Aggregate and Idiosyncratic Political Risk: Measurement and Effects

by Tarek A. Hassan, Stephan Hollander, Laurence van Lent, and Ahmed Tahoun

BFI Conference on Elections, Policymaking, and Uncertainty
Discussion by Scott R. Baker (Northwestern)
September 13, 2016
This Paper

“We propose a new measure of political risk faced by individual US-firms based on textual analysis of earnings conference call transcripts”

- Develops a new measure of firm-specific political risk
- Demonstrates a relationship with firm-specific stock vol
- Evaluates topic-specific linkages
- Details a set of firm-specific responses to such risk
Lobbying and Donation Responses

- One of most novel and interesting parts of the paper
- Much of the literature focuses on wait-and-see effects when thinking about uncertainty
- One reason policy uncertainty may be separately interesting is that different responses can be taken!
Overall

- Develops a very useful set of data
- Performs a large amount of analysis, producing some nice results
- Hardest part of the paper is in the interpretation
- Moves into a new direction for ‘EPU’ papers
Political Risk Measurement

- Primary measure derived from fraction of ‘political’ bi-grams near ‘risk’ terms as a fraction of total bi-grams
- Data taken from conference call transcripts
Political Risk Measurement

- Primary measure derived from fraction of ‘political’ bi-grams near ‘risk’ terms as a fraction of total bi-grams
- Data taken from conference call transcripts
- Incorporates:
  - Aggregate level of political risk/uncertainty
  - Exposure of firm to economic uncertainty in general (eg. fixed investment firm?)
  - Exposure of firm to regulatory risk
  - Composition of investors across firms?
- Could use some additional clarification on authors’ interpretation
How should we think about this?

Level of political risk?

Political risk as fraction of overall risk?

Political risk as a fraction of overall financial news?

Can authors differentiate?

Do questions about political risk displace questions about other risks during the calls?
Measurement Methods

“We distinguish political from non-political topics using a pattern-based sequence classification method developed in computational linguistics.”

- Nice way to be more ‘impartial’
- Easy to expand and modify measurement
“We distinguish political from non-political topics using a pattern-based sequence classification method developed in computational linguistics.”

- Nice way to be more ‘impartial’
- Easy to expand and modify measurement
- Many resulting bi-grams seems unrelated (eg. ‘a more’, ‘a bit’, ‘to those’, ‘may not’, ‘is always’)
- Perhaps some human reading could be useful?
“...the only judgments we have to make is about training libraries...”

- Still many dimensions of discretion
  - Bi-grams rather than single words or larger combinations
  - Risk terms
  - Terms to exclude from libraries
Authors do not discuss first moment shocks, wider firm-specific uncertainty

Increases in ‘first moment’ political action OR non-political risk will **mechanically** increase their measure

Potentially large biases in results
Authors do not discuss first moment shocks, wider firm-specific uncertainty

Increases in ‘first moment’ political action OR non-political risk will \textit{mechanically} increase their measure

Potentially large biases in results

Possible clarifying exercises:

- Solely search for the risk term (overall uncertainty)
- Require closeness to ‘good’ or ‘bad’ terms (political first moment?)
Currently examine only contemporaneous effects

Strong predictions about the timing of lobbying, donations relative to a discussion of risks

Gulen and Ion (RFS, 2015) show strong investment dynamics

Dynamics with lobbying/donations could much more definitively show direction of causality
“Taking full advantage of our decomposition by firm and topic, we show evidence of a causal effect of political risk on lobbying activities.”

- Could this still not be reverse causality?
- Lobbying to remove or modify or implement a regulation could drive the political uncertainty
- Would be nice to see a time series of both
Types of Uncertainty

- Many results rest on firm-topic-specific measures
- Giving us more data means prompting more questions!
Types of Uncertainty

- Large range of topics not normally associated with corporate investment (eg. Abortion, Church, Drugs)
- Some associations are quite positive (eg. Foreign Policy)
- Could it be that there are first moment effects here?
  - For Lockheed, foreign policy uncertainty probably correlated with sales
- Test for asymmetric effect by looking at resultant contracts across SICs?
Uncertainty and Lobbying Interpretations

“Strongest elasticity of lobbying with respect to discussion of uncertainty about health care, energy, environment, tax reform, and corporate regulation.”

- What should we take away from this?
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- What should we take away from this?
- A few possibilities:
  - Cost of uncertainty highest?
  - Cost of marginal lobbying dollar lowest?
  - Elasticity of political action highest?
  - Elasticity of political results highest?
  - Impact of marginal regulation highest?
  - Ability to capture marginal regulation highest?
Some Potential Avenues...

- Any ex-ante beliefs about who may benefit from lobbying? HHI?
- Any way to measure political outcomes? Broad v. tailored?
- Are firms donating to one party or both?
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- Any ex-ante beliefs about who may benefit from lobbying? HHI?
- Any way to measure political outcomes? Broad v. tailored?
- Are firms donating to one party or both?
- Can relate more to the existing political science literature
- Useful literature about power ⇒ lobbying and lobbying ⇒ contracts
Aggregate Risk and Spread Across Firms

- Potentially a very interesting result
- How mechanical is this?
- Nature of calls: If some conference calls never discuss risk $\Rightarrow$ mechanical correlation
- Nature of measurement: If effect is proportional $\Rightarrow$ mechanical correlation?
Corruption Results

“Effects are most pronounced for...firms headquartered in states with higher levels of political corruption.”

- Result mentioned in abstract but not fleshed out greatly
- Probably many state-level political variables that correlate with size of effect (and also with corruption)
In Short...

- Interesting paper and nice contribution
- Huge amount of great new data
- Many moving parts across the various sections
- Could use a bit more guidance on interpretation
- Some additional avenues for expansion and clarification