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Examining the value
of lobbyists' political
connections. p2



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The Revolving Door

Examining the value of lobbyists' political connections.

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THE REVOLVING DOOR

Examining the value of lobbyists' political connections

By Mirko Draca

In life, as the saying goes, "It's not what you know but who you know." To the extent that this view applies in political life, measuring the relative value of "what" and "who" is possible, in fact, and the results are revealing, as my recent research with Jordi Blanes i Vidal and Christian Fons-Rosen shows.

Our work examines the so-called revolving door of politics – that is, the movement of people from government service into lobbying positions. The issue is of growing concern, as lobbyists play an increasingly important role in political life. In the United States, for example, the amount of money spent on lobbying at the Federal level doubled over the past decade. The influence of lobbyists – perceived or actual – has undermined the public's confidence in political institutions, perpetuating beliefs that government is run by a group of tightly knit elite.

Our research sheds light on the way lobbyists can and do trade on their ability to provide access to power in Washington, where recent laws have sought to constrain their activities and to increase transparency of the way they operate. In particular, it offers potential policy insights for the UK, where existing laws and proposed reforms to address lobbying concerns stop well short of provisions used in a number of other developed countries, including Australia, Canada, and the US.

The research investigated how the revenues of lobbyists who had previously worked in the offices of a member of US Congress were affected when their former employers left office. This allowed us to look at the value of "what" and "who" because we evaluated situations in which knowledge did not change, but connections did.

We discovered that a lobbyist's revenue falls by 24 per cent when his or her former employer leaves office. The effect is immediate and long lasting. The relative pay of congressional staffers-turned-lobbyists depends on the seniority and committee assignments of the congressional politicians for whom they have worked in the past. The better and more senior the connections, the higher the revenue premium. This is clear evidence that part of a lobbyist's value is who the lobbyist knows – not just the what.

Our study provides what we believe to be the first direct econometric evidence of the extent to which previous officials are able to convert political contacts into lobbying revenue. Our work quantifies the value of personal connections to elected officials for lobbyists in Washington, rather than relying on anecdotal evidence.

While we provide no direct evidence on the existence of a "payback" for lobbying clients, we believe that it is unlikely that the rents extracted by ex-staffers are politically neutral. The fact that

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A lobbyist's revenue falls by 24 per cent when his or her former employer leaves elected office.

THE REVOLVING DOOR CONTINUED

corporate or interest group clients are eager to hire the services of individuals with a past history of working for powerful politicians suggests that they must believe that they are getting a return in terms of favorable legislative outcomes.

These high returns to lobbying also have implications in terms of staffers' career incentives. The finding that a large portion of what makes revolving door lobbyists particularly attractive is perishable implies that staffers may have relatively short careers. Once a connection to a powerful Senator has been established, a staffer may want to move into lobbying and cash in on this unique asset while it is still valuable – that is, while the Senator is still in office.

The findings have implications for the selection of public servants, who are well aware of potential post-government employment. Our findings suggest that it may be a particular type of individual who may be attracted to public service: not necessarily somebody particularly able or ideology-minded, but somebody adept at the creation and maintenance of good relations that can be later converted into revenue.

The research was possible because of progressive US laws to constrain the activities of lobbyists and increase transparency about the way in which they operate, aided by two public directories of government staffers, government salaries, lobbyists and lobbyists' revenues. Similar laws are in place in other developed countries, notably Canada and Australia.

By comparison, the UK still does not have compulsory disclosure of lobbying activity and proposed reforms are much weaker than those enacted in the US. Importantly, in recent consultation by the Cabinet Office, disclosure of lobbying revenues was not included in the proposals, while in the US the legislation requiring financial disclosure was enacted in 1995.

These proposals are being considered against a backdrop of scandals concerning the perceived, inappropriate relationships between lobbyists and government. In recent weeks, the president of the Royal British Legion resigned after boasting about his influence to arms contractors. Last year, UK defence secretary Liam Fox resigned in the wake of controversy over influence peddling by his friend, Adam Werritty.

Similar controversies also erupt in the US. The situation is perhaps unavoidable, given that money spent on lobbying federal officials has doubled in a decade. There, at least, these financial relationships are the stuff of public record. Here, by contrast, these relationships stay in the back wings of the political theatre. Except, that is, when controversy thrusts them onto centre stage.

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This article summarizes "Revolving Door Lobbyists," by Jordi Blanes i Vidal, Mirko Draca and Christian Fons-Rosen, forthcoming in the December edition of the *American Economic Review*. A draft of the article is available at: <http://www2.warwick.ac.uk/fac/soc/economics/staff/academic/mdraca/>

TRADING PARTNERS

Costs of international trade are important, but so are relationships between trading countries

By Dennis Novy

Are new import duties hampering the sale of American cars in China? Are marketing restrictions pricing Philippine cigarettes out of the market in Thailand? Are China's subsidies of apparel and textiles to Mexico unfairly undercutting domestic producers? As this list from recent World Trade Organization disputes suggests, the primary concern in trade impasses stems from costs and the degree to which they impede trade. The concerns about costs are particularly resonant now, as the world recovers from an unprecedented fall in world trade. The Great Trade Collapse in the wake of the 2008 recession represented the largest drop in world trade in the last 150 years outside of wartime.

The experiences of this unprecedented period in world trade have brought increased scrutiny to the trade situation, and they have underscored a classic economic question: How much do trade costs impede international trade?

Findings from my recent research suggest the answer: It depends. Though standard economic theory has long taken a 'one-size-fits-all' approach to analysing the effects of trade costs, my research shows that trade costs impact countries in very uneven ways. Of course, transportation costs and tariffs do reduce international trade. But my research shows that the same change in costs can have widely varying impacts. It demonstrates that the relationship between trading partners – not just the costs themselves – matter, and matter a great deal.

My theoretical research provides the underpinnings of a new way of thinking about the forces at work in trade's ebb and flow. This theoretical work and evidence from OECD countries' trade show that trade costs have differential effects, depending on the trade intensity of the countries

The better and higher a lobbyist's connections, the higher the pay.

involved. When they already trade a lot, country pairs hardly benefit when transportation costs or duties fall. But bilateral trade grows faster when the initial trade relationship was thin. As a result, trade liberalization often leads to relatively larger trade creation among country pairs that previously traded very little.

In the standard international trade literature, the link between trade costs – such as tariffs, transportation costs and bureaucratic hurdles – and trade is typically very simple: if trade costs go up by a certain extent, then the 'trade cost elasticity' tells us by how much trade is affected. For example, if trade costs fall by 1 per cent and the trade cost elasticity is 5, then trade is expected to go up by 5 per cent.

But so far the literature has only allowed for a 'one-size-fits-all' scenario: for a given change in trade costs, trade was expected to react by the same percentage for all bilateral trading pairs. It made no difference whether two large countries like the US and Germany were trading with each other, or whether a large country like the US was trading with a small country like Iceland. Neither did it make a difference whether two countries had fairly low bilateral trade barriers (think US and Canada), or whether bilateral trade barriers and transportation costs were higher (think US and Italy).

But in practice, data show that the effect of trade frictions on trade flows varies widely.

My new research challenges this 'one-size-fits-all' feature. I develop a relationship that allows trade costs to have a heterogeneous impact across

country pairs. This means that a given trade cost change, say, a 1 per cent drop, can lead to different effects for different trading partners. This new approach is arguably fundamental to understanding the trade cost elasticity, and indeed, evidence from OECD trade flows shows that similar trade barriers may have widely different effects.

The results indicate that trade costs' effects vary, depending on how intensely two countries trade with each other. Specifically, the more the destination country imports from a particular exporting country, the less sensitive are its bilateral imports to trade costs. One reason for this may be that large exporters tend to enjoy a relatively powerful market position in the destination country. Demand for the exporter's goods is often buoyant, and consumers might not react strongly to price changes induced by changes in trade costs. On the contrary, small exporters might only face weak demand for their goods, and consumers may be sensitive to price changes. As a result, small exporters are hit harder by rising trade costs and find it more difficult to defend their market share.

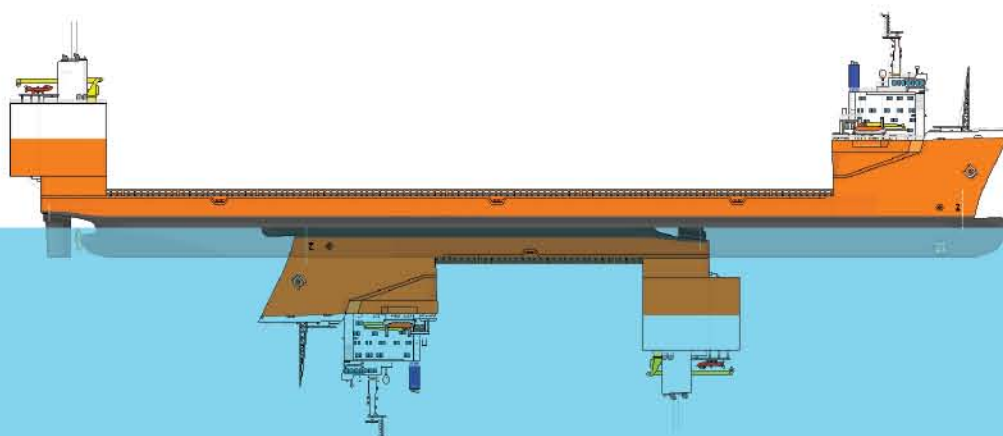
This framework has the potential to shed new light on the effect of institutional arrangements such as free trade agreements; currency unions that seek to reduce the costs of trade, such as the Eurozone; or World Trade Organization (WTO) membership on international trade. For example, some have suggested that the WTO has strongly promoted trade but unevenly. Some countries and industries have benefited more than others, and the variable effects of trade costs may be a previously hidden factor in the uneven effects.

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Publication details

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THE INFORMAL ECONOMY

Why businesses in developing countries stay under the radar

By Christopher Woodruff

The majority of businesses in most developing countries are informal – that is, they are not registered with relevant government agencies. These informal businesses are less likely to pay taxes that fund public services. Informal and formal businesses in the same industry compete on unequal playing fields because of the differing costs for labour and taxes, resulting in inefficient allocation of resources in the economy.

This informal-formal business divide generates questions for policymakers, particularly with governments around the world actively trying to induce firms to enter the formal sector, often by eliminating red tape. Why don't informal firms take the steps to become formal businesses? What steps can provide the incentives to lead them toward a transition? And, if these informal operations

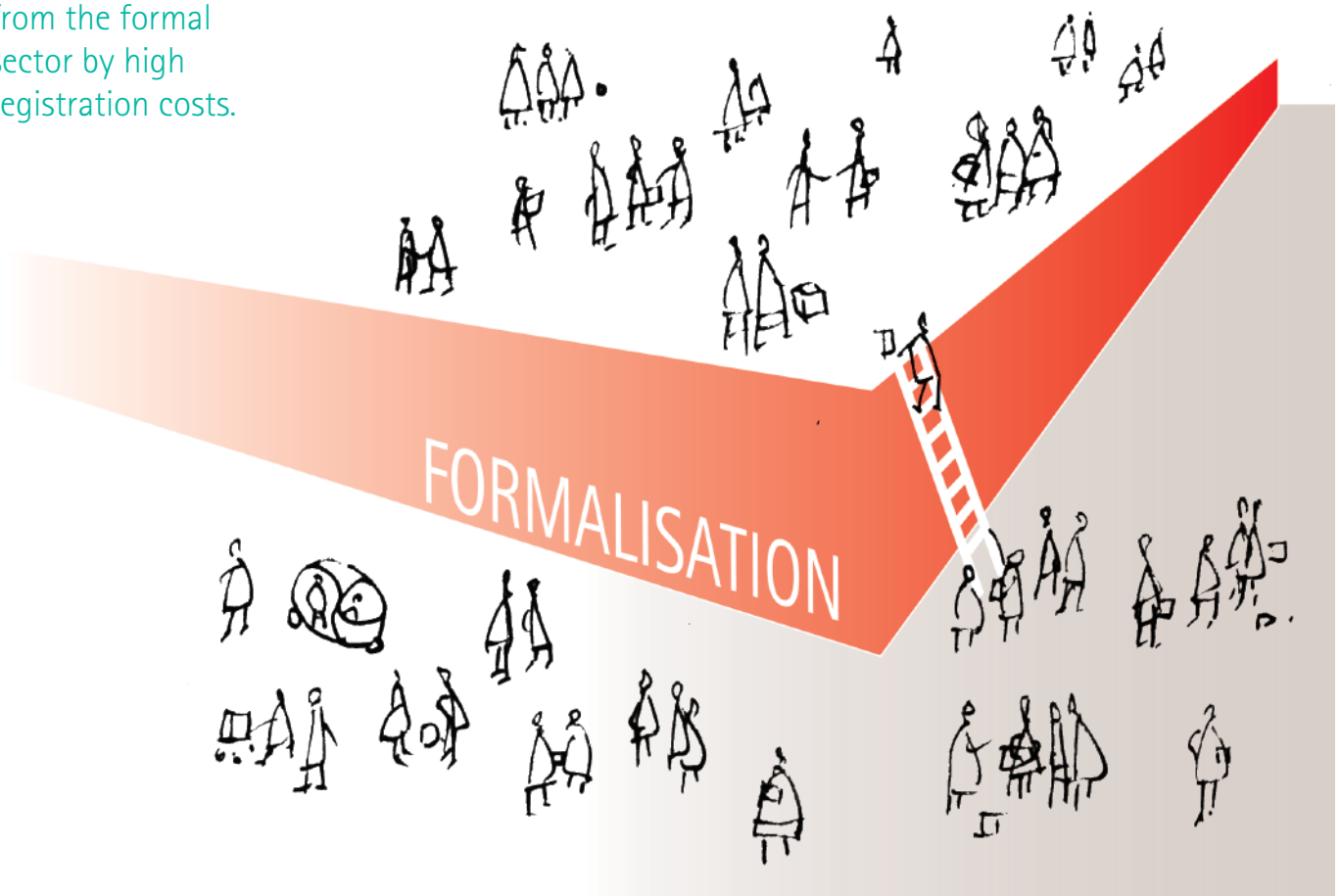
become formal ones, do profits improve? Do tax receipts rise?

These questions underlie the research two colleagues and I conducted in what is the first field experiment of its kind, offering inducements for informal firms to register as formal businesses. The experiment allowed us to analyse the demand for and consequences of formalization. It offered a test of two competing economic views: Do businesses remain informal largely due to actual or perceived costs of registering, or do they make rational decisions not to pursue formal registration because the actual or perceived benefits are not worth it.

We conducted our research in Sri Lanka, which is representative of many developing countries in that only one-fifth of firms operating without paid workers are registered with any government agency. Even among firms employing paid workers,

The first field experiment of its kind offered modest incentives for informal businesses to register with the government.

The evidence suggests that businesses are not being excluded from the formal sector by high registration costs.



the majority are unregistered with one or more pertinent agencies.

We worked with informal firms that had one to 14 paid employees. We randomly divided the sample into four experimental groups and one control group. The first group received information about the costs and benefits of, and procedures for, registering their firms with the Divisional Secretariat (DS) – the relevant registration for tax purposes. They were also reimbursed for the modest, direct cost of registration. The second, third, and fourth experimental groups received the same information and were offered payments of varying amounts, representing up to two months' profit for the median firm – an amount roughly equal to \$350. Three follow-up surveys of these same firms were conducted 15, 22 and 31 months after the intervention, enabling us to examine whether and how the firms benefited from formalization.

Prior to the intervention, owners of unregistered firms were either ignorant of or vastly overestimated registration costs. We might therefore have expected that simply informing firms about registration costs would be sufficient to induce registration. But, in fact, it did not. Instead, registration was spurred only when the information was combined with incentive payments. A payment of two months' profit was sufficient to lead half of the firms to register.

The businesses' decisions to remain as informal operations, even when the direct costs of registering would have been reimbursed, suggests these firms are not being excluded from the formal sector by high registration costs. The willingness of firms to register for a modest payment suggests that they perceive modest costs but even more modest benefits from establishing themselves as formal operations. It provides support for the view that firms are making rational benefit-cost decisions in this regard.

The experiment shed light on the nature of barriers to formal registration. More than half those offered the largest incentive payment did register. These firms operated with informal leases or agreements—ironically, often on government-owned land—and hence were unable to provide authorities with the required proof of ownership of the land on which the firm operated.

The firms that did formalize saw larger increases in profits, our follow-up surveys found, although this impact seems largely due to the experiences of a few firms experiencing substantial growth. In looking at the channels through which businesses might have benefitted, we found increased advertising and use of receipt books, but no increases in receipt of government contracts,

use of bank accounts or loans, or participation in government programmes.

Our findings offer important insights on a variety of policy fronts. First, while governments clearly should not mimic our experiment with a policy of direct payments, the results do suggest that modest increases in the perceived benefits of operating as a formal business could be expected to dramatically increase demand among informal firms for registration. At the same time, however, no evidence emerged of a pent-up demand to conduct business in formal channels among existing, informal firms.

Whether tax collections increase enough to pay for any increased benefits (or, alternatively, to pay for increased enforcement efforts) is beyond the scope of our research project. Our data do suggest, however, that given the current tax code, the additional tax collections would not be large among this sample of firms. This, combined with the fact that the spillovers to growth are modest suggests that near-term gains to the government of increased formality are limited.

At the same time, our results do hold some potential for governments to think about how formalization can affect trust and attitudes toward government. Leaders of the firms that formalized were more likely to trust local government and to agree that paying taxes is a civic duty. At the same time, one must note, they were also more likely to agree that small businesses are taxed too much.

The Authors

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Informal firms seem to be making rational benefit-cost decisions – weighing what they believe to be the modest costs of formalizing against the even more modest potential benefits.

THE COST OF KEEPING SECRETS

The measures that hid Stalin's labour camps also crippled them

By Mark Harrison

Today many people think modern dictatorships such as that of the Chinese Communist Party might have the upper hand over constitutional democracies in effective decision making. Examples include fiscal consolidation, migration, and infrastructure projects. However, the true costs of dictatorship are usually invisible because they are secret. The archives of the Soviet state and communist party that have become available in the wake of the collapse of the Soviet Union reveal the hidden costs of dictatorial decision making.

My research uncovers a story that took place in 1949. After World War II, the Soviet state entered its most secretive phase. One of the Soviet state's most important secrets was the location of its labour camps. Today, we read that two members of the rock band Pussy Riot convicted of hooliganism will be sent to prisons far from Moscow in Mordovia and Perm. This kind of information was once protected by an elaborate wall of state secrets, the details of which are only now beginning to surface. The identity and whereabouts of Soviet labour camps was one of the most tightly protected secrets of the twentieth century, and my research underscores the price the Soviets paid to keep them hidden.

One anecdote illustrates the depth of the secrecy covering Soviet forced labour at the time. In March 1953, after Joseph Stalin's death, the Gulag (administration of forced labour camps) was transferred from one ministry to another. For this transition to take place, officials needed to know the names and locations of the camps. Maps were needed. Though the government had long had the capacity and money to print maps, none was available. New maps of the camps were drawn in pen and pencil. The inference was clear. When it came to the Gulag, there were no maps.

In 1947, on Stalin's initiative, a law enacted long prison terms for disclosing secrets even accidentally. His target was officials and researchers who were, in his view, too ready to share government information and scientific findings with the public and with foreigners. New, more inclusive lists of secrets were promulgated. The new regulations were so secret that many of those responsible under them could not be told officially about them. As a result a wave of fear swept through the Soviet administration.

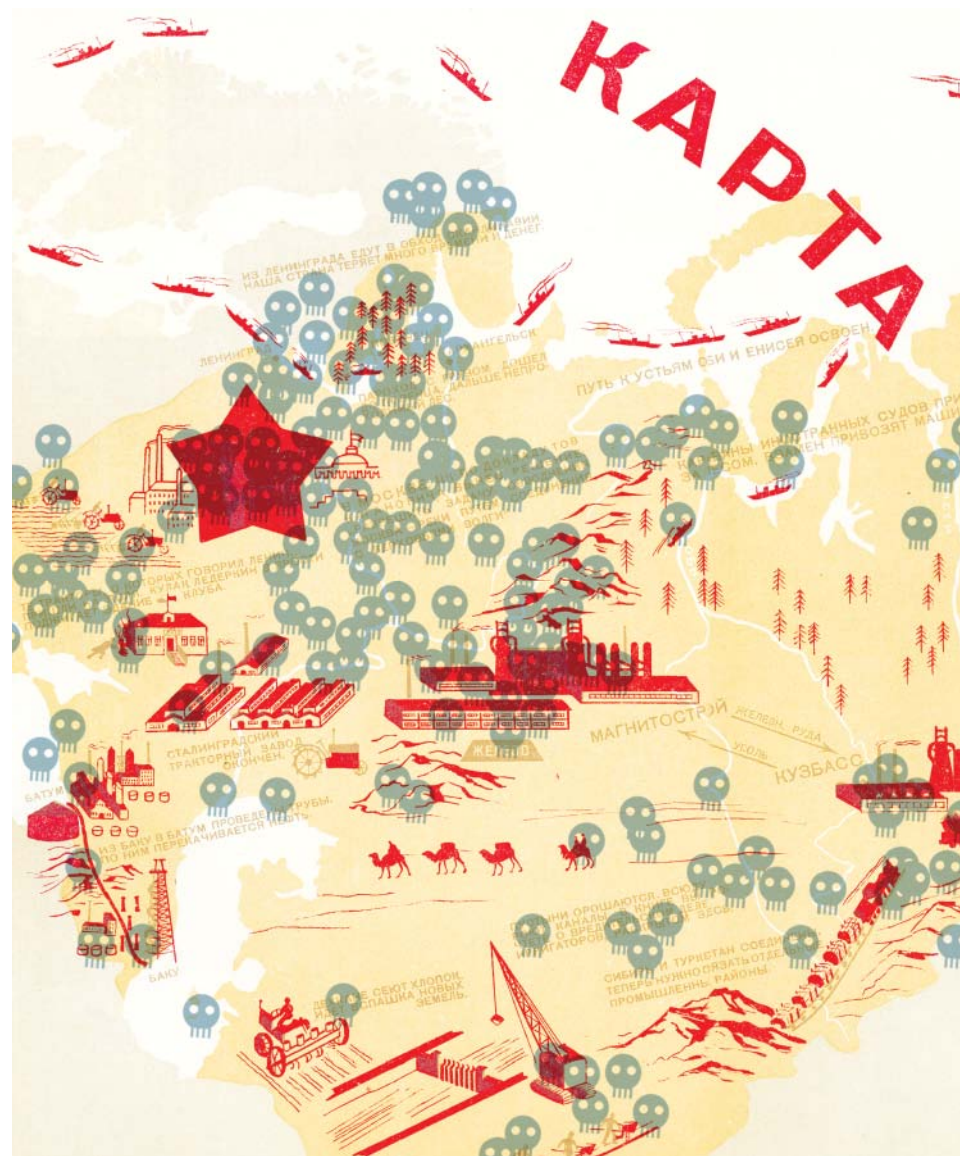
The labour camps operated as government owned businesses, so they had to receive supplies, deliver products, and manage their financial accounts, as written down in secret government plans. As their secrecy was guarded more and more closely, camp bosses found it increasingly difficult to do this everyday business. In order to turn

over goods and money, even within the planned economy, they had to risk severe punishments for disclosing a state secret: the fact that they existed. This crippled their business.

Ultra-secrecy led to breakdowns of Kafkaesque proportions. Orders for food, clothing, and building materials, began to fail. The camp commanders were victims of the Catch-22 of keeping secrets. Suppliers required full addresses to fill orders. Giving suppliers full addresses meant breaking the law on secrets. They could not pay for supplies, using their accounts in the state bank, without confirming their account details, which contained state secrets.

Historical files, made available in the wake of the collapse of the Soviet Union, show how Gulag officials tried to manage their mounting anxiety. The basic problem of how to conduct basic business while keeping the camps and their locations secret played itself out over four years. Officials worked

Ultra-secrecy led to breakdowns of Kafkaesque proportions.



around their dilemmas, expending considerable efforts to come up with alternatives. The efforts of camp commanders went into spreading responsibility and securing the collusion of higher official in workarounds. The efforts of higher officials went into endless committees and drafts of alternative solutions, none of which was ever adopted. In the end, rather than solve the problem, they got used to it and learned to live with it. Their fears subsided.

The irony is this: The contractual parties and counterparties involved were not independent buyers and sellers in a real market. They were owned by the state, were commissioned by the state to operate in an internal market the state had created, and were trying to make or complete contracts that the state had pre-authorized. But the state's own laws prevented them from identifying themselves to each other in a way that would let this happen. Or, as it happened, it was at a higher cost than would

have been necessary in the absence of these laws. The cost was paid, ultimately, by the state that made the internal market and the laws that regulate it.

The case study throws light on the quality of Stalin's decision making. The process of growing secrecy was driven by Stalin himself. The story shows the lengths to which he was willing to go to cover his system of rule under the blanket of secrecy. Stalin's motivation is clear. He launched the intensification of secrecy because he wanted to reduce perceived losses from the leaking and sharing of government information and scientific research. It is not clear whether he considered the resulting increase in transactions costs and nevertheless considered it worthwhile, or whether he failed to consider the consequences and miscalculated. We do not know. This gives us a sense of the distance we have to go before we fully understand the purposes of Soviet secrecy in its full scope and complexity.

The Author

Mark Harrison is a professor in the Department of Economics at the University of Warwick who specializes in Russia, conflict, and security. He is a research associate of CAGE and a research fellow of the centre for Russian and East European Studies at the University of Birmingham and the Hoover Institution at Stanford University. The research for this paper was carried out in the Archives of the Soviet Communist Party and State collection of the Hoover Archive. Professor Harrison was one of the first Western economists to work in the Russian archives following the fall of Soviet communism. His work has brought new knowledge about the Russian and Soviet economy into mainstream economics and international economic history.

Publication details

This article summarizes "Secrecy, Fear, and Transaction Costs: The Business of Soviet Forced Labour in the Early Cold War," forthcoming in *Europe-Asia Studies*.

A draft of the paper is available at: <http://warwick.ac.uk/markharrison/public/eas2013postprint.pdf>

Original map image:
<http://ausstellung-gulag.org>



The basic problem of how to conduct basic business while keeping the camps and their locations secret played itself out over four years.

THE IMMIGRATION QUESTION

The Final Word

By Abhinay Muthoo

Imagine that you run one of the nation's most successful export industries. You produce one of the world's most sought-after cars. Designed by the world's best engineers, these models are so hot that you can't possibly keep up with demand. Even though you can offer the car to only carefully screened, potential buyers, you can live with that limitation. It only adds cachet. Business thrives.

Then the government changes the laws to make entering the showroom harder to do. Your customers will require more scrutiny before they are allowed to walk in to make their purchases. The same goes for your design engineers. Your most promising customers are put off. They decide they will try one of your competitor's excellent new models. The world-class engineers, uncertain over whether they can come to work and whether they will be allowed to remain, are recruited by more welcoming competitors elsewhere.

This story is ridiculous, and yet, to a remarkable degree, it suggests the situation now facing one of the UK's most successful export industries. I refer to higher education.

You may not think of a university as an export industry, and that view is understandable. Universities are far more than that – charged as they are with the mission of creating an informed and skilled citizenry of the nation, the people capable of making the British economy thrive for its own population, and serving as the thought leaders in an increasingly complex world.

But we do run an export business, and increasingly so. We export education – purchased by customers and designed by intellectuals from all corners of the globe. Our customers work hard to gain the intellectual skills and money needed to access a UK degree, and a key source of that degree's value stems from professors of world stature. These are the world's strivers. They are ambitious people who are not satisfied by staying at home and buying the local version. The university is part of the knowledge industry – a business whose stock and trade is intellect and knowledge. These commodities know no border, and those who would impose ever harsher ones to deter their movement do so at their own peril. The best and the brightest have the option of going to many destinations. Let me firmly state the obvious: We want them to come here. We want the best of them to come to learn and, perhaps, to go back to their birthplaces, with the skills to improve their homelands and with the goodwill towards our country that will lead to untold business, diplomatic and political windfalls. They may want to consider staying in the UK. And, we may want to consider inviting the best of them to remain.

The government's tightening of the screws

The Author

Abhinay Muthoo is the head of the University of Warwick Department of Economics and the director of the Warwick Economics Research Institute.

The best and the brightest have the option of going to many destinations. Let me firmly state the obvious: We want them to come here.



on the "problems" raised by student immigration and visas, is but the latest indication that it has embraced a flawed and costly notion. The broader message is that foreigners arriving on our shores are largely a problem. We all agree on the need to address threats of terrorism, fraud and abuse, but the message extends dangerously beyond these legitimate concerns. Recent turns toward procedures that are far more onerous than need be and a tendency of our own government's immigration agency to treat individuals with such disdain it could be called contempt, reflect a deeply failed vision of our nation's problems. These views are out of step with the times and out of touch with reality.

These moves seem to reflect an unstated but underlying fear that we, the British people, lose out when outsiders come here. Under this kind of calculus, the arrival of one immigrant comes at a cost for one UK citizen. A son or daughter doesn't get a place at university, so it must be because a foreigner took the slot. A man can't find work, and so a foreigner here must be to blame. According to this view, the University of Manchester erred in hiring Andre Geim and Konstantin Novoselov, both Russian immigrants, for jobs that ought to have gone to two physicists in the UK. Two years ago Geim and Novoselov were awarded the Nobel Prize for Physics for the invention of graphene, the world's thinnest material which is said to be 20 times stronger than steel. Their work not only has brought prestige to the UK and its universities,

but also has introduced new materials that have the potential to revolutionize manufacturing for commercial and military use worldwide. You do the math.

Our own department's research shows what a flawed stance the view of the need for protection against immigration to universities is – and from virtually any perspective.

Work by Andrew Oswald suggests that we need to import academic talent if for no other reason than to cover our losses; more than half of UK-born elite scientists leave the country. Work by Sharun Mukand has suggested that a policy shift to globalise labour markets has the potential to be a key tool in alleviating poverty and spurring development. Work by Nicholas Crafts offers historical perspective, and one ought to take a cue from his analysis of the decline that resulted in British manufacturing when it failed to maintain competitiveness on the world stage. Crafts leads the Centre for Competitive Advantage in the Global Economy, whose mission it is to find the key ways for nations around the world to improve their economies and to enhance the well-being of their people. The work is difficult and on-going, but I am confident in saying that thus far, no one has found that cracking down on foreigners is the way forward.

Cracking down on immigration does not offer the way forward for the UK economy.



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