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What's Inside This Issue

From the Chair

In their recent working paper, "Collective Self Control" (May 2012), Alessandro Lizzeri and Leeat Yariv point out that democratically elected governments may not be very good at helping voters to save (money or the environment) for future enjoyment. Their worst-case scenario is one in which commitment decisions are decentralized whereas allocative decisions are electorally and collectively decided. Time-inconsistent voters fail to devise their own commitment mechanisms (assigning a cost to cutting a tree) if they believe that the median voter has a bias towards current consumption (cutting a tree inefficiently early).

We do not even need to assume time inconsistency to see how hard it is for democratic governments to levy taxes sufficient to cover current consumption when voters believe they can externalize the costs of their consumption. The aging Japanese electorate appears to be hell-bent on pushing the costs of social security onto future generations, refusing to pay the taxes for the services they demand. The American electorate, though not yet as old as the Japanese and European populations, may also be "turning Japanese" as *The Economist* (July 30, 2011) quipped, a fact partially masked by enormous inflows of Chinese investments in U.S. government bonds. Meanwhile, Greeks are outraged that German voters are getting cold feet about subsidizing outsized Greek spending.

The internal complexities of domestic politics, enmeshed in strategic interplays across generations and across borders, invite the consideration of multiple possible causal chains. Never has political economy been more central to understanding the world's most pressing problems, and never has political economy required greater theoretical and methodological range. Political economy is not for the timid, but there is no question that it can be a lot of fun.

There are many open frontiers of inquiry in the field of political economy, and as Section Chair for the past two years I had the distinct pleasure of taking part in the acknowledgement of some pieces of exemplary scholarship in several of them: Ben Ansell's book *From the Ballot to the Blackboard;* Tiberiu Dragu's dissertation *Essays on Executive Power;* Milan Svolik's APSA paper "Learning to Love Democracy," and John Ahlquist's APSR paper "Building Strategic Capacity." Kudos to you all! Please come to the Section meeting in New Orleans (Friday noon, place to be announced) to see who this year's winners are! I would also like to express my gratitude for the other officers cycling off their terms who have served the Section with wisdom and diligence: Sandy Gordon, who served two years Secretary-Treasurer, and three members of the six-member Executive Committee: Mark Hallerberg, Alex Hirsch, and Bonnie Meguid.

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THE POLITICAL '12 ECONOMIST

From the Editors

In this issue of *The Political Economist*, with the 2012 presidential campaign well underway, we have chosen to focus on the political economy of campaign finance. With the Citizens United decision having potentially remade the campaign finance landscape, Stephen Ansolabehere and Scott Ashworth contribute analyses of the potential effects of this decision – and finance more generally – on elections and on legislation.

Typically, our newsletters have included a column, edited by Mark Copelovitch, reviewing recent publications by political economists on the topic of the issue. Stephen and Scott's contributions do an excellent job of covering the field, however, so we thought that we could instead contribute our own view from Wisconsin, which has just seen an immensely costly and ultimately unsuccessful recall campaign against the Republican governor, Scott Walker. While of course no single race can establish a causal link between a court decision and campaign spending, or between spending and election outcomes, the vast flow of funds into the state during this election was remarkable and worthy of note.

The Wisconsin Democracy Campaign estimates that total spending in the gubernatorial recall campaign reached about $80 million, with approximately $32 million of that by the candidates themselves: Scott Walker and his Democratic challenger, Tom Barrett. Outside groups spent nearly $50 million on their own advertising during the race. The total of $80 million just exceeds the amount spent during the 2003 gubernatorial campaign in California – a state with a population nearly seven times as large as that of Wisconsin.

The level of private and PAC spending on behalf of the two candidates was overall about equal, although Walker's own spending far outpaced that of Barrett ($29 million to $3 million). Focusing on the candidates' own expenditures, one striking contrast was the ability of each to raise money from outside the state. About 66% of Walker's cash came from out-of-state donors, in contrast to 26% of Barrett's. National interest groups and expenditures played an unmistakable role in the campaign, with for example Americans for Prosperity spending millions on pro-Walker advertising.

Contributing our own personal observations, the disparity in advertising expenditures was reflected in a large imbalance in television advertising during morning and evening news broadcasts and other programs. Pro-Walker ads began running early, while Barrett was still fighting a primary challenge, and in the few weeks of the gubernatorial campaign itself, had at least a 5-1 advantage over Barrett ads.

Did all of this spending and funding from outside the state matter in the election itself, which Walker won by a 7-point margin (a margin that was accurately predicted by the polls, including some by our colleague Charles Franklin)? Of course we do not observe the counterfactual; only further collection of data on spending and election outcomes will provide insight. We would also note that a striking result in exit polls on the day of the election was the extent to which voters of both parties mentioned dissatisfaction with the recall process itself, a finding somewhat at odds with the collection of over 1 million signatures on recall petitions. (About 2.5 million votes total were cast in the recall election.) However, from our neck of the woods – a public university directly implicated in the budget and union battles at the heart of the recall – it seems natural to suspect that the current state of campaign finance law and practice was central to this election. The issues raised by Ansolabehere and Ashworth in this issue outline a compelling research agenda to help us understand whether such impressions are correct. We welcome your discussion and feedback on this issue at the Monkey Cage and on the APSA Connect discussion list.

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THE POLITICAL ECONOMIST '12

Feature Essay

Citizens United and the Changing Political Economy of Campaign Finance

Stephen Ansolabehere, Professor of Government, Harvard University

Citizens United has become the latest rallying cry for political reform in the United States. The Supreme Court of the United States in *Citizens United versus Federal Elections Commission* 558 U.S. 50 (2010) allowed corporations to use funds directly from their treasuries to pay for political campaign advertisements. According to its critics, the decision undid a nearly century-old ban on political expenditures directly from corporate treasuries and opened the floodgates of corporate political independent spending.

At the time of this writing, it is yet to be seen how much the Court's ruling in Citizens United will change campaign finance practices in U. S. federal elections. To date total campaign spending in the presidential primaries does not appear to be appreciably above the growth trends over the prior 12 years, but there may still be an explosion in corporate independent expenditures in the general election this fall.[1] Even though it may not change the total amounts spent on elections in the immediate future, the Court's decisions in Citizens United and related cases signal a fundamental change in campaign finance laws, and the decision reopens one of the most difficult problems with the United States approach to campaign finance regulation, the distinction between contributions and expenditures.

A brief history of campaign laws is enlightening both for what it instructs about the concepts behind existing campaign laws and the tension within them. Campaign finance law in the United States dates to the beginning of the 20th Century, when various acts were a dramatic response by the Congress to sensational cases of influence peddling and bribery.[2] The Tillman Act of 1911 and the Corrupt Practices Act of 1922 ban corporations from spending funds directly from their treasuries for the purpose of contributing to political candidates or parties or making expenditures to elect or defeat a candidate or party. The Taft-Hartley Act of 1943 extended to labor unions the prohibitions on direct contributions and expenditures. The AFL-CIO responded in 1955 with the invention of separate and segregated funds to which union members could contribute – also called political action committees or PACs. PACs themselves were on the verge of being stricken as a violation of federal law in 1971, when Congress passed the Federal Election Campaign Act (or FECA) establishing the legality of limited corporate and union political contributions and expenditures through separate and segregated funds.

FECA was an important change in that it allowed corporate contributions, but in a way that separated contributions from profits. Because a PAC is segregated from the corporate treasury, so the theory goes, it is not driven by the same profit motivation as the corporation itself. Because a PAC's resources derive from voluntary contributions from managers inside a corporation, the revenue and governance model is fundamentally different from the corporation itself. The PAC, then, is supposed to reflect the management's interests and ideologies, not the profit motive of the ownership and shareholders. A for-profit organization of corporate political finance, such as making contributions directly from the corporate treasury, would immediately become suspect as involving a *quid pro quo* and thus an act of bribery.

The assumption behind FECA that business contributions through separate and segregated funds lessen or even remove the incentive to make profit or even commit bribery through contributions was immediately controversial. Four decades of intense scrutiny of the influence of corporate contributions ensued.

The bottom line from this extensive research agenda appears to be that campaign contributions have little direct effect on how members of Congress decide legislation and little effect on the profitability of donor firms. In an article in the *Journal of Economic Perspectives* surveying this literature, James Snyder, John deFiguereido, and I examined every published analysis of the effect of contributions on congressional roll call votes, which were conjectured by political scientists and political economists to reflect the preferences of interest groups who supported elected officials, as well as the preferences of parties, voters, and the members themselves. Of the hundreds of analyses examined, we found that only about one in five regression analyses showed some evidence of statistically significant effects of contributions on roll call votes. Implementing instrumental variables estimation to correct for potential endogeneity dropped that ratio lower still. Of those where there was evidence of a statistically significant effect of contributions on congressional behavior, the magnitude of the effect was quite small. In only a handful of instances were the effects large enough that contributions might have made the difference between a bill passing or failing.

In a separate study, James Sndyer, Michiko Ueda, and I examined whether contributing to politics affected the profitability of firms. We examined the excess stock returns of publicly traded

continued on page 4

1 In U. S. campaign finance law an election cycle runs two years, but the first part of the cycle ends with the primary election and the second is the general election (from September to November).

2 The most notorious scandal was the New York Life Insurance Scandal of 1905, which catapulted Charles Evans Hughes to fame, and led immediately to the first prohibitions on corporate campaign contributions and expenditures. See Richard McCormick, From Realignment to Reform: Political Change in New York State, 1893-1910, Cornell University Press, 1981.

Ansolabehere Feature Essay...continued from page 3

firms who gave to politics with each moment in the passage of FECA in 1971 and amendments to FECA in 1974 and 1976, and legal challenges to that act. We further examined the stock valuation of firms engaged in soft money donations to the political parties before and after the passage of the Bi-Partisan Campaign Reform Act (BCRA), which amended FECA to close loopholes in the law, and before and after legal decisions concerning the BCRA. We found no effect of the change in the laws on the profitability of firms that contributed large amounts of money to candidates or that made large soft money donations to the parties.[3]

What's going on? One implication of these results is that the basic model of campaign finance and the influence of money in politics is not one in which donors buy legislation – of a quid pro quo. Rather the operating model appears to be on more like that of other ideological models of politics, such as of voters or members of Congress. That is, the evidence suggests that donors provide money to those legislators who share their views, rather than directly influencing how legislators vote. Even that approach to campaign finance begs the question of how much money can move legislators away from the preferences of their constituents and their parties, and the answer appears to be very little. An enormous literature on the American Congress emphasizes the primary importance of party and constituency; interest group money is a distant third.

This picture of campaign finance is one in which the reform succeeded. The Corrupt Practices Act and the Federal Election Campaign Act, while not without their problems, achieved its most basic goals. The system of contribution limits and segregated campaign funds managed to create a regime that made it difficult for donors to buy political favors.

That system, however, is being remade, and Citizens United expresses most clearly the essential features of the new campaign finance regime that the Court seems to envision. There was always a confusion in the law, and that was the distinction between campaign contributions and independent expenditures. In 1976, the Supreme Court of the United States ruled in *Buckley versus Valeo* that limitations on independent expenditures by individuals or groups violated the First Amendment, but that contribution limits could be justified as they served the governmental purpose of preventing corruption "or its appearance." The reason for the distinction was that independent expenditures were merely speech acts and could not involve a quid pro quo, but contributions might involve explicit or tacit exchanges of money for favors. Furthermore, the Court ruled that any expenditure that advocated for the election or defeat of a candidate amounted to electioneering and must be disclosed. In the intervening years, the Court has repeatedly reiterated the protection of independent expenditures as political speech and has repeatedly validated contribution limits so long as they served the purpose of preventing corruption without interfering with effective political speech.

The distinction between contributions, independent expenditures, and electioneering became increasingly blurred during the 1990s, especially with the rise of soft money contributions to the political parties and the proliferation of issue ads that skirted the limits of electoral advocacy. Congress attempted to clarify these matters and to impose restrictions on party spending and issue advertising in 2002 with the enactment of the Bipartisan Campaign Reform Act (BCRA, pronounced "Bick Rah"). Surprisingly, the Supreme Court let stand limitations on independent issue ads and on party soft money in *McConnell v. FEC*.

BCRA did not settle the dispute about independent expenditures. It was only a matter of time before someone used independent expenditures to run a shadow campaign and effectively "buy a legislator"; it was only a matter of time before a state attempted to limit spending by imposing a very low contribution limit; and it was only a matter of time before a corporation used its treasury funds to buy independent expenditure advertisements. The first two problems emerged almost simultaneously in the mid-2000s, in the cases of *Caperton v. Massey* (2009) and *Randall v. Sorrell* 548 US 230 (2006). In Caperton, the Supreme Court ruled that the due process rights of Caperton had been violated because the large independent expenditures by A. T. Massey Coal Company on behalf of a candidate for West Virginia Supreme Court created a conflict of interest and should have led the winning Supreme Court candidate to recuse himself in a suit involving Massey Coal. In Randall, the Supreme Court ruled that Vermont's exceedingly low contribution limits restricted candidates' and donors' speech rights. Then, during the 2008 Presidential Primary, the organization Citizens United distributed *Hillary: The Movie* through PayPerView within 30 days of the primary elections, violating BCRA's independent expenditure ban. More problematic still, the case involved restrictions on a media corporation's ability to distribute political information. In *Citizens United v. FEC*, the Court struck down the long-standing prohibition on the use of corporate or union funds for independent expenditures, as well as BCRA's restrictions on independent issue advertising and electioneering within 30 days of the election.

The significance of the Supreme Court's ruling in Citizens United lies in its treatment of corporations. The decision removes the barrier between a corporation's for-profit function (its treasury) and its political activities (its PAC). Independent expenditures can now be made as part of a corporation's investment and profit-maximizing ac-

continued on page 5

3 Stephen Ansolabehere, James M. Snyder, Jr., and Michiko Ueda, "Did Firms Profit from Soft Money?" Election Law Journal 3 (2004): 193-198.

Ansolabehere Feature Essay...continued from page 4

tivities. That reorientation of corporate political spending raises immediate questions about the motivations behind corporate independent spending. The new regime certainly heightens the appearance of corruption, because corporate political action is now part of firms' for-profit activities. If the expenditures are drawn from the for-profit activities of corporations, then one of two concerns arise. First, the expenditures may be made to bring a return for shareholders. If that is true, then they are an exchange of money for benefits, and the theory behind Buckley's distinction between independent expenditures and contributions becomes tenuous, at best. Second, the expenditures may be made from the corporate treasury but without an expectation of a return. That, however, would violate the fiduciary responsibility of the management of the corporation to its shareholders.

It is an open question whether independent expenditures can corrupt politicians. The circumstances in Caperton offer evidence that expenditures can violate due process, but does that same reasoning extend from judicial elections to legislative or executive elections and is this a case of corruption? As with PAC contributions, we should not take it as a matter of faith that corporate independent expenditures necessarily buy political favors in exchange for favorable campaign expenditures. Rather, political economists need to rise to the challenge. We need to subject independent expenditures to the same scrutiny as PAC contributions. Using the same rigorous tests, we must examine whether corporate independent expenditures affect the behavior of politicians and alter the profitability of companies. We must also examine the concerns of shareholders. If corporate expenditures are not justified on the basis of profitability, do they violate the tacit contracts between shareholders and management? Such scrutiny will be critical in assessing the true effects of Citizens United and related cases, and whether Congress and the courts must act to restructure the political finance regime in the United States.

Feature Essay

Voters' Interests in Campaign Finance Regulation: Formal Models

Scott Ashworth, Associate Professor, Harris School, University of Chicago

The Supreme Court's decision in *Citizens United v. FEC* significantly expands the scope for corporate- and union-financed campaign activity. How should we think about this policy change?

One approach, emphasized by the court, asks about the right to free speech. But this right is not absolute—it can be overridden (under a regime of strict scrutiny) by consequentialist reasoning. In his opinion for the majority, Justice Kennedy repeats the consequentialist arguments in favor of unfettered speech in campaigns:

> *Speech is an essential mechanism of democracy, for it is the means to hold officials accountable to the people...The right of citizens to inquire, to hear, to speak, and to use information to reach consensus is a precondition to enlightened self-government and a necessary means to protect it.*

But Justice Stevens, in his dissent, points to a different set of consequentialist arguments:

> *[T]here are substantial reasons why a legislature might conclude that unregulated general treasury expenditures will give corporations "unfai[r] influence" in the electoral process and distort public debate in ways that undermine rather than advance the interests of listeners.*

Several recent formal models of campaign finance can help us think about whether privately funded campaign activity advances the interest of "listeners," in this case, citizens. Here, I survey models relevant to three arguments: the antidistortion argument, the anticorruption argument, and the antidistraction argument.

Throughout, I focus on models in which campaign expenditures allow voters to make more informed decisions. These assumptions—fully rational voters and informative campaign messages—capture two of Justice Stevens's sufficient conditions for the majority's argument based on listener interests to work: individuals have "infinite free time to listen to and contemplate every last bit of speech uttered by anyone, anywhere" and advertisements have "no special ability to influence elections apart from the merits of their arguments (to the extent they make any)." This approach has two benefits. First, with rational voters, it is clear what it means to advance the interests of listeners. Second, assuming that expenditure provides genuine information creates a best-case scenario for a system of extensive donations, one that fully embodies the benefits claimed by Justice Kennedy. As a result, a case against private campaign finance that is based on these models will be particularly compelling.

The Antidistortion Argument

In *Austin v. Michigan Chamber of Commerce*, the court upheld a limit on corporate spending because of the government's interest in limiting the corrosive and distorting effects of immense aggregations of wealth that are accumulated with the help of the corporate form and that have little or no correlation with the public's support for the corporation's political ideas.

This so-called antidistortion argument was rejected by the majority in *Citizens United*.

Coate (2003) offers a benchmark model, one useful both for thinking

continued on page 6

Ashworth Feature Essay...continued from page 5

about the antidistortion argument and as a baseline for the models to discussed later. Coate imagines an election contested by a left and a right party, each of which is dominated by ideological extremists. The median voter is moderate, with ideal policy at the midpoint of the party leaders' ideal policies. The voter, then, wants to vote for a party that has sacrificed its own ideological preferences by nominating a moderate candidate.

Unfortunately for the voter, she cannot identify moderates without information that is too costly for her to collect on her own. This is where campaign expenditure comes in. Candidates, if they can find someone to make donations that cover the cost, can credibly reveal their ideology to voters. Clearly, revealing an extreme ideology is not helpful. But revealing a moderate ideology will, in fact, attract votes.

Now put yourself in the shoes of an extremely right-wing, potential donor. You know that funding the campaign of someone who shares your views is pointless—expenditure cannot help that candidate win. But funding a moderate who leans to the right is a different matter. That candidate can use the funds to help himself win the election, and, if he does so, you are better off—not because you get your ideal policy, but because policy is moved somewhat to the right.

Even though they are dominated by extremists, parties thus have an incentive to nominate moderates: moderate candidates attract donations and use them effectively. Thus a party that nominates a moderate, like a donor who funds a moderate, is able to move policy in a beneficial direction.

In this environment, banning contributions harms moderate voters. They must cast their votes with less information, and candidates are less likely to be moderate. Members of the interest groups, on the other hand, are better off if contributions are banned. They save the cost of the contributions, and policy is no worse in expectation—the extra probability that policy is extreme in the wrong direction is exactly offset by the increased probability that policy is close to the group's preferred position.

Coate's (2003) model shows that extremism of donors need not, on its own, harm moderate voters. But it leaves open the possibility that voters would be better off if campaign funds came from a broader base of contributors. Vanberg (2008) uses an elegant model and empirical test to evaluate this idea. In his model, two candidates have attributes that are unknown to the voters. One of these attributes can be credibly communicated by an advertisement, while another attribute cannot. Advertising has a fixed cost which must be covered by interest group donations. Vanberg considers a simple contribution regulation—each member of a donor group is limited to contributing less than some threshold.

This limit implies that a group can make a successful donation only if the group has enough members. Such a policy can be beneficial to voters if candidates with desirable unadvertisable attributes have larger donor groups than candidates with undesirable unadvertisable attributes and if unadvertisable attributes are more important to voters than are advertisable attributes. These conditions imply an observable condition: conditional on party strength and aggregate spending, candidates who collect larger contributions do less well than candidates who collect smaller donations. Data from House elections between 1990 and 2002 do not display this pattern, casting doubt on this argument for individual contribution limits.

The Anticorruption Argument

In Coate's (2003) model, the only way a party could make itself more attractive to donors was to nominate a more moderate candidate. But in reality, we worry that other actions, less beneficial to voters, help in fundraising. The obvious example is the exchange of policy favors for campaign contributions.

To start thinking about this issue, assume that donors do not care directly about who wins the election. Instead, they value policy favors from the winner. Such donors will make contributions only if the value of the policy favors, weighted by the probability that the candidate wins, exceeds the value of the donation. As long as donors' interests are not the same as voters', a ban on contributions now has both costs (less information in campaigns) and benefits (less costly favors to donors). What is not clear is if the net value of campaigns can be negative to rational voters.

To see the difficulty, consider a voter who sees many ads in a campaign. The voter will learn from the content of these ads, and that might make her more willing, all else equal, to support the candidate. But all else is not equal—the very fact that the ads were run also carries information. In a world of private campaign finance with favor-motivated donors, the ad's existence tells the voter that the candidate promised enough favors to make the donation worth the while for the donor. And that makes the candidate less attractive to the voter.

A simple-minded application of rational choice theory would suggest that the voter cannot actually be harmed by this—the voter understands both effects, and will not vote for a candidate for whom the favor-promising effect dominates the informational effect. Tempting as the argument is, it ignores the crucial role of equilibrium in the competition between two candidates.

A candidate wants to make the net payoff he offers to voters as large as possible.[1] But this does not mean that a candidate will refrain from advertising whenever the cost of favors is larger than the voter's ex-ante value of information. This is because a rational voter not only learns from ads, but also from the absence of ads. So, in a world in which high-

1 To be slightly formal about this, assume that there is probabilistic voting, so the probability a candidate wins is a strictly increasing function of this net payoff, independent of what the other candidate does.

continued on page 7

Ashworth Feature Essay...continued from page 6

quality candidates raise funds to advertise that fact, the absence of ads implies that candidates are not high-quality. Thus, a candidate who advertises improves his chance of winning as long as the promised favors are not so great that they make a high-quality candidate worse than a candidate who is low-quality for sure. Candidates expand transfers until voters are indifferent between a high-quality candidate with transfers and a low-quality candidate with no transfers. This means that, from the voter's point of view, it is as if all candidates are low-quality. In such a case, the voter actually loses from the possibility of a campaign, and would be better off if contributions were banned outright—the likelihood of getting a high-quality winner is no lower, and the voter escapes the cost of favors.

The key to the inefficiency here is that the voter's knowledge that ads imply favors to interest groups makes the ads less effective at ensuring a high quality candidate is elected. Prat (2002), Coate (2004), and Ashworth (2006) show that there can be voter-welfare enhancing limits on private campaign contributions in this class of model.

The Antidistraction Argument

A final argument for the regulation of campaign finance is rooted in an observation made by Justice Stevens in his dissent in *Randall v. Sorell*:

> *Fundraising devours the time and attention of political leaders, leaving them too busy to handle their public responsibilities effectively.*

It makes sense, then, that limiting campaign contributions could improve voter welfare by inducing elected officials to choose a better allocation of their efforts.

Daley and Snowberg (2011) formalize this antidistraction argument. Their model starts with the reasonable assumption that the incumbent takes two actions, one directed to improving public policy and the other directed to raising funds. Politicians differ in ability, and high-ability types are better at both policy work and fundraising. In the least-cost separating equilibrium, low-ability candidates do nothing, while high-ability candidates choose a combination of policy and fundraising that just deters low-ability candidates from mimicking them. At this combination, the candidate is typically devoting a non-zero amount of effort to fundraising. This raises the possibility of voter-welfare-enhancing campaign finance reform—limiting the option of raising funds will force the high-ability candidates to devote more effort to policy to preserve separation.

The literature briefly surveyed above shows that voters' interests can be served by campaign finance regulation, even if campaign expenditures are genuinely informative about which candidate is best for voters and even if voters are fully rational, so that they understand that ads might be paid for by promises of favors or that fundraising took time away from the policy work that they value.

However, not all of the arguments offered in the policy discussion hold up to formalization equally well—the anti-distortion argument seems quite hard to support with rational voters. It is easy to see ways to change the model to make the results different. For example, if campaign expenditure fools voters into thinking that they are more extreme than they "really" are, then banning the expenditure might be welfare improving.

But the main contribution of the other papers discussed above is to show that there is reason to worry even if we have significantly more faith in voters. Both the anticorruption and antidistraction arguments show up robustly even under best-case assumptions about voter competence. Transparency and high quality discourse in ads are not enough to ensure that privately financed campaigns advance voters' interests.

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