Study: A powerful member of congress can have a negative effect on a state's economy

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Having a powerful member of congress could have unintended consequences for a state's economy, according to a study published today in the *Journal of Political Economy*.

Researchers from Harvard Business School found that when a member of a state's congressional delegation becomes chair of a powerful committee, that state sees a tremendous influx of government cash through earmarks and government contracts, as one might expect. But rather than stimulating private sector growth, the study found that the extra government spending actually causes businesses in that state to downsize.

The results challenge the conventional wisdom that it's unambiguously good to have a powerful ally in Washington, and also call into question the stimulative value of government spending in general, say the authors, Lauren Cohen, Joshua Coval, and Christopher Malloy.

Specifically, the study found that when a senator is appointed to a chairmanship, publicly traded firms in his or her home state scale back employment growth by anywhere from 3 to 15 percent. The average state sees a $48 million per year drop in capital expenditures and a $44 million per year drop in research and development spending by publicly traded companies. A few firms—those that directly receive a government contract, for example—probably do benefit from the chairmanship, the researchers say. But in the aggregate, government spending seems to put a squeeze on private sector activity.

"The results show up throughout the past 40 years, in large and small states, in large and small firms, and are most pronounced in geographically concentrated firms and within the industries that are the target of the spending," Coval said.

A particularly interesting aspect of the study is that it tracks money that comes with virtually no strings attached. The traditional argument against the stimulative power of government spending is that it has to be paid for by higher taxes and increased borrowing, which could ultimately swamp any expansionary effects. But the money tracked in the study comes purely as a result of a new chairmanship, not from any direct increase in taxes or borrowing. From the perspective of the state that receives it, it's free money. Yet it still seems to inhibit private sector growth.

"These findings argue that tax and interest rate channels, while obviously important, may not account for all or even most of the costs imposed by government spending," the researchers write. "Even in a setting in which government spending does not need to be financed with additional taxes or borrowing, its distortionary consequences may be nontrivial."

The authors offer a few likely mechanisms driving these findings. "Some of the [government] dollars directly supplant private-sector activity—they literally undertake projects the private sector was planning to do on its own," Coval said. "The Tennessee Valley Authority of 1933 is perhaps the most famous example of this." When the TVA expanded electrical service across the South, private companies couldn't compete and were forced to downsize or move elsewhere.

It's also possible that increases in government spending raise the cost of doing business for everybody else, the researchers say. For example, a spike in public sector hiring or increases in hiring within narrow economic sectors can drive up the cost of labor, causing other firms to slow their rate of hiring or move operations to other states.

The findings beg the question: If high-powered politicians have negative side effects for a state's economy, why do the voters keep them in office?

"The jobs created from federal transfers are generally much easier to identify and quantify than those lost—indeed Senators often tout the number of jobs that their earmarks have been able to create in their home states," the authors speculate. "Identifying and measuring those that have been lost is not as easy. When a firm shuts down because labor costs have become prohibitive, it can never be cleanly tied to the wage pressure produced by federal transfers."

More information: Lauren Cohen, Joshua Coval, and Christopher Malloy, "Do Powerful Politicians Cause Corporate Downsizing?" *Journal of Political Economy* 119:6 (Published 2/28/2012)

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