

“Overcharged”: The Economic Costs of Money-in-Politics
Roosevelt Institute Research Summary
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INTRODUCTION

The Overcharged research project centers on the premise that, while the problem of the outsized influence of money in politics—and its harmful effects on our democracy—is widely and publicly recognized, one of the major challenges reformers face is the inability to articulate clearly, in terms of dollars and cents, *why* the influence of corporate money in politics matters, both at the macro level and to individuals. An economic argument focused on how the influence of moneyed interests hurts economic growth could have a significant impact on both public debate and public policy. The cost of political money and political corruption to Americans is substantial and warrants examination. Bank fees and soaring utility bills, phone, cable, broadband, and health care: much of the increased costs here are, we believe, the result of monopolies and other “market power”—meaning the ability of a firm to raise prices above marginal costs—that our current system permits. A more truly competitive political and regulatory system would be better able to control such excesses.

Demonstrating the costs—how much Americans are being overcharged—could be a powerful motivator in the fight for reform and change. Such an analysis could also positively impact the fight for specific types of democracy reform, including the push for publicly financed elections. Opponents of these proposals often cite the costs to the taxpayer of publicly funded elections. Our argument can demonstrate that, in fact, the current system is also very costly to our economy. However, those costs are hidden. Bringing them to light will, we believe, support the efforts of democracy reformers.

With this in mind, the Roosevelt Institute has undertaken a research project that attempts to calculate the real costs of political corruption to the American economy. Our research approach consists of two parts: first we identify sectors in the economy and calculate the net costs of inefficiencies in industries due to political power and overreach. We then attempt to connect those costs with political spending.

As we describe in the next section, there is no ideal way to approach this research and our methodology certainly is not perfect. Yet, we have strived to carefully and systematically connect the dots between political spending and the costs of that spending to our economy in order to have a crucial public conversation about the outsized influence of money in politics in our democracy and economy.

OUR RESEARCH APPROACH AND METHODOLOGY

As important and significant understanding the economic costs of money in politics is, it’s a tricky research endeavor. Pinning specific numbers on the total costs to Americans of corrupt politics is a daunting challenge. There are simply too many variables to expect that any particular estimate will be credible. The task is akin to efforts to calculate the total costs of the Iraq War or climate change. Both assuredly attract brilliant and careful researchers, but differences in viewpoint between even analysts who share a common orientation remain substantial. On at least

some occasions, the diversity in the estimates probably feeds public skepticism about the terrible dimensions of both the Iraq War and climate change.

After discussions with many economists and political scientists about the complications of this research, we opted for the following approach. We have identified various sectors of the economy that we believe are most relevant to most Americans: finance, telecom, and potentially healthcare. We then analyze them in “partial equilibrium” terms. In other words, our researchers are calculating the difference between prices and quantities in a monopolistic or oligopolistic market and prices and quantities in a more competitive market: i.e. the net costs of inefficiency due to outsized political spending and influence. This is in essence a cost-benefit analysis: what are the big picture costs of, for example, our current financial system, over and above the benefits it provides?¹

To be clear, while we are using the standard neoclassical economics approach to understanding industry market structures, we do not assume that perfect competition would exist in the absence of any political corruption; in all likelihood scale economies and other technological and organizational factors would guarantee something nearing oligopoly without any political meddling.

The task then, is to make assumptions about what an industry would look like absent political spending influence and parse out reasonably assumed price and quantity levels that can protect the public while also supplying the products or services needed. This is a qualitative endeavor as much as quantitative. It requires researchers who have deep institutional knowledge of respective sectors of the economy; researchers who know the economics as well as the nuances of the myriad policy changes over the history of an industry. For example, Dr. Gerald Epstein, Professor of Economics and Co-Director of the Political Economy Research Institute (PERI), University of Massachusetts Amherst, is the principal researcher for the finance sector research that we will discuss in the next section.²

The second component of the Overcharged research project – to understand the role that political money has in creating laws (or often deregulation) that generates net inefficiencies – is in two parts. The first part defies the commonly peddled idea that money does not matter in campaigns. Using an innovative database, Thomas Ferguson and his colleagues draw on their existing work to show that the split of seats in Congress closely follows political money (and, importantly, finance and telecomm legislation generally follows that split closely). They also employ an entirely new statistical technique to resolve the traditional objection to such studies – that there must be some unmeasured variable, such as the popularity of the representative, which is driving the results. The second part of their research takes up the fact that in finance, when there are breakaway votes to loosen regulations, it’s typically Democrats who are doing the breaking. In other words, the researchers zero in on the influence of money on representatives who initially

¹ To be technically specific, the net costs we are estimating equal both economic rent and deadweight loss.

² Dr. Epstein is a finance and macroeconomic expert, having researched numerous topics including financial crisis and regulation, alternative approaches to central banking for employment generation and poverty reduction, capital account regulations and the political economy of central banking and financial institutions. Epstein has worked with numerous UN agencies including the ILO, UNDESA, UNDP, and UNCTAD on the topics of macroeconomics and monetary policy in developing countries. His most recent edited volume is: *The Handbook of The Political Economy of Financial Crises*, Oxford University Press, 2013 (co-edited with Martin Wolfson). In recent years he has been the recipient of two INET grants, one to study the “social efficiency” of the financial system and a second to look at the distributional impacts of quantitative easing.

voted in favor of these votes but who then switched, joined with Republicans, and weakened the bill.

To be sure, this is not a perfect way of calculating the economic costs of political spending. In an ideal setting, we would identify a range of deregulatory decisions, identify the political spending that arguably led to those decisions, and simultaneously also conduct cost-benefit analyses that calculate the economic effects of those policy deregulations. The problem with this approach is that it is extraordinarily difficult to do an accurate cost benefit analysis of a specific financial regulation. This has in fact led to a huge debate over the implementation of Dodd Frank.

CALCULATING THE COSTS: THE FINANCE SECTOR

The Great Financial Crisis of 2007-2008, whose massive costs are still being felt in many parts of the country, made clear to most Americans that the financial system is broken. It has also become apparent that the dysfunctions of finance go far beyond the dramatic and costly financial crash we experienced almost a decade ago; these dysfunctions also cost most members of our society dearly on a daily basis even when the financial system seems to be operating “normally,” while putting at risk the long-run prosperity of our economy. They involve overcharging for brokerage services, predatory lending, and generally charging high fees for financial services; misallocating human talent from productive employment in technology, education and health care to less socially productive employment; re-orienting non-financial corporate behavior from long term investment to short term speculation that costs jobs, wages, and productivity growth; and choosing poor investments that put people's retirement incomes at risk.

The flip side of this coin is that a relatively small number of owners and operatives in the financial sector make significant amounts of salaries, bonuses and profits as a result of these practices despite the high costs for most Americans. Yet, it is important to recognize that, in America, finance is not simply a zero sum game: it is not simply a transfer of income and wealth from customers to bankers and bank owners. It is worse than that. Finance also has very significant destructive aspects that negatively affect the overall health of the economy both in the short and the long run. That is, finance has operated in recent years as a *negative sum* game. This means that it costs us *more* than a \$1 to transfer a \$1 of wealth to financiers - significantly more. So even if you think our financiers deserve every penny they get, it would be a lot cheaper simply to write them a check every year than to let them continue business as usual.

Specifically, the finance sector research Gerald Epstein and his colleagues conducted assesses the size and surveys the mechanisms of the destructive wealth transfer from the vast majority of Americans to the financial sector of our economy. At the big picture level, they estimate the total amount of excess income extracted by financial executives and owners during the period of 1990-2005. They add to that the costs to the economy of the excess size and misallocation of resources associated with modern financial practices. In addition, they add the cost to the economy of the Great Financial Crisis of 2007-2008. All together, we estimate that, over this period, U.S. finance has cost the American people between 13 and 23 trillion dollars. This is a huge sum representing between two-thirds (66%) and one and a third (133%) of a year's aggregate income in the US (GDP). This amount represents between \$30,000 and \$68,000 for every man, woman and child in the US and as much as \$170,000 per family.

Having looked at the big picture of the high cost of finance, Epstein then details some of the key mechanisms, institutions and processes that have generated these large rents and high costs. They look first at particular industries, markets and products. They analyze the excessive costs

associated with asset management, including mutual funds, private equity and hedge funds and how these have impacted private and public pensions; they analyze the massive costs associated with mortgage financing; they look at key banking markets such as credit derivatives, and asset management services and how these contribute to excessive costs and financial instability; and they analyze predatory lending and the impacts of these practices on the poor. Along the way, they describe government practices – including the commitment to “too big to fail banks,” deregulation and regulatory capture that facilitate these practices.

THE EFFECTS OF POLITICAL SPENDING

The following describes the two phases of our political spending research approach.

Following the Money to Congress

The first part of their approach updates and expands on Ferguson et al.’s existing work to show that the split of seats in Congress closely follows political money (and finance and telecomm legislation generally follows that split closely. Passage of Dodd-Frank, for example, was along partisan lines).

That's a result that most scholars have denied. For example, a recent paper commissioned by the Campaign Finance Institute/BiPartisan Policy Center Working Group on the Money in Politics Research Agenda is representative:

There is something of a scholarly consensus at least for campaign spending in congressional races. However this consensus stands in stark contrast to the popular wisdom echoed by pundits, politicians, and reform advocates that elections are essentially for sale to the highest bidder (spender). Decades of social science research consistently reveal a far more limited role for campaign spending. Early studies tended to find that spending by challengers was far more effective than incumbent spending. More recent work argues that in principle campaign spending is equally productive across candidates, but that there are strongly diminishing marginal returns to campaign spending. Since most challengers spend less than incumbents, their spending is marginally more effective, even though the underlying “production function” that transforms money into votes is not different for challengers. Further, the best efforts at identifying the treatment effect of money in congressional races yield fairly similar substantive results: candidate spending has very modest to negligible causal effects on candidate vote shares.⁴

Three years ago, Ferguson and his colleagues published research indicating that such views were badly mistaken. Drawing on a new data base that unified the separate reporting systems of the Federal Election Commission (FEC) and the U.S. Internal Revenue Service (IRS) they constructed—really for the first time – reliable measures of total spending in Congressional campaigns, including the burgeoning flows of outside “independent” spending.³

Inspired by an “investment” approach to political competition emphasizing the “money-driven” character of contemporary political systems, the researchers broke with customary practices of sorting out how incumbents or challengers fared in favor of direct tests of the relationship of campaign expenditures to outcomes. Ferguson et al. say: “Our results surprised even us and we devoted considerable space to reciting the usual litanies about the pitfalls of confusing correlation and causality.”

³ See appendix for description of this dataset.

They showed that in three widely spaced years – 1980, when Congress functioned very differently than it does today, 1996, and 2012 –the relation between major party candidates’ shares of the two party vote and their proportionate share of total campaign expenditures were strongly linear –more or less straight lines, in fact. The relationship was strong for the Senate and almost absurdly tight for the House.

Switching Votes

In 2011, the International Monetary Fund published a study by Deniz Igan and Prachi Mishra that studied the potential link between political influence of the financial industry and financial regulation in the years before the 2007-2008 financial crisis (their data span from 1999 to 2006). Their study showed strong evidence that lobbying dollars spent by the financial industry and the “network connections” between lobbyists and legislators “were positively linked to the probability of a legislator changing positions in favor of regulation.” The way Igan and Mishra studied this was to look at cases where legislators switch positions on a specific legislative proposal. They found that “the variation in political spending by FIRE [finance, insurance and real estate industry] at the bill level and the variation in the position taken by the same legislator on the same bill in its different ‘reincarnations.’”

Ferguson et al. builds on this research – with their own database – by looking at specific deviations from party lines; in finance (and telecom) legislation, the breakaway votes are typically the Democrats. So the problem is to understand why those legislators diverge. In the case of finance, Ferguson and colleagues tackle this problem by means of fixed effects regressions that analyze representatives who voted for Dodd-Frank. The advantage of this way of approaching the problem is that it holds constant the personality of the Congressional representative, the district, its culture, and most every other variable supposed to influence voting. That permits them to identify much more convincingly where changes in political money have driven the process.

PUBLIC IMPACT

While we recognize that this approach to understanding the economic impact of political spending in our democracy is not perfect; there is no perfect research method for this broad and complicated a question. But we believe that the research we’ve described here will help the broader public find ways to talk more clearly about the costs of political corruption and would be a very important contribution to the American public debate.

APPENDIX

Our Data Source

The major sources of data on political money are the FEC and the U.S. Internal Revenue Service (the IRS is responsible for compiling data on so-called 527 committees, which have become prodigious sources of funds). Partly for understandable reasons, neither agency makes any serious effort to standardize names or addresses of people on their rosters. For less comprehensible reasons, though, both agencies routinely accept seriously incomplete reports and obviously inaccurate or misleading entries. For example, they let many business executives who are still active on the boards of large firms get away with claiming to be “retired.” The two agencies also present their data in different formats, which makes record linkage difficult. And, as we

discovered, and the FEC acknowledged, it sometimes deletes important data from its records without notice (Ferguson, Jorgensen, and Chen 2012b, 2012c).

Into this breach have stepped the Center for Responsive Politics (CRP); a handful of related organizations such as the Sunlight Foundation; and a few private, for-profit subscription services. Everyone concerned with political money owes the Center and Sunlight a great debt for their efforts to translate the forbiddingly complex FEC and IRS data into usable form. Their data (most of it originating from the CRP) has nourished a generation of journalists and a few scholars. But the data's shortcomings have long been apparent. The biggest problem is fragmentary presentation. Every source compiles different subsets of data but none integrate them, with the result that a single file of clean, research-quality data that reflects true totals is unavailable. Coupled with some occasionally mystifying gaps in coverage and the rolling disappearance of records for many past elections from the CRP's Web site, the deeply engrained habit of serving up data like slices of salami makes it virtually impossible to test broad hypotheses. It also tempts scholars to rely overmuch on the data subseries that are easiest to use—such as political action committee (PAC) contributions—and neglect the far less tractable, but more revealing, data on individual contributions, independent expenditures, and 527 donations. When the woefully incomplete easy sources are tapped by social scientists to construct indices of the political orientations of contributors and politicians, confusion is compounded; at times we wonder if a kind of Gresham's Law of bad data driving out good, operates in parts of the social sciences.

What might be termed “flow of funds” (after the Federal Reserve's well-known summary of financial sources and uses of funds) inconsistencies in the FEC data pose further obstacles. Much political funding resembles the interbank market for loans before the bankruptcy of Lehman Brothers in 2008. Donor A gives to Organization B, which shuffles it over to Conveyer Organization C, which hands it off to Final Recipient D to finally spend it. In theory, all these transactions are traceable through FEC records. In practice, they often fail to add up, including, often, the separate reports of PACs and candidate committees. We isolate original PAC donations by sorting through reports from both and take extreme pains to avoid double counting.

Perhaps the greatest data stumbling block, though, is the complexity of the contribution rosters. Investors who make multiple contributions rarely use exactly the same form of their name. Many maintain several different offices and residences in different parts of the country. When reporting contributions, they list first one and then the other in no consistent fashion. “Mr.” and “Mrs.” and “Senior” and “Jr.” also flit back and forth like the Cheshire cat. Hyphenated names can place people in entirely different parts of the alphabet, depending on whether they use the hyphen or not. And so on. The toxic combination of wild diversity and incompleteness also characterizes the reported names of corporations, regardless of whether they are referenced merely to indicate the affiliations of individual contributors or record direct expenditures out of their treasuries to Super PACs, 527s, and similar vehicles. Large concerns, especially big banks, have vast numbers of subsidiaries and subunits; often those names, rather than the parent's, are reported. In 2012 we even found contributions from one “too-big-to-fail” bank reported as coming from financial institutions that it had absorbed at the height of the 2008 crisis.

These problems are at least dimly recognized and the object of all kinds of expedients. But the bottom line is that existing data management tools that try to match up the data commonly fail to recognize multitudes of contributions coming from the very same sources. Our experience is that total contributions from particular individuals are routinely far larger than suggested in accounts by either journalists or scholars, and the true scale of contributions originating from many corporations is often invisible. It is no accident that even scholarly studies rarely try to summarize

the latter. Journalistic conventions, such as focusing on contributions to formal presidential campaign committees or Super PACs alone, further obscure matters.

This veil of ignorance, of course, has weighty consequences: It nourishes illusions that small donors play bigger roles in campaigns than they really do and hides the reality of just how concentrated American political finance really is. Or, in other words, it encourages the notion that while wealth and income in America are fabulously concentrated, somehow political money is not. The incompleteness of individual records also masks important structure in the data, especially where data on firms and occupations are incomplete or misleading. The data we use for this paper come from our “Political Money Project,” which tries to remedy these shortcomings and others that we lack space to discuss here. Starting from the original FEC and IRS data, we have intensively applied modern database management methods to sort out name problems. Our methods are certainly not foolproof, but they represent substantial improvements over anything else we have seen. Resolving the identities of individual contributors and corporations has the collateral benefit of substantially raising the percentage of contributions whose sources we can identify, since one correct identification sometimes makes it possible to complete many laconic entries. Sifting flows of funds also identifies many previously lost or doubtful contributions. For example, these methods allowed us to identify additional contributions of some \$110 million in 2008 and \$73 million in 2012.

We have gone a step further. We have created unified datasets that attempt to group together all the disparate sources of funds—from individuals, PACs, Super PACs, 527s, “independent” expenditures, and so on—that flowed into 2012 races and identify them by their final origins under single “investing unit IDs.” Do not be put off by the cumbersome terminology: Think “firm,” where that term is stretched to include major investors listed in the Forbes 400. Provided that one recalls the cautions appropriate for results of procedures that involve scoring systems and cutoff points applied to literally millions of individual cases (we still do enormous amounts of real-time checking), this approach permits analyses of the behavior of individual firms and major investors in greater detail than any other method. Suddenly, in place of myriad apparently unrelated individuals and disconnected corporations, the behemoths appear as they are, often towering over the rest of the landscape.

The Roosevelt effort has a huge comparative advantage in totaling political contributions, since it has access to the integrated database constructed by Ferguson, Jorgensen, and Chen, which combines the typically used FEC and IRS databases in many novel ways and takes full account of the different ways congressional contributions are reported by the FEC.

We are the first to acknowledge that our compilations of total contributions by individual firms remain incomplete. Even more important, they comprise only a portion of the full spectrum of politically significant money. But they offer a picture that is substantially closer to the reality that confronts candidates as they scramble for funds. The resulting change in scale is dramatic, as will become obvious below, when we compare size breakdowns of individual contributions (perhaps the most common type of analysis in studies of presidential election funding) with “firm” contributions analyzed in our terms.

Our dataset also tries to overcome what we consider the Achilles’ heel of most efforts to study political money: They do not include enough economic data to reveal many important patterns. We have made a determined effort to integrate economic data about firms and individuals (including Standard Industrial Classification [SIC] codes for members of the Forbes 400) that we believe are vital for finding the golden needles that are scattered all through the haystacks of big data on money in politics. Because we think that major firms and investors in many respects live

in a different political universe than most other political contributors, we also separately break out donations from “big business” from our larger sample.

SOURCES

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