The Effects of Firms' Lobbying on Resource Misallocation

Federico Huneeus[*] In Song Kim[†]

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Abstract

How do firms' lobbying activities affect the allocation of economic resources between them? A vast literature in international political economy has focused on the opposite causal mechanism, and find that size of firm tends to affect their propensity to engage in political activities. In this paper, we overcome the simultaneity bias by developing a novel instrument. Specifically, we measure firms' political connections based on the geographic proximity between firms' headquarter locations and politicians' districts, and trace the value of these connections over time by investigating politicians' assignment to U.S. congressional committees. Given that committee assignment is exogenous to firm-level activities, this allows us to instrument the value of firms' political connections, and thus firm-level lobbying. We find that there exists a positive causal effect of firms' lobbying on revenues. To investigate the macroeconomic consequences of these effects, we combine the industry-level lobbying model from Grossman & Helpman (1994) with the heterogeneous firm-level model of Melitz (2003) to allow for firms' endogenous entry to lobbying. In support of the theory, we provide direct evidence for firm-specific lobbying activity and document a set of novel facts regarding the relationship between firms' economic and political characteristics. Finally, we use these estimates, including the one given by the instrument, to calibrate the structural model. Our counterfactual analysis shows that the returns to firms' lobbying activities imply a decrease in aggregate productivity due to misallocation of firms' size distribution.

[*]Ph.D. Candidate, Department of Economics, Princeton University, Princeton NJ 08544. Email: fhuneeus@princeton.edu.

[†]Assistant Professor, Department of Political Science, Massachusetts Institute of Technology, Cambridge MA 02139. Phone: 617-253-3138, Email: insong@mit.edu, URL: http://web.mit.edu/insong/www/