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The Undercover Economist: The Profits Of Political Connections

By Tim Harford

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In the early hours of november 8 2000, the vice-president of the united states, al gore, was travelling to Nashville to make his concession speech. But then the messages began to arrive on Gore's pager, suggesting that perhaps he wasn't behind. Having already conceded, informally and in private, Gore called Bush again to tell him that he'd changed his mind.

November 8 was not the only pivotal date. On December 8, the Florida Supreme Court ordered a recount in certain counties, raising the chance that Gore would win. On December 13, after the federal Supreme Court halted the recount, Gore conceded to Bush.

Because these sudden decisions were hard to anticipate, they provide an excellent test of the value of political connections to listed companies. If politics means profit, a "Republican" company should have taken a knock on December 8, but surged on December 13, when Bush's victory was confirmed.

A recent study by financial economists Eitan Goldman, Jongil So and Jorg Rocholl found exactly that: Republican companies beat the market by 3 per cent over the week after Bush's victory was assured; Democratic companies took almost a 3 per cent knock. Goldman, So and Rocholl defined "Republican" companies as those with board members who had served as Republican senators or congressmen or members of a Republican administration, and with no Democratically connected board members.

Another example: in May 2001, Senator Jim Jeffords abruptly left the Republican party to become an independent senator. That decision handed control of the Senate and its committees to the Democratic party. Seema Jayachandran, an economist at UCLA, studied the market's reaction and concluded that it was bad news for the share price of large companies that had donated to the Republicans. The gains to Democratic donors were not as large, so the total effect was to wipe \$84bn off the price of US shares.

Broadly the same story seems to hold true internationally, and Thomas Ferguson, a political scientist, and Hans-Joachim Voth, an economist, have shone a light on a ghoulish example. Adolf Hitler was appointed chancellor of Germany in January 1933 as head of a coalition government; after the Reichstag fire, a snap election and a constitutional change, the Nazis had a stranglehold on power by the end of March. There was a surge in the stock market valuation of the (mostly large) companies who tied their fortunes to the Nazis between January and March 1933.

The question, of course, is why these political connections are valuable. Perhaps the intelligence and energy that propelled Tony Blair and Al Gore to high office would have justified their work with, respectively, JPMorgan and Apple, irrespective of any political connections.

A less comforting possibility is that political connections give companies access to the regulations that suit them, or to juicy government procurement contracts. Goldman, Rochol and So have found evidence that such contracts do seem to flow to companies affiliated with the party in power.

If so, that is a disgrace, if not entirely a surprise.

But not every study reaches this conclusion. Economists Ray Fisman, Julia Galef and Rakesh Khurana, and the epidemiologist David Fisman, have tried to estimate the value of personal ties to Dick Cheney. One strategy was studying the share price of Haliburton - where Cheney was CEO from 1995-1999 - when news broke of his heart problems. The estimated value of ties to Cheney? Zero - "precisely estimated". It would be nice to feel sure of that.

Tim Harford is author of "The Logic of Life".

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