

# Aggregate and Idiosyncratic Political Risk: Measurement and Effects

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# 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

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- Data taken from conference call transcripts

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- 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

# Political Risk 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

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“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?

# Measurement Methods

“...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

## Alternative Metrics

- 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

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- Authors do not discuss first moment shocks, wider firm-specific uncertainty
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- 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?)

# Dynamics

- 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

# Lobbying Dynamics

“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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“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?
- 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  $\Rightarrow$  lobbying and lobbying  $\Rightarrow$  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