their constituents. This practice, more commonly known as “pork spending,” can play a large role in protecting incumbents from challenge. This is particularly true for more senior incumbents, who because of their tenure are more effective at bringing money back to their districts or states. Rational voters recognizing that the flow of pork is an increasing function of tenure will be more apt to return their Congressman for another term.<sup>15</sup> Research has found that incumbents are effective in taking advantage of these contrived advantages. Robert Stein and Kenneth Bickers found that vulnerable incumbents aggressively pursue pork spending,<sup>16</sup> and separately

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<sup>14</sup> Morris Fiorina, “Some Problems in Studying the Effects of Resource Allocation on Congressional Elections,” *American Journal of Political Science*, 1981, pp. 543-67.

<sup>15</sup> Gerald W. Scully, “Congressional Tenure: Myth and Reality,” *Public Policy*, 1995, pp. 203-19.

<sup>16</sup> Robert M. Stein and Kenneth N. Bickers, “Congressional Elections and the Pork Barrel,” *Journal of Politics*, 1994, pp. 377-99.

that the success of incumbents in bringing back agency grants influences a potential challenger's decision to run.<sup>17</sup> According to the organization Citizens Against Government Waste, this tool, like so many others, has been growing over recent years, doubling from \$6.6 billion to more than \$13 billion over the five-year period 1993 to 1998.

As mentioned in the previous section, voters have an incentive to reelect more senior Members due to their effectiveness in delivering pork spending. This incentive also extends to the committee system, whereby Members jockey to obtain key positions on various committees that have oversight roles in important areas. Getting assigned to a powerful committee can enable an incumbent to gain additional contributions or support from voters who want to keep their representative in a position of power. For example, Bennett and Loucks found that being appointed to the House Banking Committee increases a Member's contributions from finance political action committees (PACs).<sup>18</sup> Additionally, Mark Crain and John Sullivan found that for Members belonging to the majority party, incumbents assigned to committees having significant control over industries under their jurisdiction significantly increased their vote margins between the 1988 and 1990 elections.<sup>19</sup> These empirical results, and the others like them,<sup>20</sup> are not

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<sup>17</sup> Kenneth N. Bickers and Robert M. Stein, "The Electoral Dynamics of the Federal Pork Barrel," *American Journal of Political Science*, 1996, pp. 1300-26.

<sup>18</sup> Randall W. Bennett and Christine Loucks, "Savings and Loan and Finance Industry PAC Contributions to Incumbent Members of the House Banking Committee," *Public Choice*, 1994, pp. 83-104.

<sup>19</sup> Mark W. Crain and John T. Sullivan, "Committee Characteristics and Re-election Margins: An Empirical Investigation of the U.S. House," *Public Choice*, 1997, pp. 271-85.

<sup>20</sup> For example, Loucks found an increase in PAC contributions from appointment to the Senate Banking Committee. Christine Loucks, "Finance Industry PAC Contributions to U.S. Senators, 1983-88," *Public Choice*, 1996, pp. 219-29.

Kroszner and Stratmann found that committee members get more money from PACs with an interest in their jurisdictions, and the contributions rise with seniority. Randall S. Kroszner and Thomas Stratmann,

surprising, given the tremendous power exercised by those committees and by the members who serve on them.<sup>21</sup>

Another contrived advantage is the ability of incumbents to pressure donors for campaign contributions when there is little evidence of challenge, and to carry over these resources from election to election, continually growing their reserves in order to ward off any potential challenge. Janet Box-Steffensmeier found war chests particularly effective in deterring high-quality challengers.<sup>22</sup> This is not surprising, given that challengers must recognize the enormous resources stacked up against them. This benefit no doubt helps to explain why, for instance, after the 1996 election cycle incumbents' average cash on hand was over \$175,000, and those incumbents who won with more than 60 percent of the vote had cash on hand averaging more than \$230,000.<sup>23</sup>

### III. The Role of Federal Election Laws and FEC Rules in Limiting Competition

Of even greater importance and effect are the *contrived* advantages for incumbents created by the Federal campaign laws and regulations. It is important to bear in mind the asymmetry between commercial markets and political markets with respect to monopolization. In commercial markets, there is no organized forum for the

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"Interest Group Competition and the Organization of Congress: Theory and Evidence from Financial Services Political Action Committees," *American Economic Review*, 1998, pp. 1163-87.

Anagnoson found that during election years federal agencies speed up their approval of grants to the constituents of representatives who are on committees with authority over them. Theodore Anagnoson, "Federal Grant Agencies and Congressional Election Campaigns," *American Journal of Political Science*, 1982, pp. 547-61.

<sup>21</sup> Roberts found that the death of Senator Scoop Jackson (then a member of the Senate Armed Services Committee) depressed the prices of stocks of companies in Jackson's state and raised the prices of stocks in the home state of his successor. Brian E. Roberts, "A Dead Senator Tells No Lies: Seniority and the Distribution of Federal Benefits," *American Journal of Political Science*, 1990, pp. 31-58.

<sup>22</sup> Janet Box-Steffensmeier, "A Dynamic Analysis of the Role of War Chests in Campaign Strategy," *American Journal of Political Science*, 1996, pp. 352-71.

<sup>23</sup> Financial activities of house candidates, 1996, FEC ([www.fedc.gov/1996/dates](http://www.fedc.gov/1996/dates)).

exchange of information and discussion of ways to limit competition. Indeed, if there were such a forum, not to mention if the forum succeeded in orchestrating actions to limit competition, the participants would be liable for criminal prosecution under the Federal antitrust laws. On the other hand, in political markets, incumbents have the means as well as the incentive to limit competition. *They make the laws.* They not only have a legal forum in which to discuss ways of limiting competition, their actions to carry out policies to limit competition do not create for them legal liability of any sort. Although usually debated in high-sounding, public interest rhetoric, these laws (and subsequent enabling regulations) are understood to have great impact in limiting the ability of challengers to mount serious campaigns.<sup>24</sup>

#### A. Ways Federal campaign laws limit competition

The ways Federal and state election and campaign-finance laws limit competition are varied. Only some of the major ones are addressed here.<sup>25</sup>

Perhaps recognizing the threat from third-party challengers, ballot access laws have been structured to reduce competition. Theodore Lowi concluded that state bans on “fusion tickets” (the nomination of the same candidate by more than one political party) have a simple objective -- to eliminate competition.<sup>26</sup> In a similar vein, Hamilton and Ladd found that ballot structure affects turnout (particularly for lesser-known candidates), party-line voting, and election results in partisan districts.<sup>27</sup>

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<sup>24</sup> It is really not necessary to prove motive here. It is the effect of the laws in limiting competition, whatever their official or secret rationale.

<sup>25</sup> For a more thorough examination, see *Monopoly Politics*, esp. Chapter Five.

<sup>26</sup> Theodore J. Lowi, “A Ticket to Democracy,” *New York Times*, December 28, 1996, p. A27.

<sup>27</sup> James T. Hamilton and Helen F. Ladd, “Biased Ballots?: The Impact of Ballot Structure on North Carolina Elections in 1992,” *Public Choice*, 1996, pp. 259-80.

Additionally, some states allow incumbents to have significant control in the primary process. For examples: in Virginia incumbents can demand a primary if they had been nominated that way the previous election cycle; Louisiana's open seat primary system, which favors incumbents, only saw one incumbent defeated in 22 years; and Connecticut requires a candidate for a party's nomination to receive at least 15 percent of the votes at the nominating convention to qualify for the primary. Also, incumbents work with their state legislatures and governors to formulate redistricting plans in such a way as to protect, and possibly improve, their chances for reelection. David Gopoian and Darrell West found that incumbents were more likely to gain, rather than lose, from redistricting because legislatures tended to give incumbents of both parties a greater proportion of their party's voters.<sup>28</sup> Not surprisingly, additional research has found that if there is a bias in the redistricting process it tends to favor the state's dominant party.<sup>29</sup>

Passage of FECA in 1974 dramatically changed the landscape in which campaigns are funded and undertaken. The act created a tax-return check-off for funding presidential campaigns, placed limits on spending by presidential candidates who accept matching funds, and limited the amounts individuals could contribute to presidential and congressional campaigns. (The act also limited spending on congressional campaigns, but the U.S. Supreme Court later held this provision unconstitutional.<sup>30</sup>)

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<sup>28</sup> David J. Gopoian and Darrell M. West, "Trading Security for Seats: Strategic Considerations in the Redistricting Process," *Journal of Politics*, 1984, pp. 1080-96.

<sup>29</sup> Gary King, "Representation through Legislature Redistricting: A Stochastic Model," *American Journal of Political Science*, 1989, pp. 787-824; Janet Campagna and Bernard Grofman, "Party Control and Partisan Bias in the 1980s Congressional Redistricting," *Journal of Politics*, 1990, pp. 1242-57; and Bruce E. Cain, "Assessing the Partisan Effects of Redistricting," *American Political Science Review*, 1985, pp. 320-33.

<sup>30</sup> See *Buckley v. Valeo*, 424 U.S. 1 (1976).

In researching the academic literature in the process of writing of *Monopoly Politics*, I found overwhelming agreement among scholars that the major effect of the act has been to help incumbents further fend off challengers. (Although I have not followed the literature as intensely since 1999, I am aware of no further research that is of a contrary nature.) I also found evidence that the principal motivation for the act was self-interest. Peter Aranson and Melvin Hinich showed that the limits on contributions disproportionately constrain challengers more than incumbents and thereby benefit incumbents.<sup>31</sup> Abrams and Settle found that the Democrats' support of the 1974 bill was based on self-interest -- that in the absence of limits Gerald Ford would have won the 1976 presidential election.<sup>32</sup> As another example, Bender found that even in the bill-forming stage, when various spending limits were considered, Members' votes were highly correlated with forecasts of the effects such limits would have had on their chances for reelection.<sup>33</sup> And in *Buckley*, the Supreme Court, recognized that,

Since an incumbent is subject to these limitations to the same degree as his opponent, the Act, on its face, appears to be evenhanded. The appearance of fairness, however, may not reflect political reality. Although some incumbents are defeated in every congressional election, it is axiomatic that an incumbent usually begins the race with significant advantages.<sup>34</sup>

To see how the 1974 act and subsequent restraints on contributions help incumbents, recall that a common theme in these reforms is that it makes raising money more difficult and spending it less effective. Research has shown that constraining both

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<sup>31</sup> Peter H. Aranson and Melvin J. Hinich, "Some Aspects of the Political Economy of Election Campaign Contribution Laws," *Public Choice*, 1979, pp. 435-61.

<sup>32</sup> Burton A. Abrams and Russell F. Settle, "The Economic Theory of Regulation and Public Financing of Presidential Elections," *Journal of Political Economy*, 1978, pp. 245-57.

<sup>33</sup> Bender, "An Analysis of Congressional Voting on Legislation Limiting Congressional Expenditures," *Journal of Political Economy*, 1968, pp. 1005-21.

<sup>34</sup> As quoted in Aranson and Hinich, "Some Aspects," p. 451.

incumbent and challenger fundraising/spending harms challengers much more than incumbents. A slew of research has shown that the marginal gain in votes per dollar of spending is substantially greater for challengers.<sup>35</sup> That is, a dollar spent by a challenger will increase his or her vote (or vote margin) by more than a dollar spent by an incumbent will increase his or her vote (or vote margin). The principal reason is that challengers (and their platforms) are typically not as well known as the incumbents they are challenging. Also, since they typically spend far less on their campaigns than do incumbents, their expenditures are especially productive in getting name recognition and in communicating information about themselves and their platforms. On the other hand, incumbents usually have extensive name recognition already, and their positions on issues are fairly well known. In addition, they will have taken advantage of free press coverage and the many other perks of office discussed above. As Jeff Milyo observed:

The evidence...strongly suggests that marginal spending by incumbents has little impact on their electoral success. Even shocks to spending of \$100,000 or more produce no discernible impact on incumbent vote shares.<sup>36</sup>

In sum, an incumbent knows that additional spending on his or her own campaign will be of marginal value in increasing votes (or vote margin), but that spending by an

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<sup>35</sup> See, for example, Aranson and Hinich, "Some Aspects"; Bruce Bender, "An Analysis of Congressional Voting," pp. 1005-21; Amihai Glazer, "On the Incentives to Establish and Play Political Rent-Seeking Games," *Public Choice*, 1993, pp. 139-48; Gary C. Jacobson, "Money and Votes Re-considered: Congressional Elections, 1972-1982," *Public Choice*, 1985, pp. 7-62, and "The Effects of Campaign Spending in House Elections: New Evidence for Old Arguments," *American Journal of Political Science*, 1990, pp. 334-62; Christopher Kenny and Michael McBurnett, "A dynamic Model of the Effect of Campaign Spending on Congressional Vote Choice," *American Journal of Political Science*, 1992, pp. 923-37; John R. Lott, "Does Additional Campaign Spending Really Hurt Incumbents?: The Theoretical Importance of Past Investments in Political Brand Name," *Public Choice*, 1991, pp. 87-92; John L. Mikesell, "A Note on Senatorial Mass Mailing Expenditures and the Quest for Reelection," *Public Choice*, 1987, pp. 257-65; Dennis C. Mueller, *Public Choice II* (New York: Cambridge University Press, 1989), pp. 209-12; K. Filip Palda and Kristian S. Palda, "Ceilings on Campaign Spending: Hypothesis and Partial Test with Canadian Data," *Public Choice*, 1985, pp. 313-31; and Thomas J. Scott, "Do Incumbent Campaign Expenditures Matter?," *Journal of Politics*, 1989, pp. 965-76.

<sup>36</sup> Jeff Milyo, "The Electoral Effects of Campaign Spending in House Elections," Citizens' Research Foundation, University of Southern California, June 1998, p. 27.

opponent will have a dramatic, threatening effect. Money for challengers is therefore absolutely essential if a race is to be competitive, and if the interest of citizens are to be served. Challengers tend to be relatively unknown, and without significant resources it is nearly impossible for them to have any chance at success. Thus, it is in the interest of the incumbent to limit fundraising overall and to encumber the effectiveness of spending.

One indication of the effectiveness of limits on a challenger's ability to accumulate the resources necessary to wage a competitive campaign can be found in discussions around various proposals to reform the campaign finance laws. Consider the proposal in one of the early versions of the McCain-Feingold/Shays-Meehan bill to limit spending in House races to \$600,000 per election cycle. According to Bradley Smith (now a Member of the FEC), in 1996, every incumbent who spent less than \$500,000 won versus a meager 3 percent of challengers who spent that little. Yet challengers who spent between \$500 thousand and \$1 million won 40 percent of the time, and of the six who spent more than \$1 million, five of them won. With respect to the proposal's variable limits for Senate races (from \$1.50 million to \$8.25 million per election cycle), in 1994 and 1996 every challenger who met the limit lost and every incumbent won.<sup>37</sup> It is not surprising, then, that incumbents do not like their odds against well-funded challengers and seek to limit their ability to raise such resources and to spend them effectively.

The act also advantages incumbents in another way not so generally recognized. By placing restrictions on the ability of *candidates* to communicate what they have to offer, the act increases the role and influence of the media, which are expressly

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<sup>37</sup> Bradley A. Smith, "Why Campaign Finance Reform Never Works," *Wall Street Journal*, March 19, 1997, p. A19.

exempted from FECA and BCRA with respect to news stories, commentaries, and editorials. Incumbents have a considerable advantage here: they have taxpayer-paid press spokesmen; they *make* news, and thus have more access to the media; and they have access to “inside information,” which they communicate to, and curry favor with, the press. The reporting requirements also accentuate the role of the media in campaigns (and diminish the role of the candidates): in effect, this information is a subsidy to the media – giving it stories that it otherwise would not have been able to secure so easily.<sup>38</sup>

### B. Bipartisan Campaign Reform Act of 2002

Earlier this year, Congress had an opportunity to address some of the anticompetitive features of FECA. On the whole, however, it made matters worse.

Title I of BCRA makes it more difficult for political parties to engage in educational activities that mention the names of candidates. While it has the laudable goal of limiting the influence of “special interest money,” it also limits the ability of parties to support challengers. Again, anything that makes it more difficult for candidates to get out their messages reduces the competitiveness of the political marketplace.<sup>39</sup>

Section 213 of BCRA says that a political party may engage in independent expenditures on behalf of a candidate *or* contribute to the candidate’s campaign – but not both. This change further limits the ability of challengers, especially, to acquire the requisite funds to mount a serious campaign.

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<sup>38</sup> Under the act, a newspaper, for example, may make news-story, commentary, and editorial (in-kind) contributions to a candidate *unless* the newspaper is owned by the candidate. However, a supporter of the candidate may purchase a newspaper and run news stories, commentaries, and editorials on behalf of the candidate without restraint.

<sup>39</sup> Section 103 of Title I waives the relevant restraints when the money is to be used to construct buildings to house the political parties.

Section 304 of the BCRA says, in effect, that contribution limits are warranted, but when a challenger appears on the horizon who is prepared to augment his or her campaign treasury out of his or her own pocket, the contribution limits are revised upward – but only for the opposing candidate(s). Furthermore, the candidate willing to provide full, or even partial, funding for his or her campaign must say so in advance, thus tipping off the competition to the campaign strategy. While technically the provisions contained in Section 304 would benefit a challenger facing a self-financing incumbent, the real import of the provision is to limit the ability of challengers to mount successful campaigns, since over the past years self-financing appears one of the few ways challengers have been successful in creating competitive races.<sup>40</sup>

Section 305 of the BCRA requires candidates advertising over the electronic (radio, TV) and print media to reserve a portion of the message for a complete identification of the candidate on whose behalf the advertisement is placed. Although the amount of time/space required may not seem all that intrusive, the restraint constitutes a significant diminution in the effectiveness of ads, given that they are usually quite short in duration or space. Also, there is the further encumbrance that the requirement makes the ads somewhat off-putting and therefore even less effective. Again, anything that makes the expenditure of funds (such as on advertisements) less effective gives further advantage to the incumbent.

Sections 312 and 314 of the BCRA impose more severe criminal penalties for violations of Federal election laws and require the U.S. Sentencing Commission to establish sentencing guidelines for such violations. While not taking issue with the notion of requiring compliance with *bona fide* law, it is notable that such increased

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<sup>40</sup> See, for example, Larry J. Sabato and Glenn R. Simpson, "Money Talks, Voters Listen," *Wall Street Journal*, December 28, 1994, p. A12.

penalties, combined with the lack of familiarity with the act's various provisions faced by most challengers, makes it even less likely that a challenger would venture to enter a political contest.<sup>41</sup>

In a most blatant “everyone is equal, but incumbents are more equal than others” provision, Section 403 of the Act gives incumbents, but not challengers, the right to intervene personally before the court in any challenge to the constitutionality of any and all provisions of the Act. So, if the constitutionality of a particular provision whose effect is to advantage incumbents and to place obstacles in the way of challengers is questioned, the incumbent will be heard, but the challenger will not.<sup>42</sup>

The only provision of the BCRA that would seem to address the overwhelming advantage enjoyed by incumbents and the obstacles faced by challengers is Section 307, which increases the individual contribution limit from \$1,000 per election cycle to \$2,000, increases the individual aggregate (Federal-election) limit from \$20,000 to \$25,000, and indexes both limits for inflation. Two things are notable about these changes, however. First, the uneven treatment given to other limits is curious: the PAC contribution limit is neither changed nor indexed, and the contribution limits for state parties are raised, but are not indexed for inflation. Second, the doubling of the individual contribution limit places it in *real* terms below the limit the Supreme Court

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<sup>41</sup> Given the incredible complexity of the campaign laws, challengers justifiably would be fearful of even innocent mistakes. Consider, for example, the final regulations and associated explanation and justification the FEC promulgated in February 9, 1995 regulating all expenditures by principal campaign committees designed to prohibit personal use. These regulations run 14 pages, in the Federal Register, are far from clear, and convey the notion that it is really impossible to write a clear rule, and therefore violations must be left to the judgment of the FEC. Given that penalties under BCRA for knowing or willful violations involving making, receiving, and reporting contributions or expenditures can run as high as \$25,000 and imprisonment of up to five years, novice would-be challengers might opt never to run for office.

<sup>42</sup> Because of my experience in government, I am aware of the deference the courts afford Congress. But the instances with which I am aware go to broad policy issues. In this instances, the law is brazen its uneven treatment of those competing for the privilege of representing us: one set of rules for incumbents, another (less desirable) set for challengers.

found constitutional in *Buckley*; an adjustment for inflation alone (not to mention the higher cost and greater scope of most Federal campaigns today) would raise the limit to over \$3,000.<sup>43</sup> The 25 percent increase in the aggregate limit doesn't even begin to adjust for inflation.

Thus, by further limiting the ability of contributors to fund campaigns, which in turn makes it more difficult for candidates to acquire requisite resources, BCRA comes down even harder on challengers and further increases the monopoly power found in the market for (Federal) political representation.

### C. Federal election/campaign laws are equivalent to requiring a license

Dealing with the various Federal election and campaign laws and regulations has become so burdensome that in a real sense a citizen must obtain a *license* from the Federal government in order to run for public office. Consider that *before* a citizen may campaign for Federal office he or she must file certain forms, in certain ways, with the FEC and agree to abide by its rules and regulations.<sup>44</sup>

The candidate must have his or her campaign file an initial FEC report (directly with the FEC, in the case of a run for the House of Representatives, and with the Secretary of the Senate in the case of a run for the Senate) and send a copy to the relevant state agency. The candidate must set up a formal campaign committee, recruit a treasurer, and have that person make the filing and all subsequent reports to the FEC.<sup>45</sup> (The candidate files only FEC Form 2: Statement of Candidacy.) When I served as treasurer of my spouse's campaign for Congress in 1998, I received, after the initial filing, the following from the FEC: (a) a pamphlet on committee treasurers, (b) a copy of

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<sup>43</sup> See *Monopoly Politics*, p. 116.

<sup>44</sup> Various matters trigger the requirement to file as a candidate, such as raising or spending over \$5,000.

the FEC's latest newsletter, *The Record*, (c) a copy of FEC Disclosure Form 3: Report of Receipts and Disbursements for an Authorized Committee, together with instructions, (d) a list of state offices where copies of all reports must be filed, (e) a reprint of an article describing how to file disclosure reports electronically, (f) a copy of the reporting schedule for the year, (g) a notice about the FEC's fax line, (h) an announcement of upcoming FEC conferences (with no indication whether they are optional or compulsory), (i) a compendium of Federal election campaign laws, and (j) a copy of the latest issue of the *Code of Federal Regulations* dealing with Federal elections. The number of pages totaled 618, and the package weighed 1 pound, 12.5 ounces. And that's not the end. Whether responding to often-indecipherable questions from the FEC's staff about filings or guessing about appropriate (vs. inappropriate) language to use in answering their questions or questions on the various FEC forms, the candidate is reminded constantly that in order to run for office he or she has to secure *and maintain* a license from the Federal government.<sup>46</sup>

To see what maintaining this license is all about, consider that a mistake on a report, no matter how immaterial, can result in frustrating and time-consuming dealings with the FEC. As an example, consider the letter of inquiry I received following a midyear report submitted more than one full year *after* I had lost a primary election for the U.S. Senate. In part it reads:

Your report discloses a...loan from the candidate on Line 13(a) of the Detailed Summary Page. It appears that this loan was used to finance expenditures made directly by the candidate (pertinent portion attached). Please note that expenses advanced by the candidate or other committee staff members constitute debts rather than loans; and should be reported in the following manner: the advance should be itemized as a contribution

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<sup>45</sup> Moreover, according to the FEC, the treasurer has unlimited personal liability – surely an impediment, especially for challengers.

<sup>46</sup> See *Monopoly Politics*, pp. 96-100.

on Schedule A and listed as a memo entry. If, however, the advance was paid in the same reporting period in which it was made, the filing of a Schedule A is not required. When the repayment is made, the transaction should be itemized on a Schedule B supporting Line 17. If the ultimate payee (vendor) requires itemization, it should be listed on Schedule B as a memo entry directly below the entry itemizing the repayment of the advance. Continuous reporting (on Schedule D) of all outstanding debts is required. Please amend your report, if necessary.

What is not clear from the letter is that the problem stemmed from a transcription error in my report to the FEC, indicating that a major deposit to the campaign account had been made the day *after* the campaign had written a major check to a vendor. The learning curve and costs involved in dealing with such reporting requirements are substantial and amount to maintaining a license to run for Federal office.<sup>47</sup>

#### IV. Political Markets in the Absence of Federal Laws and Rules Limiting Competition

Those who have been most adamant about the need for *stricter* regulation of Federal election campaigns no doubt will respond to the criticisms leveled above by suggesting that the alternative -- the elimination of anticompetitive restraints -- would be far worse. That is not the case. As outlined briefly below, a regime where current anticompetitive restrictions were removed would be far more competitive, and elected officials would respond much more efficiently and effectively to citizens' preferences.

An important caveat: the regime posited does not contemplate the removal of any laws and implementing regulations affecting who is allowed to contribute, fraud, and other criminal acts. That is a whole separate issue. What *is* posited is the repeal of anticompetitive laws and the elimination of anticompetitive regulations. Under this regime, corporations and unions would still not be allowed to contribute directly, voter fraud would still be a crime, and so would buying votes, bribing elected officials, *et*

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<sup>47</sup> It is worth noting that this license requirement gives incumbents another special advantage, for it says, in effect, that a challenger must give ample, and formal, notice to an incumbent that "I want your job."

*cetera*. Although there are variations on what might be characterized as a regime free (or relatively free) of anticompetitive restraints, the following discussion assumes the repeal of virtually all of FECA and BCRA. It also assumes the disestablishment of the FEC and the withdrawal of all its rules.<sup>48</sup>

How would political markets perform under such a regime? Much more efficiently and effectively than at present – and relatively free of the unsavory practices critics are likely to wave as the inevitable consequence of any freeing up of current legal and regulatory requirements.

First, three “macro” issues. It will be said that with no limits on contributions, total expenditures on Federal campaigns would be exorbitant. Judged by spending on the commercial-market analogue -- advertising -- this is very unlikely. In *Monopoly Politics*, I conservatively estimate that spending (of all types) on Federal campaigns per dollar of “sales” is only half of what is spent on advertising (per dollar of sales) in the commercial sector.<sup>49</sup> Lifting the lid on contributions would not likely result in more than a *doubling* of campaign spending. In any event, the greatest increase in expenditures would be on the part of challengers, and this would make the political market more efficient and more effective.

In addition, it will be argued that without limits on contributions some groups in society would have “undue influence” on elected officials. The question is one of degree. Undoubtedly, some contributors have “undue influence” now. Would the practice be more widespread in the regime posited? Interests could contribute more, but to some extent their contributions would cancel out, as others, with opposite

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<sup>48</sup> These changes, of course, would not remove all forms of contrived advantages. See *Monopoly Politics*, esp. Chapter Six.

<sup>49</sup> See *Monopoly Politics*, pp. 117-8.

interests, competed for favors. On the other hand, “interests” and others would have alternatives to “purchasing” influence with elected officials – supporting challengers. As we shall see below, this makes all the difference.

It will also be argued that a lack of limits on contributions would lead to general corruption in political contests. Yet the evidence on this issue suggests otherwise. The States of Virginia and Texas have no limits on contributions by individuals in statewide elections, and there appears to be no more corruption in these political markets than in states having strict limits on contributions.

Without limits on contributions and limits on the productivity of expenditures (such as the form and content of messages), political markets would be much, much more competitive. Challengers would find it much easier to accumulate the resources necessary to mount effective campaigns. (For one thing, in the absence of disclosure, a contributor wanting to support a challenger would not have to worry that the incumbent might find out and seek retribution.) In contrast, to a considerable extent, it really does not matter how much money incumbents acquire, for, as discussed above, the marginal product of incumbent spending (in terms of votes or vote share) tends to be inconsequential, whereas it tends to be quite positive for challengers. The old adage in politics, “It doesn’t matter how much money your opponent raises; what matters is whether you can raise enough to be competitive,” is operative here.

The absence of a requirement for candidates to obtain a Federal “license” before running for office (committee, treasurer, initial filing, periodic filings, responding to inquiries, *et cetera*) and the removal of threat of prosecution because of violations of laws with which few are familiar, would make it possible for more citizens to run for Federal office. Also, with more resources with which to make a run, candidates would be better able to communicate their agendas and their qualifications.

In a more competitive political market, elected officials would be more accountable. Without the assurance of so many contrived advantages in election contests, incumbents would no longer have so much “freedom” to ignore the wishes of citizens. They would have less room to maneuver and would be less responsive to “interest groups.”

For those who believe transparency with respect to contributions is highly desirable, there would be a “market test” of that proposition. As did Governor George W. Bush when he ran for president, those seeking office might voluntarily publish their contributors (and amounts) on the Internet. This could be a ready source of differentiation between candidates and an important selling point. A candidate might publish on the Internet contributions not now required to be reported to the FEC. Candidates might also make other strategic decisions, such as refuse to accept funds from business, or labor, or other “interest” groups, if they thought such tactics would increase their chances for election.

The point is, a regime in which anticompetitive campaign laws and regulations were eliminated would not degenerate into “the law of the jungle.” To the contrary, political markets would be more orderly, and far more responsive to the interests of the electorate.