# Corporate Influence and Political Corruption

## *Lessons from Stock Market Reactions to Political Events*

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Americans are deeply cynical about both corporations and politicians. For the past several decades, Gallup has conducted regular polls of public confidence in various social and political institutions, with big business and Congress consistently ranking at the bottom of the list (see, e.g., Gallup 2013). Not surprisingly then, corporate political spending and lobbying are viewed with suspicion, further fueled by exaggerated rhetoric from reform-minded pundits, advocacy groups, and demagogues. Indeed, it's hard to imagine an easier means to curry favor with the mass public than to decry the influence of big business in politics! And although there is no shortage of academics who ride this bandwagon, many scholars of American politics understand both the role of money in politics and the influence of corporations to be much more limited than imagined by the conventional wisdom.

In previous work, I have explored the contrast between popular perceptions of the role of money in politics and the lessons of political economics (Milyo 1999; Milyo, Primo, and Groseclose 2000). In this essay, I review more recent empirical research on how financial markets respond to political events with the goal of better understanding the nature and extent of corporate influence in American politics. Of course, concern about corruption in politics is not limited to the influence of

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corporate political spending and lobbying. Unions, wealthy individuals, and even the major political parties loom large as potential agents of corruption. But movements in financial markets provide a unique lens on the value of corporate activities—hence, the focus here on corporate political influence. However, before launching into a discussion of political event studies in financial markets, I provide some background.

## Corruption and Corporate Political Activity

It is no secret that the American public is worried about the existence and extent of political corruption. For example, in a nationally representative opinion survey of one thousand persons taken in the fall of 2008, a little more than 50 percent of respondents agreed that corruption in the federal government is "widespread" and an "extremely serious concern," while fewer than 5 percent considered corruption in the federal government to be "rare" or "not a concern" (Konisky, Milyo, and Richardson 2008). However, Americans are not sanguine about quick fixes for the problem of political corruption. The same survey reveals that only 7 percent of respondents strongly agree that there exists some package of reforms that would greatly reduce their concern about corruption in government. Obviously, for many Americans, politics is an inherently corrupt activity.

The timing of this survey, in the immediate aftermath of a financial panic, probably served to inflate popular concern about corruption, but evidence from other surveys indicates that there is a good deal of persistence in these views, especially with regard to members of Congress (e.g., Jones 2011 and Carroll 2006). Moreover, subsequent events likely have not had much of a salutary effect on public opinion. The past several years have witnessed government-rushed bailouts of private industry, unprecedented increases in stimulus spending, large loan guarantees to private firms, and unsavory machinations undertaken to round up votes in Congress to pass health-care reform. The most recent election cycle has also seen the rise of so-called super PACs (political action committees) and total campaign spending that far eclipses previous records.

But what exactly is political corruption? Surely, illicit activities such as bribery and influence peddling are corrupt. These quid pro quo arrangements are what the courts are most concerned about when deciding whether there is a compelling government interest to justify regulations on political activities (for example, contribution limits, mandatory disclosure requirements, and so forth). But public opinion on "political corruption" likely extends beyond this legal concept and instead reflects popular concern with practices that may be legal but are nonetheless discomfiting (e.g., Lessig 2013), such as favoritism in the awarding of government contracts and hiring and the passage of regulations and legislation to benefit certain groups or individuals. In some instances, favoritism toward friends, family, and political associates may cross the line into illicit activity, but such cronyism is often "politics as usual."

In common parlance, "corruption" also takes on meanings outside of quid pro quo relationships or cronyism. For example, legal activities, especially campaign contributions and lobbying, are often characterized as corrupt or corrupting. Beyond this, partisanship and ideology also play an important role in whether people perceive politics to be corrupt; events and actions are always more suspicious when they involve members of an opposing faction (Milyo 2012). As a consequence, in reviewing and analyzing the social scientific evidence on political corruption, it is important to distinguish between quid pro quo corruption and cronyism as well as between actual corruption and legal activities (for example, campaign contributions) that may facilitate corruption.

For many political observers, the source of political corruption is obvious: privately financed political campaigns facilitate a market for political favors (Grossman and Helpman 1994). Advocates for campaign-finance reform have long asserted that campaign contributions are bribes and that only full public financing of political campaigns can address the problem of political corruption. However, it also has long been recognized that although there is some superficial evidence consistent with the view that campaign contributions are the functional equivalent of bribes, upon closer inspection that hypothesis is not well supported by the scholarly literature (e.g., Sorauf 1992).

The best illustration of this assumed equivalence between contributions and bribes is found in analysis of corporate PAC campaign contributions and roll-call votes on issues of interest to those same corporations. Firms in industries that are more highly regulated or dependent on government contracts are more likely to form PACs (Grier, Munger, and Roberts 1994). Those PACs make contributions to party leaders and members that sit on committees with relevant policy jurisdictions (Grier, Munger, and Roberts 1991). More to the point, PAC contributions are also highly correlated with the likelihood that a firm will benefit from government investment and with roll-call votes on legislation favored by the sponsors of corporate PACs (Duchin and Sosyura 2012). Even the timing of contributions—coincident with major steps in the legislative process—suggests a market for favors (Stratmann 1998). All of this is consistent with the notion that campaign contributions are like bribes, or, as Fred McChesney (1987) argues, extortionary payoffs. But this evidence is also consistent with the phenomenon that PACs support politicians that hold beliefs most beneficial to the employees and investors in the associated firms (Bronars and Lott 1998; Levitt 1998).

In fact, both theory and evidence favor the latter interpretation, at least in the pre–super PAC era. First, bribery, influence peddling, and extortion are crimes, so it is not possible to make legally enforceable promises regarding exchanges of money for favors, which at least hinders such exchanges. Further, contributions made directly to federal candidates are limited by law, so the amounts of money being contributed from any one source may not justify the opportunity cost of illicit behavior. Moreover, contributions to candidates must be disclosed; the activities of politicians are closely monitored by competing candidates and watchdog groups eager to make accusations of impropriety. And several studies show that marginal campaign expenditures have negligible effects on federal election contests (Levitt 1994; Gerber 1998; Milyo 2001), which implies that political contributions to high-spending incumbents are particularly inefficient in-kind gifts and unlikely to win much gratitude. These facts do not preclude illegal transactions, but they do suggest a limited scope for such activities.

Empirical evidence also raises doubts about the efficacy of corporate PAC contributions as the functional equivalent of bribes (Milyo, Primo, and Groseclose 2000). The amounts of money transferred to politicians in the form of PAC contributions are not only well below the legal maximum but in the aggregate are also dwarfed by corporate lobbying expenditures, which at least suggests that contributions are less effective at influencing policy than lobbying. In turn, corporations devote far more resources to charity than all to political activities combined, which again suggests that both contributions and lobbying have limited impact. Given all this, it is not surprising that most careful research studies find no causal impact of campaign contributions on legislators' roll-call votes (Ansolabehere, de Figueiredo, and Snyder 2003).

This evidence has led many political scientists to suggest that contributions may simply buy access to politicians (Wright 1989). However, there is also little evidence that access and lobbying influence roll-call votes in any systematic manner (Ansolabehere, Snyder, and Tripathi 2002; Milyo 2002). Of course, roll-call votes are a very blunt measure of influence. It is possible that the purpose of campaign contributions and lobbying is to influence legislators to alter their behavior in committee mark-ups of legislation (Hall and Wayman 1990). Once again, though, the evidence for this is scant (Wawro 2000; de Figueiredo and Kelleher Richter 2013). Alternatively, firms and interest groups may employ lobbying and political advertising as legislative subsidy to aid political allies in government via the provision of political intelligence and coordinated marketing campaigns on specific policy issues (Hall and Deardorff 2006). As a consequence, lobbying and political contributions may have effects that are difficult for researchers to observe and may provide large payoffs to firms that engage in such activities. This is one motivation for using stock market event studies to decipher the value of political connections that might otherwise go undetected.

But to what extent must this understanding of the relatively modest role of corporate PAC contributions and lobbying be modified in the wake of *Citizens United v. Federal Election Commission* (558 U.S. 310), the 2010 Supreme Court decision that gave corporations and unions the ability to make unlimited independent expenditures on behalf of candidates? Such independent expenditures are by no means a perfect substitute for a direct contribution, but they may well grab politicians' attention nonetheless. However, several states still permit unlimited *contributions* to state-level candidates, with no apparent effect on political corruption or policy outcomes (La Raja and Schaffner 2012; Cordis and Milyo 2013). Further, prior to the 2002 Bipartisan Campaign Reform Act, corporations and unions had the ability to make unlimited donations to the national political parties, so the reaction of financial markets to that reform as well as to *Citizens United* provides an indication of whether corporate political activity is less influential than typically assumed.

## Political Event Studies

The logic of stock market event studies is straightforward (e.g., Brown and Warner 1980; Wells 2004). Under the efficient-market hypothesis, share prices of publicly traded firms reflect current information about those firms' profitability. It follows that any new information that affects a firm's bottom line will quickly be capitalized into its share price. Therefore, any surprising event that affects some industry or group of firms will produce a coincident response in the stock prices of those firms, which allows researchers to test hypotheses about what matters for firms' profitability.

The first key element of an event study is to identify an event that contains surprising information. The sudden and untimely death of a powerful politician would be one such example. Even somewhat anticipated events can contain an element of surprise. For example, the outcome of a close election resolves uncertainty, even if the result was not wholly unanticipated. The degree of surprise in events will affect the size of the response in affected firms' share prices because anticipated events are already capitalized into share prices. Thus, some caution must be exercised in interpreting findings from event studies that are not complete surprises (Snowberg, Wolfers, and Zitzewitz 2011).

The second key element of an event study is the choice of baseline for comparing stock prices before and after the event. Consider the change in actual share prices immediately before and after an event: this change captures the market valuation of the informational shock associated with an event, but it also captures the value of anything else that is simultaneously occurring. For that reason, most event studies examine "abnormal returns" by comparing the change in actual stock price of an affected firm to a prediction of what would have occurred otherwise. These predictions are usually based on the recent historical correlation between changes in a firm's share price and changes in the overall market.

### *Bush versus Gore*

Several political event studies examine the effects of elections on share values of firms expected to fare better under one administration than under another (e.g., Roberts 1990b). Although every election cycle holds some uncertainty, the hotly contested presidential election race in 2000 was an outlier in this regard. Brian Knight (2007) exploits the uncertainty in the lead-up to the 2000 election to demonstrate that a portfolio of firms that were expected to fare well under either a

George W. Bush or an Al Gore presidency was sensitive to changing expectations about the election outcome.

Knight constructs portfolios of "Bush-firms" ($n = 41$) and "Gore-firms" ($n = 29$) based on public pronouncements made by several financial analysts offering advice on which firms and industries would be most affected by the election. Knight then uses betting odds from the Iowa Electronic Market as a kind of daily tracking poll. The key insight is that these betting odds would react to information shocks that portended the electoral fate of Bush or Gore. Knight demonstrates that fluctuations in the betting odds were significantly related to fluctuations in share prices over the course of the 2000 general-election campaign. Overall, the Bush portfolio of firms was worth 3 percent more after the election and the Gore portfolio about 6 percent less; the implied value of Bush's victory was equivalent to a transfer of more than $100 billion in market capitalization from the firms in the Gore portfolio to those in the Bush portfolio.

Knight also examines the total of political contributions from firms in each portfolio and how these contributions are correlated with share-price movements. In 2000, corporations were permitted to make unlimited "soft-money" donations to political parties. Knight finds that the excess returns to firms were positively correlated with political contributions; however, he notes, this correlation does not establish a causal link between contributions and market valuations of firms. Politically active firms choose to support candidates and parties based on those actors' policy preferences, and firms that are most sensitive to political outcomes are also most likely to be politically active (Ansolabehere, de Figueiredo, and Snyder 2003). For this reason, the observed correlation between contributions and excess returns also reflects this reverse causality. Ignoring this fact can produce a highly exaggerated estimate of the efficacy of corporate contributions.

To underscore this point, if the link Knight observes between soft-money contributions and changes in market capitalization of firms is causal, it would indicate about a 2,000 percent return on soft-money contributions to political parties. This rate of return implies extreme irrationality among investors for persistently ignoring the availability of such astronomical returns or that the returns to political contributions are extremely speculative so that the risk-adjusted return is closer to normal rates of return. However, this latter explanation would mean that evidence of such realized returns on contributions should be quite rare. Instead, as shown later in this essay, researchers repeatedly find that contributions (and lobbying) are associated with high excess returns. As a consequence, Knight's study is best viewed as identifying the treatment effect of the 2000 election outcome on share prices of different firms and demonstrating that this effect varies across firms in a manner correlated with soft-money political contributions. His study fails to identify the treatment effect of corporate contributions on share prices.

John Shon (2010) has also examined the Bush–Gore election. Unlike Knight, he focuses on the postelection legal dispute over recounts as the event of interest.

He demonstrates that the net share of industry contributions to Republicans was correlated with excess returns in the industry. This finding is consistent with Knight's results but similarly fails to identify the treatment effect of contributions.

## *The Jeffords Effect*

In the spring of 2001, Senator James Jeffords of Vermont switched parties and flipped majority control of the U.S. Senate to the Democrats. Contemporaneous news reports described the defection as a surprise, which makes this change in political control of the Senate a potential natural experiment. Seema Jayachandran (2006) examines the abnormal returns from this event to firms making large soft-money contributions to either party in the 2000 election cycle. In this study, firms that chose to make soft-money contributions to Republicans lost about 0.8 percent of their market capitalization when Jeffords switched parties. This finding confirms that party control of political institutions matters to politically active firms (also see Den Hartog and Monroe 2008).

Jayachandran (2006) also demonstrates that the amounts of soft-money contributions are correlated with excess returns. If misinterpreted as a causal effect, her findings imply a rate of return of more than 700 percent on soft-money contributions. Once again, however, this study does not identify the treatment effect of corporate contributions on abnormal returns because it ignores reverse causality.

## *Taking Stock*

The event studies described to this point examine how major changes in party control of political institutions affect share prices of politically connected firms in the United States. The findings are consistent with similar studies of events in other Western democracies (e.g., Herron 2000; Bechtel and Fuss 2010; Castella and Trillas 2013). Several political event studies similarly demonstrate that legislative or regulatory policy shocks also affect corporate share prices in a predictable manner (e.g., Schwert 1981; Gilligan and Krehbiel 1988). Taken together, these studies establish the potential for corruption (because political and policy outcomes significantly affect the profitability of firms), but little else. Recent studies similarly identify a persistent correlation between corporate lobbying or contributions from corporate PACs and share values, but they are not informative about the *causal* impact of lobbying or contributions on the value of a firm (e.g., Cooper, Gulen, and Ovtchinnikov 2010; Chen, Parsley, and Yang 2013; Huber and Kirchler 2013).

The next few event studies reviewed investigate the possible presence of quid pro quo relationships with specific members of Congress; they are more informative about the importance of different types of political connections for firm performance.

## *Dead Senators*

Brian Roberts (1990a) conducted one of the more creative political event studies by examining the impact of Senator Henry "Scoop" Jackson's sudden death on "client firms" in the defense industry. Senator Jackson (D–Wash.), the ranking minority member of the Senate Armed Services Committee, died from a ruptured coronary artery on September 1, 1983. The next highest-ranking Democrat on the committee was Senator Sam Nunn of Georgia. This event transferred power to influence committee legislation from Jackson to Nunn. To the extent firms buy influence via PAC contributions, evidence of this transfer of power should be reflected in the share prices of these financial client firms. Politicians seek pork and other benefits for their constituents, so firms located in either Washington or Georgia might also have been affected by this event.

Roberts (1990a) examines the effect of Senator Jackson's death on both financial and geographic client firms. He found no abnormal returns for firms whose only connection to either senator was through PAC contributions, but he did observe that firms located in Washington and Georgia did realize abnormal returns of about −2 percent and +1 percent, respectively. Because this event is not coincident with any other change in party control of institutions, it demonstrates a treatment effect on a firm's bottom line of having an influential representative in Congress. However, Roberts (1990a) does not explore whether the amount of PAC contributions related to excess returns, so some caution is in order regarding the importance of financial client relationships.

## *Sex, Power, and Money*

In December 1998, Republicans in the U.S. House impeached President Bill Clinton. The impeachment vote itself was essentially down party lines and unsurprising. A few weeks later, as expected, the Senate refused to remove President Clinton from office. Immediately prior to the impeachment vote, Representative Robert Livingston (R–La.), the chairman of the House Appropriations Committee and Speaker-designate of the U.S. House, announced that he had been unfaithful to his wife. To the stunned protestations of Republicans, Livingston announced that he would resign from office. Within twenty-four hours, Republicans had rallied around Dennis Hastert (R–Ill.) as the next Speaker of the House. This event is similar to the passing of Scoop Jackson in that partisan control did not change, but it resulted in a rather dramatic change in the influence held by particular members of Congress.

Scott Smart and I investigate this episode (Milyo and Smart 2012). We follow Roberts (1990a) in defining financial and geographic client firms based on PAC contributions and physical presence of firms in Louisiana or Illinois, respectively. Like Roberts, we find large and significant effects for geographic clients; firms located in Illinois realized a 4 percent abnormal return compared to those in Louisiana in the immediate aftermath of Livingston's resignation. However, firms for which the only connection was via PAC contributions realized no abnormal returns. The amount of money contributed by PACs did not matter, nor did the presence or amount of soft-money contributions or lobbying expenditures.

The preceding two event studies find that powerful incumbents benefit firms in their home states, but that PAC contributions to these same incumbents have no independent effect on abnormal returns. We also find that neither soft-money contributions to parties nor lobbying activity confers any benefit to firms tied to a particular powerful member of Congress. These results contrast with several of the other studies reviewed that find a correlation between corporate political activity and abnormal returns.

## *Campaign-Finance Law*

Two recent event studies examine major changes in campaign-finance laws. The Bipartisan Campaign Reform Act of 2002 (also known as McCain–Feingold) ended the practice of unlimited soft-money contributions to parties, and the Supreme Court's 2010 decision in *Citizens United* opened the door to unlimited corporate independent expenditures. If campaign contributions buy political favors, these events should have enormous ramifications for firms. Legislation is a collective effort, so the prospect of buying off multiple legislators via limited PAC contributions (one by one and with no explicit contracting) should be relatively inefficient compared to making unlimited contributions directly to party leaders via soft money or with a possible "wink and a nod" via independent expenditures.

Stephen Ansolabehere, James Snyder, and Michiko Ueda (2004) consider several events related to the Bipartisan Campaign Reform Act: House passage, Senate passage, president's signature, U.S. Supreme Court argument, and the Supreme Court decision. They compare excess returns around each event for large soft-money donors, moderate donors, and nondonors; without exception, they find no support for the hypothesis that losing the ability to make unlimited soft-money contributions harmed firms that had previously engaged in that activity.

More recently, the Supreme Court's split decision in *Citizens United* has unleashed a torrent of criticism from reform advocates. Several prominent politicians, including President Barack Obama and Senator John McCain (R–Ariz.), have bemoaned the decision to allow corporations to make unlimited independent expenditures and warn that it will lead to massive corruption. If so, *Citizens United* should be an immense boon to politically sensitive firms.

Timothy Werner (2010) collected stock market data for *Fortune 500* firms and tracked their share prices around three events connected to the Court's consideration of *Citizens United*: the initial decision for a rehearing, the second round of oral arguments, and the ultimate decision. Werner found no overall effect on the share prices of large firms associated with any of these events. He also compared abnormal returns for politically sensitive firms based on lobbying expenditures; once again there were no effects across the board. These findings are corroborated by John Coates (2012), who not only finds no positive impact of corporate political activity after *Citizens United* but even argues that such activity is detrimental to shareholder value. However, in contrast to Werner, Coates does not conduct an event study, so he does not convincingly identify the causal impact of corporate political activity.

## *Taking Stock, Again*

The reviewed studies strongly imply that there is no cash-on-the-barrelhead market for political favors in which corporations buy favorable legislation with contributions. Nor does it appear that lobbying activity confers any treatment effect on firms' profitability. Instead, contributions and lobbying appear to be symptomatic of underlying relationships and political sensitivity. That is, contributions and lobbying activity are not the source of political connections, but they are caused by the existence of some more meaningful connection between firms and their political allies (for example, geographic location, constituent preferences, party platforms, and so forth). In particular, the constituent relationship with powerful political benefactors seems to generate abnormal returns. This is consistent with studies of political ties in authoritarian countries (e.g., Fisman 2001; Li et al. 2008; Ferguson and Voth 2008) and so may indicate corruption and cronyism. But in a representative democracy, politicians are expected to seek favors for constituents, so the import of these kinds of connections by no means rules out less nefarious explanations. The remaining event studies take a closer look at other sources of connections between firms, lobbyists, and politicians that may cross the line into corruption.

## *Is It Who You Know?*

Inspired by Roberts (1990a), Mara Faccio and David Parsley (2009) examine the impact of sudden deaths of politicians around the world on the value of geographic client firms. Consistent with the studies previously reviewed, they find that severing firms' links to politicians produces significant and negative abnormal returns. More generally, other studies conducted by Faccio and her colleagues (Faccio 2006; Faccio, Masulis, and McConnell 2006) demonstrate that the fortunes of firms are influenced by personal ties between corporations and national governments. But do personal connections matter in the United States?

Eitan Goldman, Jorg Rocholl, and Jongil So (2008) suggest that this is the case; they checked all S&P 500 firms for the presence of board members who had previously held elective office, and they classified firms as connected to Democrats or Republicans. Not surprisingly, they find that Republican-connected firms realized positive abnormal returns after the 2000 election, whereas Democrat-connected firms realized negative abnormal returns; however, these findings may reflect only the fact that party platforms tend to favor or disfavor particular firms. More intriguing, they observe positive abnormal returns upon the announcement of a new politically connected board member. This suggests that investors value firms with politically experienced and connected boards (also see Do et al. 2012).

## *Geithner versus Cheney*

President-elect Barack Obama's announced intention to nominate Timothy Geithner to be the U.S. Treasury secretary in November 2008 provides a unique opportunity to test the efficacy of personal connections in American politics. Daron Acemoglu and his colleagues (2013) use public information regarding Geithner's personal friendships and frequency of meetings with executives in various industries to show that these sources of connections are associated with significant and large abnormal returns to firms. Using the Geithner announcement as an event, this study shows that connected firms realized a 15 percent abnormal return. Moreover, when unfavorable news broke about Geithner's tax "issues," these same firms realized abnormal negative returns.

Not all personal connections matter, however. Rakesh Khurana and his colleagues (2012) conducted a similar study of firms connected to Vice President Dick Cheney. The authors define political connections based on overlapping board membership during Cheney's tenure as the CEO of Halliburton; the events examined include Cheney's selection as a vice presidential running mate, the 2000 election, and news reports on Cheney's health. However, across several events there are no abnormal returns to firms connected to Cheney. This null finding may reflect the relative unimportance of the office of the vice president, at least compared to that of the Treasury secretary during a financial crisis, or it may suggest that not all political connections can be exploited for advantage.

## *Lobbying Connections*

The evidence that personal connections can be valuable to firms raises the question of whether such connections can be purchased or rented. Professional lobbyists such as Jack Abramoff ply such a trade. Alexander Borisov, Eitan Goldman, and Nandini Gupta (2012) examine stock market reactions to Abramoff's 2006 guilty pleas related to bribery of public officials and overbilling of clients. The authors find that S&P 500 firms that spent more on lobbying in the three years prior to the Abramoff scandal realized negative abnormal returns after news of Abramoff's plea agreement. In addition, lobbying firms also realized negative returns from the introduction and passage of the Lobbying Accounting and Transparency Act of 2006. However, both the observed abnormal returns and the passage of lobbying reform could be driven by unfavorable publicity for all firms engaged in lobbying after the Abramoff scandal. To untangle the causal effect of lobbying from other confounding factors, it is necessary to examine some external change in firms' ability to lobby.

Just such an experiment occurred when President Clinton issued an executive order restricting the lobbying activities of former senior executive-branch officials. In a fascinating study, Rafael Gely and Asghar Zardkoohi (2001) compare the abnormal returns to corporate clients of lobbying firms that employed former officials before and after the executive order was issued. The events analyzed in this study are the announcements that a lawyer from a lobbying firm has been appointed to a senior executive position. The authors test whether such events benefit the corporate clients of the affected lobbying firms. Prior to Clinton's executive order, former executive officials were prohibited from lobbying their agencies for one year. Despite this restriction, corporate clients realized abnormal returns of around 2 percent when their lobbying firm "gained by subtraction" through an executive appointment. However, in early 1993 President Clinton issued an executive order extending the "cooling-off" period for lobbying by former officials to five years. Using the same methodology, Gely and Zardkoohi (2001) find that corporate clients of lobbying firms suffered a 2 percent *loss* when a lawyer from that lobbying firm was tapped for an executive position in the Clinton administration. This suggests that the value of personal ties has a limited shelf life and that "revolving-door" regulations may limit former officials' ability to exploit personal relationships for personal and political gain.

However, some caution is in order when interpreting Gely and Zardhooki's findings. For one thing, they examine a total of just nine political appointments, only one of which occurred after Clinton's executive order. Further, they identify fewer than forty corporate clients of affected lobbying firms across all nine events, so their sample is somewhat limited. Finally, even though they pool data across separate events, they do not adjust their standard errors for clustering of observations within each event, which may have led to biased standard errors (a general problem discussed in Moulton 1990 and Primo, Jacobsmeier, and Milyo 2007). As a consequence, the statistical significance of Gely and Zardhooki's (2001) findings may not hold up under reexamination. But their findings are intriguing and merit reevaluation, especially since subsequent ethics reforms provide additional events for analysis. For example, before leaving office, President Clinton rescinded the same executive order that had limited the lobbying activities of his former appointees (Bryce 2001).

## What Does It All Mean?

Much of the scholarly literature that investigates potential corruption in American politics suffers from a preoccupation with campaign contributions (and now independent expenditures). The research reviewed here strongly suggests that this is an exercise in looking under the lamp post. Well-designed political event studies do not support the hypothesis that campaign contributions buy political favors; this finding also accords with the lessons from more traditional research on money in politics. Evidence on the efficacy of lobbying is more mixed, in part owing to the limited number of event studies appropriate to identify the treatment effects of lobbying.

In contrast, there is consistent evidence from event studies that firms located in the districts of powerful incumbents benefit from political favoritism. Likewise, firms with strong personal connections to politicians via family, friendship, and past employment networks also may realize positive abnormal returns. These findings imply that trust relationships are necessary to support potential corrupt practices and that such cronyism-based relationships are a more prevalent practice than quid pro quo exchanges of money for political favors.

The absence of a formal contracting mechanism makes it difficult to buy influence or access with campaign contributions. But politicians repeatedly interact with geographic constituents and personal connections; this repeated interaction facilitates mutual trust and permits the realization of gains from cooperation. Further, favoritism to geographic constituents is not likely to be considered as suspect as other forms of cronyism, so an exchange of favors between representatives and geographic client firms may be the easiest form of cooperation to support.

The preoccupation with corporate political spending and lobbying is certainly understandable. It is easy to conceive how politicians might benefit from trading favors for campaign contributions or gifts from lobbyists. But if these pathways are not the source of political corruption, what do politicians gain by giving preferences to personal and geographic cronies? Geographic client firms employ potential voters and campaign volunteers, so, again, the gains from trade are easier to imagine between politicians and geographic clients. Similarly, favors directed at influential interest groups may result in larger "legislative subsidies" in the form of issue advocacy that may help politicians realize specific policy goals. But none of the studies reviewed here explains how politicians gain from favoring personal cronies.

A possible answer is found in the work by Alan Ziobrowski and his colleagues (2004); they argue that the stock portfolios of members of Congress consistently outperform the market. This finding suggests that politicians may profit from market-relevant inside information about public policy. This would make personal connections a more efficacious pathway for quid pro quo corruption: politicians confer policy favors to personal cronies in exchange for inside information and preferential business deals for themselves, their families, and their friends. However, new research strongly undermines the claim that politicians systematically beat the market (Eggers and Hainmueller 2013). Even so, there is still good reason to be concerned that at least *some* politicians, in particular party leaders who wield greater influence over policy, may be able to enrich themselves, their families, and their associates (including favored firms) via inside information (Schweizer 2011).

This form of corruption based on personal connections is difficult to identify and harder to prevent. This difficulty may explain why popular opinion sees corruption as pervasive and inherent in politics and not amenable to a quick fix via campaign-finance reform or lobbying reform. The public and media attention currently focused on campaign contributions, independent expenditures, and lobbying might better be devoted to exposing and monitoring personal connections between politicians and firms. However, this review of market event studies demonstrates that the popular presumption that routine corporate political activities (PAC contributions, independent expenditures, and lobbying) are extremely influential is simply not well supported by scientific evidence.

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