Election Finance Regulation in Emerging Democracies: Lessons from Canada and the U.S.

by Filip Palda
May 2000

École nationale d'administration publique
4750 Henri-Julien, #4040
Montreal, Quebec H2T 3E5
Email: Filip_Palda@enap.uquebec.ca

Contents

The moment governments get into a position to control the purse strings of their political opponents is the moment at which dissent in any society makes an unconditional surrender to conformity.

British political commentator Anthony Howard

1. Introduction

The present paper asks what rules emerging democracies should impose on election finance. Election finance laws govern candidates, parties, and private individuals. Rules fall into three categories: rules that limit campaign spending and contributions, state subsidies to politicians, and laws that oblige candidates and individuals to reveal how much money they spent or received before and during a campaign. These regulations are found in Canada and the US. The media of these countries accept limits, subsidies, and disclosure as basic checks on corruption and extortion in politics. The present paper questions this mainstream view and argues for caution before an emerging democracy takes the route of Canada and theUS. Election regulations are written by incumbent politicians. Whenever the people in power write the rules of the game, a question arises: are they writing the rules in the public interest or are they writing the rules to protect themselves from competition? This question receives almost no attention in public debates. It will be the central question I discuss here. I propose that limits, subsidies, and disclosure laws may restrict political competition and entrench the established parties. The stated aim of these laws is to protect the public from corruption, and to make elections fair. The effect of these laws may be the opposite: they can make elections unfair and open candidates to corruption. Election laws have this effect by restricting what voters can learn about their alternatives. Spending limits can make it hard for new candidates to get their message across. Contribution laws can raise the cost of raising money. Disclosure rules may impose disproportionately large fixed costs on small parties. These "barriers to entry" can block competition by making it hard for new, poorly-financed candidates to get their ideas across to voters. Any rules an emerging democracy decides to impose on election finance should be sensitive to the possibility that these rules will backfire and hurt the citizens they were meant to protect.

The lessons I draw for emerging democracies come from elections in the US and Canada. These were among the first countries in Western democracies to adopt campaign finance laws. Their traditions of such laws now span the last thirty years. These two countries provide practical experience and academic research on which to base conclusions about campaign finance laws. Lessons from these countries cannot be perfectly applied to an emerging democracy, because such a democracy differs in its institution and the education of its people. The reader should keep in mind this difference between an emerging democracy and the US and Canada throughout the essay and decide where

differences between these countries and the emerging democracy might lower the usefulness of the comparison.

The plan of the paper is to ask first of all what are the least intrusive of campaign finance laws. Mandatory disclosure and transparency seem to be the mildest form of government intervention. The idea behind disclosure and transparency is that, given information about where candidates raise their money, citizens will police candidates by punishing or rewarding them at the polls. I ask whether disclosure is really as mild a groundrule for election finance law as it seems. What emerges is that disclosure may impose fixed costs of campaigning on candidates and serve as barriers to entry to new, poorly financed candidates and movements.

Regulators who do not believe that disclosure and transparency are sufficient controls on elections may wish to impose more severe campaign finance laws, such as spending and contribution limits. They may wish to replace private money in part or entirely by allowing the state to subsidize election campaigns. Throughout I show that attempts to block or regulate freedom of expression may lead the government to ever more repressive regulations. Information is not easily contained. Candidates may get around a spending limit by having private citizens advertise on their behalf. This forces the ardent regulator to regulate all campaign spending by private citizens. For campaign finance law to restrain speech, experience suggests it must be broad and repressive. Even if government is able to control who says what, it is not clear that it will have limited the influence of money in politics. Groups who cannot gain influence during elections will simply substitute other forms of political pressure, such as lobbying or bribery.

The purpose of this paper is not to discredit all campaign finance regulation but to alert the reader to the paradoxes and limitations that saddle such laws so that we might judge which laws are beneficial to voters and which laws can harm them. To see where the problems and benefits arise we first need some idea of how money works in elections. That is the purpose of the following section.

2. Groundrules: Do we need them?

The purpose of rules in elections is to ensure that voters are given the best possible choice of candidates. This means that rules should help voters become informed about their leaders and the costs of government policies. This is a nice objective but the statement is so general as to be almost vacuous. Opposing schools of thought in political science could both agree to the objective. In 1991 the Canadian Royal Commission on Election Reform and Party Financing argued that spending limits are needed to make elections informative and competitive. Other scholars have argued that campaign spending and contributions need to be unrestricted by government and that government controls on elections should be minimal. I will argue here that a mix of controls and laissez-fair is needed to make elections informative. Competition in elections can go a long way to giving citizens efficient, cheap government. But government, just like business, is not free of agency problems. Some rules are needed to force candidates to disclose certain information that would not be forthcoming even in a competitive atmosphere. To see this

we have to understand how competition influences elections. This then allows us to ask what government regulations are needed to let competition produce its best results.

Evsey Domar explained the benefits of competition as follows "The power exercised by consumers over producers requires no police, no compulsion, and no letters to the editor of *The New York Times.* It works silently, like gravity. All the consumer has to do is not come back to the store, not buy the same product ever again." We can get a feel for the power of competition by looking at how established airlines react to challenges from newcomers. In 1998 a new airline challenged Northwest Airlines on its route from Detroit to Newark by charging a price of $78. Northwest had to lower its prices to this level on the same route. But for a flight to nearby New York city, where the small airline did not compete, Northwest charged $450.

There are two ingredients to the competition described by Domar: information and choice. Voters are consumers of public goods. They pay a tax price and want to get the best value for their money. Though it is sometimes hard to believe, we elect politicians to be our servants, not our masters. These servants have a duty that is similar to the duty of producers in a private market. Political producers are elected to provide good quality government services at a low tax price. Leaders who charge too high a tax price make hidden political profits. The communist party of the former East Bloc provided citizens with the full range of modern government services, but the cost was high and the quality was poor. Government leaders took their profits by relaxing on the job, by living in luxury at public expense, and by stealing public resources. This situation lasted for years, in part because citizens living in the East Bloc did not have a standard of comparison. Yes, things might be bad, a citizen would tell himself, but what is the alternative? To what competing party can I compare the communists? The answers to these questions did not come easily because voters did not have the chance to elect new governments or to hear what candidates from different parties had to say. Citizens also had trouble traveling abroad to learn what kind of government services existed in Western democracies. By depriving citizens of information on their choices, communist politicians kept competition down. The result of this poor flow of information was years of inefficient government. The Communist fear of political competition shows up best in that regime's suppression of dissidents. Dissidents did not have much to say and for the most part wrote in convoluted prose and held radical ideas most of the populace would find irrelevant or troubling. Dissidents scared the communist government because they dared to raise questions about the government. There seems to be a "first order effect" which gives power to dissidents in the same way that a small airline can challenge and humble a major carrier.

The East Bloc stifled competition by imposing "barriers to entry" in politics. Nobel prize winning economist Gary Becker (1958) stressed the importance of free entry of competitors when he wrote that:

> In an ideal democracy competition is free in the sense that no appreciable costs or artificial barriers prevent an individual from running for office and from putting a platform before the electorate.

Becker was careful to warn of *artificial* barriers to entry. An artificial barrier is some obstacle to new competitors that brings no benefit to consumers. An example of artificial barriers are the production quotas that restrict production have made incumbent farmers rich throughout the West. Quotas that restrict information helped incumbent tobacco producers. In 1970 the US imposed a partial ban on cigarette advertising. Studies by Eckard (1991) and Mitchell and Mulherin (1988) show that the ban stabilized the market shares of established manufacturers and stopped the progress that minor brands had been making. The ban also raised the profitability of the large incumbents. Natural barriers to entry are barriers that bring benefit to consumers. A firms reputation for solid service is a natural barrier to new firms wishing to make a name in the market. They have to reckon that consumers trust the established company and get reassurance from the old company's proved record of service. Such a barrier may allow the established company to charge a higher price than new entrants charge but this higher price reflects the value that consumers attach to the firm's reputation. In this case a barrier does not harm consumers. The key for understanding the benefits or drawbacks of campaign finance law is in spotting whether it sets up an artificial barrier to entry into politics.

Becker reasoned that politicians were no different than businessmen. To protect their positions of power, politicians would change the rules of the political game to make it difficult for new candidates and parties to put their ideas before the public. Abrams and Settle (1978) echoed this sentiment when they wrote that

> Rational, self-interested individuals, groups, or industries seek regulation as a means of serving their own private interests... When regulation has the potential for directly affecting the legislators themselves (e.g. political campaign regulations), the economic approach suggests that the regulation would be designed to serve the legislators' interest rather than some vaguely defined "public interest."

Politicians protect themselves by restricting who can speak during an election. This is best understood by looking at some facts that have accumulated about election campaigns. Usually, incumbents are talented people who have made it to power on their charisma and ability. During their tenure incumbents use government paid mailings to tell constituents about the good work they have done. Paid travel and office staffs also allow incumbents to remain visible and keep well informed on the issues. But even the most talented people make mistakes in power, or find that certain promises were impossible to keep. Incumbents would like to stop their opponents from bringing these mistakes to the public's attention. Incumbents can do this with a campaign spending limit. A limit preserves the image the incumbent has built in office from criticisms by poorly known challengers.

This is not just a theoretical story. There are studies that suggest political insiders may have a selfish interest in writing campaign finance laws. American economist Bruce Bender (1988) looked at which US congressmen voted for the campaign spending limits that Congress passed in 1974. He found that the congressmen who got few votes from

campaign spending were the likeliest to support spending limits. Bender concluded that Congress passed campaign spending limits for the selfish reason of protecting itself against challenges from new candidates. In a different study, Abrams and Settle looked at the public debate surrounding the spending limits and subsidies to US presidential candidates. One of the common arguments politicians made for imposing these limits was that campaign spending cost too much and that these costs had risen out of control. Abrams and Settle graphed US presidential campaign spending from the late 1800's to the present and found that campaign spending in real terms had been higher in the 1920's than in the 1970's. In per capita terms or as a percentage of GDP such spending had also fallen. In their view there was no problem of exploding costs. Since this public interest argument appeared bogus, they suspected that politicians had a self-interested reason for passing presidential spending limits and subsidies.

Historical evidence also supports the view that incumbents may pass campaign spending laws in their own interests. Take the example of Vladimir Lenin, founder of the Soviet Union. Lenin came to power with the help of the printing press. He founded the newspaper *Iskra* (which later became *Pravda*) to spread his views. Though Lenin is reputed to have been a talented orator, he became known to the Russians through his writings, and the writings he commissioned from his colleagues Stalin, Trotsky, Zinoviev, and others. While he was struggling for power, freedom of the press was important to Lenin. After gaining power we find Lenin giving a speech to a Moscow crowd at which he asks "Why should any man be free to buy a printing press and publish views calculated to embarrass the state?" Incumbency had changed Lenin's perspective on freedom of expression. Once in power he decided to ban all competitive campaign spending. Only the communist party was allowed to express itself.

The Abrams and Settle view needs that regulations always favour incumbents needs to be tempered. The status quo by definition will favour incumbents. Incumbents might wish a free market in campaign spending if the free market works to their benefit. This might be the case if incumbents have access to advanced techniques for getting their message across and their opponents do not have access. Incumbents will have an incentive to protect themselves with campaign regulations if the technology for getting information across changes to favour small challengers and independent movements. This seems to be the pattern in Western democracies. In these democracies the price of getting information across has fallen with the advance of computer technology. These advances have lowered the fixed costs of getting a message across. One no longer needs an expensive printing press to make noise. A laser printer and a web site will do the trick. As these opposing cases show, we cannot make a blanket statement that campaign spending regulations will always favour incumbents. Each case has to be evaluated on its particulars.

Academic research that opposes the view that campaign regulations favour incumbents comes from Lott (1987). He argues that campaign spending may be a barrier to entry which harms voter-consumers. Such spending allows incumbents to lower their costs of campaigning by investing in brand name capital. This brand name discourages talented newcomers to politics. This might not be a source of political inefficiency if incumbents could sell their political capital to more talented newcomers. Think of a fishing license.

The fisherman who can only catch 100 fish a day will sell his license to the fisherman who can catch 200 fish a day. Society gains because now more fish are caught, and the incumbent fisherman gains. Were he not able to transfer his license, fewer fish would be caught, the incumbent would be poorer, and everyone would be worse off. Lott is saying that such transfers are not easy in politics. Inept leaders have no incentive to pass the brass ring to more talented newcomers because these newcomers cannot buy their political capital. Society suffers.

There are several links with reality missing from Lott's analysis. It ignores the efforts to which parties have gone in preserving political capital. One way to preserve capital is to build means by which to pass it from one generation to another. Parties are institutions that try to build and preserve brand name reputation. In the US and Canada the main parties choose candidates who fit the ideal of the party and resemble the candidates they are replacing. The party does not really pass-on a deed to its political capital. The party uses its reputation to assure voters that the new candidate is a certified party product. This "transfer" of political capital is credible to voters because they know the party is there to suffer in the long run if it backs a political product that deviates from the lines set down by the party. The long life of Democratic and Republican parties suggests they are masters of the art of passing on and preserving their brand names.

Lott also does not consider that in building their brand incumbents face an electorate savvy to the benefits of a brand name. Voters may discount the brand name by the probability that an incumbent will abuse his political capital. This limits the incumbent's ability to abuse of his brand name capital. Supermarkets are similar in that they include the costs of shoplifting in the price of the goods sold. Society is still worse off than if no one stole, but consumers have an incentive to avoid stores that have a reputation of not being able to control shoplifters. Stores will go to lengths to assure consumers that theft is being controlled. Security cameras and guards are there as much for the reassurance of customers as for the discomfiture of thieves. Similarly, incumbents who wish their brand name capital to be fully recognized will take measures to ensure voter-consumers of their honesty. Such measures include declarations by the candidate that he will not take money from special interests, or frequent reports to his constituents on his activities. Campaign spending by incumbents may lower the incumbent's costs of creating support but such expenditures produce a product which voters find useful: information on the candidate's honesty and his performance. Before we jump to the conclusion that campaign spending creates barriers to entry we must take care not to neglect that campaign spending may be producing something worthwhile in the process.

The benefits of competition in elections I have just painted maybe enhanced with some basic government election groundrules. As I mentioned earlier, competition thrives on information. Voter-consumers might get valuable information about whether government is costing to much, by relying on government auditors to verify whether politicians are getting kickbacks for government contracts. Auditors could do this by regular exams of party finances. The possible variants and consequences of such groundrules are the subject of the following section.

3. Financial Reporting: Most innocent of Groundrules?

Where would a government puts its foot first if it wanted to set on the path of the mildest of campaign finance regulations? The basis of any kind of election finance regulation is financial reporting by politicians. Regulation is not possible without information. The benefits of a formal reporting system are that governments can track who gives politicians money. The reporting need not be made public. In its mildest form, financial reports are kept confidential by the government, just as a citizen's tax reports are kept confidential. This mild form or reporting might discourage politicians from doing favours for narrow political interests who finance their election campaigns. The danger of reporting requirements is that they impose costs on newcomers to politics. Reporting requirements can be made so severe that only a large party can justify the fixed investments needed to comply with the law. This section looks at American reporting groundrules of elections and asks whether the laws discourage corruption or whether they act as barriers to entry in politics. Canadian groundrules are similar and will not be discussed.

3.1 Brief Overview of American Reporting Law

To understand American campaign finance law we need a quick overview of who handles money in US federal elections. Candidates may raise and spend money from their own pockets, borrow the money, receive gifts in kind, or rely on the support of groups known as political action committees (PACs). A political action committee is any organization representing an individual or group that contributes money directly to a candidate's campaign, or that spends money to promote a candidate's election. These expenditures may be made with the candidate's consent or without his consent. Candidates and parties can form their own PACs. Corporations, labour unions, government employees and foreign nationals are not allowed to contribute money to election campaigns or spend money to advocate election or defeat of a candidate. Corporations and unions may spend money to form a PAC that in turn raises money from the corporation or union's members. Charities, trade associations, and private individuals are under no such restrictions. Who participates in the financing of US politics is shown in Figures 1 and 2 (who spent and who gave the money). US politics is different from most other countries in that there is great diversity and competition in who gives and spends money. There is an especially pronounced presence of small individual contributors. Both in the case of the Senate and the House the majority of *contributions* comes from private individuals.

American federal campaign finance law is based on the distinction between people who use money to advocate the election of a candidate and people who use money to promote an idea. Campaign spending to promote ideas is completely unregulated in US federal elections. There are no limits on spending to promote ideas and those who spend such money are not required to report their financial activity to any government commission (this is a special feature of American law to which I shall return). People who advocate the election or defeat of a candidate must report to a federal regulatory agency known as

the Federal Election Commission (FEC). What is confusing to anyone trying to understand the law is that those who advocate the election or defeat of a candidate fall into two categories: coordinated expenditures and independent expenditures. According to the Commission (1996a) “An independent expenditure is an expenditure for a communication which expressly advocates the election or defeat of a clearly identified candidate and which is made independently from the candidate's campaign ... While there is no limit on how much anyone may spend on an independent expenditure, the law does require persons making independent expenditures to report them and to disclose the sources of the funds they used.” The confusion lies in that an independent person may spend money to promote an idea such as a balanced-budget law, and is under no obligation to report to anyone. Should this person say “vote for candidate Perez,” without asking Perez whether he wants this free publicity, then the expenditure is considered independent. It falls under no government limits, but the individual must file a report. Should the individual have planned the expenditure with Perez then it is considered a contribution to Perez’s campaign and falls under the limits described in section 5 of the present paper.

3.2 The Costs of Reporting

I could describe the US law on reporting in detail but the best way to get a grip on it is to understand it by discussing its problems. An issue that goes almost without debate in the US is how much it costs to comply with campaign finance law. Several recent books by experts in campaign finance (see Magelby and Nelson 1990; Nugent and Johannes 1990) do not even mention that regulation may bring costs up. Both books want to saddle candidates with more complicated, restrictive laws. The problem with obeying federal election law was summarized in a report by Harvard's Campaign Finance Study Group. It emphasized that “The Federal Election Campaign Act has itself increased the costs of election campaigning ... Costs of compliance with the Act divert scarce resources from activities which involve communications with voters. (Campaign Finance Study Group, 1979. Ch1. p.17).”

There are two sorts of compliance cost. The most visible is the cost of reporting campaign contributions. Candidates must report their loans, contributions, gifts in kind, and expenditures to the Federal Election Commission (FEC). A PAC receiving more than $200 from an individual in any calendar year must make its best efforts to disclose its contributor’s name, mailing address, occupation, employer, and place of business. Individuals are not obliged to provide this information but a political committee must try to get it and provide it to the FEC. Contributions from PACs must be reported in greater detail. Figures 3 and 4 show examples of the types of forms and just a few of the details about their benefactors that candidates and independent groups must supply the FEC. It is not enough simply to say how much money one got. "Money" comes in many forms: cash, gifts in kind, loans. Loans from individuals are considered contributions, but those from banks are, under certain circumstances, not considered contributions. These and many other details must be carefully itemized. Similar detail is required in reporting what a candidate spends his money on.

Congressional candidates must make quarterly reports in election years and biannual reports in other years. In election years presidential candidates must report every month. Any contribution of $1,000 or more made at least twenty days into the congressional candidate's campaign must be reported within 48 hours in writing to the Clerk of the House of Representatives or the Secretary of the Senate. In addition to filling out forms, a campaign must educate its workers and police itself to make sure it is obeying the law. The cost not only of complying, but of ensuring *correct* compliance is a significant part of all campaigns. In the mid 1980's presidential campaigns devoted roughly 10% of their budgets to compliance (Alexander and Haggerty 1987, p. 188). In 1996 for the average House candidate this came to $22,078 and for the average Senate candidate this came to $90,379.

What is perhaps most remarkable is that PACs must itemize each expenditure of more than $200 on independent (not co-ordinated with the candidate) activities. And any other individual or group must in each reporting period (4 times in election years) provide notarized reports of independent spending exceeding $250 and certify in writing that this expenditure is truly independent. Independent expenditures of more than $1,000 made 20 days into the campaign must be reported to Congress within 24 hours. The parade of reporting rules continues through 62 dense pages of the FEC Campaign Guide for Congressional Candidates and Committees.

Any regulation that adds 10% to the cost of business is likely to have some effect on new entrants. Perhaps the main effect is that most (get number) new candidates for the U.S. House of Representatives fund their campaigns from their own pockets. Dipping into their own pockets minimizes the costs of collecting and reporting their money. Voters end up with a smaller field of candidates than if poor, but potentially popular candidates were not discouraged by the hurdle of high fixed costs needed to comply with election groundrules. More established candidates with bigger bankrolls can spread the fixed costs of complying over a larger number of contributions. The cost advantage they get from spreading their fixed costs is a barrier to entry for new candidates. To what extent new candidates are excluded is an open question. To date no studies exist that would measure their exclusion.

Reporting groundrules may have an impact beyond the costs of compliance. A vast field of economic research into tax evasion shows that a small chance of high penalties can have large effects on tax compliance. Taxpayers who fear risk find that the gains from $1 of tax evasion give them less pleasure than the losses from $1 of fines for being caught. Tax authorities can use this risk aversion as a lever to keep citizens honest. For example, if I get twice as much pain from losing a dollar in penalties to the tax authorities as I get pleasure from evading one dollar of taxes, then the government can keep me honest by scaring me with a 50% chance of being caught. The 50% chance means that on average there is no gain to cheating. If the risk aversion effect is bigger than this, the reader can see that small chances of being caught can keep large numbers of taxpayers honest. In politics, small expenditures to enforce correct reporting of expenditures may either keep politicians and independent groups honest, or may simply discourage some of them from participating in elections. The risks of improper reporting seem to be growing and uncertain in the US. The Federal election commission is increasing its number of audits.

In 1982 the FEC reviewed roughly 23,000 cases. By 1994 that figure had risen to roughly 43,000 (FEC 20 Year Report Chapter 2, p. 3). The median penalty levied by the FEC has risen from $1000 in the 1980's to $5000 by 1994.

The FEC has also sown uncertainty about what improper reporting means. An independent group may be chased down by the FEC for not reporting advertising that the FEC believes to have directly supported the election or defeat of a candidate. Even thought the Supreme Court has given a clear definition of what constitutes direct advocacy, the FEC has repeatedly ignored the Supreme Court and taken independent groups to court for what the FEC alleges are direct advocacy advertisements masquerading as independent issue advertising. As an example of such zest, in 1998 the FEC charged that Forbes magazine had failed to report columns written by presidential candidate Steve Forbes as direct advocacy campaign spending. The FEC estimated the value of the editorials at $94,900. Even the New York times (September 3, 1998) which is a strong supporter of restrictions on campaign spending, found troubling this incursion into freedom of the press.

The FECs repeated thrusts at the Supreme Court suggest that reporting of election expenses is not a "simple" requirement of candidates and groups. When an election commission is given broad space to define election expenditures and when the commission feels it can defy higher authorities, reporting requirements may grow beyond anything that well-intentioned reformers can imagine.

The FECs truculent attitude to Supreme Court definitions of campaign spending has spilled over to candidates. In a twist that the framers of reporting law could not have imagined, candidates are using reporting requirements to mute independent group criticisms of their policies. Take the case of Senator Jesse Helms and a group of homosexual bar owners. In 1990 The bar owners formed a group that circulated information asking other bar owners to boycott Miller beer. Miller beer is owned by Phillip Morris, which contributes money to Senator Jesse Helm's elections. Helms claimed that the money the homosexuals spent on their newsletter was direct advocacy advertising against him, and that by failing to report this expense the groups had violated federal election law. The Supreme Court has made it crystal clear that direct advocacy must contain words such as "vote for", "support", "defeat." Even though the newsletter did not use these words, Helm's complaint made the FEC tie the homosexual groups in court for four years until the group went bankrupt. The chilling message has probably not been lost on other independent groups who want to make a point of principle (see Hayward and Hayward 1996 for a more detailed account).

Another emerging source of risk comes from the threat that candidates and parties face of being sued in civil court. In 1996 the Democratic party began proceedings to sue the Republican party in civil court for not filing proper reports. No research in political science exists to measure the chilling effect that such uncertainty may have on political participation. Ample research from the economics of tax evasion suggests that the possibility of such effects cannot be ignored.

3.3 Making Sure Enforcers are Unbiased

The Federal Election Commission sees disclosure at the centre of its activities: "Disclosing the sources and amounts of funds used to finance federal elections is perhaps the most important of the FEC's duties" (page 2, chapt 2 20th annual report) The Commission tries to rely on citizens' willingness to comply with the law but "As effective as the Commission's efforts to encourage voluntary compliance with the FECA have been, none would have succeeded without the deterrent provided by the agency's enforcement program."

This enforcement program is less powerful than the Commission would wish. The Commission may bring cases before civil court but cannot itself impose penalties. As the Commission explained in its 1998 Legislative Recommendations, "In maintaining a regulatory presence covering all aspects of the Act, even the most simple and straightforward strict liability disclosure violations, e.g., the late filing or non-filing of required reports, may be addressed only through the existing enforcement process...The enforcement procedures provide a number of procedural protections, and the Commission has no authority to impose penalties. Instead, the Commission can only seek a conciliation agreement, and without a settlement can only pursue a *de novo* civil action in federal court."

The Commission must also exercise restraint in hunting down offenders. Here is how the Commission proceeds when it suspects someone of violating campaign finance laws. "The Commission's Reports Analysis Division reviews each report a committee files in order to ensure the accuracy of the information on the public record and to monitor the committee's compliance with the law. If the information disclosed in a report appears to be incomplete or inaccurate, the reviewing analyst sends the committee a request for additional information. The committee may avoid a potential enforcement action and/or audit by responding promptly to such a request." The Commission must proceed carefully and in a spirit of friendly inquiry. As the Commission writes "The agency must attempt to resolve enforcement matters through conciliation. If conciliation fails, however, the Commission (rather than the Justice Department) may take a respondent to court. Likewise, when Commission actions are challenged in court, the Commission conducts its own defensive litigation. The Commission has been involved in more than 350 court cases since 1980. (Chapter 2, 20 Year Report)."

Enforcers are meant to uncover corruption and present voters with an unbiased picture of electoral finances. It is possible that enforcers may be corrupted or may treat one party more harshly than others. To avoid this problem American campaign law came up with the following system of choosing its enforcers: Six chief officers administer the Federal Election Commission. The president appoints each Commissioner and the Senate approves each nomination. No more than three commissioners may represent the same party (only the Democratic and Republican parties are represented). The Commissioners serve full-time and are responsible for administering and enforcing the Federal Election Campaign Act. They meet twice a week (once in closed session, once in open session) to discuss policy and vote on legal and administrative manners (Appendix 4, 1997 Annual

Report of the FEC). Each officer is appointed for six years and their appointments are staggered so that their terms overlap.

The structure of the FEC seems to be a success from two points of view:

1) *Point of view of election commission officers*: In the only study of its sort, Huckshorn (1985) identified 26 US states that have imitated US federal campaign law and enforcement. These states have independent boards or commissions charged with enforcement of campaign finance laws. Huckshorn sent a survey to 130 commissioners to ask them about problems of bias and corruption enforcement. The response rate was 50%. He reports that "Even though all the commissions are officially bipartisan in structure, commissioners were asked the degree to which partisan divisions have occurred during deliberations and voting. Virtually all said that they had never witnessed an identifiable partisan decision." Huckshorn's evidence is indirect because it studies imitators of the FEC. His sample size is sufficiently large to make his study worthy of note.
2) *Court cases against and by the FEC*: Politicians and private citizens who feel they have been discriminated against by the FEC may take the FEC to court. Of hundreds of FEC cases listed in a lengthy document published by the FEC entitled "Selected Court Case Abstracts 1976-September 1997" only 27 challenge the FECs disposition. It is difficult to precisely evaluate whether the FEC takes prosecutes Republican or Democratic causes more often because often the nature of a cause is not apparent from the record of the court cases. There seems to be a slight tendency to prosecute Republicans more often, but this has yet to be determined and is not necessarily a sign of partisan bias by the FEC.

3.4 Success of Reporting Groundrules

No precise and satisfying assessment is possible of how well reporting groundrules have kept down the corruption of politicians. Corruption is a vague term. Is a politician who puts money in his pocket to help a special interest group corrupt? If the group in question wants to protect forests against polluters, then the politician's action may work in the public interest. What looks like corruption has given the public a government service at low cost. Even if we could say that in every circumstance disclosure laws kept politicians back from favouring narrow interests at the expense of the public interest, we could still not say whether disclosure laws served the public. If the costs of complying with the law discourages brilliant newcomers to politics from getting their ideas across, voters will be robbed of choices. Recall that choice, along with information, is one of the two basic ingredients of competition, and that competition keeps down prices. As with most aspects of campaign finance law, our only guide to assessing the success of a policy is to ask how the policy fits into our general model of politics.

The first step in assessing whether disclosure laws have kept down corruption is to qualify the term corruption. Recent research into corruption in US politics avoids this term. Researchers prefer to use the word "shirking." A politician shirks his duty when he acts more in narrow interests than in the public interest. A politician who shirks brings

government services to his constituents at a higher tax and deadweight loss price than a politician who does not shirk. This should be the only criterion that counts when designing campaign finance laws. The trick in assessing disclosure laws is to look at what circumstances favour shirking, and to see whether disclosure laws eliminate those circumstances.

There are now dozens of studies that try to measure shirking. Evidence of shirking by legislators can be glimpsed in the behavior of the US Senate. Economists Joseph Kalt and Mark Zupan tried to see whether Senators pass laws that the majority of their constituents would want them to pass. Using a statistical technique known as regression, they identified how much a Senator's position on the left-right spectrum differed from where his constituents wanted him to be. Any differences between the Senator's position and the position a majority of voters wanted is shirking. Kalt and Zupan found that the difference was largest, i.e. Senators shirked the most, in several crucial circumstances. Winning in a district where the population was very mixed and had little in common with each other, gave senators room to shirk. A divided citizenry is not much of a threat to misbehaving politicians. Deciding to retire at the end of the term, being high-up in the committee structure of the Senate, and being well known by constituents, also gave senators the slack to indulge in policies that did not entirely suit the majority of people who elected them.

Kalt and Zupan's study gives us a way of thinking about disclosure laws. Do these laws weaken the circumstances (solid entrenchment in office by incumbents) that lead to shirking? The answer is an extremely qualified "maybe." Research by myself and others (Palda and Palda 1998, Dharmapala and Palda 1998) suggests that voters punish political candidates who rely on narrow sources of campaign funding. If disclosure laws provide useful information to voters that allows them to shorten the term of incumbents who rely on narrow sources of funds, then disclosure laws may discourage shirking. If these laws discourage candidates from seeking lengthy terms of office that could expose them to bribery, then laws will have discouraged shirking. The problem with this sort of guesswork is that we do not know how high a barrier are disclosure laws to the entry of new ideas and competition into politics.

Lack of evidence on corruption is not the only reason to question the value of disclosure laws. As I pointed out in earlier research (Palda 1992, 1994) and as Milyo (1998) has recently repeated, US politicians do not have much to sell. Corruption is the sale of government to special interests. It is theft. In my 1992 study of US States I looked at races for US governor. I asked myself, if government is for sale, then how much does a dollar of government cost? I found that after controlling for all other factors that might influence contributions, governors were getting .0002 cents of campaign contributions for every dollar of government spending. Either governors were selling off government for very cheap, or they simply do not have the power to sell government off. In 1996 a scandal surrounded the US president. It appeared that China had funneled over $100,000 of contributions to his campaign coffers. The media suggested this money disposed Clinton to sell military technology to the Chinese. No one stopped to wonder that if government could be bought for so little, amazing opportunities were going unexploited

in US politics. As Milyo (1998) explained, for $100,000 an ordinary American could mortgage his house, go to Washington, and buy millions if not billions of dollars of government favours. Clearly, campaign money cannot be the force the media would have us believe.

Corruption is more of a danger in countries where politics are not competitive. Such countries block the free flow of election information. The barriers to entry into politics in such countries as Mexico, and Pakistan insulate politicians and bureaucrats from public criticism and allow them to sell government without reproach. The competitiveness of US politics may explain why a legion of studies has failed to turn up a solid link between the contributions an interest group gives and how a politician votes in Congress. Snyder (1990) showed that a group must give money over many years to have even a weak effect on the candidate. “Effect” may be too strong a word. An interest group may give money to a politician not to change his point of view but because it likes the point of view he holds.

Even if reporting groundrules discouraged corruption, these groundrules could not stand on their own. There are many roads to influence. Table 1 shows where interest groups put their efforts to influence government in the US and Canada. Efforts spent on election campaigns are a minor part of the efforts of interest groups. Any attempt to control one aspect of campaign finance law such as information about funding might simply move the interest group to switch its efforts to behind-the-scenes lobbying. Any effort to control money in elections must control all aspects of campaign spending and then spill beyond the boundaries of spending to control lobbying and drawn a skirt around every crack through which citizens might influence government. As I will show in my discussion of speech by private citizens, for campaign finance law to limit access to government, you need to build a dictatorship.

3.5 Some Reporting Could Help

The lesson from this section is that reporting requirements may discourage political participation by candidates and independent movements. Reporting is expensive and may come to 10% of the costs of a political campaign. The risk of being audited or taken to court may scare away candidates and groups who have good ideas but fear the risk of facing expensive court battles. Perhaps the greatest cost comes from the uncertainty that the FEC generates. The FEC has taken upon itself to broaden the definition of the types of campaign spending that can be reported. In repeated defiance of the Supreme Court the FEC has prosecuted independent groups on the grounds that their spending was not to advocate issues but rather to advocated the election or defeat of a particular candidate.

The problems I have described should not discourage reformers from seeking the benefits that come from reporting. The benefits are that reporting allows government auditors to root out a narrow but important forms of political corruption: kickbacks for government contracts and procurement. Kickbacks allow high cost producers to win contracts ahead of low cost producers. This raises the cost of government and works against the common interest. The reporting requirements needed to discourage this sort of corruption are more

limited than the reporting requirements now in place in the US. It would suffice to advise parties who have held power, or have held seats in the legislature, that at any moment they could be asked to prove who gave them money (there is no need to force parties to show how they spent their money, since there is no theoretical or empirical reason to believe that how a party allocates its campaign spending has any effect on its level of corruption). This would have several benefits

1) Parties would not have to fill regular reports and incur the regular costs of campaign reporting. This would save them money. Only when audited would they have to gather their receipts and present them to the auditor.
2) Independent groups and new movements not represented in the legislature would be spared the risk of audit and so would not face a barrier to entering politics.

Perhaps the most direct critique of this proposal is that parties could get around the reporting requirements by delegating campaign spending to independent movements. Evidence from the US suggests that such delegation is not as easy as one might think. To date, there is no proof that the major US parties are relying on independent groups to get around reporting requirements. This is perhaps not surprising. A party that wants its supporters to masquerade as independent spenders will have to pay the costs of the masquerade. These costs are bound to be large. A political campaign needs to be tightly organized. Orders from the strategy room need to be carried out immediately and in fine detail. Imagine that after a planning session the candidate decides he needs an opinion poll on which to base his next campaign speech and that he needs parts of the speech advertised. The task of getting pseudo-independent supporters to pay for the poll and advertise on his behalf would be hard to mask from the authorities. At best candidates could rely on independent groups to interpret what the candidate wants them to do. Interpretation is never as good as a direct order. In the heat of a political campaign, such interpretation could lead to confusion, delay, and disaster. The candidate who relied on independent groups to interpret his wishes would also face an agency problem. These groups might not wish to send exactly the same message about the candidate as the candidate would wish. Without the ability to control these groups, the candidate might wake up to read a campaign advertisement on his behalf that has nothing to do with the message he wants to send. The fear of “friendly” independent groups comes out in the comments of a congressional aide who called them “loose cannons” (Novak and Cobb 1987).

Where federal parties evade reporting rules they do so by relying on regional party organizations to raise money for get-out-the-vote drives. This is known as “soft money” and is not controlled by federal law. Some critics claim that soft-money is disfiguring campaign reporting in the US. This criticism is beside the point. There is nothing illegal about soft-money, nor even dark or sinister. Candidates raise soft-money because they can seek out large contributions for this type of activity. These contributions are not under the crippling strictures that force candidates to seek ordinary contributions in small packets.

4. Financial Transparency

American and Canadian reporting law is for the benefit of the public. The public has access to all records describing how much a candidate received, who he received it from, and how he spent the money. Public access to reported information is known as *transparency*. A visit to the web site of the US Federal Election Commission (http://www.fec.com) or that of Elections Canada (http://www.elections.ca) shows the wealth of information available in an instant to interested citizens and the media. The FEC's web site is particularly well-developed and easy to understand. Information on who gave what and who spent what is available in summary and in fine detail (provided one has the patience to wait for large files to download). The information is very much up to date and well-presented. As the FEC writes "When a committee files its FEC report, the Commission's Public Records Office ensures that a copy is available for public inspection within 48 hours. Simultaneously, the agency's Data staff begins to enter the information disclosed in the report into the FEC computer database. The amount of information disclosed has grown dramatically over the years. By December 1994, more than 12 million pages of information were available for public review."

Election commissions see transparency as one of their central functions. The idea is that by giving the public easy access to campaign finance information, the public will police the behaviour of candidates. The mechanism by which the public might learn about campaign finances is indirect. Information revealed in the FEC's 20th annual report suggests that the media and interest groups are the main clients for information. Graphs in this report show that usage of the public records has increased in recent years. Financial transparency probably works in the following manner. The media or interest groups form impressions of candidates and parties based on financial reports at the FEC. These impressions colour reporting in newspapers and TV. Citizens (who get 85% of their news through TV) form their impressions of candidates in part on the impressions of the media. This is how financial transparency laws may trickle down to the public.

4.1 Benefits and Dangers of Transparency Laws

Work I have done with others (Palda and Palda 1998, Dharmapalla and Palda 1998) suggests that candidates who rely on narrow sources of funding do poorly at the polls. This may reflect the fact that weak candidates cannot appeal to a diversified public for funds, but it may also signal that voters punish candidates who rely on narrow sources of funding. If this latter possibility is given weight, then financial transparency may be judged to provide information voters deem useful.

Judgement on this point should be cautious. Voters have proved insensitive to issues that the media and intellectuals find important. The sexual scandals surrounding President Clinton in 1996 were big business for the media and for his Republican opponents. Voters seemed to ignore the issue at the polls. In Canada large banks give money to both major parties. This has never created a scandal in the media. Since Canada started keeping records of who gives money, who gives money has never been a major election

issue. Perhaps voters understand better than analysts, that government is complex and can be influenced through many channels. They may not deem it worth their while to base their judgements of a government on inputs, such as where it got its campaign money from, but rather on outputs, such as what sort of public goods the government provided and at what price. Put slightly differently, voters may not have the labour theory of value mentality, and so may hold financial transparency of little account.

The dangers of financial transparency are as hard to evaluate as the benefits. The main danger is that financial transparency will scare away contributors. Some contributors might wish to stay anonymous. Rockefeller built the University of Chicago in the 1890's with gifts of more than $50 million. He preferred not to have his name attached to the University and to remain in the background. The member of a labour union who favours the free market party may be discouraged from contributing to the free market party for fear of offending his colleagues. The damage to politics from discouraging large contributors is that political innovations may be slowed. As Friedman pointed out "Radical movements ... have typically been supported by a few wealthy individuals who have become persuaded---by a Frederick Vanderbilt Field, or an Anita McCormick Blaine, or a Corliss Lamont, to mention a few names recently prominent, or by a Friederich Engels, to go farther back. This is a role of inequality of wealth in preserving political freedom that is seldom noted---the role of the patron (Milton Friedman 1962, p. 17)."

Damage may also be done to the education of politicians. Citizens can use contributions to express the intensity of their preferences. Yale legal scholar Ralph Winter wrote "Contributions ... serve as a barometer of the intensity of voter feeling. In a majoritarian system voters who feel exceptionally strongly about particular issues may be unable to reflect their feelings adequately in periodic votes. As members of the antiwar movement often pointed out, the strength of their feelings as well as their numbers should be taken into account...Campaign contributions are perhaps the most important means by which such intensity can be expressed ." If transparency discourages this type of contribution the costs of learning their voters' wishes will rise for candidates.

These are speculations. The numbers are flimsy to back up the notion that transparency laws will scare away contributors. The only numbers we have that might be considered evidence are that in the US roughly 8% of voting age citizens make contributions to political parties. This is larger than in any other Western democracy. In other countries where transparency is not as great as in the US fewer citizens than in the US give campaign money. The reader must form his own judgement on the value of the comparison. It could mean that transparency rules do not discourage citizens from giving money. Or it could mean that uncontrolled factors account for the differences in campaign giving between countries. The apparent lack of effect on US contributions of the transparency law might also be due to the fact that the law does not oblige a contributor to a political committee to provide personal information. The law only obliges the committee to make its "best efforts" to obtain this information (20^{th} annual report chapter 3).

4.2 Transparency Thresholds

If reformers do not want to discourage small contributors from participating in politics, reformers might wish to apply transparency laws only to large contributors. If reformers decide that a large contribution is $100,000 then only contributors of more than this sum would be exposed to the public. The US experience with limits on contributions suggests that there are ways around such a transparency threshold. In the US the threshold is very small: $200. But US law puts thresholds on how much money a person or group can contribute to candidates or interest groups. Interest groups who want to make contributions above the thresholds resort to "bundling" of contributions. Instead of giving their own money to the candidate, these groups invest their money to collect money in small packets from citizens. The group assembles the many small contributions and presents it to the candidate as one large, but perfectly legal contribution. The contribution is legal because it is made up of many small contributions. The same technique could be used to get around a transparency threshold. For a transparency threshold to work, the law would have state that no one is allowed to bundle the contributions of citizens. The US has avoided this sort of proviso because it would violate the constitutional guarantee of freedom of association. In 1993 the Canadian government fought a court case over Bill C-114. The Bill sought to prevent private citizens from putting more than $1000 together to advertise their views during elections. Several layers of courts found the law violated the freedom of Canadians to associate freely. This freedom is guaranteed in the Canadian Charter of Rights. For a transparency threshold to work, legislators in emerging democracies might have to trample recently, and hard won human rights.

4.3 Voluntary financial reports

The assumption behind the need for disclosure and transparency groundrules is that in a competitive electoral system, parties will either not provide these reports of their free will, or that if they provide these reports voters will not find these reports credible and will prefer to trust in government reports of party financial probity. A critique of these assumptions is that the private market is adept at certifying the truth of financial records. Giant accounting firms certify the financial health of companies wishing to be listed on stock exchanges. By and large the process works well. Why could parties simply not engage these firms to make public their finances? Why do we need a government agency to do the work? The problem with private firms is that they have only half the information. They do not have access to top secret information about government arms deals or even about government business contracts. Without this information they do not know what financial questions to ask. This is why a government bureau of investigators is needed to probe parties on questions of corruption. At best voluntary financial reports can act as a sort of opinion poll by which voters would judge whether many other people feel intensely enough about the candidate to give him money. In the US the group *Campaign Reform Project* (at website http://www.wacampaigndisclosure.org) provides these reports and a similar movement is developing in the UK. These are positive developments but no substitute for official audits of a party's finances.

5. Contribution and Spending Limits

The idea behind transparency laws is that citizens will use the information in financial reports to punish candidates who appear to have shady dealings with special interests. A reformer who does not believe voters are intelligent enough or well-informed enough to make sense of the financial information that reporting groundrules provide and to discipline candidates at the polls, may wish to put tighter clamps on election money. Neither Canadian nor US legislators have been content to let political competition regulate the behaviour of politicians. In the 1970's the US hammered out a law that limited campaign contributions but did not limit election spending. In the same decade Canada chose to limit how much candidates could spend but imposed no limits on contributions. In this section I look at the experience of both countries and ask whether contribution and spending limits protected citizens or acted as barriers to entry into politics.

5.1 Official Reasons for Contribution Limits

The US does not have obligatory campaign spending limits because in 1976 in a case known as *Buckley v. Valeo* the US Supreme Court ruled that campaign spending is a form of speech and as such is protected by the US constitution. It ruled spending limits to be unconstitutional, but it judged that limits on contributions were permissible because contributions were not considered speech and limits on contributions were a way to control the influence of money on elections. This official reason is widely accepted by the media and public interest groups such as Common Cause who are attached to the idea that money is an evil force in US politics. The law produced by this reasoning is complex but can be summarized as follows:

In 1971 Congress passed the Federal Election Campaign Act (FECA), which installed the Federal Election Commission and forced candidates to report their spending and contributions. The limits on contributions were part of the 1974 amendments to FECA. Big contributions by individuals were out, and corporations and labour unions were not allowed to contribute money directly to candidates from their treasuries (meaning profits, operating revenue, union dues). But allowed corporations and union to use treasury funds to solicit employees, stockholders, or union members, for contributions to be placed in a "segregated fund." Segregated funds are known popularly as corporate or labour PACs and are also called "connected". Non-connected PACs are not affiliated with any business or union and need not set up a segregated fund. They are often referred to as "Ideological PACs." Different limits apply to different type of PACs. A PAC with more than fifty contributors, which has been registered for more than six months and has made contributions to more than five candidates, may give $5,000 to any candidate. They are known as multicandidate committees. PACs that do not meet this standard may give only $1,000 per election. Democratic and Republican senatorial committees and the national committees of any party may contribute up to $17,500 to any Senate candidate. Individuals may not give more than $1,000 to a candidate, $5,000 to a non-candidate PAC, and $20,000 to a party committee. In total individuals may not contribute more than $25,000. There is no upper limit on the sum of PAC contributions. This is just a partial overview of contribution restrictions.

5.2 Academic basis for Contribution Limits

US academics have questioned the official reasons for contribution limits. US political scientist Richard Adamany wrote

> Scholarly work on campaign finance tends to concentrate on the amounts spent, the sources from which the money is raised, and the uses to which the money is put. These data are helpful, but they do not show the relationship of campaign finance to the political environment---to the kinds of party systems, (and) the available channels of communication. Much less attention is given money to as a form of functional representation than to the very infrequent instances in which campaign gifts are made for the purpose of procuring action by public officials which would have been forthcoming in the absence of contributions.

The reason for Adamany's skepticism about contributions as an evil lies in dozens of researches into how Congressmen in the US vote on legislation. These researchers have tried to find a link between how much campaign money a congressman receives from special interests and whether he votes for those interests in the legislature. Very little conclusive evidence has come from these studies. After much sifting through the data Snyder (1990) has found that an interest group has to give money over many years before it can influence policy. The meaning though of this influence is not clear. If environmentalists support a candidate through several elections in return for his support in the legislature, does this mean the candidate has been corrupted? Or perhaps has he been won over by the arguments and the persistence of the lobby group? No one can really answer this question with authority.

What seems to be more clear about the US Congress is that no single interest group can "buy" a candidate. Rather, interest groups give money in order to get the candidate's attention. After grabbing attention interest groups must then provide candidates with information on policy. This information has to help the candidate look good in they eyes of voters. No single group has much power in this system because other groups are free to contest them. If the pulp and paper industry wants looser restrictions on pollution, the environmental lobby is free to oppose the industry. In this system wealthy individuals have no overwhelming advantages. Groups of many poor individuals can pool their money to oppose wealthy interests. Money is a very visible part of campaigns, but for all its prominence, money alone cannot buy influence. Big contributions may be of limited use unless they are backing policies that are well thought out, can be supported with facts, and find some favor with voters. As Donald Matthews explains PACs do not set policy: "relatively few Senators are actually changed by lobbyists from a hostile or neutral position to a friendly one (Donald R. Matthews quoted in Congressional Quarterly Guide, Fall 1991 p. 152)." Lobbyists influence policy by providing legislators with accurate balanced information. As one member of Congress put it "It doesn't take very long to figure which lobbyists are straightforward, and which ones are trying to snow you. The good ones will give you the weak points as well as the strong points of their case. If anyone ever gives

me false or misleading information, that's it---I'll never see him again (Congressional Quarterly Guide, Fall 1991, p. 152)."

5.3 Contribution Limits and the Cost of Campaigns

US contributions limits come at a cost. The limits impose fixed costs of raising money. As explained above candidates and committees must get their money is small packets. Former Republican Representative Dick Cheney wrote of the presidential race "It simply takes a great deal more effort to raise $10-15 million, if it only comes in amounts of $1,000 or less, than it does if there are no upper limits on the amount an individual can contribute. Time spent on fundraising activities...detracts from the basic purpose of the campaign---persuading a majority of the voters to support a particular candidate (Cheney 1980, p. 244)." Of his own problems as a congressional candidate Cheney wrote "The $1,000 limit makes it very difficult for a newcomer to raise sufficient funds to get his campaign off the ground. The result is that a would-be candidate finds it necessary to finance his beginning efforts himself because no one else will, especially if he is running against an incumbent or in a primary (Cheney 1980, p.245)." The high cost of raising funds may explain why in a survey conducted by the Center for Responsive Politics, 52% of Senators said that fundraising significantly reduced their legislative time. Another 12% said that the demands of fundraising had at least some negative impact (Magelby and Nelson, p. 44, in ch 4 of 20th report).

To understand how contribution limits raise fixed costs we need to understand something about the technology of raising money. Money raising requires several types of fixed investment: contacts with prominent people and the media, offices, databases, computers. The relation between these investments and fundraising is not linear. A candidate needs a certain level of investment before funds will start to flow. This investment can act as a barrier to entering politics. A new candidate may wish to build his reputation over several elections. In the first election he might be happy with a small share of the vote. But a small share of the vote may not justify his investment in the fundraising apparatus necessary to get contributions from many small givers flowing. Without contribution limits he could focus his meager resources on a few large contributors. Faced with these obstacles, beginning candidates are forced to dip into their own pockets. This limits the field of potential candidates.

Analysts often miss the connection between contribution limits and large fixed costs. Fritz and Morris (1992 p. 3) say that incumbent fundraising and spending are "driven by the urge to build a political empire, not by the seriousness of the opposition." They note that in 1990 incumbents spent less than 40 percent of their campaign funds to communicate with voters. Most of their money went to create what one critic calls a "gold-plated permanent political machine"-a well-funded campaign organization used to discourage challengers from entering the race (p. 27). What these and similar analyst fail to note is that what incumbents invest in their “political machine” may be money spent to pay the fixed costs of communicating their message. Candidates cannot simply spend all their money on advertising. They must spend money to raise money. Contribution limits

raise the cost of raising money. What look like political machines designed to discourage challengers may be fixed costs needed to cope with raising money.

Limits also hinder independent groups. Independent PACs cannot accept sums of more than $5,000 and cannot give more than $1,000 to any candidate. This makes it hard for groups to raise money and especially to give it away. Movements are less effective if they cannot pool their members' resources and direct them in concentrated bursts. The law has forced them to set up and administer multiple committees and it is estimated that it may cost 10% more to raise and spend the same amount of money as it did before the Federal Election Campaign Act (Moore 1980, p. 58).

It is not clear whether the legislators who passed contribution limits intended them in the public interest or passed them as barriers to entry into politics by new candidates, parties, and independent movements. Whatever the objective was, its effects have been to complicate and raise the costs of US political financing.

5.4 Contribution Limits as a Battle Between Parties

Another cost of contribution laws is more subtle to trace. Republicans and Democrats are forever trying to rewrite the laws to disadvantage each other.
A recent act in this dispute was the debate behind the reform proposals of 1992. It clearly shows how self-interest shapes the positions Democrats and Republicans take. Republicans wanted a ban on PAC contributions but not on spending limits. Democrats wanted candidate and independent group spending limits, public subsidies, and a ban on PAC contributions. Each side's proposal, if passed into law, would have worked to its political advantage. Republicans raise more money than Democrats, but less of it comes from PACs. This is because PACs tend to give more to incumbents and Republicans were and had long been the challenging minority in both houses at the time. Until the early 1980s Republicans did not complain, simply because PACs gave *them* more money. The tide turned hard against them after they lost control of the Senate in 1986, and by 1989 President Bush was proposing a ban on most types of PACs and an emptying of campaign warchests at the end of each election. Today the squabbles continue. The cost of these efforts to rewrite political campaign finance laws in the interests of a particular party are a waste of resources known in the professional literature as “rent-seeking costs.”

5.5 The Canadian Solution: Spending Limits

Canada has avoided the expense and hypocrisy of US campaign finance by imposing spending limits instead of contribution limits. The 1974 Canada Elections Act imposed separate limits on spending by candidates, parties, and private individuals (in later court challenges the limits on what private individuals could spend were struck down). By taking this route Canada has avoided imposing fixed costs on entrants to politics. Individual candidates often receive a few large contributions from friends, local businesses, or eccentric philanthropists. Banks are among the largest supporters of the main parties and each bank gives almost equally to either party. Canadian politicians almost never complain about the time it takes to raise campaign money.

Spending limits may not raise the costs of soliciting contributions, but is there a danger such limits place a barrier to entry in politics? Let us review some recent empirical findings about the effect of money on electoral outcomes. Researchers have found for the US, France, the UK, and Canada that incumbents start their races with a block of devoted supporters, but that incumbent campaign spending does not win over many voters. In particular Jacobson (1978) estimated that in 1974 US House elections, challengers gained on average 12.1% of the popular vote for every $10,000 they spent, where incumbents gained only 2.8% of the vote for every $10,000 spent. Palda and Palda (1985) found that in Canadian elections, being a first term incumbent in Canadian parliamentary elections was worth an extra 8,1000 (in districts of roughly 50,000 constituents). These studies are suggestive but not conclusive. For a good survey see Milyo (1998).

Bender (1988), Jacobson (1978), and Lott (1989) reason that incumbents use franked mailing rights, paid travel, and government office staff to promote themselves while in office. This assures them a large block of initial voter support but leaves little to accomplish for incumbent campaign spending. Challenger spending is a threat to incumbents because challengers have not spent into the range where their money loses its power. A limit could protect the initial vote advantage of incumbents while saving them the expense of a pitched battle for election. This is how a spending limit may act as a barrier to entry.

Spending limits on politicians comes in varieties. In Canada there was until 1997 a limit not just on how much a candidate or party could spend but also a limit on how much time they could buy on television and radio. A bureaucrat known as the broadcast arbitrator used an obscure formula mixed with his opinion to allocate how much broadcast time each party could buy. The guiding principle was that a party was allowed to buy time in proportion to how well it did in the last election. That the formula was intended to build inertia into Canadian elections was not denied. Prominent politicians explained that the limits were meant to protect the major parties from brash newcomers. How severely such a law can be out of synch with public opinion was demonstrated in the 1993 Canadian election. During that election the ruling Progressive Conservative party was allocated 162 minutes of purchasable time. The Reform party and Bloc Quebecois which had been formed in 1988 were each allocated 17 minutes. The Conservatives lost all but two of their seats in parliament while the Reform and Bloc Quebecois parties between them won a third of the seats in Parliament. These new parties have proved to be stable popular parties. They did plunge the country in chaos. The only effect of the spending limits might have been to delay or slow the entry of these parties into Canadian politics and so limit competition to the established parties. In 1995 the court ruling *Reform Party of Canada v. Canada (Attorney General)* overturned the limit on how much time an *existing* party could buy. The ruling kept in place the limits on how much time a *new* party could buy.

5.6 The Law of Expanding Regulations: Independent Groups

Contribution and spending limits on parties and candidates have not satisfied the legislative appetites of politicians and election commissions. Both in Canada and the US, politicians have argued that for limits to be effective, they must fall on private citizens who make noise during elections. The official argument is that it is unfair to bind politicians and leave citizens free to speak as they please during elections. Politicians argue that private citizens who advertise their views are not accountable to the public. This lack of accountability and the danger that big public money will buy public opinion calls for regulation.

How much of a burr under the politician's saddle these private citizens' groups are can be seen from a selection of comments by US and Canadian politicians. A former US campaign manager said ``Independent expenditure scares the daylights out of me. A third party comes in that doesn't know my strategy or my budget and interjects itself. This could terribly jeopardise a campaign." (Sabato 1985, pp. 102-103). A Congressional aid referred to independent campaigns as "loose cannons on deck" and Republican Senator Dan Evans on whose behalf such a group had campaigned in 1983 said, ``I think unquestionably if you measured campaigning by sleaze factor, that independent expenditures on campaigns are probably the highest sleaze factor in campaigns today" (Novak and Cobb 1987, p. 35). Pierre Trudeau, former prime minister of Canada reviled an independent group known as the National Citizen's Coalition. Trudeau admonished " It is as well to remind them (the Citizen's Coalition) there remains freedom of speech in this country. Anyone can get up and oppose any Party and any Member in any way. It is just that he cannot use the power of money...to give him an advantage over other candidates (Hiebert 1989)." The sentiment of politicians on this point is so strong that both in Canada and the US, politicians have defied the highest courts in their land to impose limits on how private citizens can express themselves. In neither country have politicians succeeded in blunting the competitive fringe of free-speaking citizens, but this is not for want of trying.

Canada and the US are not alone in their fear of private citizens. France, and emerging democracies such as that of Slovenia have put similar restrictions on private citizens (see Palda 1996, and Palda and Palda 1998). In every case, politicians have written laws to keep private citizens from advertising their own views during elections. Politicians seem to agree that independent groups do not play by the rules of the game. They criticize and propose embarrassing reforms that make the life of the entire ruling order a misery. The situation is similar to that of Republican Rome. In his *Last Generation of the Roman Republic*, Erich Gruen (1969) explains how the Sullan constitution allowed fierce political competition for top posts such as consul, praetor, and quaestor, among insiders of the Senate, but how Sulla had arranged the constitution to make it hard for outsiders, especially agitators of the tribunate, and the equestrian order to make their voices heard. The lesson seems not to have been lost on the present generation of politicians.

Is there a legitimate reason to allow the basic groundrules of election regulation to stretch over the free speech of citizens? As mentioned earlier, politicians maintain that

private citizens are not as accountable to the public as are parties. Parties have long-term political capital to lose by misleading the public. This make parties reflect longer before speaking, and curbs their demagogic excesses. To cite a few opinions: "with no sponsoring organization to accept responsibility, and with contributors scattered across the country, those who make direct independent expenditures may be tempted to engage in activities that verge on excess" (Twentieth Century Fund 1984, p.4). Democratic Senator Paul Sarbanes put it more bluntly: "The independent PACs operate outside of (the) framework of accountability and simply become hit artists on the political scene. (Alexander and Haggerty 1981, p.157).

For the argument to stand one must believe that voters do not take into account who is speaking. A criminal on death row running for office may address the public, promise them great things and the public will believe him just as much as they believe a politician of long-standing who faces no death sentence and will be around a long time to face the consequences of his actions. There is no direct test of whom the public believes, but there is a growing body of evidence that the public takes into account information about how politicians perform in office. Peltzman (1992) has shown that voters in state elections remember information about government spending stretching as far back as three years. Psychological studies, surveyed by Crete (1991), and recent work in political science by Lode et al. (1995) bear out the notion that voters are not all seeing, but are sensitive to information about candidates. More direct evidence that voters think about who is speaking comes from the actions of parties. Parties invest huge budgets in finding credible, talented candidates with long records of service in either public or private office. Why invest in such a talent hunt if you believe the public is not able to distinguish between candidates who are accountable to the public, and to demagogues who will mislead the electorate and disappear the next day after the damage is done?

The American experience gives evidence that official safeguards on accountability are not necessary for balanced, informative elections. What matters is whether every argument can be contested. Money is likeliest to cloud the issues and mislead voters when competitors are forbidden to express their views. Money by itself does not buy elections. Many PACs have attacked candidates to little effect because voters simply did not like or believe what they said, or believed their the interests such groups represented were too narrow. Several important failures by the National Conservative PAC and the American Israeli PAC in the 1980s support this point, as do the many lavish but unsuccessful presidential campaigns of conspiracy theorist Lyndon Larouche. PACs and other independent spenders may fail precisely because they are not accountable. How far the public believes a message depends in part on the consequences of lying. A group that is not accountable will suffer less from lying than one that is, which is why people trust it less.

The safeguards against irresponsible campaigning which the political market imposes has benefits for voters. Campaigns by independent groups can increase the flow of information in elections. The great asset these groups have is that they can focus attention on one issue, something that major parties cannot afford to do. This specialized function is a major political innovation which promises to increase competition in elections. To see this more clearly it helps to think of independent groups as agents for the public, collecting money and

using it in a disciplined way to keep politicians in line. Some ideas have too little support for a party to embrace, or are too fleeting to found a party on. Because independent groups have low set-up costs, and no need to please the majority on a large number of issues, they are well suited to promoting such ideas. When loyal supporters of the large parties have a complaint, they can send a message to their leaders at low cost through a single-issue group. Even moderate voters can use committed groups to their own advantage. The positive function of independents has been largely ignored in the reform debate. This may explain the almost paranoid focus on the fear that wealthy, unaccountable interests will gain too much political power.

6. Are subsidies the answer?

Would *government* campaign subsidies stop the risk of electoral corruption and at the same time avoid putting barriers to entry into politics? That would depend on how the subsidies are put into place. Note the emphasis I place on "government" in the previous paragraph. Private individuals also subsidize ideas and candidates whom they think are worthy of advancement. The question is, who do we want subsidizing politics: citizens or a government subsidy board?

6.1 Spoils to the Victors

Let us look at the international experience with campaign subsidies. Gunlicks' (1993) survey book of campaign finance formulas in Canada, and Western Europe details how governments give campaign subsidies on the basis of past political performance. In all these countries subsidies come attached to campaign spending limits. There is no other way for government to respect its limited budget and at the same time minimize the role of private money in elections than to attach subsidies and campaign spending limits. In the US, only presidential candidates and candidates for presidential nomination qualify for government subsidies. If they accept the subsidies they must submit to spending limits. Democratic and Republican presidential candidates each qualify for $20 million (in 1974 dollars) of campaign subsidies. Third party candidates may receive some small subsidy, *after* the election (for a detailed explanation see Palda 1994). The fact that the spending limits are voluntary means that this type of limit does not violate the constitution's guarantee of free speech. In Canada any candidate who wins above 15% of the popular vote qualifies to get 50% of his expenses reimbursed (check). Parties who spend more than 10% of national spending limit get back 22.5% of their expenses. Contributors benefit from a generous schedule of tax credits. For each dollar contributed up to $100, the contributor gets back 75 cents, then 50 cents on the dollar for the next $450, and finally 33.3 cents per dollar on the next $500 contributed. The US also gave contributors tax breaks but this benefit was revoked in 1986. Corporations cannot deduct contributions from their taxes, nor can individuals deduct more than the amounts specified above.

The Canadian government allocates to parties "free" broadcast time on radio and television (free, of course, is a misnomer because broadcasters pass the cost on to

consumers through higher advertising costs for commercial goods). A broadcast arbitrator divides the free time in proportion to how well parties did in the previous election. For more details the interested reader may refer to (Palda 1991). Germany deserves special mention. Its expense on campaign subsidies that dwarf subsidies in other countries. Each year the major parties receive hundreds of millions of dollars to "educate" voters. Major parties receive the bulk of these subsidies which they channel through foundations. These foundations hold conferences open to the public, and even maintain offices abroad. For example, the Konrad Adenauer Foundation (the propaganda arm of the Christian Democratic party) has offices in Washington. These offices work to influence foreign reporting on German politics. Newly established parties who fall below a certain threshold of votes get no support. In Germany, more than perhaps anywhere else, the spoils go to the victors.

6.2 Subsidies as Barriers to Entry

US and Canadian subsidy schemes differ in their details but share two common features: a threshold of popular support needed to qualify for subsidy, and money given based on past performance. What effect do these subsidies have on corruption or on political competition?

1) *Corruption*. Influence peddling and corruption are not absent in countries where government pays for elections. Japan has legislated private money out of elections and replaced it with public subsidies. Yet Japan is acknowledged to be governed by a cabal of business and government interests who have made corruption a central feature of business. The Soviet Union did not allow private campaign financing of elections. This did not stop the regime from rotting through with corruption. Many other factors in these countries may explain their level of corruption, so perhaps we should not carry the analogy with the US and Canada too far. What these countries hint at is that there are many ways to sway politicians; if special interests cannot use contributions during the election to get what they want they can always spend more time lobbying the winners after the election or simply bribing them. A free market in contributions and spending may work as a force against corruption if everyone is free to contest everyone else. This means being free to raise money to expose an opposing politician who is performing badly. Far from being a force for evil in elections, campaign spending may keep democracy honest and healthy.
2) *Competition*. The expense of transfusing tax dollars to politicians might be worthwhile if we knew that the money was informing voters and so raising the competitiveness of the political system. We have no such knowledge. Public money given to a candidate who has lost the public's approval may simply be money thrown out the window. A study from the U.S. by Phillip Nelson (1976) suggests that voters have a demand for election information. There are certain things they wish to know and other things that do not interest them. Giving public money to a candidate who cannot satisfy these particular interests is a waste. Whether subsidies hinder competition by buying votes for established parties is not clear. By themselves, subsidies may change little. A party will not win, simply because it has money. The riches of Steve Forbes or Lyndon Larouche won them little support. What seems

more important to controlling competition is, as explained earlier, to block contending messages from opponents by imposing a spending limit.

Public subsidies may have a longer term effect on competition if they change the quality of candidates who present themselves. To see this is helps to understand that in the US large parties did not always start out large. Political movements often begin with meetings in community halls or parks. True believers beat the pavements to convince other voters. If the party has a good message, and the manpower to kickstart a discussion of its views, it is ready for the next test. Can it attract appealing candidates? The road to being a large party with good funding has a test at each intersection. Parties that do not pass each test, make slow progress on their journey to power.

The private market has developed similar tests for inventors. Every inventor believes he is misunderstood and has come up with a device people will want. To get the device to the people though, he needs funding. Successful inventors are those who believe enough in their product to spend painful years knocking on hundreds of doors for funding. Markets do not leave inventors completely to themselves though. A special breed of economic bloodhound called the venture capitalist has appeared as an answer to the inventors cry for help. These venture capitalists specialize in hunting down promising new products, and funding these products through years of risky development and marketing. Venture capitalists are the guardian angels of poor, unknown inventors, and help assure that the inventions that make it to market do so because they are the best.

In politics, parties are the guardian angels of poor, unknown candidates. Successful parties in the US are those with a system for hunting down political talent. The primary system that Democratic and Republican parties have is like an audition that lasts for months. At the end of the audition, the party can be confident that the best candidates will represent it. Even before primaries, both parties keep a lookout for promising young leaders. It is with the patronage of senior party members that the Bill Clintons and Richard Nixons get their initial push on their way to the top. Neither of these candidates was rich but in the end they came to control tens of millions of campaign dollars. This shows that in a competitive political system, money seeks out talent which then attracts further money.

6.3 Candidate specific or general subsidies?

No system of *government* subsidies can match the tests I have just described for bringing out the best in the political system. The practice with government subsidies instead has simply been to hand over the most money to the party that does the best after the election. This is like giving the biggest subsidy for research and development to Microsoft. The method of giving money is crude because government’s hands are tied. Imagine the criticisms a government would take if it started selecting who would or would not get the subsidy. Industrial policy calls this sort of handout a firm-specific investment grant. As Usher (1983) has explained these grants may help new firms overcome barriers to entering the market if the grants are well-targeted. The proposition does not seem controversial when applied to industries because one can argue that by helping promising

startups government is serving the general interest. The proposition is unworkable in politics. Who would trust a president to hand government subsidies to parties that might defeat him? Instead of relying on discretion, all countries with subsidies rely on rules that do not change the relative advantages of parties.

Are there never circumstances where general subsidies might help promising candidates above poor quality candidates? There is no work on this in political science, but the economic work of Stiglitz and Weiss (1981) may give some hint of the circumstances where general subsidies might help.

Stiglitz and Weiss (1981) ask us to consider the following type of scenario: take a firm with an expected rate of return of 20% but a 50% chance of bankruptcy and another firm with 20% expected return and 50% chance of earning only 10%. Who gets the loan? Stiglitz and Weiss argue that banks know only the expected rate of return but cannot tell who the high risk firm is. At any interest rate the bank charges, the high risk firm is likeliest to present itself for the loan because of limited liability laws. Limited liability means that the high risk firm's losses are limited but its potential upward gains are not restricted. High interest rates do not deter the high risk firm because it knows its failures will be mopped up by the bank. Banks on average must recapture their losses, so they end up charging very high interest rates to their self-selected group of high-risk clients. The situation is similar at all-you-can-eat restaurants. People with weak appetites stay away from these places for fear of subsidizing hungry diners. So only high-appetite people show up and the price of the buffet reflects their average voracity. To entice the firms with low risk but high-return projects, the government could give banks a interest subsidy. The subsidy would in part be a direct transfer to firms who would have accepted the loan in any case, but some loans would be taken by high-return, low-risk firms who before had not taken them.

What does this have to do with subsidies to political candidates? In the Stiglitz-Weiss world, government does not need any special knowledge of firms to improve overall welfare. A blanket subsidy does the trick. In politics we could believe a blanket subsidy to candidates would improve the overall quality of candidates if we believed that poor quality candidates were discouraging able quality citizens from presenting themselves for office. Consider a high quality and a low quality candidate presenting themselves for election. Voters may not be able to tell which is the best candidate without first electing one of them. Voters know that this means low quality candidates will present themselves for election. High quality candidates may be discouraged because a loss in the race may hurt their reputations more than a loss hurts the low quality candidate. What happens in the end is that low quality candidates are the only ones who end up presenting themselves for election. A campaign subsidy to all candidates might encourage high-cost, high-quality candidates to enter the race.

If this story sounds dubious it is because political markets have worked ways around the problem of the "adverse selection" of candidates. As I explained earlier, parties exist to screen-out poor quality candidates. Parties can do this credibly because they are long-term institutions that bear the risks of mistaken choices. In this more realistic setting,

where there is no adverse selection of candidates, a blanket subsidy will bring out the worst in politics. It will encourage fringe groups of no public value to run repeatedly for election. For example, since 1993 the Canadian government has subsidized the Natural Law Party. This party promises that "The first act of a Natural Law Party Government will be to create a group of 10,000 trained in the practice of Yogic Flying. This Group for a Government will radiate an influence of harmony and positivity in the nation which will support all facets of individual and national life (see their website at http://www.natural-law.ca)." It receives close to none of the vote, but because it skillfully registers candidates in 55 electoral districts (there are 301 electoral districts in Canada) it qualifies for a threshold level of party financing. This is not to say that new parties are not important to innovation in politics. The problem with blanket financing is that government does not know when to withdraw its support as would parties and contributors seeking the best quality candidates in the political market.

6.4 Subsidies and Fairness

What about parties that get most of their money from a few narrow sources, such as big businesses? Don't these contributions make elections unfair? The fact that a party has to rely on a few narrow sources of contributions suggests that this is not a very successful party. If you look at the US and Canada, the most successful parties get most of their money from small individual donations. All the millions of Steve Forbes could not get him nominated as Republican presidential candidate. Sometimes of course having lots of money can help, but this is when the candidate is worthwhile. John F. Kennedy came to power with the help of his father's fortune. He is also remembered as a beloved president of the United States.

The moral of this story is that money alone will not give you an advantage. You also need to be a candidate with potential. It may be unjust that some brilliant candidates have to struggle before finding money, but unworthy candidates with lots of cash are not a danger. The system of competitive fundraising that has evolved in the US is a successful method for sniffing out talented candidates. This system continues to evolve as parties seek new ways to compete with each other. Government subsidies cannot come close this competitive system when it comes to evaluating who should advance in politics because at best government subsidies must be handed out according to rigid rules, not the flexible methods of parties.

7. Election Commissions: A Case of Too Much Independence?

Whatever groundrules and limits a country chooses, it must find administrators to make sure the laws are obeyed. The US and Canada both rely on election commissions for this task. The challenge of setting up any election commission is to decide how much power it should have.

The Federal Election Commission in the US has a power that Elections Canada does not have. The FEC has the power to advise on the interpretation of election laws and to write election regulations of its own (so-called advisory opinions). The FEC's independence

has led it to indulge its own views about regulation. The FEC is a muscular advocate of tight restrictions on campaign finances. In its quest for tighter restrictions the FEC may also have imposed barriers to entry into politics.

The FEC's main assault has been on campaign spending by independent citizens. The Commission tries to widen the definition of the types of spending that come under contribution limits. In its 20th Annual Report the FEC writes that it "has struggled to find an express advocacy definition that is narrow enough to avoid impinging upon First Amendment rights (the right to free speech), but broad enough to ensure the effectiveness of the federal election laws." Why the Commission should feel it needs to struggle with the definition is not clear. In its 1976 *Buckley v. Valeo* ruling the US Supreme court spelled out what constituted express advocacy. In the Court's view express advocacy was a communication that in express terms advocates the election or defeat of a clearly identified candidate for federal office using terms such as "vote for," "elect," "support," "cast your ballot for," "Smith for Congress," "vote against," "defeat," or "reject." This seems not to have been good enough for the Federal Election Commission, which has continued to try to broaden the definition of regulated campaign speech. In a recent wrangle with the courts the FEC was rebuffed by US justices for trying to define campaign spending by independent citizens expressing their views on issues, as a form of express advocacy of candidates which would fall under contribution limits. In *Faucher v. FEC* the US Court of appeals for the First Circuit explained "In our view, trying to discern when issue advocacy ... crosses the threshold and becomes express advocacy invites just the sort of constitutional questions the Court sought to avoid in adopting the bright-line express advocacy test in Buckley." This slap in the face has not stopped the FEC.

Why the FEC should wish to pay special attention to groups on the fringe of institutionalized politics has not been studied. What makes this tendency in the FEC remarkable is that other election commissions in the US states, in Canada, and in the Canadian provinces share the same views. In the province of Quebec the election commissioner took to court Canada's two main airlines. During the provinces 1995 referendum campaign on whether Quebec was to separate from the rest of the Canada, the airlines flew in several hundred thousand Canadians at greatly reduced prices from all over the country. These Canadians came to march in a parade where they showed citizens of Quebec that the rest of Canada did not want Quebec to separate. The election commissioner saw this expression of mass sentiment as a violation of the provinces campaign spending laws and began proceedings in the courts against the airlines that made the demonstration possible. This resistance to citizen action is a constant across all election commissions I have studied. The other constant across all these commissions is that their administrators are chosen by a circle of established politicians. In the US citizens votes directly to appoint sheriffs and district attorney. In no case that I know of have citizens voted directly to appoint election commissioners. Perhaps the hostility of commissioners to outsiders who would compete with the established parties can be explained by the fact that the commissioners are creatures of the parties.

8. Election Laws as Instruments of Political Battle

In US politics, warring interests use campaign finance laws to trip up each other. To make things easy for these interests the Federal Election Commission published a brochure entitled, Filing a Complaint. The brochure explains that anyone who believes that a candidate or party or interest group have broken campaign finance law, may file a complaint with the FEC. The FEC must then ask the group being accused to prove its innocence. The FEC handles thousands of such complaints each year and in 1994 investigated roughly 43,000 cases of potential campaign finance violation.

Complaints sometimes become serious enough to be taken to court. Consider two examples among many. In 1997 the Democratic Senatorial Campaign Committee (DSCC) filed a suit for violating campaign finance laws against the National Republican Senatorial Committee (NRSC) (p. 20, 1997 Annual Report). The story begins in 1993 when the DSCC complained to the Federal Election Commission that the NRSC was violating campaign finance law. The FEC delayed and was taken to court for this delay by the DSCC. The court threw the case out, so the DSCC decided to prosecute the NRSC directly. In a different case, Common Cause (a private interest group that wants tight control on campaign spending and is closely allied with Democratic party interests) and a Montana democrat filed a complaint with the FEC that in the 1988 Senatorial race in Montana, Republicans had not properly reported their finances. The FEC dismissed the allegations and Common Cause pursued the matter in the courts (p. 21 Annual Report 1997). The FEC's book *Selected Court Case Abstracts 1976-September 1997* is stocked with similar cases.

The similarity of the above cases is that opposing political interests use campaign finance law to embarrass or impose penalties on others. No record exists of how much money or effort parties and interest groups devote to antagonizing each other. Nor is it clear what such antagonism "buys." Does it make for more informative and honest elections? What is more certain is that the mountain of campaign laws the US has written allows political movements to impose costs on each other and to raise the price of politics. This augmented price may divert resources from campaign debates over issues of government efficiency.

In Canada, interest groups have not actively used campaign finance law to put each other down. The reasons are hard to explain. Canada's election finance law is in many ways as complicated and as inviting to litigators as US finance law. The lower tendency to litigate campaign finance laws may be part of a large parcel. Canadians use the courts far less than Americans to litigate against each other in all walks of life (Robson and Lippert 1997). Whatever the reasons for the difference between the US and Canada, the US example serves to alert the reader to a cost that campaign finance law may impose on the practise of democracy.

9. Summary of Lessons for Emerging Democracies

What lessons can and emerging democracy draw from the Canadian and US experiences with campaign finance law? If regulators are confident in the education of their voters then they will be confident in the competitiveness of their elections. Competitive elections require only the most basic of election finance groundrules. These basic groundrules are that candidates and parties should report their finances, and that the election commission should make these reports public. The electorate can then decide to use this information to police their representatives. I have pointed out that reporting requirements may add as much as 10% to the costs of election campaigns. These costs are particularly onerous for new movements because these movements do not have the electoral support to justify sinking the fixed costs needed to obey reporting laws. Reporting laws may have a perverse effect. Instead of making elections competitive, they may block the entry of new ideas. This is the tradeoff.

Canada and the US have gone beyond simple reporting laws. These countries impose spending limits or contribution limits on candidates and combine these with public subsidies. Their stated goal is to remove the influence of private money from elections. To believe in the value of limits and subsidies, the reader must believe that those who impose these strictures will do so in the public interest and not in their private interests. I have presented evidence that suggests established parties use limits and subsidies to protect their political capital and keep outsiders from competing with incumbents.

The reader may wonder whether there is scope for benevolent regulation of elections. No doubt such regulation exists. The experience with the US and Canada suggests that the place to look for such benevolence is not with the elected legislatures. The rules of the political game might better be written directly by the people. Some of this goes on in the US where term limits for politicians are sometimes decided by initiative or referendum. For this solution to make sense of course a country needs to have direct democracy in which the people can themselves propose directly the shape that laws will take. A different way of getting benevolent campaign finance regulation is to convene a special assembly of 1000 citizens chosen by lot from the population. This assembly would sit for perhaps a month and set out the main ingredients of campaign finance laws. The legislature would then work out the details. Any change in campaign finance law would have to convene this assembly of the people for approval.

Even in an ideal world where campaign finance laws were written with the public interest in mind, there is a danger such laws would contain corruption about as well as the finger of the little Dutch boy who tried to plug a leaking dyke. Soon other holes appeared and he ran out of fingers. Imagine for a moment what would happened if campaign contributions were banned from elections. Interest groups would still try to influence government, but now that influence would take place in the dark. The company that wants permission to pollute a little in order to create many jobs might not get the politician’s support. The politician may find it too risky to support the company without campaign money to help him explain to the public the benefits of such support. A policy

that might have been good for most constituents would not be passed, for lack of money to explain that policy to the public. It is also possible that bad policies get passed. What happens in a world without campaign spending, will depend more on the lobbying skills of interest groups than on public debates. In the end it is not really possible to "get money out of politics." A limit on contributions just shifts use of money away from public debate and toward less public, competitive, avenues of influence.

This paper does not deny that money sometimes corrupts candidates and sways them away from the public interest. No system of competition is perfect. What I have tried to show by discussing Canada and the US is that the alternative of strict campaign regulations is no cure-all. Regulators must be alert to how competition works in political markets and how campaign finance regulation may interfere with the exchange of information between candidates and citizens.

References

Abrams, Burton A., and Settle, Russell F. ``The Economic Theory of Regulation and the Public Financing of Presidential Elections." *Journal of Political Economy* 86 (April 1978): 245-257.

Adamany, David. "The Unaccountability of Political Money." In pp. 95-116. Edited by Margaret Latus Nugent and John R. Johannes. San Francisco: Westview Press, 1990.

Alexander, Herbert E., Haggerty, Brian A. *Financing the 1984 Election.* Lexington: Lexington Books, 1987.

Becker, Gary S. "Competition and Democracy." *Journal of Law and Economics*. Vol. 1, 1958: 105-109.

Bender, Bruce (1988). ``An Analysis of Congressional Voting on Legislation Limiting Congressional Campaign Expenditures." *Journal of Political Economy*, 96:1005-1021.

Campaign Finance Study Group. *An Analysis of the Impact of the Federal Election Campaign Act, 1972-1978.* Cambridge MA.: The Institute of Politics (Harvard University), 1979.

Dharmapalla, Demika and Filip Palda (1998). "Campaign Contributions as Information: The Case of US House 1992 Elections." ENAP working paper.

Domar, Evsey D. "The Blind Men and the Elephant: An Essay on Isms." Pages 29-48 in *In Capitalism, Socialism, and Serfdom*, a collection of essays by Evsey D. Domar. Cambridge: Cambridge University Press, 1989.

Eckard, Woodrow E. Jr. (1991). “Competition and the Cigarette TV Advertising Ban.” Economic Inquiry. 29:119-133.

Friedman, Milton. *Capitalism and Freedom.* Chicago: Chicago University Press, 1962.

Fritz, Sara and Dwight Morris. *Handbook of Campaign Spending: Money in the 1990 Congressional Races.* Washington: Congressional Quarterly, 1992.

Gunlicks, Arthur B. *Campaign and Party Finance in North America and Western Europe.* Boulder: Westview Press, 1993.

Haas-Wilson, Deborah. “Strategic Regulatory Entry Deterrence: An Empirical Test in the Ophthalmic Market.” *Journal of Health Economics*, Vol. 8, 1989:339-352.

Hayward, Steven and Allison R. Hayward. “Gagging on Political Reform.” *Reason Magazine*, October 1996.

Huckshorn, Robert J. (1985). “Who Gave it? Who Got it? The Enforcement of Campaign Finance Laws in the States." *The Journal of Politics*. 47:773-89.

Jacobson, Gary C. (1978). ``The Effects of Electoral Campaign Spending in Congressional Elections." *American Political Science Review*, 72:469-491.

Kalt, Joseph P. and Mark A. Zupan. “The Apparent Ideological Behavior of Legislators: Testing for Principal-Agent Slack in Political Institutions.” *Journal of Law and Economics*. Vol 23, April 1990: 103-131.

Lodge, Milton, Marco R. Steenbergen, and Shawn Brau (1995). “The Responsive Voter: Campaign Information and the Dynamics of Candidate Evaluation.” American Political Science Review, 2:309-326.

Lott, John R., Jr. (1989)."Explaining Challengers' Campaign Expenditures: The Importance of Sunk Nontransferable Brand Name." *Public Finance Quarterly*, 17:108-18.

Lott, John R. Jr. (1987). “The Effects of Nontrasferable property rights on the efficiency of political markets: Some Evidence.” *Journal of Public Economics*, 32:231-246.

Magelby, David B., Nelson, Candice J. *The Money Chase: Congressional Campaign Finance Reform.* Washington D.C.: The Brookings Institution, 1990.

Mitchell, Mark L. and J. Harold Mulherin (1988). “Finessing the Political System: The Cigarette Advertising Ban.” Southern Economic Journal, 54:855-62.

Moore, Walter K. "The Case of an Independent Political Action Committee." In *Parties, Interest Groups, and Campaign Finance Laws,* pp. 56-67. Edited by Michael J. Malbin. American Enterprise Institute, Washington D.C., 1980.

Milyo, Jeff (1998). "The Electoral Effects of Campaign Spending in House Elections: A Natural Experiment Approach." Department of Economics working paper, Tufts University.

Nelson, Phillip (1976). "Political Information." Journal of Law and Economics. 19:315-336.

Nugent, Margaret Latus and John R. Johannes. *Money, Elections, and Democracy: Reforming Congressional Campaign Finance.* San Francisco: Westview Press, 1990.

Palda, Filip (1996). "The Economics of Election Campaign Spending Limits." *Economia delle scelte pubbliche*, 2-3: 113-137.

Palda, Filip. *How Much is Your Vote Worth? The Unfairness of Campaign Spending Limits.* San Francisco: The Institute for Contemporary Studies Press, 1994.

Palda, Filip (1993). "Desirability and Effects of Campaign Spending Limits". *Crime, Law and Social Change*, 21:295-317.

Palda, Filip. "The Determinants of Campaign Spending: The Role of the Government Jackpot." *Economic Inquiry* 30:627-638.

Palda, Filip, and Kristian S. Palda (1985).``Ceilings on Campaign Spending: Hypothesis and Partial Test with Canadian Data." *Public Choice*, 5:313-331.

--------(1998). "The Impact of Regulated Campaign Expenditures on Political Competition in the French Legislative Elections of 1993." *Public Choice.* VOLUME AND PAGES

Robson, John and Owen Lippert. Law & Markets: *Is Canada Inheriting America's Litigious Legacy?* Vancouver: The Fraser Institute, 1997.

Snyder, James M., Jr. (1990). "Campaign Contributions as Investments: The U.S. House of Representatives, 1980-1986." *Journal of Political Economy*. 98:1195-1227.

Stanbury, William T. "Lobbying and interest group representation in the legislative process." Pages 167-207 in The Legislative Process in Canada: the Need for Reform. Edited by W.A.W. Neilson and J.C. MacPherson. Toronto: Institute for Research on Public Policy, 1978.

Stiglitz, Joseph E. and Andrew Weiss (1981). “Credit Rationing in Markets with Imperfect Information.” *American Economic Review*, 71:393-410.

Usher, Dan (1983). “The Benefits and Cost of Firm-Specific Investment Grants: A Study of Five Federal Programs,” Institute for Economic Research, Discussion Paper #511, Queen’s University, Kingston, Ontario.

Winter, Ralph K. Jr. (in association with John R. Bolton). "Campaign Financing and Political Freedom." Domestic Affairs Studies of the American Enterprise Institute, n. 19, 1973.

Official Publications

Federal Election Commission (1998). “1998 Legislative Recommendations.” Electronic document obtained from www.fec.gov/pages/citnlist.htm

Federal Election Commission (1997). “Selected Court Case Abstracts: 1976- September 1997.” Electronic document obtained from www.fec.gov/pages/citnlist.htm

Federal Election Commission (1996a). “The FEC and the Federal Campaign Finance Law.” Electronic document obtained from www.fec.gov/pages/fecfeca.htm

Federal Election Commission (1996b). “Filing a Complaint.” Electronic document obtained from www.fec.gov/pages/complain.htm

Federal Election Commission (1995). “Twenty Year Report” Electronic document obtained from www.fec.gov/pages/20year1.htm

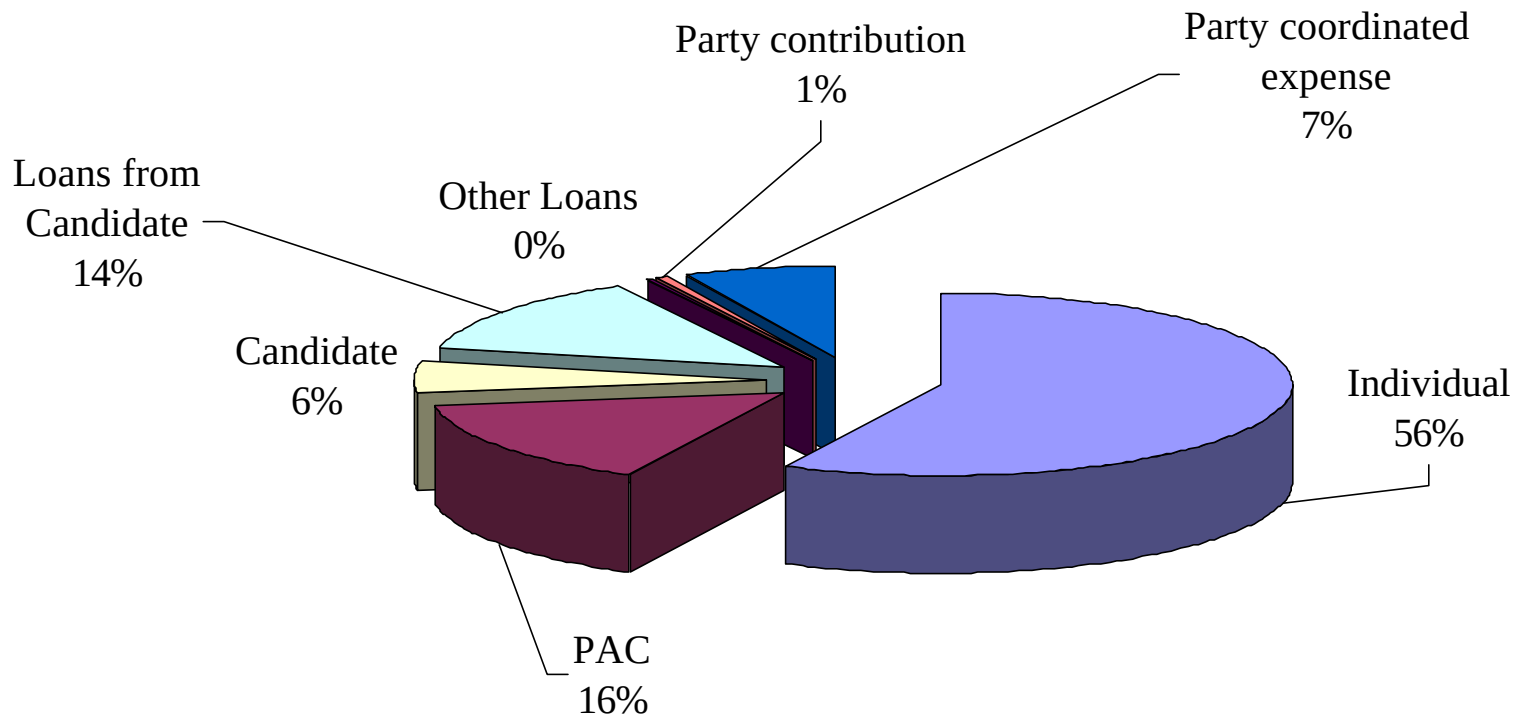
Court Cases

James L. Buckley et al. *v*. Francis R. Valeo, Secretary of the United States Senate, 424 U.S. 1, (1976).

Federal Election Commission *v*. Massachusetts Citizens for Life, Inc., 479 U.S. 238, (1986).

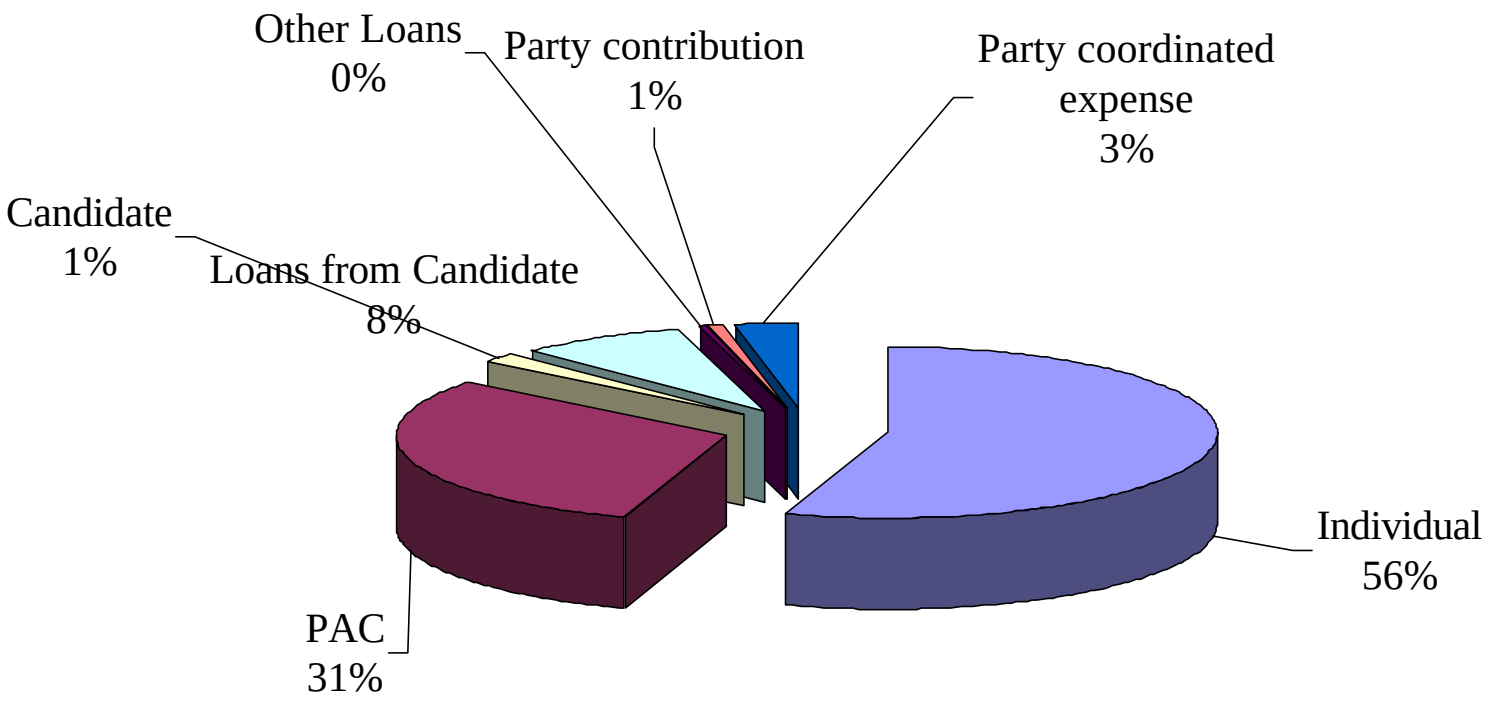
Federal Election Commission et al. *v*. National Right to Work Committee et al., 459 U.S. 197, (1982).

Figure 1: Sources of Senate Contributions, 1996



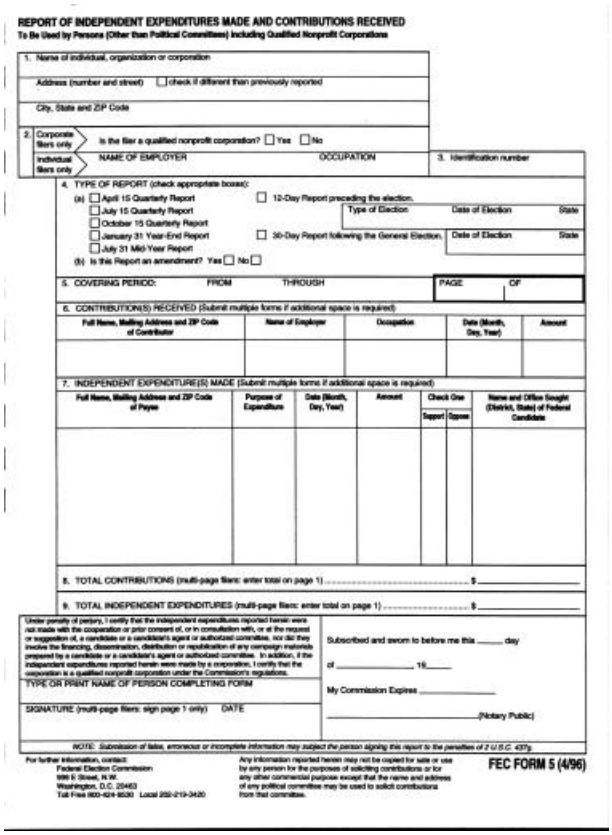
Source: Federal Election Commission

Figure 2: Sources of House Contributions, 1996



Source: Federal Election Commission

Figure 3



REPORT OF INDEPENDENT EXPENDITURES MADE AND CONTRIBUTIONS RECEIVED

To Be Used by Persons (Other than Political Committees) Including Qualified Nonprofit Corporations

1. Name of individual, organization or corporation

Address (number and street) ☐ check if different than previously reported

City, State and ZIP Code

2. Corporate filers only — Is the filer a qualified nonprofit corporation? ☐ Yes ☐ No

Individual filers only — NAME OF EMPLOYER — OCCUPATION

3. Identification number

4. TYPE OF REPORT (check appropriate boxes):

(a) ☐ April 15 Quarterly Report ☐ July 15 Quarterly Report ☐ October 15 Quarterly Report ☐ January 31 Year-End Report ☐ July 31 Mid-Year Report ☐ 12-Day Report preceding the election. Type of Election / Date of Election / State ☐ 30-Day Report following the General Election. Date of Election / State

(b) Is this Report an amendment? Yes ☐ No ☐

5. COVERING PERIOD: FROM THROUGH — PAGE OF

6. CONTRIBUTION(S) RECEIVED (Submit multiple forms if additional space is required)

Full Name, Mailing Address and ZIP Code of Contributor	Name of Employer	Occupation	Date (Month, Day, Year)	Amount

7. INDEPENDENT EXPENDITURE(S) MADE (Submit multiple forms if additional space is required)

Full Name, Mailing Address and ZIP Code of Payee	Purpose of Expenditure	Date (Month, Day, Year)	Amount	Check One: Support	Check One: Oppose	Name and Office Sought (District, State) of Federal Candidate

8. TOTAL CONTRIBUTIONS (multi-page filers: enter total on page 1) ..... $

9. TOTAL INDEPENDENT EXPENDITURES (multi-page filers: enter total on page 1) ..... $

Under penalty of perjury, I certify that the independent expenditures reported herein were not made with the cooperation or prior consent of, or in consultation with, or at the request or suggestion of, a candidate or a candidate's agent or authorized committee, nor did they involve the financing, dissemination, distribution or republication of any campaign materials prepared by a candidate or a candidate's agent or authorized committee. In addition, if the independent expenditures reported herein were made by a corporation, I certify that the corporation is a qualified nonprofit corporation under the Commission's regulations.

TYPE OR PRINT NAME OF PERSON COMPLETING FORM

SIGNATURE (multi-page filers: sign page 1 only) DATE

Subscribed and sworn to before me this ____ day of _____, 19____

My Commission Expires _____

_____ (Notary Public)

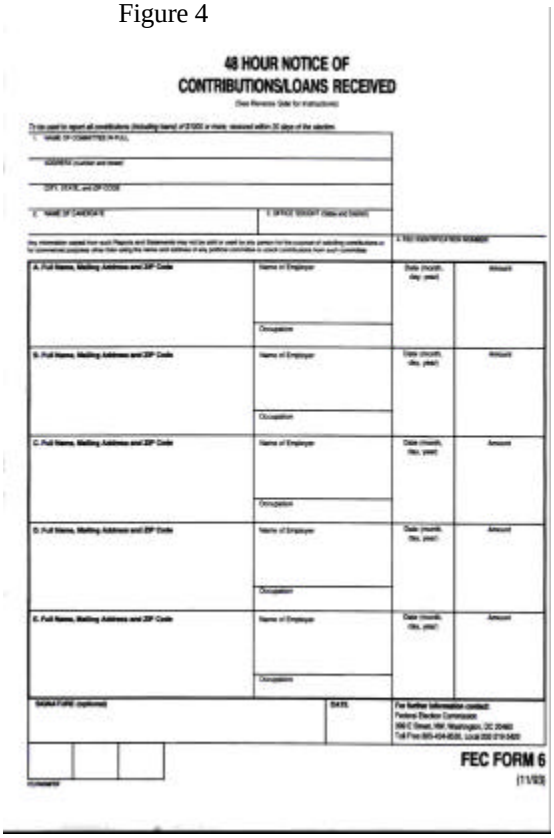
NOTE: Submission of false, erroneous or incomplete information may subject the person signing this report to the penalties of 2 U.S.C. 437g.

For further information, contact: Federal Election Commission, 999 E Street, N.W., Washington, D.C. 20463, Toll Free 800-424-9530 Local 202-219-3420

Any information reported herein may not be copied for sale or use by any person for the purposes of soliciting contributions or for any other commercial purpose except that the name and address of any political committee may be used to solicit contributions from that committee.

FEC FORM 5 (4/96)

Figure 4



48 HOUR NOTICE OF
CONTRIBUTIONS/LOANS RECEIVED

FEC FORM 6
(11/93)

Table 1

Target of Interest Group	**Canada**	**United States**
Bureaucracy	40%	21%
Legislators	20%	41%
Legislative comittees	7%	19%
Cabinet	19%	4%
Executive assistants	5%	3%
Judiciary	3%	3%
Other	6%	3%
Number	393	604

Source: Adapted from Stanbury 1978