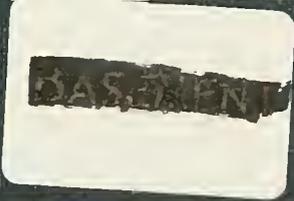


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Did Firms Profit from Soft Money?

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DID FIRMS PROFIT FROM SOFT MONEY?

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At its heart, the Bipartisan Campaign Reform Act seeks to limit the private benefits that firms receive from campaign contributions. A series of rulings by the Federal Election Commission created the opportunity for organizations and individuals to give funds to party accounts outside the system of direct contribution limits – so called soft money. Although little used before 1992, soft money ballooned during the 1990s. In the 2000 election, the two major parties raised approximately \$500 million in soft money, most of which came from corporations in donations in excess of \$100,000, at least ten times larger than the hard contribution limits set in the Federal Elections Campaign Act.¹

Companies were widely alleged to have profited directly and substantially from their soft money donations. In the years leading up to the passage of BCRA, public interest groups and the press provided numerous examples of firms that benefited from public policies and were also large soft money donors – tobacco, pharmaceutical, and oil companies were especially featured in these reports. The most telling evidence, cited extensively by the majority opinion in *McConnell v. FEC*, emerged in hearings before the U.S. Senate Committee on Commerce in 1998. Corporate executives and legislators testified that soft money donations were often given when valuable government contracts were on the line. In other cases donors feared that, if they did not contribute, then their companies would lose competitive advantages through regulations.

These were clearly stories of excess. Parties and their candidates received donations well in excess of what they could raise under the hard money limits, and corporations, which gave most of the soft party money, allegedly received excessively large benefits at public expense in return for their contributions.

¹ See the report by the Federal Election Commission at:
<http://www.fec.gov/press/051501partyfund/051501partyfund.html>.

Were these cases typical, or exceptional? If exceptional, then the government might best deal with the problems of corrupt practices through aggressive enforcement of anti-bribery laws. If typical, then the government might attempt to eliminate these problems with blanket restrictions on contributions – as they in fact did.

At issue is the extent to which donors, especially large corporate donors, benefited from soft money. Economists and political scientists have long been puzzled about the influence of campaign contributions on public policy. An extensive literature examines the association between hard money contributions and public policy decision-making, especially roll call voting in the U.S. Congress. The large majority of studies find no significant effects of hard money contributions on public policy, and, in those that do find some association, the magnitude of the effects is typically very small.²

More troubling still, the total amount of campaign contributing seems too small to produce much influence. Tullock (1973) observed that although corruption is widely alleged, it is not plausibly large. Assuming a reasonable return on investment, the total value of all goods and services that firms buy with their campaign contributions cannot be more than a several hundred million dollars per year. That might sound like a lot, but it is rounding error on the national accounts, and likely does not amount to a significant societal problem.

On the other hand, such calculations may be wrong. Under some assumptions about the nature of political bargaining, companies might command an extraordinarily high return on investment (*e.g.*, Persson and Tabellini, 2002, pp. 187-190; Dal Bo, 2002). And there are a few empirical studies that claim to find evidence for such high returns (*e.g.*, Stratmann, 1991).

Is there evidence that firms profited substantially and systematically from their soft money donations? We know of no study that has looked for a systematic relationship between soft money

² See Ansolabehere, de Figueiredo, and Snyder (2003) for a summary of this literature.

donations and policy decisions or outcomes. We address this question here, by examining corporate stock returns.

The Bi-Partisan Campaign Reform Act itself provides a lens through which to observe the value that firms' derived from soft money. If companies profited from soft money, then investors in firms should have valued the firms accordingly. Companies that gave soft money and received undue competitive advantages or large contracts in return should have been better investments in recent years than companies that gave little soft money. By the same reasoning, the imposition of new regulations and the Court's decision to uphold those regulations should have lowered the value of the firms that used the soft money loopholes for profit.

Consider a typical Fortune 100 company. Annual revenues for these companies are, on average, \$50 billion, roughly 10% of which is profit. Large firms that give soft money contributions (not all do) give an average of about \$500,000 over two years. An excellent return on this investment would double the amount invested. This would account for just one one-hundredth of one percent of the company's two-year profit – difficult to notice and not much to get excited about. The fear, however, is that companies receive returns thousands of times larger than the investment. Suppose, for example, that \$500,000 in soft money donations yields \$1 billion worth of contracts and services, and \$100 million in profits. This would represent a 20,000 percent return, and would account for 1 percent of a company's annual profit.

The elimination of soft money would eliminate this stream of profit. In the first case, where returns on investment are more modest and where the total value of goods and services bought is relatively small, the effect on a company's stock price would be negligible – in the range of one one-hundredth of one percent. In the latter case, where the returns are exceptionally large and the

cost of soft money to government and society might be substantial, the effect of banning soft money would be to lower the stock value of the hypothetical firm by about 1 percent.

We can examine the effects of BCRA using stock market data and standard event study methodology.³ Previous papers by Roberts (1990a, 1990b), Fisman (2001), Jayachandran (2002), and others have found that political events – such as the death of Senator Henry (Scoop) Jackson in 1983 and Senator James Jeffords’ party switch in 2001 – can have a noticeable impact on stock prices.

One important prerequisite for conducting an event study is the ability to determine the date of an event that releases new information into the market. We are especially fortunate in this regard because we know *precisely* the date of the Supreme Court’s decision on BCRA: December 10, 2003. Moreover, because the outcome was uncertain until the very moment the court revealed its decision, new information was clearly released to the market that day. While it is difficult to know exactly how much of a “surprise” the decision was, the fact that almost no observers were willing to make predictions suggests that they believed the court was about as likely to strike down the BCRA as it was to uphold it.⁴ An example of the tentative commentary offered by campaign finance law experts is the following, by Professor Michael C. Dorf of the Columbia University Law School: “The four-hour oral argument in McConnell indicated, above all, that the Justices remain deeply divided over how to approach campaign finance regulation... It was not clear from the lengthy oral argument which of these views will prevail. Indeed, it was not even clear what legal standard would be used to judge the challenged provisions of BCRA.”⁵ The day after the decision,

³ See Schwert (1981) for a description of the method and a survey of papers employing it.

⁴ As consultants on this case (Snyder on the side opposed to the BCRA and Ansolabehere on the side in support of it), two of the authors had detailed knowledge of the proceedings and followed the litigation closely. Both thought the plaintiffs were more likely to prevail.

⁵ Quoted from an article on the CNN web site, September 19, 2003, “The Supreme Court’s campaign finance reform argument.” The article was found at <http://images.cnn.com/2003/LAW/09/19/findlaw.analysis.dorf.campaign.finance/>.

campaign finance expert Thomas Mann said: “Yesterday, [the Supreme Court reached] another 5:4 decision that surprised many, although, certainly, not all members of this panel, in the reach and clarity of its findings on the Bipartisan Campaign Reform Act.”⁶ Other pieces of evidence support this view. The final vote on BCRA’s soft money provisions was as close as possible, 5 to 4. At the oral arguments in September, Justice Rehnquist, thought to be pivotal on this matter, subjected the defense to hostile lines of questioning, which signaled his likely vote against upholding key provisions of the Act.⁷ And many observers find that Justice O’Connor, another pivotal justice, is “even more inscrutable than usual” on campaign finance questions.^{8,9}

The prediction, then, is straightforward: If soft money donations produced profits and BCRA stopped them, then the stock prices of companies that used soft money heavily should have fallen on December 10, 2003, while those that did not should either have risen or been unaffected.

In addition to the Supreme Court’s final decision, there were four other events surrounding BCRA that might have surprised the market. Thus, we have five events in all. (1) The U.S. House passed the bill on February 14, 2002; (2) the Senate passed it on March 20, 2002; (3) the president signed the bill into law on March 27, 2002; (4) the Supreme Court heard oral argument on

⁶ Brookings Briefing, “Supreme Court Rules on Campaign Finance Case: The Legal and Political Impact of *McConnell v. FEC*,” December 11, 2003.

⁷ See, for example, the *Washington Post* article on Aug 31, 2003 by Charles Lane, “Rehnquist May Be Key for Campaign Finance Chief Justice's Past Votes Leave Outcome of Challenges to McCain-Feingold Law Uncertain.”

⁸ Quote by Professor Roy Schotland of the Georgetown University Law Center, from *Washington Post* article on Aug 31, 2003 by Charles Lane, “Rehnquist May Be Key for Campaign Finance Chief Justice's Past Votes Leave Outcome of Challenges to McCain-Feingold Law Uncertain.”

⁹ Another interesting piece of evidence is the BCRA “market” run for an undergraduate course on the Supreme Court at the University of North Carolina at Chapel Hill. About 130 students in the class traded in the market, rewarded with grades. The betting was on whether or not the electioneering communication provisions would be upheld. The last prices at which trades took place, posted on December 8, were \$.55 for the position that the provisions would be upheld and \$.55 for the position that the provisions would be struck down, on bets that paid \$1.00 – this implies beliefs very close to 50-50. See <http://www.unc.edu/courses/2003fall/poli/079/001/market/>.

September 8, 2003 (at which, Justice Rehnquist's questioning was viewed as a signal that he would side with plaintiffs); and (5) the Supreme Court issued its ruling on December 10, 2003.¹⁰

Following the event study literature, we estimate the following equation, a modification of the Capital Asset Pricing Model:

$$R_{it} = \alpha_i + \beta_i M_t + \sum_{j=1}^J \sum_{s=1}^5 \gamma_{js} D_{ij} I_{st} + \varepsilon_{it}$$

where i indexes firms, t indexes dates, j indexes donor status (*e.g.*, large donor, non-donor), R_{it} is the return on firm i 's stock for date t , M_t is the market return for date t , $D_{ij} = 1$ if firm i is a type- j donor and 0 otherwise, and $I_{st} = 1$ if $s = t$ and 0 otherwise. If events 1, 2, 3 and 5 produced "bad news" for large soft money donors, then the corresponding γ_j 's should all be negative and statistically significant; and if event 4 produced "good news", for large soft money donors, then the corresponding γ_4 should be positive and statistically significant. (Note, $R_{it} = (P_{it} - P_{i,t-1}) / P_{i,t-1}$, where P_{it} is the closing price of firm i 's stock on date t .)

We assembled data on daily stock prices for all Fortune 500 companies for the period February 10, 2001 through December 12, 2003.¹¹ Some of these companies are not publicly traded and others were involved in complicated mergers during the period under study – dropping these cases leaves 446 firms.¹² To measure the market return we used the CRSP value-weighted return. We merged this with data on the soft money donations for all these firms.¹³

¹⁰ Hertzler, Martin, and Meschke (2002) studied the impact of the first three of these events on the stock returns of 40 major soft-money donors, and found no significant effects. These were probably less surprising than the last event. The vote on final passage in the House was 240-189, and the vote in the Senate was 60-40; moreover, other events that occurred during consideration of the bill may have been equally important, such as the approval of a rule by the Rules Committee on February 8, the adoption of the rule by the full House on February 13, and the approval of the Shays-Meehan substitute amendment over two competitors on February 13. We analyze all five events for completeness.

¹¹ The first date is exactly one year prior to the first of our five events.

¹² The total number of observations is therefore nearly 325,000.

¹³ Firm stock market price data and market data are from CRSP (Center for Research in Security Prices, at the University of Chicago) and Factiva. Soft money donations are from the web site of the Center for Responsive Politics (<http://www.opensecrets.org/softmoney/index.asp>) and the Federal Election Commission.

The Fortune 500 companies include many of the largest soft money donors, as well as a large number of companies that gave little or no soft money. The ten largest soft money donors over the 4-year period 1999-2002 were AT&T (\$6.8 million), Freddie Mac (\$6.4 million), Philip Morris (\$5.3 million), Microsoft (\$4.2 million), SBC Communications (\$3.3 million), Verizon (\$3.1 million), Fannie Mae (\$3.0 million), Pfizer (\$2.9 million), Bristol-Myers Squibb (\$2.8 million), and Anheuser-Busch (\$2.7 million). On the other side, an impressive list of firms gave no soft money at all, including IBM, American Electric Power, Intel, ALCOA, Whirlpool, and Consolidated Edison.

We group firms into three categories, based on their total soft money donations over the two election cycles 1999-2000 and 2001-2002: *Non-Donors* are those who gave \$10,000 or less, *Modest Donors* those who gave between \$10,000 and \$250,000; and *Large Donors* those who gave at least \$250,000. We also conducted analyses in which we isolated *Million Dollar Donors*, who gave in excess of \$1 million over the 4-year period. The first group contains 216 firms; the second group contains 142 firms, with an average contribution of about \$90,000; and the third group contains 142 firms, with an average contribution of \$1,080,000. There are 50 *Million Dollar Donors*.

Were soft money donors hurt by the Supreme Court's decision to uphold BCRA? The short answer is: Evidently not.

At the end of the trading day on December 10, the firms that gave soft money had had a better day on Wall Street than firms that gave no soft money. The value of the broad market index dropped by about .5% on December 10th. The stock prices of *Large Donors* dropped by .3% that day, the prices of *Moderate Donors* dropped by .6%, and the prices of the *Non-Donors* lost .8% of

their value that day. The *Million Dollar Donors* – such as AT&T, Microsoft, and Philip Morris – saw their stocks drop only by .1%. This is exactly the *reverse* of our expectations.

The event study analysis confirms this conclusion. Table 1 shows the estimated effect of the events on firms' stock market valuations (i.e., their β 's) for the three types of donor firms. The events marking the passage of BCRA and the Court's decision to uphold the law had no statistically discernable effect on the valuation of firms that gave large amounts of soft money; i.e., their β 's are statistically indistinguishable from 0. What is more, the effects of the events on firms that gave no soft money and firms that gave modest amounts of soft money were not statistically different from firms that gave large amounts of soft money. Specifically, the F-statistics at the foot of the table reveal, in the first case, that the β 's for the different types of firms are not significantly different from each other and, in the second case, that we cannot reject the hypothesis that the β 's are 0. That is, the data are consistent with the hypothesis that all of the events had zero effect on the valuations of all types of firms. If anything, the court's decision appears to have *helped* the *Large Donors*, and hurt the *Non-Donors* – again, completely contrary to expectations.

In short, the Bipartisan Campaign Reform Act did not affect the profitability of corporations that gave considerable amounts of soft money.

There are two possible interpretations to these findings. One possibility is that BCRA will have little effect on behavior. Investors might have expected that firms will find a way around the new law. Indeed, the FEC now faces new challenges in dealing with committees known as 527's and 501(c)4's.¹⁴ We believe, however, that the soft money ban has teeth and will eliminate the sizable corporate donations that were the hallmark of soft money in the 1990s.

A second, more profound possibility is that the premise of most of the discourse over campaign finance is simply wrong. Firms may not care much about soft money because they do

¹⁴ These are the tax code designations for political advocacy groups.

not profit much from soft money donations. As noted in the calculations above, even if firms treated their soft-money donations as investments, and these investments produced a fairly decent rate of return, the total effect on profits would be minuscule and virtually undetectable in stock market prices.

Moreover, very few firms gave large amounts of soft money. Anyone who has followed this issue over the past decade can probably name some of the large soft money donors – such as R.J. Reynolds, Philip Morris, and AT&T. But they are the exceptions. Only one in 25 Fortune 500 companies gave in excess of \$1 million of soft money in the 2000 election, while 40% gave no soft money at all, and half gave \$10,000 or less.

The lack of apparent financial losses associated with the end of soft money indicates at the very least that the campaign contributions do not exact exceedingly large returns on investment. Thousand-fold returns, as suggested by the Senate hearings and other anecdotes, are not borne out in the behavior of investors.

This conclusion raises a problem with a basic premise in the BCRA. Is there a compelling societal interest in regulating soft money? Probably not. Apparently, we are not in a world of excessively large returns to campaign contributors. Firms do not appear to receive a lot for a little. And, even with return on investment as large as 100%, there is very little money in elections compared with the value of all goods and services produced by the government.

There may be a governmental concern about cases of corruption. That concern seems more appropriately handled through stricter enforcement of laws that prohibit bribery and quid pro quo arrangements (Lowenstein, forthcoming). This concern, however, is about a few bad apples. It is not that system-wide corruption is producing substantial private benefits from public policies.

Lacking evidence of actual corruption, the Court relied heavily on concern about perceived corruption. But, in the absence of evidence that firms profited from soft money or that there is a noticeable economic cost to society, one wonders on what the perception of corruption is based. And if investors, who back their perceptions with *real* hard money—their own—do not perceive gains for the largest contributors, one wonders whose perceptions the Court is relying on.

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Table 1: Effect of Key BCRA Decisions on Stock Returns

	House Passes	Senate Passes	President Signs	Supreme Court Argument	Supreme Court Decision
Large Donors	-.19 (.23)	.32 (.23)	.07 (.23)	-.11 (.23)	.13 (.23)
Moderate Donors	-.08 (.23)	.31 (.23)	.46* (.23)	-.17 (.24)	-.18 (.24)
Non-Donors	-.21 (.19)	.24 (.19)	.19 (.19)	-.31 (.20)	-.42* (.20)
F-statistic 1	0.11	0.05	0.81	0.24	1.69
F-statistic 2	0.69	1.84	1.78	1.14	1.89

Standard errors in parentheses

* = significant at the .05 level

F-statistic 1 is for testing $H_0: \beta_{1s} = \beta_{2s} = \beta_{3s}$ (*i.e.*, the effect of event s is the same for all 3 types of firms)

F-statistic 2 is for testing $H_0: \beta_{1s} = \beta_{2s} = \beta_{3s} = 0$ (*i.e.*, the effect of event s is zero for all 3 types of firms)

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