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Corporate lobbying, political connections, and the bailout of banks

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ABSTRACT

Political involvement has long been shown to be a profitable investment for firms that seek favorable regulatory conditions or support in times of economic distress. But how important are different types of political involvement for the timing and magnitude of political support? To answer this question, we take a comprehensive look at the lobbying expenditures and political connections of banks that were recipients of government support under the 2008 Troubled Asset Relief Program (TARP). We find that politically-engaged firms were not only more likely to receive TARP funds, but they also received a greater amount of TARP support and received the support earlier than firms that were not politically involved.

1. Introduction

Economists have long noted that firms that lobby or maintain other types of political connections receive a variety of economic benefits in return (Richter et al., 2009; Hochberg et al., 2009; Igan et al., 2009; Stratmann, 1991; Cooper and Ovtchinnikov, 2010; Hill et al., 2013; Jayachandran, 2006; Faccio and Parsley, 2009; Fisman, 2001; Roberts, 1990; Yu and Yu, 2011). Prior research shows that engagement in the political process might be used as a form of insurance against economic crises. For instance, Faccio et al. (2006) show that firms with political connections in 35 different countries are more likely to receive government bailouts in times of economic distress than non-connected firms.[1,2] This study extends this literature by not only examining whether politically connected firms have a higher likelihood of receiving government support than non-connected firms, but this study also examines whether connected firms are more likely to receive support sooner and whether connected firms are more likely to receive more support than non-connected firms.

Using the 2008 Troubled Asset Relief Program (hereafter TARP) as a natural experiment, we address three main questions: Did political ties determine the overall distribution of TARP funds? Was the timing of TARP payouts influenced by firms' political engagement? And, did political ties influence the magnitude of TARP payouts?

To answer these questions, we use two approximations for political engagement. First, we follow Yu and Yu (2011) and proxy political engagement with lobbying expenditures. In particular, we examine lobbying expenditures during the 5 years prior to the passage of TARP. Second, we follow Faccio et al. (2006) and proxy political engagement with the number of political connections a firm maintains. We obtain data from the Center for Responsive Politics (CRP), which considers a firm to be politically connected if at least one of the following three conditions applies: (1) the firm previously employed an individual that is currently employed by the federal government, (2) the firm currently employs an individual that used to be employed by the federal government, and (3) the firm currently employs an individual that is concurrently employed by the federal government.

Results in this study are striking. We find that firms that lobbied had a 42% higher chance of receiving TARP support than firms that did not lobby. Firms that received TARP support, spent up to four times as much on lobbying as firms that did not receive TARP support. Further, our univariate tests show that the fraction of TARP firms that lobbied is nearly five times greater than the fraction of non-TARP firms that lobbied. In addition, firms with political

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[1] Goldman et al. (2009) show that the effect of political connections on the value of the firm changes with the political landscape.

[2] Their research also shows that firms with political connections underperform relative to non-connected firms during the post-bailout period indicating that the outcome of the bailout was less effective for politically connected firms.

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connections had a 29% higher chance of receiving support than non-connected firms. In fact, the percentage of TARP firms that were politically connected is nearly three times greater than the percentage of non-TARP firms that were politically connected. These results suggest that political engagement is directly related to the distribution of TARP support.[3]

In our next set of tests, we examine the length of time between the signing of TARP and a firm's receipt of TARP funds, which we denote as the timing of TARP for brevity. The allocation of TARP funds were paid out over 33 different days. All of the eight firms that received support on the first payout date, October 28th, 2008, had lobbied during the 5 years prior to the bailout and all of the firms were also politically connected. Of the 15 firms that received TARP support on the second payout date, November 17th, 2008, five had lobbied and four of the firms were politically connected according to the CRP. We show that nearly 62% of firms that lobbied and received TARP, received the support during the first two payouts. Likewise, more than 70% of politically connected firms that received TARP, received support during the first two payouts. Ninety-five percent of firms that lobbied received TARP support during the first nine payouts while 100% of firms that were politically connected were recipients of TARP funds during the first nine payouts.

We use robust econometric techniques to show that firms that lobbied and/or were politically connected received TARP support sooner than other firms. In economic terms, firms that lobbied during the 5 years prior to TARP received support 21.34% sooner than firms that did not lobby. Similarly, our multivariate estimates suggest that firms with political connections received TARP support 35.37% sooner than firms without connections. Combined with our earlier results, these findings suggest that, not only is political engagement related to *who* received TARP support, but political engagement is also related to *when* firms received support.

In our final set of tests, we estimate the marginal effect of political engagement on the distribution of TARP funds. First, we find that, of the firms that received TARP support, those that lobbied received between $2.02 and $5.14 billion more in total support than firms that did not lobby. Similarly, we find that firms with political connections received between $3.08 and $6.47 billion more in TARP support than firms without political connections. We also test whether firms that both lobbied and had political connections drive our results. Indeed, we find that these firms received between $3.73 billion and $6.18 billion more in TARP support than firms that did not have both types of political ties. These results support the idea that corporate political engagement is directly related to the amount of TARP funds received by firms.

Additional multivariate tests show that for every dollar spent on lobbying during the 5 years prior to TARP, firms received between $485.77 and $585.65 in TARP support. We then condition these results on firms that both lobbied and had political connections. Interestingly, we find that those firms that had both lobbied and were politically connected drive our results. For instance, for every dollar spent on lobbying, politically connected firms received approximately $440 dollars in TARP support.

While our results tend to show that political engagement heavily influenced the distribution, timing, and magnitude of the TARP bailout, our results are peculiar given that some banks did not want to be bailed out. For instance, the New York Times reported that both BB&T and Wells Fargo protested the mandatory acceptance of TARP support.[4] In fact, banks that were bailed out were not at liberty to return the TARP loans until certain standards set by the U.S. Treasury Department were met. If some banks were forced to accept TARP support despite protesting the support generally, other questions regarding the relation between political ties and government bailouts become important. While prior research suggests that the motivation to become politically engaged is to provide a form of insurance during periods of economic crisis (Faccio et al., 2006; Yu and Yu, 2011), why would some firms that were heavily connected not want the insurance (i.e. government support) during the 2008 economic crisis? Further and perhaps more importantly, why are we able to observe a significant relationship between the level of political engagement and the characteristics of the distribution of TARP? These questions are difficult to answer because the motivation by firms to become politically connected and the motivation by government to bailout firms is unobserved. Perhaps politically-connected banks truly did want to be bailed out but also wanted to signal strength to their shareholders by protesting the acceptance of the bailout. Or perhaps unwanted government bailouts are more easily forced upon those firms with the greatest level of political connections. At a minimum, the case of TARP provides a unique look at the complexities of how the economic benefits of political engagement are passed along to politically engaged firms.

The rest of the paper is organized as follows. Section 2 provide a brief literature review and some institutional details about TARP. Section 3 describes the data used in the analysis in more detail. Section 4 reports the results from our empirical tests. Section 5 concludes.

2. Literature review

Firms are considered politically engaged if the firm had positive lobbying expenditures during the 5 year prior to the passage of TARP or if they employ an individual who was previously or is currently also politically active. Faccio (2006) provides a comprehensive picture of corporate political connections and their value around the world. She finds that political connections are essentially omnipresent and that they add to a company's value as measured by its stock price. Jayachandran (2006) studies the effect of Senator James Jeffords withdrawal from the Republican Party in May 2001 on the stock mark value of politically engaged firms. The Senator's withdrawal tipped control of the U.S. Senate from the Republican party to the Democrats. Jayachandran shows that firms that had contributed to the Democratic party had an unusual increase in their market value as a result of Jeffords departure from the Republican party, while firms that had contributed to the Republican party lost market value. Fisman (2001) uses an event study approach surrounding the Indonesian financial crisis of 1997 to estimate the value of political connections for Indonesian firms. He finds that politically connected firms derive a large percentage of their value from their connections. The broader literature on the economic benefits of political connections identifies additional benefits of political connections including beneficial regulatory regimes (Stigler, 1971; Peltzman, 1989), preferential tax regimes ((De Soto, 1989), and preferential treatment by government owned enterprises (Backman, 1999).

Political connections can also have detrimental effects on firms, particularly in times of political turmoil. Gul (2006) shows, for example, that politically connected firms in Malaysia saw a greater increase in audit fees than their non-connected peers after the

[3] During the process of our research, we found a similar paper by Duchin and Sosyura (2012) that shows that a bank's level of political connections are related to the probability of receiving TARP support. Our paper is different from Duchin and Sosyura (2012) for several reasons. First, we use different measures of political connections. Besides using lobbying expenditures, we also include the employment of politically connected individuals. Second, our study is not only focused on the distribution of TARP funds, but also on the timing of the receipt of TARP funds and magnitude of the funds received by politically connected banks.

[4] See, for example, http://www.nytimes.com/2009/08/02/business/02bbt.html?pagewanted=all and http://www.nytimes.com/2009/12/15/business/economy/15bank.html.