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## **The Returns to Lobbying: Evidence from Local Governments in the “Age of Earmarks”**

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- **With the exception of health and welfare programs, most intergovernmental grants to local governments are classified as discretionary spending**
- **In its annual appropriations process, Congress decides how funding for discretionary spending will be broken up among the various agencies, but more detailed decisions about specific uses of funds are left to the executive branch**

The federal government transfers considerable sums to local governments in the form of intergovernmental grants.<sup>2</sup> With the exception of health and welfare programs, most intergovernmental grants to local governments are classified as discretionary spending. In its annual appropriations process, Congress decides how funding for discretionary spending will be broken up among the various agencies, but more detailed decisions about specific uses of funds are left to the executive branch.

Prior to the earmark ban of 2011, members of Congress frequently intervened with the funding decisions of agencies by earmarking federal funds for particular projects.<sup>3</sup> To those in favor of the practice, earmarking represented an assertion of Congress’s power of the purse over bureaucratic objectives. To those opposed to earmarking, it represented little short of

corruption. Regardless, earmarks have been awarded to local governments for a wide variety of purposes.

In order to secure earmarks, local governments have often employed lobbyists. In 2003, the city of Treasure Island, Florida, in need of a new bridge, considered issuing bonds, increasing property taxes, and levying higher tolls. Instead, it paid lobbying firm Alcade & Fay \$5,000 per month, which resulted in a request for a \$50 million earmark by C. W. Bill Young, the Representative of Florida's 10th Congressional District and the chairman of the House Appropriations Committee at the time. That \$5,000 per month turned into earmarks for sewer and public infrastructure repairs that totaled more than \$1.5 million. Alcade & Fay also represented the cities of North Miami Beach and Homestead, who together received a total of \$13 million in earmarks, while other, similarly sized Florida cities without lobbyists on retainer received none. These stories were documented in a 2006 New York Times article (Pilhofer, 2006) that calculated an average return of \$18.41 for every \$1 spent on lobbying for 44 local government clients of Alcade & Fay from 2001 to 2006.

The academic literature measuring the returns to lobbying is sparse. De Figueiredo and Silverman (2006) is currently the only study that provides an estimate of the rate of return to lobbying.<sup>4</sup> This paper intends to fill that gap in the literature by estimating the rate of return to lobbying for local governments. I utilize the boom and bust variation in housing prices that took place over the mid-2000s as a source of exogenous variation to predict lobbying expenditures of local governments. My results indicate that the average local government that lobbied received \$5 more in federal earmarks for each additional \$1 spent in lobbying. This finding implies that local governments were leaving money on the table in their decision to lobby along the intensive margin. However, I also find that for an additional 1 percent of lobbying, or \$1,527 on average, the probability of receiving an earmark increased by just 0.06 percent; an expected value of roughly \$964. This seemingly implies that local governments were lobbying too much along the extensive margin. More likely, however, are the presence of cost prohibitive barriers to entry into lobbying that governments must incur before returns are to be made.

I focus on local governments for several reasons. First, they can be identified geographically, and are banned from forming political action committees or mobilizing their employees politically. This limits their tools of influence over the federal government to lobbying, thus avoiding the difficulty of measuring other means of influence. Second, lobbying

by local governments before the earmark ban in 2011 was almost entirely targeted at earmarks, with the exception of the largest local governments that may have also lobbied for policy changes.<sup>5</sup> <sup>6</sup> Private firms frequently lobby for policy changes, which are difficult to quantify. Conversations with lobbyists indicated that before the moratorium on earmarks, local governments routinely hired lobbyists one to two years ahead of the signing of appropriations bills in order to strategically plan for earmarked appropriations.<sup>7</sup> Earmarks to local governments represent quantifiable benefits to local governments, thus allowing for the returns to lobbying to be measured.

Data on earmarks to local governments reveal several key facts. Earmarks tend to be for a wide range of dollar amounts that are economically significant sums to local governments and serve to fund many local projects of different types. These facts follow from the fiscal reality of constrained revenue creation for many local governments.

In 2009, earmarks among county, municipal, and township governments ranged from small amounts, such as \$4,000 to Ransom County, North Dakota for “leafy spurge eradication,” and \$19,000 for “freshwater mussel recovery” in Randolph County, Arkansas, to the \$29.4 million awarded to the city of Sault Sainte Marie, Michigan for the St. Mary’s River project. A closer look at the data confirms the impression of wide variation in the size of earmarks relative to local government budgets. Figure 1 shows the distribution of earmarks by year as a percent of 2007 local government own-source revenues for county, town, and municipal governments aggregated to the county geographic area. The highest percentage was a \$9.6 million earmark in 2009 for the operation and maintenance of Wappapello Lake in Missouri that represented 184 percent of county total, own-source revenues. Separating out the data into population quartiles shows that less populous counties experienced the most variation in the ratio of earmarks to own-source revenues. The variation increased dramatically, especially from 2008 to 2009 for counties in the bottom two population quartiles, as Table 1 indicates.

As a stylized fact, local governments are heavily reliant on the property tax.<sup>8</sup> This reliance has a stabilizing benefit such that sharp downswings in property values do not immediately translate into lost revenues for local governments (Alm et al., 2011), (Doerner and Ihlanfeldt, 2011), (Ihlanfeldt, 2011). Despite the stability of property tax revenues in relation to the direct effect of declining housing prices during the Great Recession, local governments were impacted by decreases in intergovernmental aid (Chernick et al., 2011), (Jonas, 2012), declines

in job and residential growth (Hoene and Pagano, 2010), (Lutz et al., 2011), (Strauss, 2013), and increases in liabilities (Chapman, 2008), (Shoag, 2013).

The Great Recession placed local governments in a constrained position in terms of revenue creation, but the nature of multilevel government in the United States also makes it difficult for local governments to raise revenues due to state mandates such as Proposition 13 (Joyce and Mullins, 1991). Additionally, the fiscal federalism literature predicts the under-provision of public goods at the local level as a result of decentralization. Beginning with Oates et al. (1972), this literature models the way in which local governments compete for investment dollars by decreasing tax rates, which in turn hampers the production of public goods to sub-optimal levels.

In the mid-2000s, with the Great Recession impacting employment, consumption, and the demand for services, local governments were in a difficult position in terms of generating revenues in the face of rising expenditures. For example, all of the Florida cities detailed in the 2006 New York Times article saw slowdowns in residential growth as a result of the Great Recession. Thus it would seem that for them, lobbying was a highly prudent investment as opposed to increasing tax rates or issuing debt. However, between 2001 and 2014, county and municipal governments in only 19 percent of all county areas lobbied. This raises the question: Why so little lobbying? One possible answer to this question is the fact that lobbying requires high initial costs before returns can be made (Kerr et al., 2014).

Data on federal earmarks from the Office of Management and Budget (OMB) show that from 2005 to 2010, the total number of earmarks decreased by 31.9 percent, while the total dollar amount dropped by 41.3 percent.<sup>10</sup> However, Federal earmarks to local governments increased dramatically both in number and in monetary value over a similar time period. Figure 2 shows that the number of earmarks to local governments increased in number by 51.8 percent and in monetary value by 68.8 percent from 2005 to 2009.

Over the same time period that local government earmarks increased relative to total earmarks, local government lobbying increased at a faster rate than total lobbying.<sup>11</sup> Figure 3 shows that while lobbying expenditures grew in general from 2001 to 2010, lobbying by local governments increased sharply from 2005 to 2006, before the Great Recession, while total lobbying spiked in 2008, after the beginning of the Great Recession.

The longer panel dataset on local government lobbying from 2001 to 2014 allows me to uncover several relevant facts characterizing counties that engaged in lobbying activity: a subset of large counties that lobby every year expend the majority of total lobbying expenditures incurred by local governments. Given that a county lobbied in the previous year, the unconditional likelihood of lobbying in the current year is 82 percent. While lobbying counties have larger populations than the full sample, counties that lobbied every year from 2001 to 2014 were much larger; on average, over 1.2 million in population. Figure 4 displays the average share of total annual lobbying by the total number of years that the county engaged in lobbying over 2001-2014. The positive correlation between total years lobbied and the average share of lobbying indicates that for the average year, the majority of lobbying expenditures incurred by local governments came from the counties that lobby every year.

The high degree of persistence, and the local government lobbying market being dominated by large counties, resembles the market for lobbying by private firms and similarly points to barriers to entry in lobbying as described by Kerr et al. (2014). It is highly possible that in order to engage in lobbying a government must invest in buying lobbying services that do not pay off immediately, i.e. there are increasing returns to “experience” in lobbying.

While local governments allow for quantifiable costs and benefits of lobbying to be measured and located geographically, an additional challenge to measuring the returns to lobbying is the possibility of endogeneity between lobbying and federal earmarks (De Figueiredo and Silverman, 2006). For at least two reasons, OLS estimates of the returns to lobbying may be biased. First, local governments may be more likely to lobby if they have been awarded an earmark in the past. Second, they may have information regarding the probability of their success in obtaining an earmark.

A final characteristic of local government lobbying presents housing prices as a potential instrumental variable. Due to the reliance of local governments on property taxes for generating revenues, housing prices before and during the Great Recession appear to be a useful proxy for the size of the (future) tax base for local governments.

While scholars have offered a range of explanations as to the cause of the rapid build up and consequent crash in housing prices that characterized the mid-2000s (Glaeser et al., 2008), (Glaeser et al., 2012), (Shiller, 2015), this variation was largely unanticipated and thus should not be correlated with the error term for an empirical model that estimates the returns to

lobbying. Figure 5 documents the rapid increase in average county housing prices that peaked in 2007 and then began to decline.

The data show that local governments that experienced decreases in housing prices lobbied more, ostensibly as an alternative means to generating revenue. Figure 6 displays lobbying expenditures for two groups of counties: those with positive growth rates in housing prices and those with negative growth rates in housing prices. For the years 2003 to 2006, the two groups lobbied roughly the same amount. Following 2006, however, the growth rate in housing prices predicts distinct differences in lobbying expenditures between the two. On average, counties with decreasing growth increased their lobbying expenditures by roughly 700 percent from 2006 to 2007, while counties with increasing growth decreased their lobbying expenditures over the same time period. This variation indicates that local governments responded to decreases in housing prices, or future revenue, by lobbying more. The data suggest that local governments lobby to buffer against the consequences of slowing growth in their tax bases.

The theoretical lobbying literature predicts that when interest groups compete in lobbying expenditures, inefficient economic outcomes result. Krueger (1974) models rent seeking for import licenses and shows that competition creates a welfare loss. Becker (1983) provides a theoretical model of how interest groups alter their levels of political pressure in an effort to maximize the total income of their members. Building off of Becker (1983), Hoyt and Toma (1989) show how state mandates regarding local government activities lead to competitive lobbying at both the state and local level, and Hoyt and Toma (1993) provide a related model of interest group competition in the context of public education. Lobbying by local governments for Federal earmarks exemplifies the dynamic of “concentrated benefits and diffuse costs,” since earmarks can be large to individual local governments, but are insignificant from the perspective of taxpayers.

The distributive politics literature often characterizes earmarks as an input in the political bargaining process (Balla et al., 2002), (Lee, 2003), (Evans, 2004). The literature predicts that interest groups more closely aligned with key policy makers will reap larger returns than those who are not (Helpman and Persson, 2001), which implies that congressional representation impacts the returns to lobbying. More precisely, relevant literature in economics and political science predicts the salience of particular aspects of political representation.

One model of legislator behavior, the partisan model of budget allocation, predicts that Congressional representatives will further their own self-interests by serving their parties' interest (Cox and McCubbins, 2007). For example, Congressional representatives may be more likely to funnel resources to districts where the majority party has a smaller advantage (Lee, 2003).

The distributive model of budget allocation implies that variables measuring the influence and position of individual legislators should matter more than partisan affiliation, whether through seniority or committee appointments. Knight (2005), for example, found that districts with representation on the House transportation committee were awarded more project grants than those without. However, due to the lack of clear direction in the literature as to which attributes of political representation dominate others, I take an agnostic approach and include variables that capture both partisan and distributive model predictions regarding budget allocation. Given the inclusion of fixed effects in my specifications and the lack of variation in congressional variables over the sample period, less significance is predicted for them.