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Influence Peddling and the Municipal Market: An Investigation of Political Contributions and Accounting Disclosures.

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INFLUENCE PEDDLING AND THE MUNICIPAL MARKET:
AN INVESTIGATION OF POLITICAL
CONTRIBUTIONS AND ACCOUNTING DISCLOSURES

A Dissertation
Submitted to the Graduate Faculty of the
Louisiana State University and
Agricultural and Mechanical College
in partial fulfillment of the
requirements for the degree of
Doctor of Philosophy

in
The Department of Accounting

by
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December 1996
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Abstract

The municipal bond market is widely perceived to be amenable to influence peddling between parties to bond transactions. One of the primary concerns of both regulators and investors is the relationship between political contributions by bond market participants and the volume and profitability of bond market business engaged in by those participants. This study uses publicly available data from the state of Louisiana to provide evidence concerning the relationship between contributions made by bond market participants and bond business awarded or influenced by recipients of those contributions.

Contributions by bond market players to officials likely to possess influence over bond transactions are determined to be larger than those made by other contributors, and candidates for three of the offices examined are identified as receiving significant contributions from bond market players. A relationship is similarly found between contribution levels and method of bond issue placement.

The study also investigates financial information disclosure by bond issuing entities and the effects of that disclosure upon bond prices. Timely disclosure, as
measured by compliance with state reporting regulation, is found to have no discernable effect upon bond interest costs. The information content of financial reports is modelled by Brown’s Index, and is shown to be a significant component of the interest cost model.
Chapter One

Introduction

The municipal bond market is currently the subject of SEC scrutiny, multiple courtroom debates, several congressional investigations and numerous articles in the financial and general press. This research project speaks to one aspect of that market: the reputed relation between political contributions and municipal bond transactions. Specifically, the research question addressed is:

Is there a direct and positive relationship between political contributions made by players in the bond market¹ and (1) selection of these players for various bond deals and (2) bond prices [Net Interest Cost]? Further, is there a relationship between availability of financial information and bond prices?

¹'Players in the bond market' is a term of art intended to refer to those firms and individuals whose occupation is providing services to issuers of municipal securities. This includes underwriters, bond counsel, those issuing legal opinions, and other consultants or advisers to the process.
The importance of this question is demonstrated by the Municipal Securities Rulemaking Board's [henceforth MSRB] recently issued Rule G-37 [MSRB 1994]. Rule G-37 prohibits any player in the bond market from doing business with state or local governments or their funding entities for two years after that firm's dealers, bond professionals or political action committee(s) contribute to an officeholder in those governments. This rule was prompted by the widespread perception that influence over municipal bond transactions is routinely used by elected officials to extract contributions from market players, and has exposed the MSRB to a hail of criticism concerning its de facto interference in the political process.

Regulation intended to influence the behaviour of political actors cannot help but reflect legislator and regulator perceptions of the political process. Providing those legislators and regulators with empirical data verifying the existence or lack thereof of this widely assumed influence peddling in the bond market will enable them to develop more accurate perceptions of the political process, which should result in more appropriate regulation of that process. Importantly, regulation to date has focused on those methods of
influence purchase amenable to discovery - that is, cash contributions to political campaigns. As discussed later, there are myriad other avenues available to those wishing to provide "off the record" support for candidates [thus possibly purchasing influence].

This study makes no attempt to investigate those avenues of support, as the data would necessarily be anecdotal and thus not amenable to statistical analysis. Corollary to this limitation of data is a restriction on interpretation of results: a finding of no relation between contributions by players and municipal bond business volume or actual bond interest rates may not be seen as conclusive evidence that influence peddling does not take place. A failure to find a significant relation between contributions and bond business should rather be interpreted as an indication that if said influence peddling is taking place, it is transacted through channels other than explicit campaign contributions. This would mean, of course, that current MSRB disclosure regulations focusing on reported contributions will probably not have much effect on the widely theorized influence peddling.

Both the MSRB and the SEC have vigourously defended Rule G-37, and both maintain their intention to continue
targeting undue influence in the municipal marketplace. This despite stories in the press of “workarounds” sculpted by players in the municipal bond market that conform to the letter of G-37 while allowing players to continue supplying funds to candidates. These “workarounds” may be as simple as providing resources for campaign fundraising events or as complex as providing for third party contributions (e.g., employing an independent political consultant who contributes heavily). To date the MSRB has mandated disclosure of contributions by market players and their consultants, and has imposed restrictions on market players’ freedom to participate in transactions with state or local governments whose elected officials accepted campaign contributions from them or their consultants. Market players, meanwhile, protest that the government has yet to provide any authentication of their claims about influence-peddling. This study seeks to provide some evidence of the existence, or lack thereof, of that influence-peddling, again subject to the caveat that only reported contributions are analyzed.

Ramifications of this issue for accountants are varied. First, CPAs often function as advisors to bond transactions or evaluators of the adequacy of refunding
arrangements. Thus CPAs are as susceptible as other market players to rent extraction by officials peddling influence over the bond transaction, and are likely to be affected by regulations concerning contribution activity.

Second, this issue is part of a wider drive for more complete and continued disclosure by municipal bond issuers. Obviously, those responsible for issuance of financial reports by debt-issuing entities will find themselves affected by this increased workload. CPAs functioning as auditors for issuers will also be affected by the need for continued disclosure.

Third and finally, the SEC specifically mentions the need for improved:

[D]isclosure of potential conflicts of interest and material financial and business relationships among issuers, advisers and underwriters, *including those arising from political contributions*... [SEC 1994, emphasis mine].

It seems likely that the SEC will attempt to impose at least some responsibility for disclosure upon auditors of governmental entity financial statements, as it has upon auditors of nongovernmental organizations. Thus, the results of this research project can provide guidance for the accounting profession as well as input into the policy setting process. Importantly, regulation may be driven more by a need to influence public perceptions
than a desire to effectively restrict behaviour. This study speaks to the likelihood of regulation altering the behaviour patterns of elected officials and bond market players rather than the effects of said regulation on attitudes about the bond market.

Perhaps because of the difficulty in obtaining details of political contributions, and in discovering the linkages between individual contributors and player firms, there is not a well-established methodology for research of this nature. Further, the availability of data concerning bond issues placed prior to recent rules on reporting such information [e.g., the 1993 disclosure mandate issued by the Louisiana legislature] is limited as well. In an attempt to overcome the limitations of data availability, this study will be limited to the state of Louisiana, and the 1991 - 1994 election cycle. Limiting the study to data from one state severely limits the extensibility of the study to other states, however that extensibility is somewhat suspect in any event because campaign finance statutes and bond issuance regulations vary widely by state.

The 1991 election cycle was selected for several reasons. First, MSRB regulation G-37 took effect in 1995, thus making the 1991 cycle the last “free for all”
cycle. Postulating that market players were aware of increasing federal agency concern with influence peddling, and that players were motivated to take full advantage of a soon to be unlawful strategy, there is a distinct possibility that contributory activities increased in this period. One of the measures of proper targeting of contribution regulation [subject, as discussed earlier, to the assumption that the purpose of regulation is to inhibit undesirable behaviour rather than to influence public perceptions] is the extent to which that soon-to-be regulated behaviour occurs prior to the effective date of the regulation.

Secondly, campaign reporting regulations underwent several modifications after the 1991 cycle, including the removal of a requirement that campaign finance filings be cumulative in nature. This change in filing format increases the difficulty of data collection, and simultaneously increases the probability that contributions which should be included in the data set will be excluded.

Finally, reporting requirements had been in place for previous elections, thus candidates and their respective campaign organizations should have been familiar with those requirements. Staff at the Ethics
Commission for Elected Officials had also had the opportunity, in the course of auditing past filings, to assist candidates in understanding what information needed to be filed and what format that information should take.

Contribution data has been collected for all relevant statewide offices by inspection of campaign finance filings with the State Board of Ethics for Elected Officials [henceforth SBE]. Firm affiliations of individual contributors are established by comparison of contributor data with membership lists of the relevant professional organizations and by review of *The Red Book*, which is a publication listing players in the municipal market by firm and location. Contributor data for bond counsel was also verified by review of the Martindale-Hubbell directory of attorneys by specialization. In the spirit of conservative data modeling, this process, if not completely accurate, will understate the relation between player political activity and business volume or bond rates.

Data was collected for bond issues by entities within Louisiana for the period 1991 through 1995, as tabulated by the Louisiana Bond Commission [LBC]. Louisiana statutes require that all governmental entities
seeking to issue debt present their offering for the approval of the LBC. Utilizing a fairly complete population of bond issues will provide greater generalizability of results as well as greater likelihood of finding an effect.

An initial analysis is performed using various statistical tests that a), provide some indication of the relation between the population of contributor/players and the population of contributors in general, b), compare the distribution of the volume of player bond-related business with the distribution of player contributions, and c), examine the relation between player contributions and the decision to competitively bid the issue. These tests should provide evidence of the existence and strength of the relation between contributions and player business.

Candidates for office frequently encounter significant startup expenses when initiating campaigns. Timing of contributions is therefore an important aspect of campaign finance. This study focusses on the relation between contribution amounts and bond business rather than contribution timing. Contribution amounts are summed over the entire election period rather than specifically identified by date. Analysis of "early
money" contributions is thus not possible within the scope of this project.

Following this general analysis, further examination of the data is performed using regression techniques to investigate the effects of contributions on net debt cost. That is, the tests will provide evidence concerning the public costs of public officials peddling influence for contributions. For this purpose, public cost is defined as an increase in NIC attributable to campaign contributions by bond issue participants. This analysis should yield information useful in deciding how much to spend in alleviating the hypothesized problem.

Importantly, this portion of the project utilizes a base regression model well established in the literature, which helps to ensure that any finding of public cost [that is, NIC greater than the base regression model would predict] is not an artefact of an unrelated characteristic of the issue. This project should therefore be seen as an incremental approach to the general problem of the municipal bond market rather than as a novel approach to a specific aspect of that market.

Hildreth [1993] suggests that the solicitation and/or making of political contributions by players in the municipal bond market can generate two fundamental
types of problems: (1) contributions are made in an attempt to obtain or retain business, and (2) contributions are made to "allow" entry into the pool of underwriters (i.e., "pay to play"). Note that these problems relate to a relationship between underwriters and politicians having influence over placement of bond issues. Both of these possibilities are exacerbated by the frequent use of negotiated rather than competitively bid sales transactions. Competitively bid sales can reduce the risk of either type of problem to some degree, however it should be noted that even under a perfectly competitive regime the possibility of soliciting contributions in exchange for non-underwriting consulting work or eventual resale of bonds at favorable rates continues to exist.

It is also important to consider the contributory behaviour of market players from a broad perspective. That is, contributors are probably not making donations in hopes of influencing a single transaction, or for that matter a single type of transaction. As Rasmusen & Ramseyer [1994] note in a discussion of bribes that relates equally well to campaign contributions:

Through the contributions, the lobbyist obtains not a vote but the privilege of conveying information to the legislator. [p. 315]
For instance, a bond attorney may very well make contributions to campaigns with the simultaneous goals of a) gaining business by “locking in” his position as bond counsel, b) gaining business by being seen to be a confidant of the candidate’s, and c) gaining business in non-bond related areas by increasing awareness of his firm.

Similarly, an investment banker may be interested in garnering a local government’s short-term investment business as well as underwriting its bond issues.

This perspective allows us to dismiss worries about targeting specific contributions to specific ends: we can safely assume that influence, once purchased, will be used wherever profitable (and possible).

Given the relative uniqueness of the topic under investigation, a discussion of theoretic underpinnings to these assumptions about influence peddling is appropriate. Section I provides a description of the transactions under investigation which section II builds upon by using extant theories (principal-agent and competitive markets) to motivate the situation and players. Section III summarizes the data required to investigate these motivations. While this study is largely descriptive and does not attempt to develop
hypotheses differentiating eventualities under the various theories, it is important to attempt at least a general theoretic explanation for why the behaviour this study investigates might occur.

A. The Bond Issue Transaction

The sequence of transactions involved in municipal bond issuance is convoluted and dependent upon several endogenous factors. That being the case, it is worthwhile to enumerate a generic sequence of events to facilitate later discussion of the motivations and actions of the various players.

The first step in the process is, obviously, a governmental unit deciding to issue debt securities. This is an iterative process of comparing costs and timing of revenue and payment streams over several alternatives. This task is usually completed with the assistance of several players, (1) the unit's bond counsel, (2) a financial advisor, (3) representative(s) of the likely underwriter(s), and (4) the unit's legal counsel. Decisions are made as to the net proceeds reasonably realizable, the amount of debt to be issued (face value, which is not equal to the amount of proceeds in most cases), stated interest rate (which is usually not the same as the rate at which the issue is sold to
underwriters or that earned by eventual holders), timing
of interest payments, and callability features.

For purposes of this study, governmental unit may be
defined as an agency of the state government of Louisiana
or one of its political subdivisions [parishes, municipalites or special funding districts]. This
includes agencies such as the Louisiana Public Facilities
Authority (LPFA), Louisiana Public Housing Authority
(LPHA), etc. The preponderance of these agencies are
staffed by administrators who are appointed rather than
elected. While appointment of administrators might seem
to negate the utility of an investigation of campaign
contributions, it merely places influence peddling on a
less direct level. Officials of these agencies are
appointed by elected officials (largely the Governor),
and thus are susceptible to the direction of those
elected individuals. It is reasonable to expect that
these appointed administrators will seek to please the
person(s) responsible for their position. Thus any undue
influence will be passed through from elected official to
decision maker. Given the by nature larger dollar volume
of state-wide agencies compared with parish or municipal
entities, attempts at influence peddling should be more
discernible at the state-wide office level.
The second step in the process is selection of an underwriter (or more often in recent years, a team of underwriters). The governmental unit often makes negotiated sales of its bonds to underwriters - that is, it does not go through the competitive bidding process\textsuperscript{2}. Some states, Louisiana for instance, have an agency specifically charged with reviewing issues for all entities within the state prior to placement: these agencies typically recommend competitive placement. Note, however, that recommendations are precisely that - recommendations and not mandates. As staff at these agencies freely admit, there are numerous legal loopholes allowing entities to circumvent agency recommendations, and several rationales for preferring negotiated placement.\textsuperscript{3}

As a more complete picture of the bond issuance process emerges, including the ways in which players take advantage of their private information and positions of

\textsuperscript{2}Nationally, approximately 80 percent of new bond issues are placed by negotiation rather than competitive bid.

\textsuperscript{3}A staff person at the Louisiana Bond Commission related the story of the Avondale bond issue. It seems that even though the structures to be constructed are several hundred yards in length, weigh thousands of tons, and are designed to be stationary and permanently anchored, bringing to mind buildings rather than vessels, the bond issue was exempt from LBC governance because these structures are not land structures. As the staff person put it, "All they need is clever counsel."
relative power, states are increasingly writing legislation requiring competitively bid sales. The primary point of competitively bid sales is reducing the ability of underwriters to buy bond business via political contributions, a secondary effect being to ensure the highest price possible for the bonds. Unfortunately, this tactic is having only limited effect as politicians, and the administrators they appoint, can effectively constrain membership in the pool of underwriters allowed to place bids by setting up certification processes of various sorts.

Finally, the underwriters offer the bonds to investors, making a profit on the spread between their cost and the market rate at time of sale. It is apparent that timing of the issue can be a crucial issue for underwriters, who carry the risk of unfavourable market rate fluctuations. Another important factor is the credit rating assigned to the issue or to the entity itself. Issuing entities are interested in being rated as highly as possible, since a higher rating translates into a larger potential market for the issue. Issuing entities may also be interested in facilitating the timing of the issue's sale, so as to demonstrate to
prospective bidders on future debt issues that the entity is a cooperative member of the relationship. These transactions are assumed by oversight agencies to be market-driven and market-policed, an assumption that, according to the media, these agencies should be disabused of. Given the peripatetic nature of bond issuance, it is prudent to recognize that the trusting reliance on market structure evinced by oversight agencies is indeed misplaced. Moreover, the after-market for municipal bonds is far from complete; trading is infrequent and no system presently exists to publicize bid-ask quotes when trades do occur.

The bond issuance process, as a result of the situations articulated above, is susceptible to abuses of the public trust and unfairly advantaged trading by some players. As a necessary precursor to any conclusions about causes or solutions to such abuses, the next section attempts to explain the actions of various players from the perspectives of two theories of economic behaviour.

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'This aspect of the issuer-underwriter relationship is pointed out in Lynch [1996].
B. Theoretic Background

Tax-exempt bonds have historically been investment vehicles bought and sold in relative obscurity. The business press discussed these bonds mostly in relation to changes in the tax code, and the lack of transaction volume made the provision of pricing information problematic. Federal regulatory agencies have treated bonds as a locally regulated issue, opting to stay out of the process, leaving disclosure an open question usually answered by underwriters. In this information scarce environment opportunism can and arguably does flourish.

Recently, significant attention has been devoted to municipal bonds, probably as a result of the default of several very large issues. Concomitantly, the clamor for modification of the bond market has become louder. This section of the chapter seeks to articulate some of the underlying motivations for observed behaviour on the part of bond market players, a necessary prerequisite to legislating constraints that will alter that behaviour.

This issue can be approached most directly from a competitive markets perspective. Keim & Zardkoohi [1988] provide a cogent analysis of the solicitation of and

\footnote{see Schifrin [1989], Hawthorne [1987], Business Week [1993] for a sample of reporting about municipal bonds.}
influence by PAC contributions that applies equally well to influence with respect to the bond transactions studied here. Keim & Zardkoohi's perspective of the market for campaign contributions is empirically supported by Snyder [1990]. Snyder uses data from open-seat races for the U.S. House of Representatives during the period 1980 - 1986 to validate a simple model based on the idea of campaign contributions as investments. Results of the analysis support Keim & Zardkoohi's work. Following their lead, we view the bond issuance transaction as taking place in a market for services (influence).

Adapting their perspective, underwriters are seen to be buyers of future business, while candidates for office are sellers of "good will" that ostensibly assures the buyers of future business. Note that the buyers are not certain of actually receiving the influence they pay for, as the election is, at least in some sense, a gamble. Therefore buyers are motivated toward two activities that moderate the "cost" of acquiring influence. Even given that potential profits from bond business are quite large, buyers are still motivated to minimize the expense of capturing that business. Buyers may well consider campaign contributions as relatively minor expenses, but
expense minimization remains a primary tool for increasing profits.

For illustrative purposes, assume that the influence underwriters are trying to buy is only usable during the immediately subsequent term of office. This assumption merely clarifies the situation, relaxing it does not change the point or the motivations behind actions. In fact, relaxing this assumption, that is looking for influence-peddling over a longer period of time, would make finding evidence of the hypothesized relation more likely.

First, underwriters seek to drive the price of said influence down in response to the risk that their candidate will not be successful. This price reducing behaviour is moderated by the knowledge that at some point reduced contributions could be a causal factor in the candidate's failure to win the election. Candidates are motivated by their need for reputation to fulfill their obligation to exert influence on their contributors' behalf.

The second response of buyers to the cost of influence, in this case targeted toward reduction of risk rather than reduction of outlay, is to purchase influence from all candidates. This practice should be reflected
in campaign contributions to every candidate. Again, it is obvious that this strategy has negative ramifications, assuming that there is some increase in probability of election associated with an increase in funds available. The negative ramifications are the tendency of contributory behaviour to spiral the cost of successful campaigns (hence the cost of influence) upward. In this case the buyers, in an attempt to reduce risk, increase costs for themselves.

Bondholders are affected by similar motivations. Rather than purchasing business, they are seeking to purchase an investment that pays better than alternatives available in the market. Importantly, that increased payoff may consist entirely of risk reduced below the level assessed by the general marketplace. In the obvious case, the bondholder is provided information not publicly available regarding the ‘true’ financial situation of the entity, or is provided assurances of payment not incorporated into the formal bond purchase agreement. For this strategy to work, underwriters do not need to be party to private information concerning actual risk levels or the arrangement between officeholder and bondholder. Because of the lack of information concerning the identities of ultimate bondholders, this
facet of the hypothesized relation will not be investigated.

A similarly useful perspective to adopt is that of principal-agent theory. Under this theory, all players are modeled as self-interested and able to make rational decisions based upon complete information in furtherance of that self-interest. While the issue of information availability to decision makers is key to hypotheses developed under this theory, the present analysis does not address the issues of continued information disclosure by issuing entities. The study focuses rather on the behaviour of parties to the debt issuance transaction.

The very nature of representative forms of government mandates that a subset of government transactions will occur outside the boundaries of publicly observable behaviour. The important issue here becomes moral hazard (the ability of agents to make choices that are not discernable to the principal, that is, choices not affecting reputation). In this case the

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6Simon [1982] and others have addressed the more realistic situation where information is incomplete and/or decision makers have limited abilities to process information. As our focus is on putatively unobservable behaviour rather than decision making mechanisms, this study does not address those issues.
decisions themselves, as well as the outcomes of those decisions, may not be apparent to the general public. Agency theory, with its focus on moral hazard, thus has several applications to the topic of this study.

On the highest level, the candidate seeks to achieve a position with access to public resources. Her self-interested goal is to maximize her benefit from these resources. This self-interested goal remains relevant even if contributions from bond market players are not, in toto, significant relative to total contributions. As Rasmusen & Ramseyer [1994] indicate:

Legislators in modern democracies (a) accept bribes that are small compared to the value of the statutes they pass ... [p. 305]

It is apparent that the awarding of bond issues is a situation where the office-holder is handling a public resource, and that the office-holding agent is motivated toward siphoning off the largest fraction of that resource possible without incurring penalties. One method of siphoning off resources is to trade influence over the underwriter selection process (an action usually unobservable to the public) for campaign contributions.

Equally, the underwriter is motivated to secure as much underwriting business as possible at the least cost possible. As might be expected, competitive bidding is
not the most efficacious method for him: the underwriter would prefer negotiated placement, which effectively removes competition from the process of determining interest costs. The underwriter is motivated to make campaign contributions to garner uncontested business by the fact that the contribution is less costly than the reduction in profits caused by competitively bid business. It is also possible, as discussed previously, for officials to create a "pay to play" environment. In this environment competition for bond business is limited to a select pool of bond market players. The included players have a significant advantage over those not included in the pool of available transaction partners.

Using either theoretic perspective highlights the issue at hand; do underwriters and candidates behave in the manner predicted? As is evident from the cited articles in the business media and the interest in regulation indicated by the convening of several federal investigative committees, the common perception is that players in the bond market do participate in influence peddling.

C. Data Sources

This study requires data about several disparate roles and the individuals filling those roles. Data

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concerning the sources and amounts of campaign contributions to candidates for public office, the number of issues and dollar volume of bonds placed with the various underwriting firms is required as are the identities and contributory activities of other players in the bond marketplace. In the interests of clarity, the discussion of data elements and sources is segregated by player role.

1. Elected Officials

As elucidated above, politicians are perennially in search of campaign funds. The information relevant to this study is directly related to the success or failure of that search: that is, data regarding contributions received. Federal and state election regulations mandate the filing of campaign finance statements which provide detailed listings of contributions. These documents should be readily procurable for all states, however this study will be restricted to Louisiana.

Given the vast number of elective offices contested in elections scattered across the calendar and around the state, the study focusses on elections for state office only. This focus should facilitate data availability and precision since local election data is often delayed, discarded more quickly, and of questionable accuracy.
While it could be argued that a large fraction of tax-free government bond issues are locally designed and placed, the surge in creation of state oversight commissions in recent years ameliorates the influence of local officials. Further, market players seek to maximize their business transaction volume (both dollar volume and number of transactions), and thus are motivated to focus their efforts on officials having influence over multiple transactions. To further focus the data set, elective offices most likely to possess influence over the bond placement decision are investigated. Those positions are listed in table 1.1. The Representatives and Senators chosen, as well as the Treasurer, Governor, and Attorney General are all members of the LBC. The Lieutenant Governor and Secretary of State are included as well, under the hypothesis that their offices possess significant political power.

The selection criteria tend to accentuate any relation found between contributions and placement, payments to candidates not as likely to exercise influence over the bond issuance process are excluded. This strategy ameliorates the problem of non-targeted influence (the situation where other influence seekers attempt to purchase generic suasion over elected
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officials). That exclusion also functions to contract the pool of large contributors and thus highlight those attempting to influence placement decisions. It should be noted, however, that this restriction obscures a potentially large influence effect. It is probable that some officials with influence over bond placement function as indirect influence hubs. That is, their influence may be purchased by contributions to the campaigns of supporters, relatives, or even opponents. Given the tenuous, continuously changing and largely sub rosa nature of such relations they are left out of this analysis. Subsequent research attempting to highlight relationships in this area will need to be extremely sensitive to contextual issues, a task that is clearly beyond the scope of this project.

Data required with respect to political offices for this study include contribution amounts, source, source affiliation, and recipient. All of this information is available in gross form in the required filings.

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7I refer, of course, to the widely circulated story that Edwards' 1991 gubernatorial campaign found some method of providing funds for Duke's campaign in hopes (realized, as it turns out) that Duke would draw enough support away from Roemer to force a runoff between Edwards and a candidate he could beat, Duke.
In order to restrict contribution data to those most likely to be quid pro quo in nature a floor amount for individual contributions is established. Contributions under that floor amount will not be incorporated into the analysis. The rationale for doing so is that influence is probably not sold cheaply. Following the strictures of competitive markets and agency theory discussed above, candidates are strongly motivated to maximize the price of any influence they seek to peddle. Further, even determined attempts to evade the intent of disclosure regulation would be unlikely to resort to having myriad individuals donate small amounts, as the logistics of such a ploy would rapidly become unmanageable. For this study the floor amount is set at $250, the maximum allowable contribution under the MSRB's Rule G-37. That amount should be large enough to limit the volume of contributions to manageable proportions and small enough to capture most if not all influence purchases.

2. Underwriters

Hildreth [1993] speaks solely to the issue of underwriter contributions to campaigns, as does all pending regulation. As Hildreth suggests, underwriters are motivated to develop exchange relationships with elected officials capable of influencing bond placement.
decisions. Determination of the existence and nature of the relation between contributions and that influence rests on two issues.

First, the volume of underwriting business (both in dollars and number of issues) of each underwriter needs to be tabulated. This information is available from the recorded proceedings of the agency responsible for placement of the issue. In Louisiana, the information is also available at the Louisiana Bond Commission. Additionally, supplementary documentation relating to bond placement issues is procurable and may be used to fill gaps in data from government records.

The one limitation of data availability is related to multi-underwriter issues. The exact apportionment of dollar volume to specific underwriters may not be available, as negotiations between the lead underwriter and other members of the underwriting pool are not part of the public record. This is a minor issue, however, as it is the lead position that carries the most influence over distribution and the identities of all underwriters are always readily available.

Second, a critical link is the association between underwriting business and contributions. Contributions can be masked in a variety of ways. The most common
methods of masking contributions are to have them made by "related parties" who are not under constraints limiting contributions. For purposes of this study, related parties includes company PACs, employees and the families of employees. Information about employees of underwriting firms will be acquired by determining the underwriting firm office handling the issue and reviewing business directories for the cities in which the offices are located, as said directories routinely list employees by office location. While the task of connecting contributor and beneficiary is an arduous one, the candidate, prior to using her influence, would want to independently verify the promised contributions as well. This indicates that the driving force behind contributions is fairly easily determinable. In support of that theory, consider the statements Harlan [1993] attributes to spokesmen for Kathleen Brown and Mary

8Family members are defined as individuals listing the same address and/or the same surname. While there are obvious problems with using address or surname as a linkage device, I believe the effects on this study are minor. This belief rests upon the facts that this study deals with state elections (which limits the possibilities of surname repetition by reducing the population of interest and limiting the area of possible residence) and large contributions (which places limits on inclusion by virtue of the relatively greater wealth required to support large contributions). Both of these factors should minimize distortion of results.
Landrieu, state treasurers of California and Louisiana respectively:

(Brown) "[A]bout 8% of the contributions to her 1990 statewide campaign came from bond firms."

(Landrieu) "[S]he tries to limit bond-related contributions to about 20% of her total campaign funds."

If other office-seekers are as aware as Landrieu and Brown seem to be of the ultimate sources of their campaign funding, it seems likely that outside data collection and analysis can produce similar results. Assuming that these sorts of transactions do not encourage trust simply makes that eventuality more likely.

Third, information about the nature of the placement will be collected. Specifically, whether the issue was placed by competitive bid or negotiation. Negotiated placement makes quid pro quo arrangements easy to fulfill, therefore collecting this information should allow more conclusive analysis of the relation between elected official and underwriter. Further, net interest cost (NIC) data will also be collected for each issue. The purpose in collecting NIC data will be to determine whether the bonds were issued at a market equivalent rate or not. Bonds issued at higher than market equivalent rates provide evidence consistent with influence
peddling. Market equivalence will be proxied for by a combination of the following: size of issue, Moody's rating of the issuing entity, date of issue (as evidenced by bond purchase agreement signature date), risk limiting devices (insurance, guarantee, etc.), term of the investment (measured by years to first call).

Since all issues under study were issued by Louisiana entities, no adjustment for exogenous regional economic factors is included. Bond investors are much more likely to be concerned with long-term economic factors, and those factors arguably will influence all issues from the area similarly. That is, investors are more likely to see Louisiana as an economic whole than to dissect it into smaller entities when looking at overall economic conditions that would influence investment choices. This is not to say that investors equate New Orleans Airport Commission debt with that of the Bossier Parish Water Districts, but rather to suggest that when investors consider longer term economic trends (e.g., continued viability of American oil production or long term market demand for chemical feedstocks produced by Louisiana chemical manufacturers) they do not differentiate across the various political subdivisions.
D. Summary

This chapter has identified the research question addressed by the study: is there a relationship between bond player contribution activity and the public cost of municipal debt [NIC]? An explanation of the bond issuance process is provided, and the various parties to the transaction are identified.

The chapter also provides a theoretic analysis of the hypothesized behaviour, based upon both competitive markets theory and principal-agent theory. Following the discussion of theoretic backing, an assessment of data required to investigate the question of interest is presented. Three distinct datasets are identified: (1) contributions made to campaigns of candidates for the offices identified above; (2) details of issuance transactions for bond issues included in the study; and (3) financial information for each of the entities issuing bonds included in the study. Sources for each of the datasets are identified, as is the method of associating individual contributions with bond market player firms.

There is a rich tradition of research focusing upon the nature of the municipal bond marketplace. That
tradition, as enumerated in chapter 2, serves as the baseline for this research.
Chapter Two

Review of Literature

Relevant research studies investigating the primary municipal market can be partitioned into two categories: (1) those comparing results of negotiated versus competitive placement of the issue and (2) those focusing on the association between accounting information, financial report presentation and net interest costs.

The competitive placement process begins with the issuer (usually with the assistance of financial and legal consultants) establishing maturities, interest rates, and minimum yields for the issue, preparing a preliminary official statement of offering, setting a sale date and obtaining a rating. The issue is then offered for sale to underwriters, who make sealed bids for the issue. Per the axioms of market theory, this process should ensure that the issuer is able to maximize the price at which the issue is sold to underwriters. Underwriters, of course, seek to maximize their returns by selling at a maximal price to investors. Therefore, underwriters are willing to pay more for bond issues that investors find attractive, and competition among the
underwriters should prevent them from extracting undue rents from either issuers or investors.

Negotiated issues, on the other hand, lack that competition between underwriters. In this method of placement, the issuer solicits proposals from various underwriters prior to setting characteristics of the issue. The underwriter and issuer agree that the underwriter will purchase the issue at a set price. Obviously, this method of placement allows issuer officials much greater latitude to shift business to or from players. The issuer is no longer afforded the advantage of market driven monitoring of the transaction. That is, the transaction price is set via negotiation rather than the market, allowing collusion between players and issuers and offering opportunities for extraction of excess rents by the underwriter.

Other participants to the bond issuance transaction may also be susceptible to contribution extraction by elected officials. Bond counsel, financial consultants, and various advisors to the process all profit from inclusion in the issuance transaction. Placement method is not directly related to the inclusion of these

*Note that the solicitation process is usually not formal and may not take place at all, especially in situations where undue influence is being exercised.
individuals, as they tend to be selected prior to the decision about what kind of placement would be appropriate. The selection process for these players is typically specified by state or local acquisition regulation [e.g., the entity may require bid solicitation for legal services and advisory services]. Fees for services are also often capped by regulation, which limits the ability of advisors to trade political contributions in exchange for excess fees.2

Studies of placement method, focussing on underwriter selection and thus on a primary means of influence peddling, are especially relevant to this research. Researchers and regulators hypothesize that political influence peddling is facilitated by negotiated placement - that is, that directing business toward certain market players is easier in a non-competitive environment [Hildreth 1994, Roberts 1994, Levitt 1993, Harlan 1993, Hildreth 1993, SEC 1994]. This theory leads to the idea that incorporating a variable for placement method in the research model would mask any significance associated with political contribution variables.

2This is the case in Louisiana for bond counsel. Fees charged are constrained by state regulation specifying maximum fees by issue size.
As recent studies have indicated (Simonsen & Robbins, 1994), variation in interest costs over placement method choice has steadily narrowed over the last twenty years. This reduction in cost difference suggests that either players are foregoing the possibility of maximal rent-extraction as a means of de-emphasizing the non-market nature of their transactions or that competition is occurring in the negotiated placement underwriter selection process. Hence, players appear sensitive enough to reputation effects that they maintain lower cost structures even under monopsony conditions. It seems possible, therefore, that the political contribution variable may overwhelm the placement variable.

Another factor of interest is the strong trend toward negotiated placement. As Simonsen and Robbins [1994] note, in 1970 83% of municipal bonds were sold via competitive placement: by 1993 only 20% were sold competitively. This switch towards negotiated placement has been portrayed as an after-effect of increasingly prevalent influence peddling. The studies discussed in this section seek to shed light on the phenomena of

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1[Patterson 1993], [Cross 1993], [Levitt 1993], [Business Week 1993], [Hedges et al. 1993] are representative.
placement and the various theories that have evolved to explain observed data.

A. Studies of Placement Method

One of the original items of interest to researchers was the notion that some issuers of tax-exempt securities have paid interest rates significantly above the market rate. The earliest research focussed on the effects of restrictive bidding practices. The most obvious practice is negotiated placement of a new issue rather than a competitively bid sale of the issue. This practice is often held out to be a necessary precursor to influence peddling, as the competitive bid process provides limited opportunity for shifting business to or away from specific market players. As Hildreth [1993] notes, however, influence may be in the form of "pay to play" rather than outright award of business. At any rate, studies investigating the effects of competitive versus negotiated placement have a history dating back to the 1960s.

The initial study of monopsony in the municipal bond market, West [1966], used a regression model to

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'That is, players wishing to be "qualified" as capable, able to handle business the size of a particular issue, and having "suitable depth of personnel" may be induced to contribute.'
approximate net interest cost for selected issues between 1956 and 1963. West's model incorporated five independent variables: (1) a measure of the market interest rate, (2) issue size, (3) Moody's rating of the issue, (4) average maturity and (5) number of bids submitted for the issues. West found that all variables were significant predictors of net interest cost, and that issues with at least three bids submitted had lower interest cost. West interpreted his results as demonstrating that underwriters collude on issues receiving only one or two bids: that is, underwriters of sparsely bid issues exercised their comparative market power to extract larger than normal spreads from issuers. Importantly, said underwriters may not need to engage in explicit collusion to exercise their relative market power. Underwriters would not necessarily have to communicate with their competitors in order for collusion to occur. It would be sufficient for underwriters to be able to identify those issues which will not attract multiple bids, and for each underwriter (or subset of underwriters) to identify some segment of the limited-bid market to bid on.

Kessel [1971] approached the issue of interest costs via a closer look at the effects of differing numbers of
bidders for an issue. His results demonstrate that the incremental benefits accruing to issuers receiving larger numbers of bids grow progressively smaller as the number of bids increases. Kessel's hypothesis is simple: since any new bidder's bid yield may be lower than the others, an issuer's expected interest costs decline as the number of bidders increases. Kessel also notes that as the number of bids increases underwriter spread decreases. In agency theoretic terms, this indicates that the competitive bidding process is an effective monitor if sufficient players participate.

Ederington [1978] seeks to adjudicate between West's and Kessel's theories. While he explicitly states that the theories are far from mutually exclusive, he advances still another theory - competition among underwriters drives interest costs down (that is, underwriters become price-takers as the number of bids increases). Ederington's study dealt with public utility debt rather than municipal, tax-free debt, but his results - support for his competition hypothesis, weak support for Kessel's search theory and not much support for West's economic monopsony theory - should be readily transferable to the municipal market.
Sorensen [1979] examines both competitive and negotiated placement issues, providing a comparison of interest costs across the two methods of placement. Sorensen's theory— that bond issues suffering from high demand uncertainty might pay lower interest costs when negotiated rather than competitive placement was used—is borne out by his analyses. The competitive sample was split into two groups by rating⁵, and the resultant interest costs were compared with negotiated issue interest costs. Sorensen found that issues receiving only one competitive bid actually paid higher interest costs than comparable negotiated issues. Issues receiving multiple bids were sold at significantly lower interest rates than comparable negotiated issues. Sorensen therefore concluded that the issuer's decision about placement method should be driven by an analysis of market forces governing underwriter participation in the bidding process, as issues garnering less than three bids were likely to incur interest cost premiums if competitively bid.

⁵The theory behind this is that issues with lower ratings suffer from higher demand uncertainty than higher rated issues. Sorensen asserted that this theory was buttressed by the readily observable fact that lower rated issues routinely sell at higher interest costs. His interpretation is that a part of the higher interest cost is a result of demand uncertainty.
Note that Sorensen's results suggest that there may be rational, market driven reasons (such as maximization of return) for selecting negotiated placement. This interpretation problematizes the current trend toward statutory requirement for competitive placement (as epitomized by New Jersey governor Jim Florio's recent mandate). Sorensen's study thus brings into question the simplistic solution of requiring competitive placement as a way to prevent suasory behaviour. Therefore it is important to establish the nature and magnitude of interest cost variations under present conditions prior to attempting to rectify the perceived problem.

Joehnk & Kidwell [1980] partition issue cost into two component costs: (1) underwriter spread and (2) reoffering yield. As they note,

> Net interest cost (NIC) is the key measure of borrowing cost to the municipality since it indicates the effective rate that will be borne by the issuer. When measured in terms of yield (percent), these costs elements are additive for an individual bond to the extent that

\[
\text{NIC} = \text{Spread} + \text{Reoffering Yield} \quad \text{[p. 223]}
\]

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6[GF0A 1994] provides a succinct discussion of the benefits and disadvantages of negotiated sales.
7As cited by Dickson [1993], Florio's executive order stated in part that, "state-level issuers must select underwriters on the basis solely of price, as determined by sealed bids submitted after public notification."
In their analysis Joehnk & Kidwell respond to the explanation for NIC variation most often offered by players - that underwriters of negotiated placement issues provide additional services not rendered by underwriters of competitive placement issues. Joehnk & Kidwell provide a set of carefully matched issues, and look at the variation between competitive and negotiated NIC, underwriter spread and yield. Their findings are that negotiated issues' underwriter spreads average $1.48 to $2.36 higher per $1,000 bond: an amount reasonably close to MFOA survey estimates of $2.02 to $2.21 per $1,000 bond consultant fee experienced by competitive bid issuers. This increase in spread therefore seems to be of an amount to compensate underwriters for their increased efforts on negotiated issues. The higher yield (.23 to .27 %) thus appears to be unrelated to the additional work performed by negotiated issue underwriters. Note, however, that the higher yield could be related to the higher risk perceived to be associated

8 Joehnk & Kidwell used the following criteria to match issues: (1) type of issue (general obligation or revenue), (2) Moody's agency rating, (3) sale dates were within two weeks of one another, (4) final maturity was at least ten years and issues could vary by no more than five years, and (5) par values of the issues varied by no more than 24 percent.
with negotiated issues rather than an artefact of influence peddling.

Braswell et al. [1983] also address the issue of origination cost variation across negotiated and competitive placement issues. True Interest Cost (TIC) is used as the dependent variable rather than NIC under the assumption that TIC is a more "correct" measure of issuer costs and thus will provide a more accurate picture of the variation between competitive and negotiated placements. Braswell et al. find a variation of approximately 18 basis points between negotiated and competitive TICs, and note that for the average size, maturity and TIC rates of their sample this translates into about $265,000 in cost difference. The size of the cost difference suggests that underwriters are extracting more than compensation for their additional labours. As Braswell et al. put it,

"Surely, this more than offsets the value of the added origination services provided by negotiating underwriters that is not provided under competitive bidding. [p. 105]."

Bland [1985] takes a different perspective, suggesting that variation in NIC rates is a function of

*True interest cost, a.k.a. internal rate of return or Canadian method, acknowledges the time value of money and has been advocated as superior to NIC as a metric for bid evaluation.
issuer experience in the bond market as well as characteristics of the bonds. According to Bland, neophyte issuers lack the ability to competently negotiate with underwriters and thus settle for higher NICs than more experienced issuers would. This view is borne out by Bland's study. There is an experience effect, but it seems to stabilize after four bond issue experiences. Bland's research, then, indicates that there is a base level of competency which is reached on average after participation in four bond deals. Issuers with that base level competence are able to negotiate agreements that approach the NIC rates of those issues competitively bid by more than seven underwriters (that is, the most attractive investment rates). This study may be interpreted as suggesting that if influence peddling exists, it may not cause much of a NIC differential. Alternatively, influence peddling may be so pervasive over both competitive and negotiated issues that it is impossible to produce conclusive evidence as to its existence by comparing the two.

Another consideration is the corrective nature of the market. If the primary market yield differential is due to mispricing (sale at a price not supported by issue or issuer characteristics), there should be a
corresponding adjustment in the secondary market. Maese [1985] investigates this issue by utilizing a sample set composed of bonds for which secondary market data was available. The number of issues outstanding at any one time (over 45,000) and the unregulated, over the counter nature of transactions severely limits data availability in the municipal market. In this information sparse environment Maese was able to find secondary market data on 58 issues. Her analysis of primary market data confirmed earlier studies' findings that competitively placed issues with more than 2 bids were sold at significantly lower NIC rates.

Surprisingly, Maese's secondary market results indicate that no systematic price adjustment occurs for either competitively placed bonds with less than three bids or negotiated placement bond issues. This discovery supports the contention of some industry analysts that price differentials are due to characteristics of the bonds rather than intensity of bidding competition. In terms of political influence peddling, the study implies that either said peddling does not affect the price of bonds or that the value of peddling is seen to be an enduring characteristic of the bond issue.
The issue of competitive versus negotiated issuance was revisited recently by Simonsen & Robbins [1994]. As with Braswell et al., Simonsen & Robbins approximate TIC rather than NIC with their model. Simonsen & Robbins get results in line with previous research - TIC for competitive issues is significantly lower than TIC for negotiated issues. The amount of variance is, as expected, greater for issues with more intense bidding competition.

Theoretically, this study's discussion of the bond market environment is somewhat troubling. Simonsen & Robbins accept with little discussion the arguments of defenders of negotiated sales, especially the assertions that negotiated sales are more suited to bonds with "unusual structures or other atypical features" [p. 28]. Their advocacy of competitive placement is largely based upon the idea that bond transactions must be above suspicion. This assertion may be entirely correct, but a more detailed look at the problem of influence peddling seems warranted prior to drawing such a conclusion.

Leonard [1996] provides another recent review of the negotiated versus competitive issuance question. His research investigates two issues: 1) do issuers maximize expected net benefits by rationally selecting the most...
efficacious method of sale and 2) is there a difference in yield between issues that can be solely attributed to the method of sale.

The first issue speaks directly to the moral hazard problem discussed in this document - are public officials maximizing their own utility or that of their constituency? Leonard finds, that:

An issue could be classified as having been sold by negotiation or competitive bidding using variables that measure issue size, credit risk, market conditions, and issue complexity. [p. 25]

His interpretation is that this finding is consistent with the "traditional" view of negotiated placement benefiting issuers most for issues with complex structure, issues from low credit rating issuers, larger issues, and issues brought to market during periods of market fluctuation. Thus negotiated placement may be portrayed as the optimal placement method, depending on the circumstances involved.

Leonard's second research question assesses the social cost of placement method by seeking a difference in yield attributable solely to placement method. His analysis found no difference in reoffer yields due to placement method. Further, the analysis suggests that competitive and negotiated issues should not be pooled
into a common sample without properly specifying the regression equation (Leonard suggests pooled interactive regression techniques). The argument is that the influences of several explanatory variables are not contiguous across the two placement methods.

Leonard succeeds in casting some doubt on the results of earlier studies, perhaps as much for his trenchant observation that the preponderance of earlier studies date prior to 1985 and thus arguably fail to reflect changes in market structure [e.g., an order of magnitude increase in refunding issues, a sharp increase in “special district” debt issuance, and much more widely available information sets] as for his refinements of regression techniques. Note, however, that the issue of more than minimal debt cost to the entity, and hence to its constituency, is not resolved. It is entirely feasible for competitively bid issues to go out at greater than optimal yields if the pool of bidders has been constrained artificially by public officials.

In summary, the literature investigating placement method provides mixed evidence, with no definitive support for any of the various theories proposed to explain variation in interest rates. Perhaps the most convincing explanation is that offered by Bland [1985].
which suggests that a basic level of experience with bond issues is the key factor in achieving lower interest rates. Regardless, the political influence perspective can be adapted to any of the above theories.

This research also seeks to understand the connection between accounting information, auditing and interest costs. As a precursor to building a model to investigate those relations, a brief review of the literature dealing with municipal bonds from an accounting perspective is warranted.

B. Accounting Information Studies

Wallace [1981] brought the issues of external audits and accounting information into the set of factors associated with bond interest costs, which she measured by NIC. While acknowledging that NIC calculations do not account for the time value of money, Wallace suggests that generally NIC will be in a monotonic relationship with yield-to-maturity, and further that NIC has a well-documented history as a metric in municipal bond studies which greatly enhances generalizability of results. As Wallace notes

Moreover, empirical support for the correspondence of NIC and yield in the period under study is provided by Kidwell [1977]. [p. 506].
The primary goal of this study was associating accounting variables with NIC, however Wallace chose to incorporate several variables previously determined to have significant explanatory power as well. Her model is an evolution of the models used in finance to explore the bond market, and contains both demographic and finance variables investigated in prior research. This approach adds credibility to the study, as readers can be assured that variables unique to her study are not merely proxying for previously discovered relationships.

Wallace's findings are that accounting and auditing variables do not significantly contribute to the explanatory power of the model investigating interest cost variation. She does find a relation between those variables and bond rating, which in turn is a significant explanatory factor for NIC. These results suggest that accounting variables may be an important factor in determining NIC differences across issues rather than determining NIC itself.

Wilson & Howard [1984] extend Wallace's [1981] study, using "improved research methods on a greatly expanded database" [p. 208]. Their results are largely similar, although they conclude that both accounting and
auditing variables are related to bond ratings and to NIC.

Benson et al. [1984] focus on the regulatory environment of municipal financial reporting. The federal government has in the past largely been restricted from using the SEC to dictate municipal accounting and reporting practices by the Tower amendment, leaving regulation to the various states. This environment enables the current situation where regulations differ markedly across states, adding further complexity to an already labyrinthine market structure. Benson et al.'s hypothesis is that stringent state regulation forces disclosure (and accuracy) that might be otherwise absent, and that the enhanced credibility of financial reports produced under more stringent regulation will be acknowledged by the market in terms of "more accurate" interest costs.

Obviously there is a multitude of conflating variables to be dealt with here. Interest costs may reflect the additional risk assessed to issuers whose poor condition becomes apparent under heightened disclosure, players may discount the effectiveness of various regulatory schema, or regulations may simply reinforce already present disclosure behaviour. Benson
et al. acknowledge the weaknesses inherent in their research and attempt to ameliorate some of those weaknesses by performing additional analyses, but are unable to counteract the strong multicollinearity among their variables. Their conclusion is that accounting regulations do affect how accounting information is reported and interpreted but it is not possible (at least at present) to assess the magnitude or direction of effect on interest cost.

Apostolou et al. [1984] set out to test the association of a specific quanta of financial information - reporting of a surplus/deficit - with NIC of general obligation bonds issued by Minnesota municipalities. Their objective is to "extend Ball and Brown's study [1968] to the municipal market" [p. 9]; that is, to look at the relationship between a single 'bottom line' number and security pricing. Apostolou et al. select annual surplus/deficit as the municipal equivalent of net income.

This study seeks to illuminate the similarities and differences between the equity securities market and the municipal debt securities market in terms of information usefulness. The results of this research indicate that "changes in the surplus/deficit are not associated with
unexpected changes in NIC" [p. 21], suggesting that municipal accounting numbers (or at least general fund surplus/deficits) have less relevance to investment decisions than corporate accounting numbers. Structurally, this may be because municipalities are not perceived as default risks in the same manner as private organizations, or it may be a recognition of the possibility of strategic behaviour on the part of municipal administrators looking for easy passage of a tax increase. As Apostolou et al. point out, their study does suggest that regulation of municipal reporting in order to increase uniformity of reporting practice may be beneficial to security purchasers.

Benson et al. [1986] also investigate the usefulness of accounting information to bond investors. Their hypothesis is that accounting information is differentially useful across the spectrum of risk categories. Risk categories are proxied for by ratings assigned to issues by Moody's. Results of the study confirm the hypothesis to some degree. Accounting variables for bonds rated A1 and A are demonstrated to have larger coefficients than Aaa and Aa in Benson et al.'s regression model, which also incorporates finance and economic variables. Further,
more of the accounting variables have statistically significant coefficients in the Al/A sample. The insights gained from this research suggest that the common practice of treating municipal bond issues as homogenous with respect to accounting information may be concealing the significance of some of that information.

Feroz & Wilson [1992] also investigate the differential influence of accounting information, but look for differences across market segmentation. Their hypothesis is that the association between the quality and quantity of financial disclosure and interest costs is stronger for entities issuing debt in local or regional markets than for those utilizing the national market. Note that Apostolou et al.'s [1984] theories may have some relevance here, as local and regional markets, by their number, inculcate more variation in disclosure practice than the (at least theoretically) market enforced comparability of information found in the national market. Therefore Feroz & Wilson's results arguably reinforce Apostolou et al.'s recommendation for more uniform disclosure regulation.

Feroz & Wilson's results support their differential information hypothesis. Their conclusions are that reporting quality is higher for entities utilizing the
national market, but that market players are more sensitive to variations in quality and quantity of financial disclosure in the regional marketplace. This implies that entities using regional markets for debt issuance can significantly reduce interest costs by improving their financial disclosure (not necessarily 'improving' the situation presented in those financial reports).

Brown [1993] develops an innovative approach to the problem of political entities' lack of a "bottom line." Brown [1993] proposes a method of assessing the financial condition of cities that arguably could provide just such a "bottom line" evaluation tool. Brown's assertions rest upon the idea that good financial health is a prerequisite for continued provision of services to constituents, and further that financial health may be assessed by establishing an entity's financial strength relative to other entities of similar size [as measured by population]. Brown [1993] uses ten ratios [calculated from information available from the entity's general purpose financial statements] to create his index. Brown [1993] uses a database maintained by the GFOA to compare key financial ratios of entities with those of hundreds of entities of similar size across the nation. One of
Brown’s innovations is a method of ‘grading’ an entity’s ratios so as to create a “bottom line” equivalent for financial health of not-for-profit entities. Brown's study is an important innovation in the accounting information literature, and the Index he develops will be incorporated into this study’s regression analysis.

C. Regression Model

The placement method, financial reporting practices and accounting information studies provide a thorough evaluation of the generic model underlying all of these studies. This generic model\textsuperscript{10} is composed of the following:

Dependent variable:

NIC \hspace{1cm} Net interest cost

Independent variables:

Size \hspace{1cm} Issue size to nearest thousand dollars. This variable is scaled in thousands rather than millions because of the relatively small size of some local issues.

\textsuperscript{10}See Table 2.1 for an indication of the degree of consensus among prior studies with respect to the components of the base model.
Table 2.1
Genealogy of The Base Model

<table>
<thead>
<tr>
<th>Study:</th>
<th>Interest</th>
<th>Size</th>
<th>YrsToCall</th>
<th>Rating</th>
<th>MktRate</th>
<th>YrsToMat</th>
<th>CorNIssue</th>
</tr>
</thead>
<tbody>
<tr>
<td>West 1966</td>
<td>NIC</td>
<td>$M</td>
<td></td>
<td>Moody's</td>
<td>Bond Buyer</td>
<td>Yrs</td>
<td></td>
</tr>
<tr>
<td>Kessel 1971</td>
<td>NIC</td>
<td>$K</td>
<td>5 Level</td>
<td>S&amp;P</td>
<td>White's</td>
<td>ln(Yrs)</td>
<td></td>
</tr>
<tr>
<td>Ederington 1978</td>
<td>ln(#bids)</td>
<td>$M</td>
<td>Indicator</td>
<td>Moody's</td>
<td>2 wks prior</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sorensen 1979</td>
<td>NIC</td>
<td>ln($K)</td>
<td>Yrs</td>
<td>Moody's</td>
<td>Salomon</td>
<td>Avg Yrs</td>
<td>3 level</td>
</tr>
<tr>
<td>Braswell et al. 1983</td>
<td>TIC</td>
<td>$M</td>
<td>2 level</td>
<td>Moody's</td>
<td>Bond Buyer</td>
<td>Yrs</td>
<td>2 level</td>
</tr>
<tr>
<td>Maese 1985</td>
<td>NIC</td>
<td>ln($K)</td>
<td>ln(Yrs)</td>
<td>Moody's</td>
<td>Salomon</td>
<td></td>
<td>3 level</td>
</tr>
<tr>
<td>Bland 1985</td>
<td>NIC</td>
<td>ln($M)</td>
<td>Moody's</td>
<td>Salomon</td>
<td>Avg Yrs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Simonsen &amp; Robbins 1994</td>
<td>TIC</td>
<td>Vector</td>
<td>Vector</td>
<td>Moody's</td>
<td>Salomon</td>
<td>Avg Yrs</td>
<td>3 level</td>
</tr>
<tr>
<td>Wallace 1981</td>
<td>NIC</td>
<td></td>
<td></td>
<td>Moody's</td>
<td>Bond Buyer</td>
<td>.1(Yrs)</td>
<td>ln(#bids)</td>
</tr>
<tr>
<td>Benson et al. 1984</td>
<td>NIC</td>
<td>$K</td>
<td>2 level</td>
<td>Moody's</td>
<td>Salomon</td>
<td>ln(avg yrs)</td>
<td>ln(#bids)</td>
</tr>
<tr>
<td>Apostolou et al. 1984</td>
<td>NIC</td>
<td></td>
<td>Moody's</td>
<td>wkly Region</td>
<td>ln(avg yrs)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Benson et al. 1986</td>
<td>NIC</td>
<td>$K</td>
<td>2 level</td>
<td>Moody's</td>
<td>Salomon</td>
<td>Avg Yrs</td>
<td>ln(#bids)</td>
</tr>
<tr>
<td>Feroz &amp; Wilson 1992</td>
<td>NIC</td>
<td></td>
<td>2 level</td>
<td>Moody's</td>
<td>Bond Buyer</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
YrsToCall Time until the issue can be called (in years). This variable measures the 'yield lock in period' of the issue.

Rating Moody's rating, if available, for the entity and/or issue.

MktRate Comparable market interest rate for the week of sale. The Bond Buyer Twenty Bond Index will be used.

CorNIssue Competitive or negotiated placement. This will be a categorical variable set to 1 if competitive and 0 if negotiated or privately placed.\[11\]

The dependent variable selected, NIC, was chosen to facilitate comparability between this research and prior studies. As [Simonsen & Robbins 1994] note, true interest cost (TIC) is a measure of interest cost that incorporates the time value of money and thus is arguably a more precise metric of interest cost. However, NIC is routinely used by players in the market, and, when accompanied by suitable constraints on rate variation and

\[11\]This variable may be supplanted by the number of bids received for the issue for competitively placed issues if I can get that information.
payment timing\textsuperscript{12}, can approach TIC in usefulness as a measure of interest cost. Further, TIC data will be collected (if possible) and the model may be run with each as a check on the possible imprecision of the NIC model.

The base model, by design, does not include several of the variables found significant in prior studies. Brown's Index, which is incorporated into the expanded model, arguably encompasses several of these variables, including most if not all of Wallace's [1981] accounting variables, Apostolou et al.'s [1984] surplus/deficit, and some of Wilson & Howard's [1984] accounting variables.

D. Summary

This chapter has discussed extant literature investigating the factors influencing the public cost of debt financing [NIC]. The evolution of that literature is traced from West's original study of monopsony in the bond market to Leonard's current work suggesting that the bond marketplace has changed in nature as well as in volume.

The literature relating to accounting information in the bond market is also discussed. Results of the

\textsuperscript{12}Common constraints include limits on the timing of interest payments and limits on the variation in interest rates across various maturities among others.
various studies suggest that the utility of accounting information to participants in the bond market is not easily measured, in part because the entities in question, parishes, municipalities and districts, are not profitmaking institutions and thus cannot be evaluated via "bottom line" analyses. As a means of dealing with that issue, Brown's Index is proposed as a more appropriate measure of entity financial health.

This study proceeds by utilizing the regression model presented in this chapter to investigate the relationship between the factors of interest and debt cost [NIC]. Before regression can profitably be used for this research some indication of the existence and strength of the relation between contributions and bond business needs to be provided. Toward that goal, the analyses described in chapter three will be performed.
Chapter Three

Methodology

This chapter discusses the methodology of the study. Section one presents the research question. The second section develops hypotheses based on that question. The third section discusses research design and possible threats to validity, and explains testing of the hypotheses. Finally, section four summarizes the material contained in the chapter.

The municipal debt market, as noted in chapter one, is presently the subject of much scrutiny. Regulatory agencies are studying the market and simultaneously attempting to alleviate perceived weaknesses in that market via additional regulation. Often this regulation addresses issues that are in the limelight as a result of widespread media attention, which suggests that it is media focus rather than public policy that drives much of the regulatory environment. Further, it is entirely possible that the issues regulators seek to address are not amenable to regulatory solutions.

This research project is intended to provide some empirical data concerning the issue of contributory behaviour by players in the municipal debt market,
arguably one of the most-discussed aspects of the municipal marketplace. Additionally, this project will look at the completeness of the publicly available information set concerning municipal debt issues. Finally, an attempt is made to assess the public cost of non-optimal debt placement decisions made by elected officials.

A. Research Questions

Formally stated, is there a statistically significant relationship between political contributions made by players in the bond market and the selection of those players as participants in the debt issuance process? Further, can the traditional municipal debt interest cost model be used to estimate the public cost of that relationship? Finally, can the traditional model for determining interest cost of municipal debt, with the addition of relevant variables, provide a measure of the value of entity financial information to purchasers of the securities?

B. Statement of Hypotheses

These questions are operationalized via the following hypotheses [stated in the null form]:

H₁: Bond market players are not major sources of contributions for publicly elected officials exercising control over the bond issuance process.
H₂ The distribution of the size of player contributions to the campaigns of elected officials is less than or equal to that of non-players.

H₃ Contributions to these officials have no correlation with the type of placement selected.

H₄ The independent variables included in the base model [market interest rate, face amount of debt, rating of the issuer, first call characteristics, and placement type] do not have significant explanatory power for NIC.

H₅ Contributions by bond counsel involved in the issuance process do not have significant explanatory power for NIC.

H₆ Contributions by underwriters involved in the issuance process do not have significant explanatory power for NIC.

H₇ Contributions by all parties involved in the issuance process do not have significant explanatory power for NIC.

H₈ Brown’s Index of financial well-being does not have significant explanatory power for NIC.

H₉ Issuing entity compliance with state reporting requirements does not have significant explanatory power for NIC.

H₁₀ The issuing entity’s last audited financial report being dated 12 months of the issue’s sale date does not have significant explanatory power for NIC.

1. Hypothesis One

The bond market is often portrayed as an environment amenable to moral hazard. That moral hazard is epitomized by the ability of elected officials to award bond business to market players contributing to their election campaigns. As explained in chapter one, it seems reasonable to expect those elected officials to
maximize their expected gains by seeking contributions from all possible sources. Therefore, one method of gauging the likelihood that officials are falling prey to moral hazard is to determine the total amount of contributions received from market players in relation to that received from all sources. The hypothesis investigated is expressed as follows:

\[ H_{A1} \text{ Contributions by bond market players will account for more than 10\% of total contributions received by campaign funds of candidates for offices prospectively able to influence bond issue business.} \]

The choice of ten percent as a cutoff point for differentiating between significant and non-significant campaign funds sources was based on discussions with various interested parties. Those involved in campaign financing suggested that ten percent would certainly direct their [and thus their candidate’s] attention to the contributors as an important interest group. The perception of bond market players as an important interest group certainly facilitates the perspective of bond market players as possible trading partners in the market for favours.

Staff at the SBE likewise agreed that contributions of ten percent or more arising from a single interest group [that is, from bond market players] would be likely to generate attention by candidates. From their,
regulative, perspective, that amount would probably warrant direct attention from the candidate. In line with those intuitions, hypothesis one incorporates the ten percent figure.

2. Hypothesis Two

A second measure of elected officials succumbing to moral hazard in the bond issuance process is the size of contributions made by bond market players. As above, it seems reasonable that candidates for office attempt to maximize their gains by extracting as much as possible from each contributor. Given market players’ expectations of significant income from non-competitively awarded business, it would be rational for them to contribute heavily, as discussed in chapter one. A testable version of that hypothesis is expressed as follows:

\[ H_{A2} \text{ The distribution of the size of market player contributions to officials in a position to exercise influence is significantly different from that of non-players, and that difference is skewed toward larger contributions.} \]

3. Hypothesis Three

The market-driven nature of the competitive bidding process suggests that it would be much easier to award bond issue business outside “least cost” parameters via negotiated placement than via competitively bid
placements. Officials seeking to dispense influence are thus motivated toward negotiated placements rather than competitively bid placements. This perception is reified by the rising tide of state legislation mandating competitive bidding, and by the wealth of research investigating net interest cost variance across placement method.

The use of negotiated placement is not, however, eo ipso evidence of influence peddling. As discussed by the Government Finance Officers Association [GFOA 1994], the State Bond Commission of Louisiana [LSBC 1995], and the California Debt Advisory Commission [CDAC 1992], there are a number of factors to be considered in the placement method process. This study assumes that the variance of those factors across the bond issues included in the sample is representative of the total population of Louisiana bond issues. The factor of interest here is the correlation of placement method and player contributions. A testable version of the above is:

$H_{a3}$ Contributions made by players involved in bond issuance transactions are significantly related to placement method.

4. Hypothesis Four

As discussed in chapter two, there is a rich tradition of research using regression analysis to
explore various aspects of the municipal debt issuance process. This project seeks to take advantage of that tradition by utilizing a base regression model developed by aggregating the variables common to much of prior research in the area:

\[ \text{NIC} = \text{Size} + \text{Rating} + \text{MktRate} + \text{YrstoCall} + \text{CorNissue} \]

Hypothesis four tests the applicability of that generic model to Louisiana bond issues.

The independent variables included in the base model possess significant explanatory power for Net Interest Cost.

There are several differences between the datasets routinely used by prior research and that used in this project. First and foremost, previous research, largely conducted in the 70’s and 80’s, focused on relatively large issuing entities and relatively large issues. This focus was driven by a lack of information on smaller issues, and the truism that the gain to be had from information about larger issues is larger than that arising from information about smaller issues. The preponderance of prior research used bond issue information derived from commercial information sources such as The Bond Buyer, a daily industry newspaper, and was thus limited to information available to those
sources [usually information about issues large enough to be traded somewhat actively].

By contrast, this project uses information collected from state agencies, thus providing a much more complete mix of both large and small issues, offered by both large and small entities. Using a more complete mix of large and small issues means that the sample more closely matches the municipal debt investment marketplace, and perhaps more closely mirrors the information sparse environment of that marketplace. Smaller issues also tend to be traded less frequently, which compounds the lack of readily available information by limiting the amount of transaction information available. Given the significantly reduced information set, the generic model should possess lower explanatory power over this sample than evidenced in previous research studies.

Secondly, prior research tended to utilize information from issues originating in various geographic and political areas, largely because of the information limitations mentioned above. This project breaks from tradition in that regard, restricting data as it does to issues originating in the state of Louisiana. While some constraints on generalizability of results is endemic to that restriction, focusing on a single political entity
is necessary to an investigation of an inherently political phenomenon.

5. Hypotheses Five - Seven

After looking at the relationship between contributions and bond business from a macro level [hypotheses one - three], the intent of this project is to localize on the public cost of that relationship. The public cost of any influence exercised on the bond placement process by elected officials is likely to be impounded within the cost of debt issuance [that is, net interest cost]. The base model developed by prior researchers is used as a framework to investigate the influence of contributory behaviour on net interest cost.

This investigation is partitioned into several segments, seeking to provide information relating to the various players in the bond market and their respective contributions. Hypothesis five relates to contributions made by bond counsel:

\[ H_{A5} \quad \text{Contributions made by bond counsel involved in an entity’s debt issuance have significant explanatory power for Net Interest Cost.} \]

Hypothesis six speaks to contributions from underwriters:

\[ H_{A6} \quad \text{Contributions made by underwriters involved in an entity’s debt issuance have significant explanatory power for Net Interest Cost.} \]
Hypothesis seven aggregates contributions from bond counsel, underwriters, and consultants to the issuance process:

\[ H_{A7} \text{ Contributions made by market players involved in an entity's debt issuance have significant explanatory power for Net Interest Cost.} \]

These hypotheses, taken as a group, will provide some evidence concerning the effects of contributions on Net Interest Cost, and thus the effect on cost to the rate-paying public.

6. Hypothesis Eight

As mentioned previously, the municipal debt marketplace is often described as information asymmetric, in the sense that financial information about issuing entities is often limited, out of date, or simply unavailable. Hypotheses eight through ten explore the effects of that dearth of information.

Financial reporting for governmental entities is often considered more arcane than that of profit oriented organizations, simply because there is no clear measure of goals met. Governmental entities are not seeking to maximize reported profits, but are seeking to provide services for their constituents and other designated individuals. There is, therefore, no “bottom line” equivalent for governmental entities. Government finance
professionals often remark upon this lack of a "bottom line" as one of the inherent limitations in manager [investor] interpretation of entity financial reports.

Brown [1993] provides a method of calculating an index of financial health based upon data available from an entity's General Purpose Financial Statements]. The data is then evaluated by comparison of entity financial data with that of similarly sized entities from across the nation and expressed as Brown's Index of Financial Health. Table 3.1 presents the components of Brown's Index.

While the assertion that financial health can proxy for the admittedly difficult to measure attribute of success at provision of services, it is much less troublesome to utilize Brown's Index as a measure of the attractiveness of an entity's debt offerings. That is, the municipal debt market, by all accounts, follows closely the corporate debt market in paying attention to financial health.

Brown's Index, relying as it does on comparative indicators, may function as a proxy for a more complete information marketplace. Hypothesis eight utilizes Brown's Index as follows:

\[ H_{8a} \quad \text{Brown's Index of financial well-being has significant explanatory power for NIC.} \]
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<table>
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</thead>
<tbody>
<tr>
<td><strong>Table 3.1</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Brown's Index Components</strong></td>
<td></td>
</tr>
<tr>
<td>1.</td>
<td>Tl Revenues / Population</td>
</tr>
<tr>
<td>2.</td>
<td>Tl General Fund Revenues [own sources] / Tl General Fund Sources</td>
</tr>
<tr>
<td>3.</td>
<td>General Fund Sources [from other funds] / Tl General Fund Sources</td>
</tr>
<tr>
<td>4.</td>
<td>Operating Expenditures / Tl Expenditures</td>
</tr>
<tr>
<td>5.</td>
<td>Tl Revenues / Tl Expenditures</td>
</tr>
<tr>
<td>6.</td>
<td>Unreserved General Fund Balance / Tl General Fund Revenues</td>
</tr>
<tr>
<td>7.</td>
<td>Tl General Fund Cash &amp; Investments / Tl General Fund Liabilities</td>
</tr>
<tr>
<td>8.</td>
<td>Tl General Fund Liabilities / Tl General Fund Revenues</td>
</tr>
<tr>
<td>9.</td>
<td>Direct Long-Term Debt / Population</td>
</tr>
<tr>
<td>10.</td>
<td>Debt Service / Tl Revenues</td>
</tr>
</tbody>
</table>
7. **Hypothesis Nine**

Local government financial reporting in the United States is largely exempt from regulation by the Securities Exchange Commission, unlike that of publicly held corporations. This exemption from regulation leads to an environment where financial reporting is sporadic, and often driven by a need to issue debt rather than by a need to inform current investors or the public. In the absence of regulation by the federal government, more and more states have begun to mandate financial reporting by local entities. Typically, however, those states have been less willing to put teeth into their reporting statutes. That unwillingness to establish penalties for failure to provide continuing financial reports leads to a situation where the state mandates, for instance, annual audited financial reporting for all local governmental entities, but the costs of non-compliance with those mandates are trivial. Not surprisingly, many entities choose to ignore the state mandates and fail to produce regular audited financial reports.

Louisiana, as many other states, has legislation in place mandating continuing financial disclosure by governmental subdistricts. One measure of information availability, therefore, is an entity's compliance [or
lack thereof] with state reporting requirements. Information as to an entity’s compliance is available from the Legislative Auditor’s office, and is included in materials prepared by that office for the LBC prior to each of the LBC’s monthly meetings. Hypothesis nine, looking at the determinable value of entity financial information in the bond marketplace, can thus be expressed as:

\[ H_{A9} \]  
Issuing entity compliance with state financial reporting requirements has significant explanatory power for NIC.

8. **Hypothesis Ten**

One of the tenets of the theory of capital markets is that participants always act immediately on currently available information. Therefore, a test which places more emphasis on currency of information available in the bond market is indicated. Most states, Louisiana included, phrase their reporting requirement statutes such that entities need to produce audited reports on at most a biannual basis to be in compliance with the statutes. The capital market should be much more sensitive to timely information, and thus should demand [by way of interest costs] more current information.

One test of the availability of more timely information is to compare the date of the most recent
audit report available with the sale date of the bond issue. Note that sale date of the issue is the date on which the sale agreement is formally completed, and may occur some time after the issue is conceived of. In some cases, the sale date may be two or three years after design and approval of the issue. Arguably, prospective investors are concerned with current status of the issuing entity rather than its financial health at some point in the past. Therefore, investors should be willing to pay a premium [in the form of lower interest rates] for issues from entities producing continuing financial reports. Hypothesis ten examines the existence of that premium price and is expressed as:

\[ H_{410} \text{ The date of the entity's most recent audited financial report being within twelve months of the sale date of the issue has significant explanatory power for NIC.} \]

C. Research Design

The above hypotheses delineate the questions at the center of this study. Before they can be addressed in detail, some consideration needs to be given to research design and the various threats to validity caused by that design as well as how the study deals with those threats. The following discussion speaks to the issue of research
design, and attempts to provide some guidance for interpretation and application of the study's outcomes.

Research projects in the social sciences are by definition studies of humans and their interactions, and thus much less amenable to quantitative rigour and replication than research projects in the physical sciences. Similarly, outcomes from social science research projects need to be interpreted with more attention to aspects of the study that may not be universal in nature.

One particularly troublesome aspect of much research in the social sciences, including the present study, is a reliance on archival data pertaining to situations that arguably may not be representative of the environment as a whole. This might be expressed more clearly as a lack of replicability. The use of archival data also limits the ability of researchers to provide the kind of experimental controls useful in minimizing validity concerns and maximizing generalizability of results, specifically randomization of samples and equivalence of control groups. Given that society is not now and is not likely to become static, and that archival studies can and do provide decision-useful information, researchers have developed a means of communicating about these
issues that attempts to describe their content without exaggerating their generalizability. In the spirit of that communication, the following discussion of the study's research design is provided.

This study utilizes a research design referred to variously as "one-shot case study" [Huck et al., 1974] or "one group posttest only" [Cook & Campbell, 1979]. The portion of the study looking at contributions is comparing two groups of contributors to the elected officials identified in chapter one: one composed of persons or firms in the bond business, and the other composed of everyone else. The second segment of the study focusses on bond issues, comparing a group of bond issues handled by those making sizeable contributions with a group of bond issues handled by noncontributors. In neither case is it possible to have a control group, exogenous to the issues of interest, as a background metric for validation of the analyses provided.

Huck et al. [1974] suggest that this design is perhaps more appropriately referred to as a descriptive study than an experimental study. I have no quarrels with that assessment: the purpose of this study is to answer questions about whether an influence-peddling
effect could be demonstrated by analysis of archival data, not to explore causality. As they note, [C]hanges in observations or measurement of the dependent variable cannot be attributed exclusively to exposure to the independent variable. [p. 228]

The point is well taken - this study does not purport to provide conclusive evidence as to the existence, or lack thereof, of influence-peddling. The study does attempt to find some evidence of that behaviour by looking at campaign contributions, which are widely suggested to be a primary vehicle for these transactions. As discussed in chapter one, the regulative approach has been to focus on those contributions: one of the principal objections municipal bond market players raise to recent regulation [MSRB Rule G-37] is the lack of evidence supporting regulators' assertions that influence-peddling is widespread. This study utilizes archival, publicly available data to provide an analysis of the relation between contributions and bond business.

Cook & Campbell [1979] take a less dismissive approach to what they refer to as "one-group posttest only" designs. They assert that experimental design is not the only, nor perhaps the most feasible, method of ruling out alternative interpretations, and continue by stating:
This is especially the case when particular threats seem implausible in light of accepted theory or common sense or when the threats are validly measured and it is shown in the statistical analysis that they are not operating. [p. 96]

Given the nature of the relationship in question – largely sub rosa, and only beneficial when it remains so – and the fact that regulators can only be assured of regulating transactions that are publicly reported, it is obvious that researchers attempting to address the issue by analyses of multiple-transaction data are severely limited in their ability to design research strategies that would function to minimize threats to validity. The ensuing discussion addresses the various threats to validity identified by Cook & Campbell [1979] and is segmented in line with their taxonomy of research issues: statistical conclusion validity, internal validity, construct validity and external validity.

1. Threats to Statistical Conclusion Validity

As Cook & Campbell [1979] note, there are three basic issues to be addressed with respect to covariation:

(1) Is the study sensitive enough to permit reasonable statements about covariation? (2) If it is sensitive enough, is there any reasonable evidence from which to infer that the presumed cause and effect covary? And (3) if there is such evidence, how strongly do the two variables covary? [p. 39]
The first issue obviously relates to the power of the statistical analyses performed. The likelihood of incorrectly concluding that correlation does not exist can be minimized by using larger sample sizes, setting $\alpha$ at a reasonable level, and using the highest power statistical tests available for the data at hand. This study addresses the issue of sample size by including every transaction for which data could be obtained, rather than attempting to randomly select a sample for the available data. As will be mentioned later in this section, that decision does have some implications for other validity concerns. The $\alpha$ for this study is set at .05, which is a level commonly used in research in this area. Given the truncated nature of the contributions data [contributions under $250 are discarded from the dataset], and the non-normal nature of the data, nonparametric statistical tests were selected. The Wilcoxon-Mann-Whitney test and Kolomogorov-Smirnov two-sample test were chosen to test the hypothesis that contributions from the two groups [market players and all others] came from the same population. The Wilcoxon-Mann-Whitney test closely approaches the power of the parametric t-test [close to 95 percent], and in some
cases may be more powerful. This test examines the central tendency of the two populations.

The Kolmogorov-Smirnov test is sensitive to any kind of difference in distribution - skewness, dispersion, central tendency, etc. This test is a more conservative approach, therefore if the null is rejected using this test more confidence in the result is warranted [Siegel & Castellan, 1988].

Another concern is violation of assumptions underlying the statistical tests chosen. The most troublesome assumption made by tests used in this study is that of independence: that the observations are unrelated. Given that this study incorporates all available data from the state of Louisiana and its political subdivisions, it incorporates multiple contributions from individuals or corporations, and it also incorporates multiple bond issues from a single issuing entity. My rationale is that artificially truncating the dataset to enable conformance to the precepts of independence would give rise to more damaging problems of sample size and would damage the richness of the analysis. Conceptually, one may argue that contributions to candidates for different offices are unique, and that multiple contributions to a single
candidate may be summed to provide a fuller picture of the relative influence of the contributor.

The measures used in this study, contribution amounts, inclusion in the group of market players, NIC, and bond issue characteristics are also considered. A common problem with social science research is reliability of measures. The variables of interest in this study are all evidentially supported: contribution amounts and bond issue data are all exogenously determined. Classification of contributors as bond market players is accomplished by review of professional affiliations, materials intended to attract clients and past participation in bond transactions, and is therefore the best possible method of determining the 'true state' of the contributors included in the study.

Random irrelevancies in the environment can also be source of validity concerns. Attempts were made to reduce the risk of such irrelevancies by incorporating them, to the extent possible, into the analysis [e.g., the financial characteristics of issuing entitys are represented by Brown's Index, and fluctuations in the market are represented by the BB 20 Bond Index].
2. Internal Validity Concerns

Internal validity speaks to the issue of determining whether there is a causal relationship between two covarying variables, and what the direction of that causality may be. This study does not address directionality, as for this study directionality is irrelevant. It is not discernable whether contributions relate to prior business awarded or future prospects of business awards, and extremely likely that contributors would not make contributions without some expectation of future gains commensurate with those contributions. Finding evidence of a relation between past business and present contributions would not disaffirm the hypothesized relation between contributions and bond business, but would suggest that bond market players possess more power in the relation than is commonly acknowledged.¹ As the relation would be in evidence regardless of perceived directionality, the issue is not considered.

History and maturation address changes in the environment generated by causes exogenous to the

¹Bond market players responding ex post to business awards would imply that the market for influence is characterized by few bidders for money and many offerors, a characterization at odds with experience.
analyses, and in this study could possibly instantiate in cases of multiple issuance by a single entity. Similar issues are raised by reference to selection, although in this case the threat is that there are differences between the issuing entities. The assertion of this study is in accordance with Bland's [1985] finding that issuers with more than four bond issuance experiences possessed a plateau of expertise in the process that enabled them to approximate competitively bid NIC via negotiated placement. Given that this study uses NIC as the dependent variable, it is reasonable to assert that entities are in very relevant ways equivalent with respect to bond issuance techniques. That equivalence is considered prima facie evidence that history, maturation and selection are adequately controlled for.

Importantly, determining the level of response a study should direct to internal validity concerns is a recursive and systematic process. First, researchers need to develop a sensitivity for ways in which those concerns may have influenced the data. Second, an examination of the data will assist in determining which of the threats need to be addressed directly. Finally, when all possible threats have been ruled out, one may draw conclusions. Those conclusions may provide input to
further thought about one or more issues may be influencing the data.

As Cook & Campbell explain, one avenue of addressing these concerns is via the plausibility of alternative explanations implicit in recognizing said concerns. It may well be that alternative interpretations can be ruled out by consideration of their nature and implications. Chapters four and five of this study address alternative interpretations of study results. As with all archival research, the strength of causal inference in this study is not as robust as that produced by randomized experimentation.

3. Possible Threats to Construct Validity

Influence-peddling in and of itself is not amenable to measurement. A precursor to investigation of the phenomenon, therefore, is developing a measurable construct to represent that phenomenon which does not simultaneously measure other phenomena. That is, the possibility that alternative, equally probable explanations of observed phenomena exist.

In the situation of interest to this study, several factors operate to reduce the risk of threats to construct validity. One factor minimizing the risk to construct validity is the assumption that contributors
are, in important ways, economic rational actors - that is, they do not gratuitously make contributions, but rather are motivated to do so only by the prospects of some sort of reward. This self-interested behaviour on the part of contributors ensures that candidates need to dispense something in return for contributions; the relationship is quid pro quo.

Another factor limiting alternative explanations is the assumption that any influence purchased will be used where and when possible. Contributors are characterized as buying a route to the official’s attention, rather than as purchasing specific instances of influence. This assumption functions to dismiss worries about the intended nature of influence, as any influence purchased is treated as pervasive. Alternative explanations focussed on specificity of intention are thus ruled out.

A final limiter of construct validity concerns is the study’s nonconsideration of causal linkages. For purposes of this study, it is nonrelevant that the relation between contributions and bond business may be indirect and confounded with other variables, for instance friendship with the candidate. The present study does not attempt to establish causality, merely to demonstrate covariance.
Concerns over construct validity are also addressed by the use of more than one test of the hypothesized relation. Contributions to candidates are considered in toto, and the distribution of those contributions is also investigated. Various alternative explanations for test results were also considered, for example, the possibility that the population of bond market players is wealthier than the general population of contributors. Results of the analyses tend to disaffirm this interpretation. Contributions by players, in toto or individually, do not appear to be inherently higher than those of the balance of the population.

4. Threats to External Validity

The key concern of researchers and consumers of research is typically the generalizability of research results. Note that generalizability across populations is different than generalizing to a well-defined target population, and that both may be desirable traits of research studies. This study attempts to provide information generalizable to player selection and bond issuance in the state of Louisiana. The further extension of that information to other states is subject to several limitations, which will be discussed in chapter five.
Interactions between selection and the event of interest can produce biases in results of tests. For this study, interactions should theoretically be minimized, as all data examined was extracted from the public record - that is, no effort on the part of reporting entities was involved other than that necessary to comply with state and federal regulations. The use of public data may, however, incorporate some systemic recruitment factors. Primary among these is the tendency for those violating the law to fail to report information which might lead to public knowledge of their violations. In terms of this study, entities populated by opportunistic officials may choose to disobey reporting requirements. This factor should be minimized in the present study by virtue of the study's focus on statewide elections only. Obviously, the decision of a local entity to report or not is made by local officials, thus not directly made by the officials under consideration in this study. It is certainly true that methods of suasion may be exercised by state officials, but that practice, as that of influence-peddling, should be consonant with practices in the balance of the state.

There may also be interactions between setting and treatment. This study utilizes data from all issues
reported, and includes data from issuing entities of varying sizes, financial health, and economic climate. The economic climate of the state, and the South in general, serve as a common background for all issues.

This section of the chapter has addressed validity concerns for the study as a whole. Concerns with specific hypotheses are spoken to as the hypotheses and results are presented. The next section of the chapter presents a discussion of the hypotheses individually, and places each within the framework of this study.

5. Hypothesis Testing

Hypotheses one through three and five through seven rely upon data collected from campaign finance reports filed by candidates for election. While these reports are generated by the candidates themselves [or their funding committees], they are subject to audit by the Ethics Commission. This possibility of audit functions to discourage inaccurate reporting, and thus lends legitimacy to analyses based on this data. Data concerning cumulative contributions of $250 or more were collected for all candidates for the offices of interest [see table 1.1].

Determination of bond market players was made in accordance with the plan enumerated in chapter one.
Underwriting, consulting and bond counsel firms and individuals were identified by several measures: review of the "Red Book" published by Thomson Publishing, Moody's Municipal and Government Manual, compilation of firms actually having an association with the issues included in the sample, and review of business directories. Additionally, the Martindale-Hubble directory of attorneys was reviewed for attorneys specializing in bond-related matters.

Once the firms were identified, their employees were identified by perusal of city directories, yellow page advertisements of the firms [which routinely list those practicing under the firm's banner], and by reference to individual names appearing on various forms filed with the LBC. Affiliated persons [spouses, immediate family members] were identified by surname and/or address, both of which are required information on campaign contribution reporting forms.

Hypothesis one examines total contributions from bond market players [importantly, this is total player contributions, not just successful player contributions] as a fraction of total campaign contributions reported. Contributions of less than $250 are excluded from the calculations. The predicted result is that, for each of
the offices selected, bond market player contributions total more than 10% of all contributions over $250.

Hypothesis two, concerning the distribution of player contribution sizes, tests for a difference between that distribution and the distribution of non-player contributions. Again, only contributions of $250 or more are considered. This hypothesis is tested by calculation of Mann-Whitney test statistics and Kolmogorov-Smirnov 2-sample Test statistics. Given the truncation of distribution inherent to using a level of the variable of interest to limit sample selection, it seems prudent to utilize non-parametric tests that should be less influenced by the normality of distribution.

Tests will be run on the aggregate of contributions to all selected offices, and also on individual offices. This should allow conclusions as to the pervasiveness of the behaviour under study, as well as allowing isolation on specific offices. The predicted result is that the distribution of player contributions is negatively skewed with respect to the distribution of all other contributions over $250.

Hypothesis three tests the relation between contributions by successful players [those actually participating in the issuance] and method of placement.
As above, nonparametric test statistics are performed. The prediction arising from the prior discussion of candidate motivations is that there is a positive relation between contributions and negotiated placement of bond issues.

A multiple regression model was used to test hypotheses four through ten. The regression model used is developed by reference to extant research examining municipal debt issues. As discussed in chapter two, Net Interest Cost is used as a dependent variable rather than True Interest Cost [a discounted cash flow measure] so as to maximize comparability with prior research and sample size [the state agencies requiring bond issue information reporting routinely collect NIC rather than TIC].

Additional variables are added to the model in an attempt to discern their significance with respect to Net Interest Cost, which is the primary public cost of debt issuance. These additional variables are incorporated singly and also in concert. All variables are subjected to analysis for covariance with other variables, as well as analyses intended to bring out the need for transformation of any of the variables.
The additional variables are:

**BCCont** Contributions to candidates made by the issue’s bond counsel. This variable is the amount of contributions made by successful players rather than the total of all contributions by bond counsel.

**UWCont** Contributions to candidates made by the issue’s underwriters. As above, this variable is the amount of contributions by successful players only.

**SumCont** Total contributions made by all parties involved in the bond issuance.

**Brown** Brown’s index calculated with scoring from 1 to 4 rather than -1 to 2. This alteration was made so as to remove the possibility of an Index score of 0.

**AudComp** A categorical variable indicating the issuing entity’s compliance [or lack thereof] with Louisiana reporting statutes, as reported by the Legislative Auditor.

**LastAud** A categorical variable indicating whether the entity’s most recent financial
statement at sale date was dated within the last twelve months.

Predictions of coefficient signs can be made based on the earlier discussions concerning market theory. Each of these coefficients were tested against the null that there is no measureable effect on Net Interest Cost arising from either political contributions or availability and timeliness of financial information about the issuing entity. Those predictions are:

- BCCont positive
- UWCont positive
- SumCont positive
- AudComp negative
- LastAud negative

D. Summary

This chapter presents the research questions investigated by the study: Is there a relationship between political contributions and bond business? Is there a public cost [as measured by increases in Net Interest Cost] to those political contributions? Is there a relationship between issuing entity financial information availability and the cost of that entity's capital? Testable hypotheses are developed from these questions. Data collection methods are presented and
parameters for sample selection are discussed. The chapter also enunciates expected results, and details the statistical analyses performed.
Chapter Four

Data Analyses

This chapter presents details of the analyses performed and discusses results of the study. The first section explicates data collection methods and provides descriptive information about the bond issues included in the sample. Section two presents analyses of the research hypotheses relating to campaign contributions. The third section discusses the regression model, and presents results of analyses investigating the publicly available information set. Finally, section four presents an extension of the regression analysis, with an eye toward the changing nature of the municipal bond marketplace.

A. Data Collection

Information required for this study is derived from several sources. All of the data sources rely upon publicly mandated information disclosure, which greatly facilitated data collection. All filings are also subject to review for accuracy by state agencies, which lends some assurance of reliability to those filings.
1. Campaign Contributions

Contribution data was collected from filings with the State Board of Ethics for Elected Officials. The SBE requires candidates for office to file election finance reports for all elections in which contributions total $5,000 or more, the candidate disburses more than $5,000 in campaign related expenses, or the election area comprises more than 250,000 constituents. Reports were available for all of the offices determined to be of interest to this study.

Campaign finance reports are required periodically throughout the election period, so there were several filings for each candidate. During the 1990 election cycle regulations mandated that reports be cumulative in nature: candidates were required to report not only the dollar amount of contributions as they were received but also the cumulative total of contributions from each contributor for the entire election cycle. This requirement has since been rescinded, making data acquisition for subsequent election campaigns significantly more difficult.

Transaction details were collected for all contributions greater than $250 [the maximum amount allowed under MSRB G-37]. Data collected included
candidate to whom the contribution was made, cumulative amount contributed, and the name and address of the contributor. As discussed in chapters one and three, bond market players were identified by perusal of industry manuals, business directories and LBC records. The contribution dataset was then matched with player information to provide player contribution data by candidate. Table 4.1 provides an analysis of contributions partitioned by source.

2. Bond Issuing Entities

Louisiana, as other states, mandates financial disclosure by its political subdivisions. The office of the Legislative Auditor is charged with accepting and reviewing financial reports from the various entities, and is empowered to provide audit services to those entities unable or unwilling to procure them elsewhere. The Legislative Auditor's office also maintains a database of these financial reports, and provides reports to the LBC concerning compliance with state reporting requirements and the financial condition of entities seeking to offer debt.

Financial data necessary to compute Brown's Index were collected from the Legislative Auditor's repository of financial statements. As detailed in Table 3.1,
Table 4.1
Contribution Source Data

<table>
<thead>
<tr>
<th>Source</th>
<th>Mean</th>
<th>Mode</th>
<th>Median</th>
<th>Maximum</th>
<th>Total $ This Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond Counsel</td>
<td>1,395</td>
<td>500</td>
<td>600</td>
<td>10,000</td>
<td>224,541</td>
</tr>
<tr>
<td>Underwriters</td>
<td>2,105</td>
<td>5,000</td>
<td>1,000</td>
<td>5,500</td>
<td>214,722</td>
</tr>
<tr>
<td>All Players1</td>
<td>1,708</td>
<td>1,000</td>
<td>1,000</td>
<td>10,000</td>
<td>462,943</td>
</tr>
<tr>
<td>Non-Players</td>
<td>1,412</td>
<td>500</td>
<td>712</td>
<td>10,000</td>
<td>13,610,041</td>
</tr>
</tbody>
</table>

1 All Players includes bond counsel, underwriters, financial and other consultants.
Brown's Index is calculated from financial data available from the entity's general purpose financial statements [GPFS]. The Legislative Auditor's office also provides reports to the LBC concerning entity compliance with reporting statutes, and that information was gathered from monthly summaries prepared for the LBC.

3. Bond Issues

The LBC is charged with monitoring public debt arising from sub-districts of Louisiana, and must approve new issues prior to sale as a part of that monitoring process. The LBC must also approve appointments of bond counsel, financial advisors, underwriters, and other parties to the issuance [LBC 1995]. Therefore the LBC maintains records for each bond issue, including details of the transaction such as involved players, sale date, amount of the issue and Net Interest Cost. Data was collected for all issues mentioned in the minutes of the monthly meetings of the LBC.

Data concerning bond issues was also gathered from Thomson Publishing, publishers of the industry's daily newspaper, The Bond Buyer. Thomson collects data on larger issues, limiting its focus to those having a face value of more than $1 million. Data from both sources were combined, and issues with incomplete data were
discarded. The final sample is composed of 290 issues. Descriptive data for the sample are presented in Table 4.2.

Sample statistics do not, in general, mirror those of the publicly reported bond market. For instance, negotiated issues comprise nearly 80 percent of new issue debt according to the 1994 Bond Buyer Yearbook, but are 56 percent of issues in this sample. 65 percent of all issues are revenue bonds, while 72 percent of this sample are. Mean issue size also varies, with the general population having larger means than this sample. There is a distinct relation between issue size and rating, with rated bonds accounting for 85 percent of the dollar volume of the sample but only 60 percent of the number of issues. Unrated bonds make up 40 percent of the sample by issue count, but less than 15 percent by face amount.

The sample is fairly consistently spread across issuing entity, with 23 percent arising from municipalities, 73 percent from parishes and under 5 percent being state agency issuances. This spread indicates that the sample is not being overpowered by state agency issues and thus reinforces the extensibility of the study to the general population of Louisiana bond issues.
Table 4.2a

Descriptive Sample Statistics

<table>
<thead>
<tr>
<th>Placement Method:</th>
<th>Total $ Vol</th>
<th>Mean Issue $</th>
<th>K-S Z'/P</th>
<th>N-ct</th>
<th>% (N-ct/$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negotiated</td>
<td>1,269,258,756</td>
<td>7,803,595</td>
<td>3.3384/.0000</td>
<td>161</td>
<td>55.5/56.2</td>
</tr>
<tr>
<td>Competitive</td>
<td>988,662,104</td>
<td>7,664,047</td>
<td></td>
<td>129</td>
<td>44.5/43.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Issue Type:</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>1,633,384,466</td>
<td>10,889,230</td>
<td>2.0342/.0005</td>
<td>150</td>
<td>51.7/72.3</td>
</tr>
<tr>
<td>General Obligation</td>
<td>624,536,394</td>
<td>4,460,974</td>
<td></td>
<td>140</td>
<td>48.3/27.7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rating:</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Aaa or Aa or A</td>
<td>1,592,318,715</td>
<td>16,084,027</td>
<td>5.5438/.0000</td>
<td>99</td>
<td>34.1/70.5</td>
</tr>
<tr>
<td>Baa or Lower</td>
<td>331,443,042</td>
<td>4,419,241</td>
<td>1.7179/.0055</td>
<td>75</td>
<td>25.9/14.7</td>
</tr>
<tr>
<td>Unrated</td>
<td>334,159,103</td>
<td>2,880,682</td>
<td></td>
<td>116</td>
<td>40.0/14.8</td>
</tr>
</tbody>
</table>

1 Kolmogorov-Smirnov Z statistic comparing the distribution of face value between the indicated groups and the associated p value.

Table cont'd.
Table 4.2b

Descriptive Sample Statistics

<table>
<thead>
<tr>
<th></th>
<th>T1 $ Vol</th>
<th>Mean Issue $</th>
<th>K-S Z/P</th>
<th>N-ct</th>
<th>% [N-ct/$]</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Issuing Entity:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local</td>
<td>511,913,392</td>
<td>7,528,138</td>
<td>1.0428/.2269</td>
<td>68</td>
<td>23.4/22.7</td>
</tr>
<tr>
<td>Parish</td>
<td>1,644,737,468</td>
<td>15,470,026</td>
<td></td>
<td>215</td>
<td>74.1/72.8</td>
</tr>
<tr>
<td>State Agency</td>
<td>101,270,000</td>
<td>14,467,143</td>
<td></td>
<td>7</td>
<td>2.4/4.5</td>
</tr>
<tr>
<td><strong>Issue Size:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large [ &gt; $1M]</td>
<td>2,226,244,757</td>
<td>10,550,923</td>
<td>2.2635/.0001</td>
<td>211</td>
<td>72.8/98.6</td>
</tr>
<tr>
<td>Small</td>
<td>31,676,103</td>
<td>400,963</td>
<td></td>
<td>79</td>
<td>27.2/1.4</td>
</tr>
<tr>
<td><strong>State Audit Regulations:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Compliant</td>
<td>1,765,309,175</td>
<td>8,487,063</td>
<td>7.5815/.0000</td>
<td>208</td>
<td>71.7/78.2</td>
</tr>
<tr>
<td>Non-compliant</td>
<td>492,611,685</td>
<td>6,007,460</td>
<td></td>
<td>82</td>
<td>28.3/21.8</td>
</tr>
<tr>
<td><strong>Last Audit:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Within 12 months of sale</td>
<td>1,454,550,071</td>
<td>8,762,350</td>
<td>1.9924/.0007</td>
<td>166</td>
<td>57.2/64.4</td>
</tr>
<tr>
<td>Noncurrent</td>
<td>803,370,789</td>
<td>6,478,797</td>
<td></td>
<td>124</td>
<td>42.8/35.6</td>
</tr>
</tbody>
</table>
The above are to be expected given the nature of the sample collected. Louisiana is a largely rural state, and does not contain the population centers that typically generate larger debt issues. This sample also contains issues not typically recorded in industry statistics because of their small size and the peripatetic nature of bond issuance by small, less populous districts. Including those smaller issues from less frequent issuers allows conclusions about the bond market in Louisiana as a whole, rather than just the large issue, more completely traded segment of the market.

B. Analyses of Contribution Data

1. Hypothesis One

Bond market players are not major sources of contributions for publicly elected officials exercising control over the bond issuance process.

The magnitude of influence attributable to bond market players is the focus of Hypothesis One. As explained in chapter three, market theory prompts us to the belief that influence is if not directly at least proportionately related to contributions. This belief is demonstrably shared by government regulators, who have focused their attempts to minimize improper influence on the campaign finance process. Therefore, an
investigation of said improper influence needs to begin with an assessment of the relative strength of influence of interested parties: in this case, bond market players.

As discussed in chapter one, individual contributions of less than $250 are considered to be too numerous to possess significant influence and to be too small in amount to attract the necessary attention from candidates and their staff. This dismissal of contributions smaller than $250 is echoed by the MSRB, who chose to set the statutory cap on non-influential contributions by bond market players at that amount.

Table 4.3 summarizes contribution data for the offices of interest in this study. Candidates for three of the offices under consideration received contributions in excess of $250 from bond market players totaling more than 10 percent of all contributions greater than $250.

Interestingly, the candidate for Treasurer garnered 33 percent of total contributions from bond market players. The staff of the LBC, charged with preparing information to assist the commission in its deliberations, reports to the Treasurer. The Treasurer is also responsible for arranging debt issuance for state agencies. It is not surprising, then, that bond market
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Attorney General</td>
<td>2,466,922</td>
<td>72,221</td>
<td>2.9</td>
<td>1755</td>
<td>46</td>
<td>2.6</td>
</tr>
<tr>
<td>Governor</td>
<td>9,645,620</td>
<td>268,545</td>
<td>2.78</td>
<td>5932</td>
<td>105</td>
<td>1.8</td>
</tr>
<tr>
<td>Lt. Governor</td>
<td>962,255</td>
<td>18,000</td>
<td>1.87</td>
<td>946</td>
<td>14</td>
<td>1.5</td>
</tr>
<tr>
<td>Sec. of State</td>
<td>217,345</td>
<td>4,450</td>
<td>2.05</td>
<td>195</td>
<td>10</td>
<td>5.1</td>
</tr>
<tr>
<td>Treasurer</td>
<td>183,109</td>
<td>60,400</td>
<td>32.99</td>
<td>214</td>
<td>42</td>
<td>19.6</td>
</tr>
<tr>
<td>Rep. Ackal</td>
<td>35,002</td>
<td>749</td>
<td>2.14</td>
<td>55</td>
<td>2</td>
<td>3.6</td>
</tr>
<tr>
<td>Rep. Adley</td>
<td>5,931</td>
<td>0</td>
<td>0</td>
<td>12</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Rep. Alar</td>
<td>48,599</td>
<td>3,900</td>
<td>8.02</td>
<td>63</td>
<td>4</td>
<td>6.3</td>
</tr>
<tr>
<td>Rep. Dimos</td>
<td>26,499</td>
<td>650</td>
<td>2.45</td>
<td>48</td>
<td>2</td>
<td>4.2</td>
</tr>
<tr>
<td>Rep. Laborde</td>
<td>4,499</td>
<td>0</td>
<td>0</td>
<td>7</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Rep. Riley</td>
<td>26,400</td>
<td>1,000</td>
<td>3.79</td>
<td>78</td>
<td>4</td>
<td>5.1</td>
</tr>
<tr>
<td>Rep. Theriot</td>
<td>52,399</td>
<td>8,850</td>
<td>16.89</td>
<td>86</td>
<td>13</td>
<td>15.1</td>
</tr>
<tr>
<td>Sen. Johnson</td>
<td>40,475</td>
<td>2,500</td>
<td>6.18</td>
<td>52</td>
<td>1</td>
<td>1.9</td>
</tr>
<tr>
<td>Sen. Jumonville</td>
<td>155,944</td>
<td>4,931</td>
<td>3.16</td>
<td>157</td>
<td>9</td>
<td>5.7</td>
</tr>
<tr>
<td>Sen. Nunez</td>
<td>159,248</td>
<td>16,149</td>
<td>10.14</td>
<td>213</td>
<td>17</td>
<td>8.0</td>
</tr>
<tr>
<td>Sen. Rayburn</td>
<td>42,646</td>
<td>599</td>
<td>1.40</td>
<td>54</td>
<td>2</td>
<td>3.7</td>
</tr>
</tbody>
</table>
players would have an interest in gaining the ear of the successful candidate.

Representative Theriot also received contributions in excess of 10 percent of total contributions\(^1\). Theriot is a CPA, and has been involved with public finance for some time. Since the time period of interest to this study, Theriot has run successfully for the office of Treasurer.

Senator Nunez was at the time President of the Senate as well as a member of the LBC. Contributions to his campaign by bond market players also exceeded 10 percent.

While three of the offices of interest thus show evidence of significant contributory activity by interested parties, it is crucial to remember that contributions in excess of an arbitrary percentage are not conclusive evidence of undue influence. Hypothesis one seeks merely to provide some indication of the possibility that interested parties perceive contributions to the campaigns of influential officials as reasonable behaviour.

\(^1\) Theriot ran unopposed for reelection, so the analysis speaks to contributions to his campaign as shorthand for contributions to candidates for the 83\(^{rd}\) State Representative District seat.
2. Hypothesis Two

Another, perhaps more accurate measure of the likelihood of contributions being made by bond market players in pursuit of privileged treatment is a comparison of the distributions of contribution amounts. The rationale for this comparison is that players, if seeking to "purchase" business yielding greater than normal profits, will make correspondingly larger contributions. Thus hypothesis two:

\[ H_A: \text{The distribution of the size of market player contributions to officials in a position to exercise influence is significantly different from that of non-players.} \]

Table 4.4 provides results of an analysis of the distribution of player contributions in comparison with that of total contributions. As noted above, only contributions of $250 or more were included in this analysis. Both Wilcoxon-Mann-Whitney and Kolmogorov-Smirnov statistics are provided. The Wilcoxon-Mann-Whitney test measures the central tendency of distributions, and is arguably slightly more efficient than the Kolmogorov-Smirnov test for large samples [Siegel & Castellan, 1988]. The Kolmogorov-Smirnov test is sensitive to any kind of difference in the distributions from which the samples were drawn. The
Table 4.4a
Analysis of Contribution Distributions

<table>
<thead>
<tr>
<th>Office</th>
<th>Cont Source</th>
<th>Mean Cont</th>
<th>K-S Z'</th>
<th>2-tail p&lt;=</th>
<th>M-W Z'</th>
<th>2-tail p&lt;=</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tl Sample</td>
<td>BC</td>
<td>1395</td>
<td>0.9485</td>
<td>0.3293</td>
<td>-1.0399</td>
<td>0.2984</td>
</tr>
<tr>
<td></td>
<td>UW</td>
<td>2105</td>
<td>2.2483</td>
<td>0.0001</td>
<td>-4.1548</td>
<td>0.0001</td>
</tr>
<tr>
<td></td>
<td>Sum</td>
<td>1708</td>
<td>1.5</td>
<td>0.0222</td>
<td>-1.9999</td>
<td>0.0455</td>
</tr>
<tr>
<td></td>
<td>NonPlayer</td>
<td>1412</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Att General</td>
<td>BC</td>
<td>1470</td>
<td>0.5121</td>
<td>0.9557</td>
<td>-0.3793</td>
<td>0.7044</td>
</tr>
<tr>
<td></td>
<td>UW</td>
<td>490</td>
<td>0.9226</td>
<td>0.3623</td>
<td>-1.3168</td>
<td>0.1879</td>
</tr>
<tr>
<td></td>
<td>Sum</td>
<td>1570</td>
<td>0.6695</td>
<td>0.7612</td>
<td>-0.532</td>
<td>0.5947</td>
</tr>
<tr>
<td></td>
<td>NonPlayer</td>
<td>1401</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Governor</td>
<td>BC</td>
<td>2070</td>
<td>1.5272</td>
<td>0.0188</td>
<td>-2.7706</td>
<td>0.0056</td>
</tr>
<tr>
<td></td>
<td>UW</td>
<td>3021</td>
<td>3.0788</td>
<td>0.0001</td>
<td>-5.3715</td>
<td>0.0001</td>
</tr>
<tr>
<td></td>
<td>Sum</td>
<td>2558</td>
<td>2.9014</td>
<td>0.0001</td>
<td>-5.9325</td>
<td>0.0001</td>
</tr>
<tr>
<td></td>
<td>NonPlayer</td>
<td>1609</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lt Governor</td>
<td>BC</td>
<td>1042</td>
<td>0.5228</td>
<td>0.9475</td>
<td>-0.5899</td>
<td>0.5553</td>
</tr>
<tr>
<td></td>
<td>UW</td>
<td>2750</td>
<td>0.6535</td>
<td>0.7866</td>
<td>-1.0439</td>
<td>0.2965</td>
</tr>
<tr>
<td></td>
<td>Sum</td>
<td>1286</td>
<td>0.6998</td>
<td>0.7115</td>
<td>-0.9437</td>
<td>0.3453</td>
</tr>
<tr>
<td></td>
<td>NonPlayer</td>
<td>968</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

BC = Bond Counsel  
UW = Underwriter  
SUM = All Players  
NonPlayer = Other Contributors  
"Kolmogorov-Smirnov test of equality of distribution"  
"Mann-Whitney-Wilcoxon test of equality of distribution"

Table cont'd.
<table>
<thead>
<tr>
<th>Office</th>
<th>Cont Source</th>
<th>Mean Cont</th>
<th>K-S Z</th>
<th>2-tail p&lt;=</th>
<th>M-W Z</th>
<th>2-tail p&lt;=</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sec of State</td>
<td>BC</td>
<td>306</td>
<td>1.5052</td>
<td>0.0215</td>
<td>-2.8344</td>
<td>0.0046</td>
</tr>
<tr>
<td></td>
<td>UW</td>
<td>1000</td>
<td>0.5176</td>
<td>0.9516</td>
<td>-0.6839</td>
<td>0.494</td>
</tr>
<tr>
<td></td>
<td>Sum</td>
<td>445</td>
<td>1.1238</td>
<td>0.1599</td>
<td>-2.2364</td>
<td>0.0253</td>
</tr>
<tr>
<td></td>
<td>NonPlayer</td>
<td>1151</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Treasurer</td>
<td>BC</td>
<td>1136</td>
<td>0.4263</td>
<td>0.9934</td>
<td>-0.4804</td>
<td>0.6309</td>
</tr>
<tr>
<td></td>
<td>UW</td>
<td>1589</td>
<td>2.0025</td>
<td>0.0007</td>
<td>-4.0991</td>
<td>0.0001</td>
</tr>
<tr>
<td></td>
<td>Sum</td>
<td>1438</td>
<td>1.6037</td>
<td>0.0117</td>
<td>-3.1813</td>
<td>0.0015</td>
</tr>
<tr>
<td></td>
<td>NonPlayer</td>
<td>713</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R. Theriot</td>
<td>BC</td>
<td>629</td>
<td>0.4035</td>
<td>0.9968</td>
<td>-0.5879</td>
<td>0.5566</td>
</tr>
<tr>
<td></td>
<td>UW</td>
<td>417</td>
<td>0.8200</td>
<td>0.5119</td>
<td>-1.1642</td>
<td>0.2443</td>
</tr>
<tr>
<td></td>
<td>Sum</td>
<td>681</td>
<td>0.6581</td>
<td>0.7794</td>
<td>-0.7685</td>
<td>0.4422</td>
</tr>
<tr>
<td></td>
<td>NonPlayer</td>
<td>597</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>S. Nunez</td>
<td>BC</td>
<td>756</td>
<td>1.0842</td>
<td>0.1904</td>
<td>-1.9798</td>
<td>0.0477</td>
</tr>
<tr>
<td></td>
<td>UW</td>
<td>1169</td>
<td>0.3908</td>
<td>0.998</td>
<td>-0.169</td>
<td>0.8658</td>
</tr>
<tr>
<td></td>
<td>Sum</td>
<td>950</td>
<td>0.9935</td>
<td>0.277</td>
<td>-1.3511</td>
<td>0.1767</td>
</tr>
<tr>
<td></td>
<td>NonPlayer</td>
<td>730</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Kolmogorov-Smirnov test statistic is influenced by differences in central tendency, dispersion, and skewness and may therefore be a more appropriate test for this purpose.

Results for hypothesis two vary across offices, although the distribution of contributions by underwriters differs significantly from that of other donors over all the offices considered. Player contributions to candidates for Governor, Secretary of State, and Treasurer display evidence of belonging to a differently distributed population than that of total contributions. In the Governor's race both bond counsel and underwriters appear to contribute more heavily than one would expect based on overall contributions. Bond counsel tended to contribute larger amounts to candidates for Secretary of State than other contributors, while underwriters provided larger contributions to candidates for Treasurer.

Importantly, contributions from players to the other offices of interest seem in line with those from the public at large. This indicates that players do not as a matter of course contribute larger amounts to all candidates than other donors, and tends to reinforce the conclusion that players have more interest in currying
favour with some officials than with others. Note especially that bond counsel contributions to candidates for Attorney General are not demonstrably out of line with those from other sources.

3. Hypothesis Three

The municipal bond market literature often suggests that elected officials can much more easily award business to their contributors when an issue is placed by negotiation rather than competitively. To date, no irrefutable evidence has been produced demonstrating the truth of that suggestion. Hypothesis three attempts to explore the validity of that suggestion by testing for a significant relation between contributions by players involved with specific issues and the placement method used for those issues:

\[ H_{A3} \] Contributions to officials by market players involved in the issue are significantly related to the placement method selected.

Table 4.5 presents results of an analysis of placement method and contributions. Test statistics investigate the independence of the distributions of contributions made by market players dependent upon issue placement method. The hypothesis is that players participating in negotiated issues will contribute larger amounts than those participating in competitively bid
<table>
<thead>
<tr>
<th></th>
<th>Comp. Mean</th>
<th>Neg. Mean</th>
<th>M-W Z&lt;sup&gt;1&lt;/sup&gt;</th>
<th>1-tail p&lt;=</th>
<th>K-S Z&lt;sup&gt;2&lt;/sup&gt;</th>
<th>1-tail p&lt;=</th>
</tr>
</thead>
<tbody>
<tr>
<td>BC</td>
<td>22,248</td>
<td>25,669</td>
<td>-4.0052</td>
<td>.0000</td>
<td>1.3116</td>
<td>.0320</td>
</tr>
<tr>
<td>UW</td>
<td>20,468</td>
<td>6,758</td>
<td>-8.1134</td>
<td>.0000</td>
<td>3.8648</td>
<td>.0000</td>
</tr>
<tr>
<td>Sum</td>
<td>42,716</td>
<td>32,427</td>
<td>-5.5171</td>
<td>.0000</td>
<td>3.0014</td>
<td>.0000</td>
</tr>
</tbody>
</table>

<sup>1</sup> BC = Bond Counsel contributions  
<sup>2</sup> UW = Underwriter contributions  
<sup>3</sup> Sum = All market player contributions  
<sup>1</sup> Mann-Whitney-Wilcoxon test of equality of distributions  
<sup>2</sup> Kolmogorov-Smirnov test of equality of distributions
issues. As in the analysis of hypothesis two, both Wilcoxon-Mann-Whitney and Kolmogorov-Smirnov statistics are provided. Contributions by both underwriters and bond counsel are significantly related to the placement method selected. Note that overall market player contributions are also significantly related to choice of placement method, despite the opposing direction of the relationship between contribution size and placement method between underwriters and bond counsel.

Bond Counsel participating in negotiated bond issuance contribute more heavily than those involved in competitively bid issues. While it seems at first glance as though bond counsel would have no reason to prefer one method of placement over the other [regardless of method, bond counsel are required], they may have less direct reasons for soliciting negotiated placement business. As bond counsel are normally consulted at the inception of a bond issuance, they may have some influence over the selection of other players invited to participate in the transaction. If that is the case, bond counsel could extract rents from underwriters in exchange for advancing the underwriters’ case with issuing officials.

As discussed in chapter three, there are well-accepted reasons for choosing to place an issue by
negotiation rather than competitive bid. Therefore, the rejection of the hypothesis of no relation between contributions by bond counsel and placement method should not be seen as conclusive evidence of exercise of undue influence by elected officials.

Evidence from Table 4.5 indicates that underwriters participating in competitive issues contribute more. This result is in direct opposition to our intuition that campaign contributions by market players are in part fees expended to purchase non-competitively bid bond issue business.

As discussed in chapter two, the gap between negotiated and competitive interest rates has steadily narrowed over the last few decades. That is, the benefit [increased profit] from underwriting negotiated placement issues as opposed to competitively bid issues has diminished over time. Increased attention paid to negotiated transactions by regulators and the media may be a factor in this narrowing gap.

Hildreth's [1994] suggestion that campaign contributions are solicited in exchange for player inclusion in the pool of approved issuance participants may provide an explanation for the observed relation between contribution size and placement method. His
theory in part is that contributions are made in exchange for erection of barriers to entry into the municipal bond issuance process. Those barriers to entry may consist of a list of "approved underwriters and bond counsel", requirements as to firm size, experience, geographic location or innumerable other factors. If Hildreth's perceptions are accurate, underwriters may well prefer competitively bid issues, which are commonly understood to be much less amenable to influence peddling on the part of elected officials. Competitively bid issues thus are subjected to much less scrutiny than negotiated issues - the assumption is that market forces will ensure lowest cost debt placement.

C. Analyses Using The Regression Model

This project further investigates the relationship between contributions and municipal bond business by utilizing regression analyses. The base model is developed by aggregating variables common to prior research. As discussed in chapter two, studies focusing on municipal debt commonly include the following variables:

Size  Face amount of the issue
Rating Bond rating assigned by a ratings agency
MktRate A measure of municipal market interest rates
The most commonly used dependent variable is some measure of net cost of debt, usually Net Interest Cost. As explained in chapter two, Net Interest Cost does not incorporate the time value of money, but is commonly used in the bond marketplace [NIC is also specified as required information on the LBC bond issue reporting form]. In order to facilitate comparison with prior research this study uses Net Interest Cost as a dependent variable.

The sample is partitioned into large [over $1 million] and small issues in order to facilitate comparison with the extant literature, which commonly uses samples containing only issues of greater than $1 million face value. As explained in chapter three, commercial bond information providers routinely collect data only for issues larger than $1 million, as their target audience [investors] is primarily concerned with issues widely available in the market.

Leonard [1996] uses logistic regression analysis to provide evidence that competitive and negotiated placement issues should not be pooled into a common sample for purposes of regression analyses. Leonard's
study demonstrates that the influence of explanatory variables varies across placement method, and thus calls into question the validity of much prior research. Note, however, that much of that literature consists of studies performed at a time when competitive issues comprised the vast majority of issues. Therefore prior research may have been accurate for the market of the time, while current research should adapt to the shift in placement method.

Following Leonard's perception, the portion of the sample having face amounts greater than $1 million is further partitioned by placement method. The small issue size portion of the sample contains only 7 competitively placed issues, so is not partitioned. The assumption is that issue size is more determinate than placement method for purposes of this study.

1. **Hypothesis Four**

While the regression model used in this study has been demonstrated to provide explanatory power for bond issue transactions by prior research, much of that research took place some time ago. Hypothesis four seeks to legitimate the model by using data from current, Louisiana issues:
The independent variables included in the base model possess significant explanatory power for Net Interest Cost.

Table 4.6 presents results of the base model regression analysis. The model possesses some explanatory power for issues larger than $1 million (regardless of placement method), which drives the model's significance for the sample as a whole. In the case of negotiated issues, that significance is centered in two variables: face amount of the issue [Facek] and the market interest rate [BB20Bond]. Competitive issue NIC is more closely related to the market interest rate and the "lock-in period" of the investment [YrsToCall].

The model does not provide much explanatory power for the subsample of issues smaller than $1 million. As discussed above, that lack of fit is reasonable given prior studies' lack of small issue size data. Of the model's variables, only the market interest equivalent [BB20Bond] and "lock in" period [YrstoCall] are significantly related to NIC. Issuing entity rating [Rating], issue size [FaceK] and placement method [CorNIssue] appear to be non-significant contributors to NIC. The conclusion is that small issues are constrained...
Table 4.6
Base Regression Model Results (t-values)

<table>
<thead>
<tr>
<th></th>
<th>Face &lt; $1M</th>
<th>Face &gt; $1M Negotiated</th>
<th>Face &gt; $1M Competitive</th>
<th>Complete Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>3.545247</td>
<td>-1.115390</td>
<td>.595933</td>
<td>.693040</td>
</tr>
<tr>
<td></td>
<td>(2.841)***</td>
<td>(.813)</td>
<td>(.810)</td>
<td>(1.285)</td>
</tr>
<tr>
<td>YrstoCall</td>
<td>-0.014813</td>
<td>-.007066</td>
<td>-.036782</td>
<td>-.019730</td>
</tr>
<tr>
<td></td>
<td>(-1.008)</td>
<td>(-.556)</td>
<td>(-4.175)***</td>
<td>(-3.632)***</td>
</tr>
<tr>
<td>FaceK</td>
<td>-3.2388E-04</td>
<td>1.30442E-05</td>
<td>3.16565E-06</td>
<td>1.12565E-05</td>
</tr>
<tr>
<td></td>
<td>(-1.032)</td>
<td>(2.826)***</td>
<td>(.568)</td>
<td>(3.348)***</td>
</tr>
<tr>
<td>BB20Bond</td>
<td>.375911</td>
<td>1.125523</td>
<td>.919181</td>
<td>.851314</td>
</tr>
<tr>
<td></td>
<td>(1.753)*</td>
<td>(4.818)**</td>
<td>(8.269)***</td>
<td>(9.270)***</td>
</tr>
<tr>
<td>Brate</td>
<td>-.128437</td>
<td>.116417</td>
<td>.131479</td>
<td>.035980</td>
</tr>
<tr>
<td></td>
<td>(-.450)</td>
<td>(.466)</td>
<td>(.742)</td>
<td>(.307)</td>
</tr>
<tr>
<td>Arate</td>
<td>-.914219</td>
<td>-.206842</td>
<td>-.326584</td>
<td>-.385344</td>
</tr>
<tr>
<td></td>
<td>(-1.230)</td>
<td>(-.939)</td>
<td>(-1.857)***</td>
<td>(-3.306)***</td>
</tr>
<tr>
<td>CorNIssue</td>
<td>.378053</td>
<td>n/a</td>
<td>n/a</td>
<td>.129855</td>
</tr>
<tr>
<td></td>
<td>(1.252)</td>
<td></td>
<td></td>
<td>(1.264)</td>
</tr>
</tbody>
</table>

Sample Size  79  89  122  290
Adj. R²  .05961  .26927  .47983  .33026
Regression F  1.82411  7.48537  23.32326  24.75179

NIC = Size + YrstoCall + Rating + MktRate + CorNIssue
NIC = Net Interest Cost
FaceK = Face amount of the issue/1000
BB20Bond = Bond Buyer 20 Bond Rate for the week of sale
Brate = 1 if the issue has a rating of Baa or lower
Arate = 1 if the issue has a rating of Aaa, Aa or A
CorNIssue = 1 if the issue was placed via competitive bid

*  p < .10  
** p < .05  
*** p < .01
by factors much different than those influencing larger issues.

Diagnostics for the model suggest that while not possessing a high degree of explanatory power, the base model is relatively robust with respect to common threats to model adequacy. Multicollinearity is not a problem, as the maximum variance inflation factor [VIF] for this model is 1.64. Neter et al. [1989] assert that maximum VIFs in excess of ten indicate multicollinearity problems, which in turn suggests that multicollinearity is not an issue for this analysis. Outlying observations were identified by inspection of plots and residuals analysis. These outliers were evaluated for influence using DFFITS, DFBETAS, and Cook's Distance calculations. None of the outliers was determined to be unduly influential, therefore all of the observations were incorporated in the analyses [Neter et al., 1989].

2. Hypotheses Five - Seven

The preceding analyses have demonstrated some measure of relation between campaign contributions and bond issue business. That relation may be seen as behaviour to be constrained. As discussed in chapter one, the approach of the MSRB and various state regulatory agencies has largely been precisely that.
Alternatively, one might adopt an accounting perspective and attempt to develop a cost benefit analysis relating the benefit of ameliorating that behaviour with the cost of behaviour modification.

This study seeks to provide some evidence of the public cost of elected officials trading bond business for campaign contributions. The public cost of non-optimal selection of bond issue participants will [at least in part] be embedded within Net Interest Cost. Recall that underwriters profit on a bond issue by purchasing the issue from the issuer and then reselling the issue to investors at higher price [that is, higher effective interest rate]. Therefore the public cost of non-optimal issuance practices can be measured in part by the variance in Net Interest Cost attributable to contributions.

Amounts contributed by the various players in a bond issue are incorporated into the regression model to test hypotheses five through seven:

\[ H_{A5} \text{ Contributions by bond counsel involved in the issuance process have significant explanatory power for Net Interest Cost.} \]

\[ H_{A6} \text{ Contributions by underwriters involved in the issuance process have significant explanatory power for Net Interest Cost.} \]
HA7. Contributions by all market players involved in the issuance process have significant explanatory power for Net Interest Cost.

As shown in Table 4.7, none of the contribution variables [BCCont, UWCont and SumCont] evidence a significant association with NIC. Therefore the analysis provides no support for hypotheses five, six or seven. This lack of support should not be construed as evidence that the behaviour in question does not occur. As explained by Hildreth [1994], contributions may be solicited by officials, and made by bond market players, as an entry price into a lucrative market [in Hildreth’s terms, pay to play]. If Hildreth’s explanation is accurate, the public cost of this behaviour would only be determinable by comparison of interest rates in the municipal bond market with those of alternative investments not susceptible to third-party moral hazard, a task beyond the scope of this study.

3. Hypotheses Eight - Ten

This study also investigates the information asymmetry of the municipal bond marketplace. Chapter three sets forth arguments that the bond market is much less complete than the equities markets in terms of information availability. As explained therein, governmental financial reporting is troublesome because

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<table>
<thead>
<tr>
<th></th>
<th>Face &lt; $1M Negotiated</th>
<th>Face &gt; $1M Negotiated</th>
<th>Face &gt; $1M Competitive</th>
<th>Complete Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Model R²</td>
<td>.05961</td>
<td>.26927</td>
<td>.47983</td>
<td>.33026</td>
</tr>
<tr>
<td>GO</td>
<td>-.457684</td>
<td>-.254027</td>
<td>.111427</td>
<td>-.124195</td>
</tr>
<tr>
<td></td>
<td>(-2.692)***</td>
<td>(-1.248)</td>
<td>(.833)</td>
<td>(-1.352)</td>
</tr>
<tr>
<td>Brown</td>
<td>-.011744</td>
<td>-.034823</td>
<td>-.038346</td>
<td>-.033302</td>
</tr>
<tr>
<td></td>
<td>(-.585)</td>
<td>(-2.693)***</td>
<td>(-2.343)***</td>
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<td>BCCont</td>
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<td></td>
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<tr>
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<td>1.98705E-06</td>
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<td>(.683)</td>
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<td>5.22538</td>
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<td>14.6516</td>
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NIC = Base Model + GO + Brown + BCCont + UWCont + SumCont + AudComp + LADate
GO = 1 if a general obligation issue
Brown = Brown's Index score
BCCont = Contributions made by issue's bond counsel
UWCont = Contributions made by issue's underwriters
AudComp = 1 if issuer is compliant with state reporting statutes
LADate = 1 if last issuer audit within 12 months of sale date

* p < .10
** p < .05
*** p < .01
of a lack of easily quantifiable measures of goal achievement. That is, the goal of government is not to produce maximal profits in the form of cash but rather to produce maximal return on investment in terms of services provided to some constituency. This lack of "bottom line" focus has often been offered as an explanation [ego te absolvo?] for the common perception of government financial reports as arcane or labyrinthine.

Brown [1993] provides a scoring system whereby information commonly available from the general purpose financial reports [GPFS] of a governmental entity can be summarized and compared with similar scores for other entities with similar characteristics [most commonly population]. Brown's contention is that this index may thus be used as a proxy for some of the information contained within financial reports. Strongly influencing Brown's argument is the notion that most investors, indeed the majority of governmental officials, are unable or unwilling to parse GPFS's for relevant information. Thus Brown's Index provides useable information not otherwise available to the majority of investors: information concerning the entity's financial position and ability to repay debt. Hypothesis eight investigates the relation between that information and NIC:
Brown’s Index of financial well-being has significant explanatory power for NIC.

Table 4.7 demonstrates that Brown's Index [Brown] is significantly related to NIC for issues larger than $1 million. Small issues, as noted above, exist in a necessarily smaller market, and it seems reasonable to suppose that players in that smaller, and less complete, market are possessed of information about the issuing entity and its debt-repayment ability outside the bounds of publicly available financial reports.

A measure of the public availability of entity financial information is compliance with state reporting requirements. Louisiana statutes require audited financial reports biannually for all governmental entities. Noncompliance with statutes, as indicated in chapter three, does not entail onerous penalties, making it possible for entities to neglect financial reporting without dire consequences.

Information about the financial status of debtors is routinely shown to be a factor in credit and investment decisions. Availability of that information for governmental entities is not, however, assured as it is for non-governmental entities issuing securities publicly. Hypothesis nine speaks to financial
information availability in a minimal sense by using state reporting requirement compliance:

$H_A$: Issuing entity compliance with state financial reporting requirements $[\text{AudComp}]$ has significant explanatory power for NIC.

There are 82 entities not in compliance with state reporting requirements at the time their bond issue was presented to the LBC for approval. Of these entities, 39 were issuing debt with face value less than $1$ million. 70 placed issues by negotiation, while 12 used the competitive bid process. Compliance with reporting requirements is not significantly related to NIC for any of the sample subsets, or for the sample as a whole.

Given the above-mentioned truism that information as to the financial status of debtors is relevant to investment and credit decisions, it is surprising that no relation is found between public availability of audited financial data and NIC. The reason may lie in the incompleteness of the bond market and the competitive advantage of market players. It is doubtful that underwriters would agree to purchase issues without information as to the entity's ability to retire the issue, but entirely possible that parties to the transaction [bond counsel, underwriters, private placement purchasers] acquire that information through
nonpublic channels, and in fact demand that information prior to participation. The incomplete nature of the bond market may function to limit the necessity of disseminating that information more completely.

Another tenet of market theory holds that financial information possesses value in relation to its timeliness. That is, financial information is more valuable when more recent. Investors should therefore demand [again, by way of interest cost] continuing financial reporting. Given that it is not uncommon for an issue approved by the LBC to be brought to market one or two years later, it seems likely that market players and investors would prefer more current information than that available at time of LBC approval.

The value of timely information, as indicated by an audited financial report dated within twelve months of the issue’s date of sale, is explored by hypothesis ten:

$$H_{A10} \text{ Timeliness of financial data [LADate] has significant explanatory power for NIC.}$$

As for compliance with state reporting requirements, there is no significant relation demonstrated between timeliness of financial reports and NIC.
D. Extension of Regression Analyses

Leonard [1996] provides evidence that past attempts to determine factors of Net Interest Cost for bond issues may have been flawed. Leonard's contention is that competitively bid issues are not identical to negotiated issues in terms of influencing factors. Equally, bond issues with dedicated repayment streams [Revenue bonds] are argued to differ from issues sold without the backing of specific repayment sources. As mentioned in chapter one, the majority of bonds issued in recent years have been revenue bonds. As with the competitive versus negotiated split, this shift in bond characteristics may indicate a fundamental change in the underlying characteristics of the bond marketplace.

In order to examine the significance of repayment options on the NIC models developed in this study, the portion of the sample with face value of $1 million or more was partitioned by repayment schema. Tables 4.8 and 4.9 present results of redoing the regression analyses discussed above with the modified sample partitions.

The base model [Table 4.8] results clearly demonstrate that GO bond interest costs are much more closely approximated than those of Revenue issues. Significant variables in the analysis of GO issues
Table 4.8

<table>
<thead>
<tr>
<th>Bond Type Base Regression Model</th>
<th>Results (t-values)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Face &lt; $1M</td>
<td>Face &gt; $1M</td>
</tr>
<tr>
<td>Constant</td>
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</tr>
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<td></td>
<td>(.105)</td>
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<tr>
<td>YrstoCall</td>
<td>-.015061 (-1.303)</td>
</tr>
<tr>
<td></td>
<td>(.105)</td>
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<tr>
<td>FaceK</td>
<td>.375911 (.1.753)*</td>
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<tr>
<td></td>
<td>(5.164)**</td>
</tr>
<tr>
<td>Brate</td>
<td>-.014813 (-1.808)*</td>
</tr>
<tr>
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<td>(.105)</td>
</tr>
<tr>
<td>BB20Bond</td>
<td>-.015061 (-1.303)</td>
</tr>
<tr>
<td></td>
<td>(.105)</td>
</tr>
<tr>
<td>Arate</td>
<td>-.014813 (-1.808)*</td>
</tr>
<tr>
<td></td>
<td>(.105)</td>
</tr>
<tr>
<td>Sample Size</td>
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</tr>
<tr>
<td>Adj. R²</td>
<td>.05961</td>
</tr>
<tr>
<td>Regression F</td>
<td>1.82411</td>
</tr>
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</table>

NIC = Net Interest C.
FaceK = Face amount of the issue/1000
BB20Bond = Bond Buyer 20 Bond Rate for the week of sale
Brate = 1 if the issue has a rating of Baa or lower
Arate = 1 if the issue has a rating of Aaa, Aa or A
CorNIssue = 1 if the issue was placed via competitive bid

* p < .10
** p < .05
*** p < .01
include market interest rate [BB20Bond], investment period [YRsToCall] and placement method [CorNIssue]. As would seem reasonable, market interest rate is directly related to NIC and inversely related to the length of the investment period.

Higher NIC are associated with competitive placement. This relation is contrary to our expectations that competitive placement, by virtue of its public bid process, will produce lower NIC than a privately negotiated, non-market transaction. Note, however, that placement method is not a significant variable with respect to the Revenue bond portion of the sample.

Table 4.9 presents data from the extended model. As in the prior analysis, underwriter contributions [UWCont] and total player contributions [SumCont] are not significant contributors to the model. Bond counsel contributions are significant for the sample composed of large general obligation [G 0] bonds. This significance must be interpreted cautiously because of the previously mentioned near-monopoly on bond counsel business by a single firm.

Variables representing timely availability of financial information also demonstrate no significant explanatory power for NIC. For Revenue bonds, Brown's
Table 4.9

Bond Type Extended Model Results' (t-values)

<table>
<thead>
<tr>
<th></th>
<th>Face &lt; $1M</th>
<th>Face &gt; $1M</th>
<th>Face &gt; $1M</th>
<th>Complete</th>
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<tr>
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<td>Revenue</td>
<td>GO</td>
<td>Sample</td>
<td></td>
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<td>Comp</td>
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<tr>
<td></td>
<td>(1.332)</td>
<td>(-.039)</td>
<td>(2.197)**</td>
<td>(-1.352)</td>
</tr>
<tr>
<td>Brown</td>
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<td>-.005809</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(-.706)</td>
<td>(-3.411)**</td>
<td>(-.456)</td>
<td>(-3.960)**</td>
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<td>BCCont</td>
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<td>-1.37299E-05</td>
<td>2.09693E-06</td>
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<td></td>
<td>(-.640)</td>
<td>(1.658)</td>
<td>(-2.597)**</td>
<td>(.312)</td>
</tr>
<tr>
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<td></td>
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<td>(.296)</td>
<td>(.149)</td>
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<td>(1.15)</td>
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<td>(.683)</td>
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<tr>
<td>AudComp</td>
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<td>(1.055)</td>
<td>(.426)</td>
<td>(.268)</td>
<td>(1.386)</td>
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</table>

Sample Size 79 114 97 290
Adj. R2 .02135 .33541 .75326 .36182
Regression F 1.15471 6.18457 27.64262 14.65416

1 NIC = Base Model + GO + Brown + BCCont + UWCont + SumCont + AudComp + LADate
GO = if a general obligation issue
Brown = Brown's Index score
BCCont = Contributions made by issue's bond counsel
UWCont = Contributions made by issue's underwriters
AudComp = if issuer is compliant with state reporting statutes
LADate = if last issuer audit within 12 months of sale date

*  p < .10
**  p < .05
***  p < .01
Index is inversely related to NIC, in line with our expectations that increasing financial health enables entities to borrow at lower rates. Note, however, that Brown's Index displays no explanatory power over NIC for the general obligation bond sample. This result is counterintuitive, as we would expect information concerning financial health of the issuing entity to be more important to prospective purchasers of debt not incorporating specific revenue streams for payback.

E. **Summary**

This chapter details data collection methods and presents descriptive information about the disparate datasets used in the analysis. Results of the nonparametric analyses of campaign financing are presented and interpreted in terms of the theoretic approach detailed in chapter one. Results of a regression analysis with the sample data partitioned by size and placement method are discussed, as are results of a further analysis of the sample partitioned by repayment characteristics.
Chapter Five

Summary and Conclusions

This chapter summarizes the study and provides an interpretation of results aimed at both aligning the study with other research in the field and discussing the implications of the study for public policy. The first section presents a brief overview of the study's intent and methodology. Results of the research and implications for policymakers are discussed in the second section. Section three focuses on limitations of the study and the chapter concludes with suggestions for further research.

A. Overview of the Study

Past research investigating the municipal bond marketplace has focused on determining factors that influence cost of debt. While there has been significant agreement between the various studies as to influential factors, it is important to note that the municipal debt marketplace has changed significantly since the majority of that research was performed. For example, the portion of issues sold via the competitive bid process has gone from 80 percent of all issues to less than 20 percent. Similarly, the percentage of general obligation debt has
decreased while that of revenue bonds has increased. Therefore a reassessment of factors influencing cost of debt is warranted.

Interest has also increased in the mechanisms of municipal debt issuance, driven in part by the tremendous increase in municipal debt issuance and the general tightening of municipal finances caused by exogenous economic factors. Municipal debt has become a much more widely held investment vehicle as well. The increase in appeal of municipal debt has emphasized the lack of information available to potential investors, and revitalized research investigating the municipal debt market.

Additionally, perceptions of the market as biased and amenable to privileged trading have focused regulator interest. Federal and state regulators have evinced an abiding interest in the municipal debt marketplace. A significant portion of that interest revolves around the ability of elected officials to extract campaign contributions as a quid pro quo for bond business.

This study attempts to investigate the relationship between political contributions and municipal bond transactions in Louisiana. Data was collected from several state agencies - the Legislative Auditor's Office.
[entity financial statements], the Louisiana Bond Commission [information about bond issues], and the State Board of Ethics [campaign finance filings]. Nonparametric tests were used to investigate the relationship between bond market player contributions and bond transactions. Regression analysis was used as a means to examine the relationships between several proxies for financial information availability and as a tool to explore the public cost of influence peddling.

B. Results and Implications

The first section of the study sought to establish evidence that players in the municipal bond market behave differently than the rest of the public with respect to campaign contributions to candidates for influential office. Influential offices were defined as those elected members of the state government in a position to affect municipal bond issuance transactions by either the state or one of its political subdivisions [Governor, Lt. Governor, Secretary of State, Attorney General, State Treasurer, and those members of the legislature sitting on the Louisiana Bond Commission]. Contributions by bond market players accounted for more than ten percent of total contributions to candidates for the office of State Treasurer, and for two
of the legislators sitting on the LBC. One of the legislators was President of the Senate at the time, and the other subsequently ran successfully for the office of State Treasurer. Thus expectations that bond market players are sources of significant levels of contributions to candidates for influential office were only partially met. Explanations for this may rest in the relative size of total campaign contributions to the various offices, and in the fact that several of the candidates were running unopposed.

A second measure of influence via contributions to campaigns is a comparison of the distribution of contributions from market players with that of non-market players. Nonparametric tests of equality of distribution were used to investigate the significance of differences between distribution of contribution amounts. These tests were itemized by office, as the initial analyses indicated differences in contributory behaviour across the offices of interest. The tests were also partitioned by player type [bond counsel or underwriter], as staff at both the LBC and the Legislative Auditor's Office suggested that benefits [and hence motivations] were likely to differ between the two.
For the offices of interest as a group, the distribution of contributions by underwriters is significantly different from that of non-market players: contributions by underwriters tend to be larger than those made by the balance of the population. This difference is large enough that the distribution of all player contributions is also significantly higher than that of non-market players. Likewise, the distributions of contributions to the Governor's and State Treasurer's candidates were significantly higher than those of non-market players, again driven by underwriter contributions.

A final measure of the relationship between contributions by market players and bond business is less direct. As discussed in chapter two, a common assumption made by observers of the public finance markets is that influence peddling is much easier [and more profitable] when municipal bond issues are placed via negotiation rather than the competitive bidding process. If that assumption is true, we should see a direct relation between contribution levels and selection of placement method. Our expectations are that higher contributions
will be an indication that placements are more likely to be negotiated than competitively bid.

Tests of the association between contribution levels and placement method do not produce results in line with expectations. Contrary to expectations, the relationship between underwriter contributions and negotiated placements is negative - that is, higher contributions are associated with competitive placements. The association between bond counsel contributions and negotiated placement is positive. As discussed in chapter four, bond counsel may prefer negotiated placement because, as originary members of the project staff, they are able to influence underwriter choice. If counsel can indeed influence underwriter choice they are therefore able to extract rents of some sort from underwriters. In this situation influence peddling, if extant, is an indirect relation between underwriters, bond counsel, and elected officials.

Explanations for the unexpected negative relationship between underwriter contributions and placement method may be a function of the narrowing of the spread between negotiated and competitively placed issues, which functions to minimize the benefits of negotiated placement [that is, underwriters seem no
longer able to extract excess rents via negotiated transactions]. Note also that as regulators and other interested parties focus more attention on negotiated issues they tend to concurrently assume that competitively bid issues are less in need of review. Underwriters seeking to benefit from influence peddling may therefore prefer competitively bid issues. This explanation is supported by Hildreth's [1994] suggestion that "pay-to-play" has supplanted more direct forms of influence peddling. Again, Hildreth's proposition is that bond market players, rather than buying business in discrete quanta, buy into the pool of qualified bond issue participants.

Thus the first section of the study produces results only partially in accord with expectations. While contributions from players in the bond market are demonstrably larger than those from other members of the public, it is far from clear that there is any direct influence being sold.

The second section of the study utilizes linear regression techniques in an attempt to discern the public cost of the theorized peddling of influence. As a baseline for the analysis, a regression model was created by aggregating variables common to prior research. The
baseline model, in line with prior research, uses Net Interest Cost as a dependent variable, and the face amount of the issue, rating assigned by external agency [if any], a measure of market interest rates for the week of issue sale [the Bond Buyer 20 Bond Index], and years to first call [a measure of the "lock-in period" of the investment] as independent variables. This baseline should enable ready assimilation of the study into the extant literature. A further advantage of the baseline approach is a more effective isolation of the effects [if any] of contributory behaviour on Net Interest Cost [NIC].

The sample of bond issues is partitioned into large [face value greater than $1 million] and small issues. The large group is then partitioned by placement method [competitive or negotiated]. As explained in chapter four, Leonard [1996] provides compelling evidence that negotiated and competitively bid issues are influenced differently, and the partitioning of sample data acknowledges the strength of Leonard's arguments.

As the baseline model is an aggregation of variables found significant in past research, we expect the model to possess considerable explanatory power over NIC. Congruent with the discussion in chapter four, the model
does not fit the small issue subsample particularly well. That lack of fit is reasonable given the lack of small face value issues in prior research samples. Prior research, often limited by availability of data, focused almost exclusively on larger issues, thus producing models composed of items pertinent to investors weighing alternatives in the larger capital markets. Smaller issues, on the other hand, are sold in a much less complete market, and are sold to investors with different concerns.

The baseline model also possesses limited explanatory power over larger issues placed by negotiation. One rationale for this lack of fit is the ability of negotiated issue participants to acquire information outside normal channels of distribution. Size of the issue and prevailing market interest rate are the only significant variables in the model for negotiated issues, which adds credence to the theory that participants have non-public channels for information [that is, they do not rely on agency ratings].

Large competitive issues are most closely modeled by the baseline equation. This is congruent with the perceived characteristics of the bond market during the majority of prior research. The baseline model thus
provides a link to prior research and an indication of how the municipal bond market has changed structurally over the intervening period.

Arguments concerning regulation of political contributions by bond market players tend to focus on the public cost of such activities. The perception is that market players recoup the cost of contributions by lowering the price at which they are willing to purchase debt issued by the entities of officials contributed to. If contributions to officials of debt-issuing entities can be properly characterized as purchases of influence for which below market prices of municipal debt will be the quid pro quo, it also is reasonable to assume that larger contributions will elicit [command] larger variances from market interest rates. That is, contributions by successful players should be significant additions to the baseline model.

Contrary to expectations, contributions by market players evidence no explanatory power over NIC. This suggests that the common perception of the municipal debt marketplace as rife with corruption is either wrong or misspecifies the problem. Note that the lack of significance holds for player contributions considered as
a whole as well as individually [bond counsel or underwriter].

Implications for policymakers are contrary to the opinions expressed by regulators. Given the study's failure to find a relationship between market player contributions and NIC it does not appear that influence peddling behaviour, if it exists, significantly affects the public cost of entity debt issuance. If influence peddling was a factor in the observed elections, it was not widely evident from an analysis of reported campaign contributions. Regulation can, of course, only be enforced over the universe of reported events. Therefore, regulation of market player contributions may be beneficial from a perspective of image management, but it does not seem likely to pass the sort of cost benefit analysis accountants routinely impose on decision alternatives.

This study also investigates the information asymmetry of the municipal debt marketplace. If generally accepted accounting theory is given credence, information embedded in publicly available financial statements will have a demonstrable relationship to NIC. That is, investors will use said information to determine the risk/return on investment tradeoff of that particular
investment. If such is the case, we should see a significant and negative relationship between increasing measures of financial health and NIC.

Information from bond-issuing entities' General Purpose Financial Statements is used to create Brown's Index of Financial Health. As discussed in chapter four, Brown's Index is calculated by preparation of ten measures of financial health. Those ratios are then scored by comparison with the ratios of comparably sized entities participating in the Government Finance Officers Association's Certification for Excellence in Financial Reporting program and the scores summed to provide the index.

Obviously not all entities choose to participate in the GFOA's program: equally obviously participants do not represent a random sample of entities. However, participants in the program are arguably among the healthiest of entities, and thus the possibility of overstatement of financial health is minimal. Given that investors are motivated to seek out the healthiest entities to invest in, this index seems a reasonable choice for investigating the relationship between financial information and investor assessment of risk [aka NIC].
Results of the regression analyses indicate that the hypothesized negative relation between Brown's Index and NIC does exist for issues with face amounts larger than $1 million. NIC of issues smaller than $1 million is not significantly influenced by Brown's Index, a result which is in accordance with our intuition that smaller issue investors have different concerns than large issue investors. Smaller issue investors also tend to be institutions within the region, which may indicate that these investors are provided with information exogenous to and perhaps contradictory to that found in financial reports. Another interpretation is that financial report based measures of financial health are not as precise for smaller entities. In other words, the smaller transaction amounts endemic to smaller entities, and the correspondingly larger percentage variances, may make the use of standardized ratios problematic.

The study also investigates the effect of information timeliness on NIC. Financial information is often likened to newspaper stories and portrayed as information with value that decreases markedly over time. The rationale for that portrayal is simply that investors will act immediately on information they receive. The ability to profitably use information is thus tightly
constrained by its age. Investors should therefore be willing to pay a premium for more recent information.

Two measurements of timeliness are incorporated in this study. First, a dichotomous variable signifying compliance with Louisiana statutes governing entity financial disclosure [AudComp] is incorporated into the regression model. As discussed in chapter three, Louisiana statutes require at a minimum biannual audited financial reports. Compliance with these statutes is measured as of the date the entity's bond issue was presented to the LBC for approval. This measure of timely disclosure exhibits no significant relation with NIC.

Second, a more restrictive measure of information timeliness is created by determining whether the debt issuing entity had released audited financial reports dated within twelve months of the sale date of the bond issue [LastAud]. Investors, if making investment decisions, should be interested in information current at the time of their decision. That is, at the moment when the bond issue becomes an investment alternative rather than when the entity solicits state approval for the issue. The second measure of timeliness of information
disclosure should therefore be more closely related to effects on NIC.

Neither of the two measures of information timeliness demonstrate significant explanatory power over NIC. This result is in line with accounting research studies looking at corporate information disclosure, which suggest that the influence of publicly reported financial information on stock prices [cost of funds] is largely embedded within stock prices prior to the official release date of the information. While bond issues are peripatetic events rather than a continuous market, a similar phenomena seems reasonable given that the equity and debt markets are, at least to some degree, substitutes for one another.

Implications of this analysis for legislators and regulators are clear - statutory requirement of public entity financial reporting does not appear to benefit investors in municipal debt by providing decision-useful information. Importantly, this analysis does not address other audiences for municipal financial reporting. Concerned citizens, special interest groups, and government oversight committees may well benefit from mandated reporting. The only point this analysis makes is that the timeliness of financial reporting by debt
issuing entities does not appear to influence the cost of that debt.

C. Limitations

In an effort to standardize regulatory constraints on contributory behaviour and limit variations in exogenous economic factors sample data was collected from entities within a single state. While that strategy reduces the risk of mistaking economic or cultural variance for influence of the factors studied, it perforce limits generalizability of the study to other political subdivisions of the country. The majority of players in the bond market in Louisiana reside within the borders of the state, and primarily do business in Louisiana.

Regulation governing the behaviour of those players and the entities they do business with is also unique to Louisiana. There may be considerable similarities between statutes concerning political contributions, financial disclosure and municipal debt issuance in Louisiana and those of other states, but the degree of that similarity should be determined before extrapolation of this research to other states.

Another limitation of the study is the necessary reliance upon self-reported data from self-interested
parties. While campaign finance reports have been required for some time and thus candidates have had time to learn the requirements of those reports, there is little assurance that the reports as mandated and filed contain an information set completely specifying all contributions and their sources. Staff at the SBE audit a sample of the filings, and the reports are available for public perusal and questioning, however the volume of reports filed [over six thousand per election year] limits the probability of a report being audited and that limitation may influence the preparation of the report.

Similarly, bond issue data was gathered from a time span in which information disclosure was largely voluntary. The Louisiana state government has implemented regulations requiring completed issue worksheet filings, but implementation of that regulation is constrained by the limited number of staff available to oversee compliance and by an unwillingness on the part of market players to comply with the regulations. Therefore the sample of bond issues included in this sample is not random, although it is composed of every issue for which the requisite information was accessible.

The composition of the pool of market players in Louisiana may well be unique also. A single law firm
handles approximately 90 percent of the bond counsel work in the state. The bond counsel market, therefore, can hardly be described as open or complete. This lack of completeness in the market, coupled with a tendency for bond counsel to charge whatever the State Legal Commission sets as a maximum fee for bond counsel work, perhaps limits the application of this research to other, more complete, markets. Note, however, that the single law firm handling the majority of bond counsel business maintains that majority in part by merging with or purchasing firms which demonstrate an ability to get and keep bond counsel business.

This study looks at the campaign contributions of bond market players to statewide officials in a position to influence bond issue transactions. Arguably, influence peddling also goes on at the local level. For Louisiana, that local level is difficult to isolate. Louisiana municipalities tend be governed by elected councils, who often select mayors and city treasurers from their own ranks. Determining ex ante which officials might be selected would require a degree of knowledge not easily available and which would require a strong focus on each entity of interest. As our perception of bond market players is one of individuals
interested in doing business with as many entities as possible, it is likely that market players are not willing to devote the time and energy necessary to keep up with the local political situation of multiple, relatively small entities that do not issue debt often.

D. Suggestions for Future Research

The results of this research are based solely on data relating to transactions taking place in Louisiana. As mentioned earlier, the single state focus of the study may limit generalizability of results to other locations. An important extension of this study would thus be research using data from other states.

While political and regulatory environments probably mandate individual state by state analyses, multiple studies of states could be combined using meta-analytic techniques. Such a meta-analysis would provide valuable information concerning commonalities across political and cultural borders. Illuminating the commonalities would allow better-informed conclusions to be drawn concerning the underlying structure of the municipal bond market, and provide input to the regulatory process currently underway at the national level.

The discussion of results above mentions that bond issue data was provided to the LBC on a voluntary basis.
prior to 1993. The voluntary nature of that disclosure [of transaction details] can be interpreted as suggesting that the bond issues included in this study do not represent a random sample of Louisiana issues. Similar research focusing on a period after disclosure became mandatory would not be subject to that interpretation, and could therefore provide additional evidence of the significance of issuing entity financial disclosure variables.

The literature would also benefit from more ethnographic approaches to the problem of influence peddling by elected officials. The necessarily sub rosa nature of that influence peddling suggests that statistical analyses, focusing on large quantities of publicly available data rather than the stories told by individuals involved in specific situations, may not be the most effective method of studying the issues at hand. In-depth studies of the individuals involved on a case by case basis might provide a more accurate picture of the problem, and would enable researchers to address common perceptions of political behaviour and the bond market more readily.

Another important extension of the study would be a replication performed with data from the period
immediately subsequent to the effective date of MSRB Rule G-37. That replication would allow at least limited conclusions to be drawn concerning the efficacy of regulatory activity. Comparison of data between the two studies might also provide indirect evidence of influence peddling by highlighting changes in relative market position of players as contributory activity was constrained.

This research project is currently being expanded by investigations of data from other states. One of the enabling factors in expanding the study is the trend toward making campaign finance data available electronically. The Federal Election Commission and several of the relevant state agencies are currently allowing access to filings via electronic means, which greatly reduces the time and financial investment necessary to conduct similar studies. Similarly, the MSRB and the various states are in the process of instituting financial disclosure repositories where entities can place their financial reports for improved public access.
References


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Vita

Steven Filling, a native of Cedar Rapids, Iowa, was awarded a bachelor of science degree in accounting from Mount Mercy College in 1980. Filling became a certified public accountant in 1980 as well. He practiced accounting in industry for ten years, returning to graduate school in 1990. Filling earned a master of arts degree in accounting at the University of Iowa in 1991.

In the fall of 1991 Filling joined the doctoral program at Louisiana State University and Agricultural and Mechanical College, where he was the recipient of a Regents’ Fellowship. Filling was awarded the doctor of philosophy degree in the fall of 1996. Currently, Filling teaches accounting, technology and critical theory at California State University, Stanislaus.
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